Commission for
Communications Regulation

Consultation Document

Accounting Separation and Cost Accounting Review

Draft Accounting Direction to Eircom Limited

Document No:	**09/75**
Date:	**5, October 2009**

All responses to this consultation should be clearly marked:- "Reference: Submission re ComReg 09/75" as indicated above, and sent by post, facsimile, e-mail or on-line at www.comreg.ie (current consultations), to arrive on or before 5pm, 4 December 2009, to:

Ms. Vanessa Devereux
Commission for Communications Regulation
Irish Life Centre
Abbey Street
Freepost
Dublin 1
Ireland

Ph: +353-1-8049600 Fax: +353-1-804 9680 Email: wholesaleconsult@comreg.ie

Please note ComReg will publish all respondents submissions with the Response to this Consultation, subject to the provisions of ComReg's guidelines on the treatment of confidential information – ComReg document 05/24

An Coimisiún um Rialáil Cumarsáide
Commission for Communications Regulation
Abbey Court Irish Life Centre Lower Abbey Street Dublin 1 Ireland
Telephone +353 1 804 9600 *Fax* +353 1 804 9680 *Email* info@comreg.ie *Web* www.comreg.ie

Contents

1 Executive Summary

1.1 The Commission for Communication Regulation ('ComReg') is now consulting on a set of proposed measures which is intended to improve and refine the current Accounting Separation and Cost Accounting obligations on Eircom Limited ('Eircom'). A key objective of this consultation is to increase the level of transparency of the current Separated Accounts of Eircom, by better making available adequate information on the profitability and costs of the various parts of Eircom's regulated business. This will also be of significant benefit to Eircom when demonstrating its compliance with its legal and regulatory obligations, while assisting ComReg in monitoring such compliance.

1.2 Following various market analysis processes, Eircom has been designated as an operator with Significant Market Power ('SMP') in a number of the relevant markets (including Retail Narrowband access, Leased lines, Wholesale Call Origination, Wholesale Call Termination and Wholesale Broadband Access). The SMP remedy of Accounting Separation and Cost Accounting has been imposed on Eircom in accordance with Regulation 12 and 14 of the Access Regulations[1]. This is consistent with ongoing requirements on Eircom where SMP is found to continue since market liberalisation in December 1998.

1.3 The current accounting requirements on Eircom were devised almost ten years ago, at a time when regulatory reporting requirements were at an early stage of development. Over the past ten years, both ComReg and Eircom have had first hand experience of the need for 'fit for purpose' (i.e. adequate and appropriate) separated accounting in order to facilitate Eircom in demonstrating its compliance with its regulatory obligations and enable ComReg monitors such compliance in the most effective and efficient way possible.

1.4 ComReg sets out in this consultation document and in a draft accounting Direction, proposals for consultation which it is hoped will provide greater clarity as to the processes and procedures that should be applied by Eircom, without creating an excessive burden.

1.5 The proposals relating to its processes and procedures include:

- volume and revenue measurement and identification
- principles of cost allocation and apportionment
- the level of granularity of the functional cost categories together with disclosure of network elements
- the format and content of the Separated Accounts
- requirements for Additional Financial Information from time to time
- the level of disclosure contained in the accounting document
- the audit assurance process.

1.6 It is proposed that an accounting Direction be developed that is sufficiently robust and 'fit for purpose' reflecting current business developments while also being sufficiently robust to meet future requirements.

1 European Communities (Electronic Communications Networks and Services) (Access) Regulations 2003 – S.I. No. 305 of 2003.

2 Introduction

Background

2.1 On 10 March 2005, ComReg published a consultation document, ComReg 05/18[2] that outlined its preliminary proposed financial obligations for Eircom, particularly with regard to Accounting Separation and Cost Accounting. Five responses[3] were received to this consultation but no changes to the existing obligations were made by ComReg at that time. While the 2005 consultation is now considered closed, where useful ComReg draws attention to particular discussions from that Consultation process.

2.2 Over several years, ComReg has completed a market analysis of a number of regulated markets[4] and has imposed on Eircom the SMP remedy/obligation of Accounting Separation and Cost Accounting in accordance with the Access Regulations 12 and 14. Regulation 17 of the Access Regulations[5] allows ComReg to specify the requirements relating to these obligations and ComReg has done so in the past.

2.3 Following the completion of various market reviews, the introduction of bundled offers at a retail level together with technological developments including the current and planned introduction of Next Generation Networks (‘NGNs’), concerns have arisen as to whether Eircom’s Separated Accounts in their current format are ‘fit for purpose’ (i.e. to meet all stakeholder needs). In addition, as the Separated Accounts are not provided at a sufficient level of granularity to enable ComReg fulfil its regulatory responsibilities, ComReg has had to request additional information from Eircom on an ad hoc basis, conduct its own tests and retain expert consultants to verify and review the accounts and submissions provided during normal annual reviews of regulated pricing. This is at a considerable cost to ComReg and Eircom both in terms of time and money when better value could be achieved with a co-ordinated approach to audits and the presentation of key regulatory accounting information. Over the last year, the difficulty encountered by ComReg in reconciling the service[6] and product information with the Separated Accounts, together with a lack of visibility as to how costs have been allocated/ apportioned at the market, service and product levels has heightened ComReg’s concerns. These concerns have also been raised and discussed with Eircom.

2.4 Eircom currently publishes Separated Accounts for four businesses i.e. Local Access Network, Core Network, Retail and Other Businesses. While financial statements are produced at the activity level within the Retail and Other businesses (e.g. Retail Business activities include Local calls, National Calls, International Calls, Calls to Internet etc.), no detailed breakdown at the market, service or product levels within the Access or Core businesses are provided.

---

2 ComReg Consultation Document 05/18 “Consultation on the Proposed Financial Reporting Obligations for Fixed Dominant Operators having Accounting Separation and/or Cost Accounting obligations”.

3 Respondents being Eircom, Esat-BT, Vodafone, Alto and ICAI.

4 See further detail at “Section 11– “Legal Background” where a list of Markets are set out in full.

5 Regulation 17 of the Access Regulations provides: The Regulator may, for the purpose of further specifying requirements to be complied with relating to an obligation imposed by or under these Regulations, issue directions to an undertaking to do or refrain from doing anything which the Regulator specifies in the direction.

6 See Appendix E ‘Glossary of Terms’ and section 2 of the draft accounting Direction ‘Definition and Interpretation’ for explanation of terms.

2.5 For example, the 'Local Access Network' business provides inputs to services which are included in a number of regulatory 'markets' as previously defined by the EU Commission[7] and as more recently defined by the EU Commission in its Recommendation of 17 December 2007[8]. In addition and within the LLU 'market' for example[9], there are a number of 'services' e.g. Local Loop Unbundling ('LLU'), Geographic Number portability and Unbundled Local Metallic Path ('GLUMP'), Co-location, Line Share ('LS') and Sub Loop Unbundling ('SLU'). Within each 'service', ComReg considers there are a number of 'products' e.g. the LLU service is comprised of the following products: provisioning, repair, service, establishment testing, survey charges, co-location charges etc. Indeed while the WPNIA[10] market is still being considered (and the outcome of that market analysis cannot be pre-empted nor can any SMP finding) it can be seen that the consultation documents published to date, discuss that this market may consist of similar service and product levels. It can however be noted that WPNIA is an updated and technology-neutral version of the LLU market.

2.6 As Eircom does not currently provide Separated Accounts to the market, service or product levels, ComReg has had to request from Eircom detailed accounting data on an *ad hoc* basis so as to enable it conduct individual price reviews or consider price submissions from Eircom. This presents a significant resource burden on both ComReg and Eircom throughout the year. Furthermore an *ad hoc* analysis of specific services and/or products may be more prone to error. This is due to the fact that to date ComReg has not been in receipt of a set of Separated Accounts disaggregated for all services and products at any point in time and it is therefore difficult to conduct a comparative analysis to assess accuracy and reliability of the accounting information year on year. In addition, ComReg has encountered difficulties in reconciling these (detailed service/product) figures with the information contained in Eircom's Separated Accounts (as the detailed information is received in a piecemeal fashion).

2.7 The format and content of the Separated Accounts should be fully aligned with the market definition and must be sufficient to enable Eircom demonstrate its compliance with specific obligations (i.e. transparency, non discrimination, price control/ cost orientation) and facilitate ComReg monitor such compliance. This would mean (under this consultation) that while some of the current Separated Accounts disclosures will no longer be required there will be a need for additional disclosures at the market and service level. In this regard it can be noted from the draft accounting Direction that it is proposed to supersede and/or withdraw many accounting obligations previously imposed on Eircom.

2.8 It is thought likely that, should Eircom be found to have continuing SMP in various markets such as WPNIA (as and when these are determined but noting that the outcome of any market analysis, nor finding of SMP cannot be pre-

7 Commission Recommendation of 11 February 2003 on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services.

8 Commission Recommendation of 17 December 2007 on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services (notified under document number C(2007) 5406) (Text with EEA relevance) (2007/879/EC).

9 Wholesale unbundled access (including shared access) to metallic loops and sub-loops; Decision D8/04, ComReg Document number 04/70.

10 Wholesale Physical Network Infrastructure Access market, as defined by the European Commission in its Commission Recommendation of 17 December 2007.

empted) it may have a market structure that continues to be consistent with the European Commission's recommended markets - such that the current business split (i.e. Core Network, Local Access Network, Retail and Other Business) would therefore be less relevant. ComReg is of the preliminary opinion that information at this service level is required so as to facilitate Eircom in demonstrating its compliance with its present obligations under the current markets, in particular the Transparency Obligations and how ComReg monitors such compliance.

2.9 It is thought likely that the data gathering exercise for both Eircom and ComReg should therefore be reduced to a more manageable level as the Separated Accounts and the Additional Financial Information:

- will support individual service/product prices
- will enhance transparency
- will speed up the regulatory price setting process
- prevent the omission or double recovery of costs.

2.10 ComReg does not however, in its initial view, consider it appropriate to use Separated Accounts in isolation to set prices for individual services/products as the costs disclosed may not reflect efficient costs and could contain legacy issues that a new entrant may not be subject to. To aid the decision making process for price setting, pricing models tend to be developed, many of which are forward looking based on the efficient costs of a new operator[11] as opposed to the historical costs recorded in the Separated Accounts.

2.11 The ability of Eircom to provide reconciliations of such costing data with the data contained in the audited Separated Accounts will however increase ComReg's confidence in the accuracy and reliability of the information presented and should lead to a more efficient assessment of Eircom's compliance with its regulatory obligations (such as its accounting obligations, but also of its transparency, price control and non-discrimination obligations as appropriate).

2.12 While it is proposed that there should be consistency in the format and content of the Separated Accounts from year to year, ComReg reserves the right, in relation to the "Additional Financial Information"[12] that this be determined in advance of year end (but pending any price reviews and ComReg's own work programme). This will lead to a more co-ordinated approach that will hopefully reduce the number of clarification requests from ComReg throughout the year.

2.13 In addition to concerns surrounding Eircom's Separated Accounts, there are also concerns regarding the lack of transparency and explanation in its Accounting Documents as to the processes and procedures employed to identify revenues, measure volumes and allocate and apportion costs (at the market, service and product levels). Without going into a very micro level of analysis with Eircom, implementation of ComReg's proposals (as set out below) should eliminate these issues significantly.

11 See for example, ComReg document 09/39 on the Bottom Up – Long Run Average Incremental Cost ('BU-LRAIC') model developed for the LLU access network.

12 See section 6.2 of the proposed Draft accounting Direction.

ComReg's Obligations and the Obligations on Eircom

2.14 ComReg considers that this draft accounting Direction is proportionate and justified in light of ComReg's functions and objectives[13], to ensure compliance by undertakings with its obligations (including under Regulations 12[14] and 14[15] of the Access Regulations in relation to accounting separation, price control, cost orientation and cost accounting). ComReg believes that the draft accounting Direction will, by ensuring that Eircom is complaint with its regulatory obligations help facilitate the promotion of competition and thereby benefit consumers.

2.15 Eircom has obligations pursuant to Regulations 12 and 14 of the Access Regulations in relation to accounting separation, price control, cost orientation and cost accounting. This draft accounting Direction should now bring in line Eircom's accounts and will bring Eircom's obligations in this regard up to date and in line with best practice.

2.16 A full consideration of the likely benefits, costs and impacts of the draft accounting Direction are set out at Section 9 - Regulatory Impact Assessment ("RIA").

2.17 ComReg in defining markets (see section 2 of the draft accounting Direction which lists the Markets where Eircom have been designated with SMP) considered whether or not the "relevant market" is effectively competitive. The Framework Regulations provides that ComReg shall designate undertakings with significant market power (SMP) on that market and shall impose on such undertakings such specific obligations as it considers appropriate[16]. ComReg imposed on Eircom obligations in accordance with Regulation 12 and 14 of the Access Regulations as SMP remedies necessary and appropriate to the competition issues identified.

2.18 Under the regulatory framework in operation since 2003, the format and content of the Separated Accounts must be fully aligned with the market and sufficient to enable Eircom demonstrate its compliance with specific obligations (e.g. transparency, non-discrimination, cost orientation and price control) and for ComReg to monitor its compliance. In this regard it can be noted Article 11(2) of the Access Directive (2002/19/EC) provides that:

> *"….to facilitate the verification of compliance with obligations of transparency and non-discrimination, national regulatory authorities shall have the power to require that accounting records, including data on revenues received from third parties, are provided on request……"*

2.19 ComReg considers that where a SMP operator is vertically integrated, it has an incentive to provide wholesale services on terms and conditions that discriminate in favour of its own retail activities in such a way that may have an adverse effect on competition.

---

[13] As more particularly set out in sections 10 and 12 of the Communications Regulation Act 2002. ComReg further considers this Decision/Direction will also, in accordance with Regulation 14 (3) promote efficiency, sustainable competition and maximise consumer benefits -for the reasons explained throughout this document.

[14] See "Legal Background" section below.

[15] See "Legal Background" section below.

[16] Regulation 27(4) of the European Communities (Electronic Communications Networks and Services) (Framework) Regulations 2003 (S.I. No. 307 of 2003), ("the Framework Regulations").

2.20 The purpose of imposing this proposed accounting Direction is to further specify a higher level of detailed information required to reflect as closely as possible the performance of parts of the SMP operator's business as if they had operated as separate businesses, and in the case of vertically integrated undertakings which provide electronic communications networks and/or services, to prevent discrimination in favour of their own activities (and to prevent unfair cross-subsidising). The Access Directive provides that:

> "*Accounting Separation allows internal price transfers to be rendered visible, and allows national regulatory authorities to check compliance with obligations for non-discrimination where applicable*."[17]

2.21 Regulation 12 (2) provides that the

> *"Regulator may require an operator, which is vertically integrated, to make transparent its wholesale prices and its internal transfer prices, inter alia, to ensure compliance with any obligation imposed under Regulation 11 or, where necessary, to prevent unfair cross subsidy and, where it does so, may specify the format and accounting methodology to be used."*

2.22 ComReg considers that an obligation to maintain Separated Accounts is therefore necessary to support and to complement other obligations of transparency, price control (e.g. cost orientation) and non-discrimination that are typically imposed on vertically integrated operators with SMP. It would also assist in monitoring and ensuring compliance with an obligation not to unreasonably bundle products or services.

2.23 Eircom's legal obligation to maintain Separated Accounts derives from ComReg's power under Regulation 12 (1) of the Access Regulations to impose on an operator having SMP obligations for Accounting Separation in relation to specified activities related to interconnection, access or both interconnection and access. For the purpose of ex-ante regulation, ComReg may and has required Eircom as a vertically integrated operator, to make transparent its wholesale prices and its internal transfer prices, *inter alia*, to ensure compliance with its obligations of non-discrimination (imposed under Regulation 11 of the Access Regulations) and to detect and prevent unfair cross-subsidising. Where ComReg imposes such an obligation on Eircom it may specify the format and accounting methodology to be used. In order to facilitate the verification of compliance by Eircom with its obligations of transparency (under Regulation 10 of the Access Regulations) and non-discrimination (under Regulation 11), Eircom has also a statutory obligation to provide accounting records, including data on revenues received from third parties, to ComReg at its request.

2.24 Accounting Separation is itself typically supported by an obligation on the SMP operator to maintain appropriate cost accounting systems. Under Regulation 14 of the Access Regulations, ComReg has also imposed obligations on Eircom in regulated markets for Eircom to maintain appropriate cost accounting systems. The purpose of imposing an obligation to implement a cost accounting system on Eircom is to ensure that fair, objective and transparent criteria are followed by it in allocating its costs to services and products in markets where it is subject to a SMP obligation of cost orientation or other price controls. Eircom's Cost Accounting and Accounting Separation systems need to be capable of reporting

[17] Recital 18, 2002/19/EC of the European Parliament and the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities.

regulatory financial information to demonstrate full compliance with the regulatory obligations mentioned.

2.25 Regulators may specify the level of detail and disaggregation that is required to be presented in Separated Accounts. This is necessary to properly monitor compliance with SMP obligations. For example, non-discrimination must be capable of being implemented, where appropriate, on a service or product basis. It is not sufficient for monitoring to be carried out only at the market level, as this would not enable ComReg to identify whether products and services are being provided on a non-discriminatory basis.

2.26 Operators may operate in markets in which they have been designated as having SMP, as well as in competitive markets where they are not so designated. In order to carry out its regulatory tasks, ComReg may need information about markets where operators do not have SMP. When an obligation for Accounting Separation is imposed on a SMP operator with SMP on one or more markets, the imposition of Accounting Separation may cover markets where the operator does not have SMP, e.g. to ensure the coherence of data.

2.27 Accounting Separation can play an important role in competition. The preparation of properly Separated Accounts plays a very significant role in avoiding cross-subsidisation leading to unfair competition. Transparency in Eircom's accounting system should enable ComReg to ascertain whether there is cross-subsidisation in the cases in which this question arises. This transparency can be provided by an accounting system which ensures the fully proportionate distribution of all costs between activities in markets that are competitive and activities in markets that are not competitive. An appropriate accounting system approach should permit the identification and allocation of all costs between the activities which they support. In this system all products and services should bear its fair share of all relevant costs. It should enable the production of recorded figures which can be verified and these figures should not be obscured.

2.28 ComReg further considers that Eircom is obliged to maintain a cost accounting system that is suitable for compliance and capable of verification by ComReg in accordance with Regulation 14 of the Universal Service Regulations[18]. In addition it can be noted from Regulation 24 of the Framework Regulations that Eircom has a duty to maintain Separated Accounts in accordance with that provision.

2.29 ComReg considers Separated Accounts must be prepared to a standard and to a level of sufficient detail, fit for the purpose to enable ComReg properly fulfil its functions of investigating and where necessary, taking enforcement action.

2.30 In light of the concerns above, and Eircom's legal and regulatory obligations, and the resulting difficulty for ComReg assessing Eircom compliance with its legal obligations, ComReg is now launching a public consultation, together with proposals, on the content and scope of an accounting Direction to be issued to Eircom.

2.31 The following sections summarises the issues encountered by ComReg in fulfilling its regulatory responsibilities and concerns it has regarding Eircom ability to demonstrate its compliance with its regulatory obligations. Each section sets out the background to the particular process and procedure, the issues and

[18] European Communities (Electronic Communications Networks and Services) (Access) Regulations 2003 (S.I. No. 305 of 2003), amended by the European Communities (Electronic Communications Networks and Services) (Universal Service) (Amendment) Regulations 2007 (S.I. No. 373 of 2007).

regulatory problems identified by ComReg and international best practice. There then follows a preliminary conclusion and recommendation as regards issues for possible inclusion in the draft accounting Direction, (and regarding which respondents views are then sought) which relate to:

- Volume and revenue identification
- Cost allocation and apportionment
- Separated Accounts
- Accounting Document
- Audit
- Other Matters
    - Corporate Governance
    - Timeframe for compliance
    - Draft accounting Direction.

2.32 While it is recognised that Eircom will not be able to adjust its accounting systems overnight, it is imperative that Eircom address the concerns of ComReg as efficiently and effectively as possible. This will lead to the production of a set of accounts that are 'fit for purpose' from which ComReg can make regulatory decisions and assess Eircom's compliance with its legal obligations.

2.33 All responses to this consultation are welcome. While ComReg requests that comments be restricted to the issues raised in this document (and referenced to the relevant question number from this document), it will be glad to accept any other comments on other elements not specifically addressed in this paper but deemed relevant.

2.34 The Consultation period will run from 5 October 2009 to 4 December 2009. Thereafter ComReg will issue a response to consultation (and may issue a final decision) where ComReg will set out its reasoning for the decision having carefully considered all responses.

Q. 1. Do you agree or disagree that a review of the Accounting Separation and cost accounting obligations should take place at this time? Please detail your response in full.

3 Volume and Revenue Identification

Background

3.1 The distribution of revenues by market, service and product is considered by ComReg to be of great importance to both Eircom and ComReg and the wider industry. In particular it assists in assessing the ability of Eircom to recover its costs, identify any possible margin squeeze or predatory pricing issues and the rates of return being generated on a market by market, service by service and product by product basis.

3.2 In addition and so as to enable Eircom demonstrate its compliance with its legal obligations and ComReg monitor such compliance, it is notable that Regulation 12(3) of the Access Regulations, provides that:

> *"….in order to facilitate the verification of compliance by an operator with any obligations of transparency under Regulation 10 and non-discrimination under Regulation 11, include a requirement that accounting records, including data on revenues received from third parties, are provided by any such operator to the Regulator on request."*

3.3 In addition, Regulation 14 provides that ComReg may:

> *"… impose…. obligations relating to cost recovery and price controls, including obligations for cost orientation of prices…."*

3.4 With regard to the cost orientation of prices/tariffs, the Commission Decision 97/114/EC[19], in clarifying the concept of cost-oriented prices, identified that:

> *"cost orientation of tariffs means as a general rule that prices are adjusted such that revenues are balanced with costs".*

3.5 In addition and because some revenues cannot be directly attributed to individual markets, services and products (e.g. due to bundling) there will be a need for Eircom to apportion revenues.

3.6 Unit cost calculations are critically dependent on volumes, e.g. traffic volumes, number of calls, number of lines etc. In the case of the Core Network, for example, traffic volumes, measured in minutes (i.e. the duration of calls) are considered by ComReg to be an important factor in determining the unit costs associated with each network element (nodes and links which convey traffic throughout the network). The costs associated with each network element involved in providing a specific service are combined to determine the total unit cost from which regulatory prices are set. The particular cost methodology used (i.e. Historical Cost Accounting ('HCA'), Current Cost Accounting ('CCA') or Long Run Incremental Costs ('LRIC')) being determined for each market separately.

3.7 Access to reliable volume information is therefore of vital importance to the calculation of accurate unit costs, which are then compared with the associated revenues to ensure that the associated tariffs comply with the non-discrimination and cost orientation obligations. For example, this information is needed for Line

19 97/114/EC: Commission Decision of 27 November 1996 concerning the additional implementation periods requested by Ireland for the implementation of Commission Directives 90/388/EEC and 96/2/EC as regards full competition in the telecommunications markets.

Rental as ComReg needs to monitor costs incurred against actual revenues received. This ensures that accurate reporting of unit costs and revenues which can inform related price/cost reviews performed by ComReg.

Issues identified by ComReg

3.8 This section summarises some of the issues encountered by ComReg following recent price reviews / price change applications.

3.9 This appraisal, together with ComReg's assessment of EU recommended practice and more generally of global best practice (see below), has informed ComReg in its preliminary recommendations and in the formulation of a draft accounting Direction.

3.10 For regulatory purposes, ComReg requires unit cost data (incorporating volume data) and revenue information for regulated markets, services and products, so as to enable it conduct price reviews or consider price increase applications. Eircom's Separated Accounts do not currently facilitate this detailed analysis and therefore it has been the practice of ComReg to request that Eircom provide more detailed information (at the service and/or product level) on an *ad hoc* basis. Unlike the current Separated Accounts, this *ad hoc* information is unaudited and therefore there may be concerns surrounding its accuracy and reliability (concerns which ComReg has previously expressed to Eircom).

3.11 Following a number of price reviews / price change applications, ComReg identified a number of concerns with Eircom's Separated Accounts and the additional information (provided by Eircom for specific services/products on an *ad hoc* basis).

3.12 With regard to revenue and volume these include the lack of visibility in the Separated Accounts as to how transfer charges between businesses (i.e. between the Core Business and Retail Business and the Access Business and the Retail Business) and markets have been calculated (i.e. basis of volume, cost and return on capital employed calculations) compared to charges levied on Other Authorised Operators ('OAO's').

3.13 Given the complexity of the process, together with the reliance on network studies, ComReg considers that there is a need for greater transparency as to how these calculations have been performed together with detailed information to support the inputs to the calculations. Without this level of information and in light of current regulatory framework markets, ComReg will not be in a position to make a robust assessment as to whether such calculations are 'non discriminatory' and therefore reflective of the price that would be charged to any external customer.

3.14 ComReg is also of the preliminary view that there is a need for greater transparency as to the process of allocation/apportionment of revenues across bundled products. ComReg considers that this is particularly important given the increase in bundled products offered by the incumbent (i.e. new bundled Talktime, Broadband and Mobile packages) which offer discounts implicit in the bundle. Visibility as to how this bundle discount is assigned across Eircom's markets, services (and products) is important to the transparency of the accounts and is likely therefore to be fundamental to monitoring activities, particularly those that include regulated and unregulated services and products.

3.15 ComReg is of the preliminary view, therefore that there is a need to ensure that volume data (e.g. number of working lines, number of broadband customers etc.) as set out in the Quarterly reports (and which are provided in confidence to ComReg) are consistent with the data contained in the published Separated Accounts.

3.16 ComReg is of the preliminary view that there is a need for greater clarity as to the process of volumes measurement (at the market, service and product levels) e.g. direct identification or the use of sampling. With regard to sampling, there is a need for increased disclosure in the Accounting documents so as to enable ComReg make an assessment as to the accuracy and reliability of the results being generated.

3.17 For example, ComReg considers that more information is required with regard to the following:

- Process of allocation of duct costs i.e. Eircom Accounting document states that:
  "….the allocation of duct costs is based upon physical examination of a sample of duct routes. Network element route factors are based upon call volume data drawn from a number of sample representative periods in the financial year"

- Line faults per 100 samples

- Tests of exchanges/network usage patterns to arrive at percentage cost allocation

- Node Managers samples used for cost allocations.

3.18 In addition, ComReg is of the preliminary opinion that there is also a need to identify the guiding principles that should be used when deriving sample data. This would include a need for greater clarification as to the process of volume identification i.e. the 'total units' for the Core and Access businesses. ComReg is also of the preliminary view that there is need for disclosure of volumes at the market, service (and product levels) on the face of the Separated Accounts (or Additional Financial Information), split into volumes directly attainable and volumes derived by statistical means.

Best Practice

3.19 ComReg has reviewed the practice of revenue and volume identification for a number of telecom operators, together with the recommended practice from the EC Commission and the European Regulators Group ('ERG')[20]. ComReg has confined its benchmarking to the processes and procedures employed by other (English speaking) Telecom operators such as BT Plc. and New Zealand Telecom. However ComReg confirms that while it has in its preliminary assessment, taken account of benchmark data, it has in doing so assessed it carefully. ComReg further confirms that the benchmark data reviewed has been

20 The European Regulators Group for electronic communications networks and services was set up by the Commission to provide a suitable mechanism for encouraging cooperation and coordination between national regulatory authorities and the Commission, in order to promote the development of the internal market for electronic communications networks and services, and to seek to achieve consistent application, in all Member States, of the provisions set out in the Directives of the new regulatory framework (see : www.erg.eu.in).

used to inform ComReg's preliminary recommendations as set out herein, while recognising that circumstances can be different from one country to another.

3.20 In reviewing best practice regarding revenues and volumes, ComReg has considered:

- disclosure of information in supporting documentation regarding the processes and procedures applied for revenue and volume identification

- level of disaggregation of revenues and volume in the Separated Accounts.

3.21 Best practice regarding the disclosure of information in supporting documentation has been dealt with in the Accounting Document section below.

3.22 **The level of disaggregation of revenues in the Separated Accounts**

3.23 The European Commission (in its document 2005/698/EC)[21] recommended that National Regulatory Authorities ('NRA's') should:

> *"require from operators the disaggregation of their ……. revenues to the level required to be consistent with the principles of proportionality, transparency and regulatory objectives mandated by national or Community law"* [Point 2]

3.24 Pursuant to these recommended principles, the European Commission (in the annex to its document) identified that:

> *"…. cost accounting and Accounting Separation systems must produce financial information at a level of detail which demonstrates compliance with the principles of non-discrimination and transparency, adequately identifying and attributing revenues,……… and volumes for **the various activities** performed by the operator. Such accounting information should be made available promptly to the national regulatory authority."*[emphasis added].

3.25 ComReg is of the preliminary conclusion therefore, that the level of disaggregation of the accounting systems must be sufficient to facilitate the operator in demonstrating its compliance with its legal obligations (such as transparency, price control, cost orientation and non discrimination). It is also important that there is complete transparency as to how revenues and volumes have been allocated or apportioned between the various activities (e.g. markets, services and products) so as to enable the NRA make an assessment as to whether such allocations/apportionments are appropriate.

3.26 The ERG in its Guidelines[22] for implementing this Commission Recommendation recognised that in developing Separated Accounts, a number of matters could, *inter alia*, be taken into account, including the identification of:

> *"… markets and services to be separated, providing more detailed*

21 Commission Recommendation of 19 September 2005 on Accounting Separation and cost accounting systems under the regulatory framework for electronic communications (2005/698/EC).

22 ERG Common Position: Guidelines for implementing the Commission Recommendation C (2005) 3480 on Accounting Separation & Cost Accounting Systems under the regulatory framework for electronic communications.

> *information, (e.g. an individual profit and loss statement, a statement of capital employed and information on the main cost drivers, such as minutes, access lines and/or full time equivalent or labour costs)."* (section 1).

3.27 Using Accounting Separation, the ERG recognised that it is then up to the NRA to impose on the notified operator a set of rules on how accounting information should be collected and reported, with

> *"Each item of revenue….[being] attributed to the products and services provided by operators." (*section 2.1)

3.28 Based on the above, the first issue for the NRA in developing Separated Accounts is to identify the markets and services for which detailed accounting information must be produced. The NRA can then determine the processes and procedures that should be applied to collect and report accounting information e.g. volume measurement and revenue identification for each market, service and product.

3.29 Ofcom[23] (the UK Telecom's Regulator), as part of its consultation document[24] (in April 2008) made proposals to enhance the presentation of and improve the quality of BT Plc's regulatory financial statements, with the aim of ensuring that they are fit for purpose.

3.30 Although BT Plc objected to Ofcom's proposals for disaggregation of services for a specific market (i.e. the Alternative Interface Symmetrical Broadband Origination (AISBO) market), Ofcom in its explanatory statement and notification[25] clarified that:

> *"BT's cost orientation obligation applies to "….each and every charge…." and it is essential that regulatory financial reporting is consistent with this key obligation. One of the reasons the condition refers to "each and every charge" is that there is a clear risk that bundling charges together could easily result in a bias against a particular group of customers with potential anti-competitive effect.* ***To meet this concern it is essential that BT is able to produce information on the costs and revenues of each charge****."*[emphasis added] (section 5.7)

3.31 Having considered the responses from interested parties, Ofcom required that BT Plc provide:

> *"Increased granularity of services in the Alternative Interface Symmetrical Broadband Origination (AISBO) market statement".* (section 2.13)

3.32 In justifying this decision, Ofcom stated that a further analysis of services is necessary:

> *"so that BT's non-discrimination obligation can be more effectively monitored".* (paragraph 2.13)

3.33 The Commerce Commission of New Zealand in its document 'Telecom Accounting Separation Information Disclosure Requirements for Financial Years

23 Office of Communications.

24 'BT's Regulatory Financial Reporting – Changes to BT's 2007/08 Regulatory Financial Statements'.

25 'Changes to BT's 2007/08 regulatory financial statements Explanatory statement and notification' – June 2008.

ending 2009 and 2010' (dated 25 March 2009) requires that Telecom New Zealand's regulatory statements disclose revenues at the service group and product levels.

3.34 Based on the Ofcom and New Zealand precedents among other reasons as set out in this document, it might be reasonable to conclude that more detailed information at the service level for each market should be provided as part of the Separated Accounts of Eircom so as to facilitate ComReg in its assessment of Eircom's compliance with its non discrimination obligations.

3.35 In an Ofcom consultation document 'Replicability of BT's Regulated Business Services' (July 2005), Ofcom considered whether BT's business retail exchange line, inland call and leased line services were replicable by its competitors, typically by using BT's Wholesale Line Rental ("WLR"), Carrier Pre-Selection ("CPS") and Partial Private Circuit ("PPC") services. Having concluded that such services are still not replicable, Ofcom as part of its 2008 consultation response required that BT Plc prepare (and submit in confidence to Ofcom) a statement reconciling the revenue recognised in BT Plc's general ledger and the calculated service by service revenue for the business connectivity markets (leased lines) covered by the replicability review.

3.36 It is reasonable, in ComReg's preliminary view, to conclude that this level of detail will provide greater transparency, improve understanding of differences between revenues in the Separated Accounts and revenues in the general ledgers and facilitate Ofcom in monitoring compliance with the non discrimination obligations (i.e. ensure that there are no anti competitive practices being employed).

3.37 Ofcom's consultation document 'BT's Regulatory Financial Reporting – Changes to BT's 2007/08 Regulatory Financial Statements' also raised concerns that the 2006/7 reports failed to address the issue of BT Plc's compliance with its obligations not to unduly discriminate. Ofcom as part of its consultation response therefore required that BT Plc provide a split of internal and external sales for the downstream product groups that use inputs from regulated (business connectivity) markets. Such statements are to be provided in confidence to Ofcom and will therefore not be made publicly available[26].

3.38 The Commerce Commission of New Zealand requires that where there is an arm's-length, documented arrangement in place for a Telecom Business Unit to supply another Telecom Business Unit with a particular service, then income from the resulting transaction should be recorded in the financial statements as internal revenue of the Business Unit providing the service and as a cost of the Business Unit receiving the service. In circumstances where there:

> *"is no arm's-length, documented arrangement in place for a Telecom Business Unit to supply another Telecom Business Unit with a particular service, attribute the costs of providing such a service to the receiving Services Group."* (section 13.2 paragraph (2))

3.39 While it is proposed that the Separated Accounts will contain accounting information for regulated markets and services only, it is recognised based on the New Zealand precedent that there is a need to split such revenues into internally

26 See section 1.7 of document 'Changes to BT's 2007/08 regulatory financial statements – Explanatory statement and notification' dated 26 June 2008.

generated revenues and externally generated revenues. In addition and based on the Ofcom decision, it is recognised that there is a need for complete transparency of internal and external revenues for all markets, services and products (both regulated and unregulated) so as to facilitate the NRA in its assessment as to whether any anti competitive practices are being adopted e.g. cross subsidisation within regulated and between regulated and unregulated markets, services and products.

3.40 **The level of disaggregation of volumes in the Separated Accounts**

3.41 Volume information is required for the purpose of average revenue and unit cost calculations so as to ensure that the cost orientation obligation is complied with when setting or reviewing tariffs. Ofcom requires that BT Plc disclose volume information on the face of its regulated financial statements at the market and service level (see Annex's to document 'Changes to BT's 2007/08 regulatory financial statements Explanatory statement and notification'). Volume data is also required for each network component. The importance of volumes were also identified in the calculation of internal and external revenues (i.e. price * quantity calculation).

3.42 In developing the schedule of network components, the Commerce Commission of New Zealand in its 'Draft Notification of Information Disclosure Requirements on Telecom New Zealand under Part 2B of the Telecommunications Act' (dated 23 October 2008) identified that in addition to costs, a schedule of component volumes will enable the calculation of the average unit cost for all network components and therefore services and products. This has been reflected in the Commerce Commission's Information Requirements for 2009 /2010 (see Appendix 1 of that document).

3.43 It is reasonable to conclude that based on this precedent together with the other reasons set out in this document, volume data should be disclosed on the face of the audited Separated Accounts statements and included with the Additional Financial Information provided on an *ad hoc* basis.

Preliminary Conclusion

3.44 It appears that the proposals set out in this consultation (see recommendation section below) with regard to revenue and volume are consistent with the practices employed in the countries considered in our benchmarking analysis, with Commission Recommendations and with regulatory obligations.

Preliminary Recommendations and Consultation Questions

3.45 Having reviewed the gaps in the information provided by Eircom and considered current practices (in the UK and New Zealand in particular) together with recommendations of the European Commission and the ERG group, ComReg now proposes a number of recommendations. It is thought likely that these recommendations should enable Eircom demonstrate more fully its compliance with the principles of transparency, non-discrimination and price control (e.g. cost orientation) and facilitate ComReg in monitoring such compliance.

3.46 The recommendations relate to the following areas:

- the disclosure of information in Accounting documentation
- revenue identification and disclosure
- volume measurement.

3.47 Recommendations relating to disclosure of information in the Accounting documents have been set out in detail at the "*Accounting Document*" section of this document.

3.48 The draft accounting Direction, at section 12 of this document takes account of these recommendations.

3.49 **Revenue Identification and disclosure**

3.50 The Separated Accounts of Eircom are currently only produced to the business level[27] and hence this is the only level at which revenues are provided (with the exception of *ad hoc* information requests at the individual services/products levels). The distribution of revenues on a market by market, service by service and product by product basis is of vital importance to Eircom if it is to properly identify contributions and ensure that cross subsidisation does not occur between regulated markets, services and products and between regulated and unregulated markets, services and products. This level of information is also required by ComReg to enable it monitor and enforce various obligations imposed on Eircom being an SMP operator i.e. transparency, non discrimination, price control (e.g. cost orientation).

3.51 So as to increase the usefulness of such accounts and ensure that they are 'fit for purpose', it is proposed that the current business revenues be disaggregated to the market, service and product levels (the product level being part of the Additional Financial Information).

3.52 Having regard to the issues identified above together with best practice, it is now proposed that that accounting Direction include preliminary proposals requiring Eircom to provide:

- HCA profit and loss accounts[28] and balance sheets for each regulated market as part of its final audited Separated Accounts. This information should also be published by Eircom

- HCA profit and loss accounts for each regulated service as identified by ComReg to be included in the final Separated Accounts. This information should also be published

- Specific Service (which are not already included in the Separated Accounts) or Product profit and loss statements (regulated only) to be provided in confidence to ComReg as part of the Additional Financial Information shall be determined by ComReg on an annual basis following discussion with Eircom prior to the financial year end and dependent on pending price reviews/applications

- HCA profit and loss accounts and balance sheets for non regulated markets, services and products to be provided as part of the Additional Financial Information to be determined by ComReg prior to the financial year end or as required on an *ad hoc* basis where necessary in

27 Retail and Other business units are, however, prepared to the activity level.

28 The reference to "profit and loss accounts" can also mean "Income Statements" depending on the basis of the preparation of accounts.

the event of for example a dispute etc, where detailed accounting information is necessary

- HCA profit and loss accounts at the market, service and product levels shall provide details of external, inter-segment and intra-segment revenues (and costs) where relevant. This will provide greater transparency in the Separated Accounts and the Additional Financial Information and facilitate ComReg in assessing Eircom compliance with its non discrimination obligations and ensure that there are no anti competitive practices being employed (e.g. cross subsidisation)

- Information relating to revenues attributed to each service, distinguishing between revenues which have been directly allocated to specific services, and other revenues which have been allocated or apportioned on the basis of statistical sampling or other accounting allocator should be disclosed in the Separated Accounts

- Details of bundled discounts allocated/apportioned at the service and product level (regulated and unregulated) and disclosed in the Additional Financial Information.

3.53 It is worth noting that Eircom in its BCMIF[29] accounts[30] (see extract below), provided details of gross revenues, total discounts and total net revenues. Therefore, while ComReg does not envisage an increased burden on Eircom at the market level, it would be required to provide a detailed split at the service and product levels.

Table 1 – Extract from BCMIF accounts

Fixed line services and other revenue

The following table shows our revenue from the fixed line services segment, analysed by major products and services, and the percentage change for each category, for the periods indicated:

	In the six months ended 31 Dec 2007 € 'm	In the six months ended 31 Dec 2008 € 'm	% Change[2] 2007/2008 %
Access (rental and connections)	**329**	**342**	**4**
Voice traffic	193	190	(1)
Advanced voice services traffic	32	31	(3)
Total voice traffic	**225**	**221**	**(1)**
Data traffic	24	15	(40)
Total voice and data traffic	**249**	**236**	**(5)**
Data communications	91	86	(5)
Interconnect services	118	107	(10)
Other products and services	94	97	3
Revenue before discounts	**881**	**868**	**(2)**
Discounts*	(48)	(62)	29
Total fixed line services and other revenue	**833**	**806**	**(3)**
Intracompany eliminations	(15)	(15)	3
Total fixed line services and other revenue	**818**	**791**	**(3)**

**Discounts are primarily related to revenue derived from access, voice and data traffic and ADSL and bitstream, which are presented on a gross basis in the table above.*

3.54 Within each of the markets, revenues shall be allocated to each of the services and products in the following manner:

29 "BCM Ireland Finance Limited"

30 http://investorrelations.eircom.net/pdf/BCMIF_Quarterly_and_Half_Year_results_report_to_31_December_2008.pdf

- revenues which can be directly assigned to a particular service or product shall be so assigned

- revenues which cannot be directly assigned to their use for specific services or products shall be apportioned on the basis of statistical sampling accurate to +/-1% at the 95% Confidence Level[31].

3.55 It is thought likely that disclosure at this level of detail in the Separated Accounts and in the Additional Financial Information requests will reduce the number of *ad hoc* information requests, which will ensure consistency of reporting year on year and allow for an improved regulatory process.

Q. 2. Do you agree or disagree with the preliminary proposals regarding the disaggregation of revenues by market, service and product with further analysis into (a) direct/apportioned and (b) internal/external revenues together with disclosure of bundled discounts? Please detail your response in full.

3.56 **Volume Measurement and Disclosure**

3.57 ComReg considers that accurate and transparent volume data is very important for all operators, in particular the need to calculate unit costs upon which many regulated prices depend.

3.58 Having considered the issues faced by ComReg, the precedents of BT Plc and Ofcom, ComReg now proposes that the accounting Direction include details of the process of deriving ‘weighted average volumes’ and ‘total unit’ figures, the calculations of which to be disclosed in the Primary Accounting Document (See *Accounting Document* section). This will also include the basis of derivation of the relevant usage factors applied to calculate the ‘weighting factors’ used to derive the weighted average volumes.

3.59 Given that it is proposed that the Separated Accounts be based on a market structure, there is a need for weighted average volumes/total units to be identified and disclosed at the market level and within each market for specific services. In addition it is proposed that the Additional Financial Information include weighted average volumes/total units for other regulated services and products (not included in the Separated Accounts) together with unregulated markets services and products as required by ComReg and determined on an annual basis.

3.60 For example, for the ‘Retail Access’ market there is a need to disclose the number of retail customers. As the number can increase as well as decrease throughout the year, a weighted average number should be calculated and disclosed in the Separated Accounts at the market level. This can then be further analysed at the service level e.g. number of Public Switched Telephone lines (‘PSTN’), number of Integrated Services Digital Network lines (‘ISDN’) etc. As with the market level, a weighted average volume figure should be disclosed at the service level.

31 See key principles for sampling data below.

3.61 ComReg considers, in its preliminary view, that the processes and procedures used by Eircom should be subject to a review by a competent independent reviewer on an annual basis and this is discussed in more detail in the section on "*Audit*" below.

3.62 ComReg considers that the volume data as set out in the Quarterly reports should be reconciled with the volume data contained in the published Separated Accounts and should be included as part of the Additional Financial Information. This should include detailed explanations of differences, if any.

3.63 ComReg considers that it also requires details of the sampling processes employed. In addition to disclosure of details of the design, scope, objectives, and methodologies, there is a need for the accounting Direction to specify the level of statistical reliability to be achieved so as to ensure that the financial information produced is 'fit for purpose'. In this regard, there is a need to consider the margins of error and confidence levels that are acceptable to ComReg.

3.64 How well the sample results reflect actual results can be measured by the margin of error and confidence levels. The margin of error relates to the imprecision that is inherent in sampling data whereas the confidence level relates to the probability that the sample results are representative of the actual results. For example a sample may have a margin of error of +/- 1% at a 95% confidence level. This means that if the sample was conducted 100 times, the results would be within 1% (above or below) of the true measurement for 95 of the 100 samples. The basis of calculation of these sample sizes should also be disclosed in the Secondary Accounting Document.

3.65 In this regard, it is initially proposed that the accounting Direction requires that within the markets, volumes shall be allocated to each of the services and products either directly, or where volumes cannot be directly assigned they shall be apportioned on the basis of statistical sampling accurate to +/-1% at the 95% Confidence Level.

3.66 ComReg is of the preliminary opinion that Eircom shall ensure that the sample data is based on either generally accepted statistical techniques or other methods. This should result in an accurate allocation of revenue (including transfer charges), costs (including transfer charges), assets and liabilities. In this regard, **a**ny sampling processes used to apportion volumes and revenues takes account of the following key principles:

- The sample data is unbiased and objective
- The sample size has been assessed in a statistical manner and is statistically significant
- The sample data is representative of the entire population
- The sample data is not obscured by seasonal or other factors
- The sample data is updated annually.

3.67 In addition and so as to increase transparency, ComReg proposes that Eircom provide a split on the face of the Separated Accounts of volumes directly attainable and volumes derived by statistical means.

3.68 While such proposals may be at an additional cost to Eircom, it is thought likely that it should increase both ComReg and industry confidence in the accuracy and reliability of such information, while reducing the need for independent verification by ComReg and so improve regulatory process.

Q. 3. Do you agree or disagree that weighted average volume / total unit figures should be disclosed on the face of the Separated Accounts analysed into volumes directly attainable and volumes derived by statistical means? Please detail your response in full.

Q. 4. Do you agree or disagree with the preliminary proposal that the Additional Financial Information shall include a reconciliation statement of Quarterly Reports and Separated Accounts volumes together with detailed explanations? Please detail your response in full.

Q. 5. Do you agree or disagree that all samples which drive costs to the market, service and product levels should be within a +/-1% margin of error at a 95% confidence level? Please detail your response in full.

Q. 6. Do you agree or disagree with the key principles that should be applied in using sample data? Please detail your response in full.

3.69 Specific questions with regard to the disclosure in the accounting documents have been dealt with in section on the "*Accounting Document*" below.

4 Cost Allocation and Apportionment

Background

4.1 The electronic communications sector is a multi-service industry and as with any other such entity, accurate service costing is a very important task.

4.2 The cost associated with the provision of a service/product may be its marginal cost (i.e. direct costs only) or a fully distributed cost (i.e. direct, indirect and a share of common costs).

4.3 The allocation and apportionment of costs through the fully distributed cost methodology allocates all of an operator's costs to all services and products, both regulated and unregulated of the company. Fully distributed costs can also be adjusted to reflect changes between historic costs and current costs.

4.4 While direct costs refer to those costs which can be directly attributable to a service/product, indirect costs cannot be directly attributed and therefore need to be apportioned between a number of services/products on the basis of an appropriate cost driver. Common costs on the other hand refer to costs which are common to all services/products (e.g. corporate overheads) and which need to be apportioned on the basis of an Equal Proportionate Mark-Up ("EPMU").

4.5 Costs can also be classified as fixed or variable. Fixed costs are costs that do not vary with production or sales e.g. rent whereas variable costs are costs that do e.g. repair and maintenance costs.

4.6 The telecoms industry is characterised by high fixed costs and significant common costs across products/services. It is therefore of utmost importance that the choice of allocator is appropriate. If too much cost is allocated to a particular service, it could appear that this service was not profitable when actually it was. Eircom may therefore propose to increase specific prices unnecessarily which may have implications for volume growth, service profitability, customer satisfaction and competition.

4.7 The visibility of costs at the market, service and/or product levels is therefore very important as it will assist in the identification of anti-competitive behaviour e.g. cross subsidisation (between regulated and unregulated services/products) or undue discrimination between charges levied for services provided internally (e.g. from Eircom Wholesale to Eircom Retail) and charges levied on OAOs for equivalent services. In this regard it important that clear Transfer Charging Principles are set out to be followed by Eircom.

4.8 In this section, we consider the processes applied by Eircom to identify and allocate direct costs and apportion indirect costs (based on associated cost drivers) and common costs between regulated and unregulated markets, services and products.

4.9 Due to the limited access of ComReg to Eircom's costing data (at the market, service and product levels) and the limited data provided by Eircom on its cost allocation system, ComReg's analysis has been confined to a review of the information provided by Eircom as part of recent price reviews/applications of specific services/products. ComReg also considers that Eircom's systems are far too extensive for ComReg to have sight of all data other than sample data.

4.10 In undertaking the analysis of Eircom's costing data which ComReg considers is comprehensive, ComReg has reviewed the processes and procedures employed by Eircom, compared this with best practice and regulatory recommendations and have identified specific areas where there is a need for improvement.

4.11 ComReg's preliminary recommendation for an accounting Direction is set out in section 12 below.

Issues identified by ComReg

4.12 As identified above, ComReg, following a number of price reviews and price change applications, identified concerns with Eircom's Separated Accounts and additional supporting information (provided by it for specific services and products). As regards costs, these include the:

- difficulty in reconciling the total cost of all the component parts to the total as set out in the Separated Accounts i.e. total products reconciling back to service level and total services reconciling back to the market level and market level reconciling to the statutory financial accounts

- need for greater granularity in the Separated Accounts, therefore reducing the need for *ad hoc* (unaudited) information requests so improving the efficiency and effectiveness of the regulatory process. The Wholesale Broadband Access ('WBA')[32] market is just one example of a market where detailed information is not published by Eircom but nevertheless accounts for a significant percentage of Eircom's revenues and costs. In addition, the WBA market is comprised of the Bitstream (and the Digital Subscriber Line ('DSL') services). This level of detail is not however currently disclosed in the Separated Accounts despite the need for ComReg to price such services

- lack of visibility as to how costs have been allocated or apportioned amongst the markets, services and products. There is also limited information available about functional cost categories (e.g. Repair & Maintenance, Finance & Billing and Installation & Provisioning etc.) (and network elements), the associated costing activities and cost drivers applied to allocate/apportion indirect costs to the markets, services and products (see "*Accounting Document*" section below for further details).

4.13 In addition, there are also concerns with the:

- timeframe within which Eircom responds to ComReg's information requests which has caused considerable delays in conducting price reviews and other analysis work

- the accuracy and reliability of Eircom's accounting information for regulatory purposes such as pricing reviews

- lack of assurance from an independent suitably qualified source.

[32] See ComReg Decision Notice 'Retail minus wholesale price control for the WBA market' Document No. 06/01 Decision D01/06.

Best Practice

4.14 This section provides an overview of the European regulatory environment, the findings of the European Competitive Telecommunications Association ('ECTA') report, the processes employed by other telecoms operators, in particular in the United Kingdom and New Zealand, and other regulatory benchmarks.

4.15 As with revenue and volume practices, ComReg has been restricted in its benchmarking exercise due to the lack of publicly available information (in English), on the processes and procedures employed by other Telecom operators throughout Europe. ComReg considers that BT Plc and New Zealand Telecom are however representative of good practice.

4.16 **European Regulatory environment**

4.17 The EU Commission Recommendation (2005/698/EC) identified the purpose of imposing an obligation to implement cost accounting as being:

> *"…to ensure that that fair, objective and transparent criteria are followed by notified operators in allocating their costs to services in situations where they are subject to obligations for price controls or cost-oriented prices."* (Point 1)

4.18 As already set out above, ComReg following a market analysis process has imposed Cost Accounting obligations on a number of markets. There is, however, a need for more transparency about how the costing system should operate in practice.

4.19 In this regard, the EU Commission recommended that costs should be allocated:

> *"…in accordance with the principle of cost causation (such as activity-based costing, 'ABC')"* (Point 2) and disaggregated to a level to be *"consistent with the principles of proportionality, transparency and regulatory objectives mandated by national or Community law"*. (Point 2)

4.20 The ERG Common Position Paper (which set out guidelines for implementing the Commission Recommendation) identified that the costing system should for example allow the allocation of costs to "unbundled network components" so as to determine the cost of unbundled services (see section 2) and identified a three staged attribution process to ensure compliance with the principle of 'cost causality' i.e.:

- *"Review and justify the relevance of each item of cost…..;*
- *Establish and quantify the …"driver" that caused the item to arise;* and
- *Use the driver to allocate each item to individual businesses/activities/network components or services."* (see section 2.1)

4.21 It was also recognised that such attribution methodologies should be satisfactory to the regulatory authority.

4.22 Based on this, ComReg is of the preliminary conclusion that Eircom should document in its Accounting Document details of each functional cost category and network element (and associated activities) together with the associated cost drivers at the market, service and product levels. This will increase transparency of the processes employed and facilitate ComReg in its assessment of their appropriateness or otherwise.

4.23 The Commission recommended that an NRA, when assessing the features and specification of the cost accounting system:

> "*reviews the capability of the notified operator's cost accounting system to analyse and present cost data in a way that supports regulatory objectives. In particular, the cost accounting system of the notified operator should be capable of differentiating between direct costs and indirect costs.*" (Point 3)

4.24 In this regard, the Commission defined direct and indirect costs as follows:

> *"Direct costs are those costs wholly and unambiguously incurred against specified activities."* (See footnote 1)

> *"Indirect costs are those costs that require apportionment using a fair and objective attribution methodology."* (See footnote 2)

4.25 In addition to direct and indirect costs, the ERG paper also identified costs that are "common" to a number of activities and therefore:

> *"cannot be avoided unless all the activities to which they are common are closed."* (see section 4.2.6)

4.26 It identified that:

> *"In a regulatory environment it is accepted that all services should bear, in addition to their incremental cost, a reasonable proportion of the common costs. The preferred method of allocating costs is Equal proportionate Mark-Up (EPMU)[33]."* (see section 4.2.6)

4.27 Using the EPMU method, common costs are apportioned across business units and network products in proportion to the costs already allocated/apportioned.

4.28 For example Table 2 provides an example of apportioning common costs.

Table 2 – Example of apportioning common costs

	Product A	Product B	Product C	Total
Direct Costs	30	20	10	60
Indirect Costs	15	15	10	40
Total Direct & Indirect Costs	**45**	**35**	**20**	**100**
Common Costs	22.5	17.5	10	50
Total Costs	**67.5**	**52.5**	**30**	**150**

Source: ComReg

4.29 In this example common costs of €50 has been allocated across Product A, B, and C in proportion to the direct and indirect costs already allocated/apportioned i.e. 45%, 35% and 20% respectively.

33 Equi-proportional mark up *"allocates the joint costs and overheads to a product in the same proportion as that product's share of total LRMC costs"* (Long Run Marginal Cost). Source – Oxera Report 'Equi-proportional mark-ups: regulatory precedents' July 2005.

4.30 Based on the recommendations of the EU and the ERG Guidelines, it seems appropriate that ComReg establish guidelines for cost allocation and apportionment of direct, indirect and common costs.

4.31 The ERG also proposed that:

> *"the attribution methodologies should be comprehensively documented and transparent to the satisfaction of the NRAs. A description of attribution methodologies should also be published by the notified operator."* (See section 2.4)

4.32 In addition:

> *"All aspects of the cost attribution process including cost driver definitions and calculations, survey and sampling techniques and valuation methodologies must be made available to, and subject to review by, the NRA."* (See section 2.4)

4.33 On this basis, it seems reasonable for ComReg to require that Eircom provide details of its attribution methodologies (including cost driver definitions, samples etc.) as part of its Accounting documents, with a non confidential summary being published (see section on "*Accounting Document*" below for more details).

4.34 The ECTA Regulatory Scorecard for 2008[34] in its recommendation stated that:

> *"NRA's should ensure the timely publication of regulatory accounts containing sufficient public data to allow independent verification that products are cost-oriented and no anti-competitive cross-subsidies have occurred".*

4.35 It is also worth noting that the EU Commission with regard to the issue of efficiency recommended that:

> *"…national regulatory authorities take due regard to further adjustments to financial information in respect of efficiency factors, particularly when using cost data to inform pricing decisions since the use of cost accounting systems (even applying CCA) may not fully reflect efficiently incurred or relevant costs*" (See Recommendation 3).

4.36 **BT PLC - UK**

4.37 BT Plc is obliged to meet certain regulatory financial reporting requirements for SMP markets, Technical Areas and disaggregated activities were deemed necessary by Ofcom. The current basis of preparation of BT Plc's regulatory financial statements has been applied since the 2004/5 financial year. The regulatory financial obligations were imposed on BT Plc to monitor and enforce ex-ante obligations including cost orientation, cost recovery, price controls and no undue discrimination. The cost accounting and Accounting Separation requirements are detailed in the Final Statement and Notification in 2004 as amended in 2005, 2006, 2007 and 2008.

34 http://www.ectaportal.com/en/upload/File/Regulatory%20Scorecards/2008/ECTA%20Regulatory%20Scorecard%202008%20-%20Executive%20Summary.pdf

4.38 In addition to regulatory reporting requirements, BT Plc is also required to produce a Primary Accounting[35] and a Detailed Attribution Methods ('DAM')[36] documents. The Primary Accounting Document contains high level principles of attribution, transfer charging methodologies and accounting policies whereas the DAM describes in detail the methods used to derive the fully allocated costs of the markets, technical areas, components, products and services which is used by BT Plc to prepare the Regulatory Financial Statements on a fully allocated cost basis. Details of the DAM are set out in greater depth in the section on the "*Accounting Document*" below.

4.39 Based on BT Plc precedent, it is reasonable to conclude that Eircom be required to produce a Primary Accounting Document and a Secondary Accounting Document. While the Primary Accounting Document should be published on its website, the Secondary Accounting Document should be submitted in confidence to ComReg for its review and approval.

4.40 In the recent document published by Ofcom 'Changes to BT and KCOM's[37] regulatory financial reporting – 2008/09 update – Explanatory Statement and notification[38]' it identified that:

> *"…some of the non-regulated Openreach services do not appear to pick up an appropriate share of costs".*

4.41 In light of such concerns, ComReg is of the preliminary view that there should be complete transparency in the accounts of Eircom so as to facilitate an assessment that costs have been shared out in a fair and equitable manner (between regulated and unregulated services and products).

4.42 **Telecom New Zealand**

4.43 The Commerce Commission of New Zealand requires Telecom New Zealand to adopt a particular attribution methodology when preparing the required regulatory statements. The methodology is based on the requirement that costs (revenues, assets and short term liabilities) must be fully attributed to the prescribed business activities and services, and that causality is the key to the attribution process.

4.44 Telecom New Zealand is required to disclose the way in which it applies the attribution methodologies prescribed by the Commission, in a manner that a reasonably informed person can understand the documented processes and the regulatory financial statements. In this regard, it is required (for 2009/2010) to produce an Attribution Methodologies Manual which must describe how costs are treated from their initial appearance in Telecom New Zealand's accounting records to their final attribution to market serving activities or to network components.

35Source: http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2008/PrimaryAccountingDocuments2008.pdf

36 Source : http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2008/DAM2008.pdf

37 previously Kingston Communications Plc.

38 http://www.ofcom.org.uk/consult/condocs/btkcom09/statement/

4.45 The Commission in its Draft Notification of Information Disclosure Requirements on Telecom New Zealand, identified that the approach to the process of attribution of financial information to components, services and products can be summarised as follows:

- Review each item of revenue, cost, asset and short-term liabilities
- Establish a driver (the process that caused the cost to be incurred or the revenue earned)
- Use the driver to attribute costs to components, services or products
- Use the driver to attribute revenue to retail products or wholesale services.

4.46 The fundamental requirement is to have Telecom New Zealand's costs fully attributed to cost objects, which are further attributed to the network components and eventually to services and groups of services so that ultimately all costs are driven to all market activities or network components.

4.47 Based on precedent in New Zealand, there is a need for complete transparency and reconciliation of the general ledger records with the allocations and apportionment to the market, service and product levels.

4.48 The other processes adopted by New Zealand have been dealt with in previous sections but nevertheless ComReg considers they provide further justification for its proposals.

4.49 With regard to the level of detail required to be disclosed at the network component level, the Commerce Commission of New Zealand set out the following table (Table 3) as an example of the structure and detail that is required for financial years ending 2009 and 2010:

Table 3[39] – Example schedule of Network Components - extract from Commerce Commission of New Zealand

NETWORK COMPONENTS	NETWORK ACTIVITY										NETWORK USAGE & COST			
Example Schedule	HCA operating cost ($m)	Supplementary depreciation ($)	Holding gains and other CCA adjustments	Total CCA operating costs	CCA mean capital employed	Applicable rate of return on capital %	Capital costs	Total of operating costs and capital costs relating to current year	Component Volume and Unit	Average costs per unit on a current cost basis relating to current year	Relevant Product A Usage	Relevant Product B Usage	Relevant Product A Cost	Relevant Product B Cost
Access Regional Transport	$	$	$	$	$	%	$	$	x	$	%	%	$	$
Access National Transport	$	$	$	$	$	%	$	$	x	$	%	%	$	$
UBA Backhaul Router	$	$	$	$	$	%	$	$	x	$	%	%	$	$
UCLL Backhaul Router	$	$	$	$	$	%	$	$	x	$	%	%	$	$
etc														

Note: The Access Regional and National Transport relates to transmission within a local/national network.
'UBA Backhaul Router' refers to Unbundled Bitstream access
'UCLL Backhaul Router' refers to Unbundled copper local loop network backhaul.

4.50 ComReg has taken into account publications by Ofcom and the Commerce Commission of New Zealand in relation to network component (elements).

39 http://www.comcom.govt.nz//IndustryRegulation/Telecommunications/AccSepofTelecom/ContentFiles/Documents/draft%20requirements%20paper.pdf

4.51 **Other Regulatory Benchmarks (*The Postal Sector*)**

4.52 The EU Postal Directive[40] establishes a harmonised regulatory framework for postal services throughout the European Union and for securing improvements in the quality of service provided.

4.53 Article 14 of the Directive provides for certain accounting rules, in particular the separation of accounts for Reserved universal services, Non-Reserved universal services and non-universal services and the allocation method of costs i.e.

4.54 Article 14(2) provides that:

> *"The universal service provider(s) shall keep separate accounts within their internal accounting systems in order to clearly distinguish between each of the services and products which are part of the universal service and those which are not. This Accounting Separation shall be used as an input when Member States calculate the net cost of the universal service. Such internal accounting systems shall operate on the basis of consistently applied and objectively justifiable cost accounting principles."*

4.55 Article 14(3) provides that:

> *"The accounting systems referred to in paragraph 2 shall, ..., allocate costs in the following manner:*
>
> *(a) costs which can be directly assigned to a particular service or product shall be so assigned;*
>
> *(b) common costs, that is costs which cannot be directly assigned to a particular service or product, shall be allocated as follows:*
>
> > *(i) whenever possible, common costs shall be allocated on the basis of direct analysis of the origin of the costs themselves;*
> >
> > *(ii) when direct analysis is not possible, common cost categories shall be allocated on the basis of an indirect linkage to another cost category or group of cost categories for which a direct assignment or allocation is possible; the indirect linkage shall be based on comparable cost structures;*
> >
> > *(iii) when neither direct nor indirect measures of cost allocation can be found, the cost category shall be allocated on the basis of a general allocator computed by using the ratio of all expenses directly or indirectly assigned or allocated, on the one hand, to each of the universal services and, on the other hand, to the other services;*

40 Directive 2008/6/EC of the European Parliament and of the Council of 20 February 2008 (amending Directive 97/67/EC with regard to the full accomplishment of the internal market of Community postal services).

> *(iv) common costs, which are necessary for the provision of both universal services and non universal services, shall be allocated appropriately; the same cost drivers must be applied to both universal services and non universal services."*

4.56 The Postal Directive provides no further guidance on cost allocation, and provides little guidance on the level of disclosure that should be provided to the NRA. The Postal Directive does however state that:

> *"the national regulatory authorities shall keep available,...information on the cost accounting systems applied by a universal service provider, and shall submit such information to the Commission on request.*"

4.57 Irish law requires ComReg to issue directions setting out how An Post, the Universal Service Provider ('USP'), should maintain cost accounts so as to achieve transparency of accounting in respect of the costs incurred in providing the various postal services within the scope of universal service. In light of these requirements[41] and following a consultation process, an accounting Direction[42] was first issued to An Post in September 2001. ComReg updated the processes employed by An Post to identify revenues, measure volumes and allocate and apportion its costs, in a new accounting Direction issued in 2006[43].

4.58 With regard to cost accounting obligations, the accounting Direction set out the principles and rules to be applied in allocating and apportioning costs to the business units, services and products, the hierarchy of costs to be applied to each service and product (distinguishing between direct, indirect and common costs). It also requires that An Post submit to ComReg in advance of the start of each accounting period an Accounting Manual that sets out (amongst other things) details of:

- the process by which An Post identifies how costs are found to be directly or indirectly attributable, joint or common
- the process by which An Post identifies how avoidable, variable and fixed costs are defined
- how costs are allocated to products with different weight, format and payment characteristics
- how cost drivers are reviewed, updated and verified
- together with detailed schedules showing how each individual cost category is treated at the business unit, service and product levels.

4.59 In establishing the guidelines for cost allocations and apportionments (of direct, indirect and common costs), ComReg is of the preliminary opinion that it is appropriate that it should consider the requirements of the telecom sector in addition to other regulated sectors.

41 Regulation 12(2) of the European Communities (Postal Services) Regulations, 2000 (S.I. No. 310 of 2000)..

42 D15/01 ODTR 01/74 Decision Notice & Report on Consultation "Regulation of Universal Postal Services- Accounting Separation & Costing Methodology Proposed Direction to An Post".

43 Response to Consultation – ComReg document 06/63 'Regulation of Universal Postal Services – Accounting Separation & Costing Methodology – Accounting Direction to An Post'.

Preliminary Conclusion

4.60 ComReg is of the preliminary view that the proposals set out in this consultation (see recommendation section below) with regard to cost allocation and apportionment are consistent with the practices employed in the countries considered in our benchmarking analysis, with Commission Recommendations (including ERG) and with other regulated industries (i.e. Postal Sector). ComReg's experience to date has been that the time and effort initially required to implement better reporting procedures is more than offset by a more transparent process going forward.

Preliminary Recommendations and Consultation Questions

4.61 Having considered the issues faced by ComReg and the processes and procedures applied by other operators and in other regulated industries, ComReg now sets out its recommendations with regard to cost allocation and apportionment issues.

4.62 With regard to the apportionment of common costs, it is worth noting that the 'Merger Determination of the Competition Authority M/05/050'[44] recognised the importance of common cost apportionments and therefore included an obligation (Commitment No 1 (d)) on Eircom to provide to ComReg on request:

> *".... a description of costs which are common to its fixed-line business and Meteor, the amounts involved, the basis of the allocation of the costs between the fixed line business and Meteor, and any other elements of the transactions reasonably necessary for an understanding of the treatment of these costs in the financial statements."*

4.63 In addition to the disclosure requirements relating to Meteor, ComReg needs to have access to the details as to how common costs have been apportioned at the market, service and product levels. This will enable ComReg make an assessment as to the appropriateness of such apportionments and so satisfy itself that there has been no cross subsidisation.

4.64 ComReg is therefore of the opinion that within the markets, costs should be allocated to each service and/or product in the following manner:

(a) costs which can be directly assigned to a particular service or product shall be so assigned

(b) common costs, which are costs that cannot be directly assigned to a particular service or product, shall be allocated as follows:

(i) whenever possible, common costs shall be allocated on the basis of direct analysis of the origin of the costs themselves

(ii) when direct analysis is not possible, common cost categories shall be allocated on the basis of an indirect linkage to another cost category or group of cost categories for which a direct assignment or allocation is possible, the indirect linkage shall be based on comparable cost structures

44 Competition Act 2002 Merger Determination of the Competition Authority (M/05/050) Proposed acquisition of Meteor Mobile Communications Limited by eircom Group plc - 18 November 2005.

(iii) when neither direct nor indirect measures of cost allocation can be found, the cost category shall be allocated on the basis of an equi-proportional mark-up computed by using the ratio of all expenses directly or indirectly assigned or allocated, to each service or product.

4.65 It is ComReg's preliminary view that Eircom discloses to it in confidence an analysis of functional costs and network element costs as part of the Additional Financial Information. This will be divided into costs which have been directly allocated to markets, services and products, common costs which have been apportioned on the basis of the associated cost driver, and common costs which have been allocated on the basis of an equi-proportional mark-up.

4.66 It should be noted that what may be a direct cost at one level may be an indirect or common cost at a subsequent level. It is proposed that this level of information be disclosed on the face of the Additional Financial Accounts (for all markets and services and for the agreed product list) with detailed schedules (listing functional cost categories and network elements and the associated activities) disclosed as part of the Accounting documents (see the section on "*Accounting Document*" below) at the market, service and product levels. In addition, it is proposed that the Secondary Accounting Document shall provide at a minimum details of :

- the means by which Eircom identifies how costs are found to be directly or indirectly attributable, joint or common
- the means by which Eircom identifies how avoidable, variable and fixed costs are defined
- the means by which costs drivers are reviewed, updated and verified together with justifications of changes in basis of allocation/apportionment from year to year.

4.67 For example, Repair & Maintenance cost is composed of a number of different activity costs (some direct, some indirect and some common at the market, service and product levels), such as repair, preventative maintenance, re-active maintenance etc. Specific marketing campaigns undertaken to promote specific services (e.g. the broadband service) should be treated as an indirect cost and apportioned to all services offered in the bundle (as all services will benefit from increased sales not just the broadband service) whereas costs incurred to promote the Eircom brand should be treated as a common cost and apportioned across all markets, services and products (regulated and unregulated).

4.68 Given the ERG Position that:

> *"Costing systems should allow the allocation of costs to unbundled network components, in particular to determine the cost of unbundled services.*" (section 2)

4.69 ComReg is of the initial opinion that this and other cost allocations should be performed on a Fully Distributed Cost Basis. This ensures that all services and products will receive its direct costs and an appropriate share of indirect and common costs.

4.70 It is thought likely that this level of information should:

- increase transparency as regards Eircom's regulatory obligations and facilitate ComReg in its assessment of the appropriateness or otherwise of Eircom's allocation/apportionment of functional costs and network element costs between markets, services and products

- enable ComReg assess whether there has been any issues of cross subsidisation or discriminatory pricing in contravention of Eircom's obligations

- increase stakeholder confidence in the accuracy of unit cost calculations and therefore prices

- introduce greater certainty in the regulatory process and reduce the number of *ad hoc* requests as regards its regulatory obligations from Eircom thus improving regulatory process.

4.71 In addition and while ComReg recognises the importance of the application of the principle of Cost Causation in the allocation and apportionment of costs, it is important that this is applied in a non discriminatory manner, ensuring that all services that obtain benefits from the provision of a particular activity receive an appropriate share of the associated costs. However, ComReg would only consider efficiently incurred costs as the consumer should not have to bear the costs of an inefficient operator in the form of high or increased prices.

4.72 In relation to the details of the appropriate functional cost categories and expenditure by network element it is initially proposed that at a minimum the hierarchy of costs[45] (analysed into pay and non pay) and which has to be disclosed on the face of the Separated Accounts/Additional Financial Information to be applied to each service and product shall enable the cost of the following activities to be calculated:

- Product Development & Management
- Marketing & Sales
- Repair/Maintenance
- Finance & Billing
- Installation/Provisioning
- Supply of customer lines
- Connections
- Network support
- General support
- General management
- Accommodation
- Information Technology (IT)
- Transport

45 A hierarchy of costs is a list of functional cost categories (i.e accommodation). Each functional cost can be analysed by activity (e.g. rent and rates). Network element costs shall also be included here.

- Personnel & Administration
- Other operating expenses.

4.73 It is also proposed that accounting items not involving the movement of funds (e.g. depreciation) shall also be separately identified.

4.74 It is however important to note that costs which may be relevant in a retail context may not necessarily be relevant in a wholesale context and *vice-a-versa* e.g. the cost associated with supply of customer lines and connections are only relevant to the retail market.

4.75 ComReg also considers that it would require annually a list of any manual journals/adjustments made by Eircom to reallocate/reapportion specific costs (together with its justifications) after year end and when preparing the Separated Accounts. This will allow ComReg review the manual journals for objectivity and accuracy. It is ComReg's preliminary view that these should be supplied as part of the Separated Accounts. The journals would include those made between the statutory financial statements and the Separated Accounts as well as within the Separated Accounts themselves as these will have taken place subsequent to the statutory audit and would directly impact upon the Separated Accounts.

4.76 While Eircom will have to provide a more detailed analysis of its costs, it is envisaged that this extra work will be more than offset by an increase in transparency and an improved regulatory process as it will facilitate ComReg in a more detailed review of costs.

Q. 7. Do you agree or disagree that there is a need for greater transparency of costs split by the proposed functional cost category and network element for each service and product as part of the Additional Financial Information, distinguishing between direct, indirect and common costs? Please detail your response in full.

Q. 8. Do you agree or disagree with the preliminary proposal (together with disclosure in Accounting Document) regarding the allocation and apportionment of costs (i.e. direct, indirect and common on a fully distributed cost basis)? Please detail your response in full.

Q. 9. Do you agree or disagree with the preliminary proposals with regard to the hierarchy of costs and listing of manual journals? Please detail your response in full.

4.77 It is ComReg's preliminary opinion that a Schedule of Network Components together with a Usage by Service Schedule and Network Activity Statement for each network component (by market, service and product) shall be included as part of the Additional Financial Information. It is proposed that Eircom submit draft schedules to ComReg for its review within four months of the effective date of this Direction.

4.78 In considering the level of disclosure, it can be noted that the new requirements are similar to those previously set out, including under Decision 3.8 (D5/99), Decision 3.3 (D10/99), Decisions 4.3.3 and 4.3.5 (D9/00) and Decision 8.10 (D7/01) (which it is proposed here shall be superseded by the terms of the proposed draft accounting Direction). See the draft accounting Direction at section 12 for specific details of the newly proposed obligations.

4.79 In addition, the content of the Draft Notification of Information Disclosure Requirements to Telecom New Zealand could be considered where relevant and may assist with developing these schedules, in particular the following:

a) A Schedule of network components/elements which should include the following:

- Component/element name at a functional level
- Description of function (e.g. call set up)
- Controlling Service Group
- Element Count (total number of such elements controlled by the service group)
- Location in Network (e.g. remote cabinet)
- Average Historic Cost Value
- Average Current Cost Value
- Average Designed Maximum Capacity
- Metric of Volume (e.g. minute of use or call setup or circuit etc)
- Average Capacity Utilisation (percentage).

b) A Network Activity Statement (detailing the average unit cost[46] for each network component/element listed in the Schedule of Network Components/Elements). The Activity Statement should also include the following information for each combination of network component/element:

- Component name at a functional level (e.g. transit exchange circuit)
- Controlling Service Group
- Region (i.e. geographic region)
- Operating cost (HCA) per component/element
- CCA Adjustments
- Operating cost (CCA)
- Mean Capital Employed (CCA)
- Weighted Average Cost of Capital (‘WACC’)

46 Analysed by functional cost category consistent with that provided at service and product level.

- Total Cost (Capital, depreciation and Operating cost)
- Unit of Usage and Volume
- Average Cost per Unit (CCA)

c) A Usage by Service Schedule for network components/elements. This will identify the use made of each network component/element by each service and product and should include:

- Product or Service Name (e.g. national call)
- Component Name at a functional level (e.g. transit exchange circuit)
- Controlling Service Group
- Average Component Usage (e.g. "4" if the average duration of a national call is 4 minutes).

4.80 While it is evident from Eircom's Accounting Document that it is attributing costs (revenues, assets and liabilities) to network elements, no detailed information is provided in the Accounting Documents or in the Separated Accounts. ComReg is of the preliminary opinion that the proposed level of disclosure will improve its understanding of the network components/elements and the process of allocation of such costs to the service and product levels. This will have implications on the regulatory and ComReg's decision making processes.

4.81 As this information should be readily available to Eircom, ComReg does not envisage significant additional costs. ComReg is of the preliminary view that this information should be submitted for all markets, services and products. This would include as a minimum:

- LLU
- Wholesale broadband
- Interconnection
- Leased lines.

Q. 10. Do you agree or disagree with the preliminary recommendation that Eircom be required to develop and submit to ComReg as part of its AFI a 'Schedule of Network Components', a 'Network Activity Statement' and a 'Usage by Service Schedule' for all markets, services, and products? Do you agree or disagree that the content of such schedules/statements should be prepared and submitted by Eircom to ComReg for its review within four months of the effective date of this Direction? Is there any additional information that you believe should also be provided? Please detail your response in full.

4.82 ComReg considers that costing information in relation to unregulated markets, services and/or products will be required by it for both ex-ante and ex-post analysis purposes i.e. in circumstances where ComReg needs to investigate possible below cost selling. Possible abuses that ComReg may investigate include predatory pricing, margin squeeze, discriminatory pricing, anti competitive bundling, horizontal or vertical leverage or unfair cross subsidisation.

4.83 In this regard, it is worth noting the French Supreme Administrative Court (Conseil d'Etat) decision (Decision No 309 of 7 May 2008). This related to a challenge by La Poste to L'Autoritité de Régulation des Communications Électronique et des Postes ('ARCEP' – national regulatory agency of France) decision that ARCEP may request detailed information on products/activities outside the Universal Service area. This, ARCEP considered was necessary to get the global view on the USP's accounts, which is necessary for assessing the economics of the universal service.

4.84 ComReg is of the initial opinion that there is a need for complete transparency in Eircom's accounting system so as to enable it assess that there has been proportionate distribution of all costs between regulated and competitive markets, services and products. For example, within the Market for Leased Lines, there are both regulated and unregulated services. There is a need for transparency as to how shared costs (including network element costs) have been apportioned between such services, so ensuring there is no cross subsidisation. However, ComReg would be obliged to hear from interested parties on this matter.

4.85 It is proposed therefore that Eircom provide profit and loss accounts and balance sheets (in a format consistent with that of its Separated Accounts) for its unregulated markets, services and products as part of the Additional Financial Information. These would be determined by ComReg annually following discussion with Eircom but in advance of the year end. For example where a service is based on a retail minus price control and the retail market is not regulated then ComReg would require AFI for that retail market each year. Alternatively Additional Financial Information for unregulated markets might only be requested in the event of (for example) competition cases or margin squeeze investigations. In addition, it is proposed that details of allocations/apportionments including cost drivers be provided as part of its Secondary Accounting Document.

4.86 It is thought likely that this information should be readily available to Eircom, and so there would not be a significant increase in costs in providing this information to ComReg. From a stakeholder perspective it will increase their confidence in unit cost calculations as all apportionments of costs e.g. common costs will be subject to review by ComReg.

Q. 11. Do you agree or disagree with the preliminary recommendation that Separated Accounts for non regulated markets, services and/or products should be provided to ComReg as part of the Additional Financial Information determined on an annual basis as required? Please detail your response in full.

4.87 ComReg's proposals with regard to disclosure of inter and intra segment costs on the face of the Separated Accounts have been dealt with in the section on "*Volume and Revenue identification*" above. With regard to the Transfer

Charging Principles to be followed, it is proposed that these will continue be broadly based on Decision 3.11 of ODTR document 99/35[47] and be included in the Accounting Document i.e.

- Transfer charges (revenues and costs) shall be attributed to cost components, for regulated and unregulated services, products and markets 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 market, regulated or unregulated

- 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 justifiable (with supporting calculations available)

- The transfer charges for internal usage should be determined as the service/product (regulated and unregulated) 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 (regulated or unregulated) 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 reference interconnect offer (“RIO), if different this charge must be appropriately justified[48]. (See for example suggested format of the Profit and Loss Account in Appendix B)).

4.88 See section 12, draft accounting Direction for further detail.

Q. 12. **Do you agree or disagree with ComReg’s proposals regarding Transfer Pricing Principles? Please detail your response in full.**

4.89 **Demarcation between the traditional Core and Access Networks**

4.90 For cost allocation and network delineation purposes ComReg considers that the access boundary between what has traditionally been the Core and Access networks remains at the switch side of the line card.

4.91 ComReg notes that while it considers that Decision 9 of ComReg document D7/01 should be superseded, it is of the preliminary view that the delineation of the Core and Access boundary as discussed in that document is still relevant. It should be further noted that the definitions of “Business Areas” as contained in

47 ComReg document 99/35 – “Accounting Separation and Publication of Financial Information for Telecommunications Operators: Decision Notice 5/99, Consultation Report and issues for further consultation”.

48 See paragraphs 3.260 and 3.267 of ComReg document 09/66 –“Response to Consultation and Decision: Rental Price for Shared Access to the Unbundled Local Loop”.

Appendix II of that document have been superseded by new market definitions. See draft accounting Direction (and annex's) at section 12 for further detail.

Q. 13. Do you agree or disagree that for cost allocation and network delineation purposes that the boundary between the Access and Core network should remain at the switch side of the line card? Please detail your response in full.

5 Separated Accounts

Background

5.1 In this section, ComReg considers the existing accounting and reporting obligations placed on Eircom and the current level of transparency of Eircom's Separated Accounts. It later discusses problems ComReg has encountered as regards Eircom's current obligations.

5.2 In accordance with decision notices[49] issued by ComReg/ODTR[50], Eircom provides ComReg with Separated Accounts in the form of profit and loss accounts and statements of mean capital employed for the following businesses and activities:

CURRENT STRUCTURE OF SEPARATED ACCOUNTS	
Businesses	**Activities**
Local Access Network	N/a
Core Network	N/a
Retail	Access Local Calls National Calls International Calls Calls to Mobile Directory Enquiry Leased Lines Public Payphones Calls to Internet Internet Services Supply Supplementary Services Remaining Activities
Other Business	Apparatus Supply Other Remaining Activities Indigo Meteor Other Subsidiaries

5.3 ComReg is of the initial view that Eircom will need to provide ComReg with information for both SMP and Non SMP markets so it can for example ensure that all markets and services receive an appropriate share of common costs and ensure that inter-segment transactions are charged on an arm's length basis. This will enable ComReg satisfy itself, for example, as to whether there has been any issues of cross subsidisation or price discrimination.

5.4 ComReg considers that it is necessary that Eircom update its current reporting process from its current business split (i.e. Local Access Network, Core Network Retail and Other Business) towards a market structure consistent with and reflective of the product and service markets that the Commission Recommendation has identified and where ComReg has designated or may designate Eircom, from time to time, with SMP and impose Accounting Separation and Cost Accounting obligations.

---

49 In particular Decisions, D5/99, D8/99, D10/99, D9/00, D10/00, D2/01, D7/01, D12/01, D3/03.

50 ComReg's predecessor 'Office of the Director of Telecommunication Regulation'.

5.5 Given that Eircom only produces (publishes and has audited) Separated Accounts to the business level for the Access and Core business units (see Appendix A for the comparative levels), and as this is only to a high level it is insufficient to enable ComReg meet its regulatory responsibilities and to determine if Eircom is meetings its regulatory obligations. As a consequence and as identified above, it has been the practice of ComReg to request information not only at the 'market' level but at more detailed 'service' and 'product' level so as to facilitate it to conduct/consider price reviews/applications. For example, a recent review of LLU[51] required that Eircom supply information at the service level in confidence to ComReg.

5.6 As part of such reviews, ComReg has encountered difficulties in reconciling the published audited Separated Accounts with the additional accounting information provided by Eircom on an *ad hoc* basis (at market/service/product levels). ComReg has had concerns as to the completeness, accuracy and reliability of the accounting data.

5.7 In addition to the levels of reporting in the published and audited Separated Accounts, ComReg has also concerns that the information provided by Eircom in its Separated Accounts are not sufficiently transparent, both in terms of the processes and procedures employed and the level of disclosure in its Separated Accounts. For example, the level of disclosure relating to wholesale services is mainly insufficient on their own to enable ComReg make an assessment that its charges are cost orientated and non-discriminatory (i.e. between internal charges to the Retail market and the payments expected from the provision of an equivalent service provided externally to OAOs).

5.8 In the next sections, ComReg considers in further detail a number of issues of relevance to Separated Accounts, best practice and finally ComReg's preliminary recommendations and consultation questions regarding each issue.

Issues identified by ComReg

5.9 **Level of Detail in the Separated Accounts**

5.10 ComReg and Eircom have differing views on the level of disclosure that should be included in the published and audited Separated Accounts.

5.11 Eircom in its response to ComReg's consultation document 05/18 was of the opinion that Account Separation and Cost Accounting are two separate obligations.

5.12 While ComReg agrees that the Accounting Separation and Cost Accounting remedies are indeed two separate remedies, they are closely inter linked. For example, for Accounting Separation to be meaningful there must be some understanding of the way in which costs are allocated and apportioned at the market, service and product levels and for the cost accounting remedy to work there must be some form of separation of the markets, services and products which are being costed.

51 ComReg document number 09/62 ' Further Input to Consultation Document No. 09/39 on Local Loop Unbundling ('LLU') and Sub Loop Unbundling ('SLU') Monthly Rental Charges'.

5.13 In addition, for the cost orientation remedy, ComReg considers that it must have an understanding as to how costs have been allocated/apportioned to ensure there is no discrimination (either internally or between internal and external customers).

5.14 The ERG Common Position on Remedies[52] recognised this inter-relationship and identified that in order to calculate a cost oriented price (which is part of Regulation 14 'Price Control and cost accounting obligations') an NRA may have to impose an obligation of Accounting Separation.

5.15 Eircom in its response to ComReg document 05/18 expressed concerns that Eircom was being asked:

> *"as part of its annual Separated Accounts submission, to produce and have audited a level of detail on a wide range of services on the basis that some of this detail may be needed to monitor a particular, but as yet unidentified, aspect of compliance."*

5.16 To clarify, it is not the intention of ComReg to impose an excessive burden on Eircom or one that cannot be offset by resulting gains. However it is important that Eircom comply with its obligations, in particular the Transparency obligations. In this regard and so as to facilitate ComReg in monitoring such compliance, it is proposed that Separated Accounts to the level of service are published and audited by Eircom annually. In circumstances where Eircom's auditors do not, or perhaps, cannot adequately undertake a satisfactory review/audit below the market level and provide an opinion to the regulator, ComReg may have to conduct its own review/audit to gain some assurance as to the accuracy and reliability of the results in order to determine Eircom's compliance with its regulatory obligations.

5.17 So as to assist ComReg with the formulation of the list of services and products, ComReg had a number of discussions/meetings with Eircom in recent months. ComReg's proposals now reflect to a large degree its understanding of these discussions and its own preliminary opinions. It can be noted from the draft accounting Direction that for the purposes of this Decision/Direction and to assist Eircom in meeting its regulatory obligations, an effort has been made to define what might be contemplated by the term product and service. Eircom's input into these proposed definitions is now sought.

5.18 In relation to the production of financial information for non-SMP markets, Eircom is of the opinion that:

> *"…this is an impractical and inefficient way of monitoring pricing Obligations."*

5.19 It is also of the opinion that many of the costs that are common between SMP and Non-SMP markets:

> *"can refer to highly sensitive information and need to be considered in the context of commercial confidentiality."*

---

52 ERG Common Position ERG (03)30 of 2 April 2004 on the approach to appropriate remedies in the new Regulatory Framework.

5.20 ComReg is of the initial opinion that this information is needed so as to ensure that common costs (including corporate overheads) have been apportioned on an appropriate basis across all markets (both SMP and Non SMP) and so assure itself that there has been no cross subsidisation or discrimination. This issue has been also recognised by the EU in the Commission Recommendation, section 5 of which states that:

> *"Operators may operate in markets in which they have been designated as having significant market power, as well as in competitive markets where they are not so designated. In order to carry out its regulatory tasks, a national regulatory authority may need information about markets where operators do not have SMP. When an obligation for Accounting Separation is imposed on a notified operator with SMP on one or more markets, the imposition of Accounting Separation may cover markets where the operator does not have SMP, e.g. to ensure the coherence of data."*

5.21 With regard to the sensitivity and confidentiality of information, it can be seen from the proposed accounting Direction that, ComReg will consider what information needs to be published and audited by Eircom and what information should be included as part of the Additional Financial Information (which should be provided in confidence to ComReg).

5.22 Eircom in its response to ComReg document 05/18 expressed concerns that the:

> *"the level of granularity that ComReg is proposing for publication could have implications for commercial confidentiality and could adversely affect Eircom's ability to compete."*

5.23 In accordance with Regulation 10 of the Access Regulations, ComReg may specify the precise:

> *"information to be made available the level of detail required and the manner of publication."*

5.24 While ComReg is of the opinion that there is significant value in publishing separated accounting information particularly in light of the obligation on Eircom to comply with the transparency obligations, ComReg needs to ensure that it maintains the commercial confidentiality of information. ComReg will at all times ensure that where appropriate, commercially sensitive information is not disclosed publicly. However this is generally accepted already when publishing any third party information and as per ComReg Document 05/24.

5.25 With regard to ComReg's proposals to implement the Accounting Separation obligation on a service and/or product basis, Eircom in its response to ComReg document 05/18 was of the opinion that it is:

> *"not proportionate* or *justified."*

5.26 ComReg is of the initial opinion that the preparation of accounts at a level of detail that supports individual service or product prices will enhance transparency, speed up the regulatory price setting process and help prevent the omission or double recovery of costs as well as providing information about compliance with non discrimination requirements. ComReg as a preliminary view considers it is not sufficient for information to be held solely at the market (or business) level because the obligation of cost orientation must be given effect at an individual service or product level. Eircom's cost accounting system must therefore be capable of separately identifying and attributing revenues and costs to these services or products.

5.27 **Regulated Rate of Return Adjustment**

5.28 ComReg considers that the use of the regulated rate of adjustment included in the Separated Accounts requires further consideration as to whether it is relevant and necessary going forward when presenting regulated accounts, particularly on a historical cost basis.

5.29 The Regulated Rate of Return (also known as the WACC) allows Eircom a minimum return on its investment from particular regulated services or products. Many of Eircom's regulated prices are derived using theoretical cost models, which use as an input the WACC. Theoretical cost models are generally forward looking models, and as such many regulated prices are set on a forward looking basis therefore ignoring potential legacy issues that may exist. In Eircom's Separated Accounts regulated revenues are derived from actual volumes and regulated prices whereas the associated costs tend to be the historical costs which, might include certain legacy issues relating to Eircom's network.

5.30 ComReg, following a consultation process set the applicable rate of return on capital employed for Eircom's business. For 2008, the annual rate of return was set at 11.5% from 1 July 2007 to 22 May 2008 and 10.21% from 22 May 2008 to 30 June 2008 – averaging at 11.36% for the year[53]. This reflects the rate of return that Eircom is allowed to achieve on its regulated products and services. Eircom applies this rate to both its HCA and CCA accounts. However, the regulated rate of return is not a guaranteed rate of return on actual costs incurred as actual costs incurred may have to be assessed for inefficiencies and relevance when reviewing regulated services and products.

5.31 It is ComReg's understanding that the Separated Accounts initially record the actual profit or loss generated over a specific accounting period (which may be above or below that which Eircom is allowed earn). A Regulated rate of Return Adjustment is then made against the turnover figure in the Local Access Network Business, the Core Network Business (and to facilitate reconciliation, a balancing adjustment is made to the turnover of the Other Business Unit). This adjustment (which is calculated by multiplying the Mean Capital Employed by the regulated rate of return and comparing the resulting regulated profit or loss to the actual profit or loss) will facilitate reconciliation between the actual return and the allowable return.

5.32 For 2007 and 2008 the regulated rate of return adjustments (as disclosed in the Separated accounts) were as set out in Table 4 below:

53 'Response to Consultation and Decision Notice (D01/08) – Eircom Cost of Capital '– Document No. 08/35.

Table 4: Regulated Rate of Return Adjustments – 2007 - 2008

Business Area	30 June 2008	30 June 2007
	€'000	€'000
Core	(19,200)	(25,867)
Access	182	15,007
Other	19,021	10,860

5.33 ComReg is of the preliminary view that the regulated rate of return adjustment does not aid transparency nor does it provide assistance in enabling stakeholders to understand the Separated Accounts. In addition ComReg is not aware of this adjustment being applied to the Separated Accounts of other SMP operators in other jurisdictions.

5.34 ComReg is of the preliminary view that the Profit and Loss Accounts should therefore record the actual results for the year as this will allow the users of the Separated Accounts to understand the actual results for the year. ComReg is also of the preliminary view that the Profit and Loss Accounts should include the return as a percentage of Mean Capital Employed thereby allowing a far better assessment of the actual return against the regulated return.

5.35 **Commentary on Separated Accounts**

5.36 ComReg is of the preliminary opinion that there is a need for the Separated Accounts to include a detailed commentary providing an explanation of trends together with details of key adjustments made to the accounts.

5.37 Although Eircom state in its Separated Accounts that:

> *"the…..regulatory financial statements have been prepared based on the Statutory Financial Statements prepared in accordance with IFRS."*

there is a need for additional commentary in the Separated Accounts to explain the basis of preparation including its key accounting policies.

5.38 **Regulatory Accounting Principles**

5.39 The ODTR is its document 99/35 set out the Regulatory Accounting Principles that should be applied when preparing the Separated Accounts including Cost Causality, Objectivity, Consistency and Transparency. ComReg considers there is now a need for it to consider whether such principles are still applicable and whether they should be reflected in the proposed accounting Direction.

Best Practice

5.40 UK regulators have identified the following practical applications of regulatory accounts:

- *"monitoring performance against the assumptions underlying current price controls;*

- *informing future price control reviews and other regulatory decisions that require financial information such as setting determined prices;*
- *in the relevant markets, assisting in the detection of certain anti-competitive behaviour such as unfair cross-subsidisation and undue discrimination at the appropriate level within the business concerned;*
- *assisting in comparative competition;*
- *assisting in monitoring financial health; and*
- *improving transparency in the regulatory process as Regulatory Accounts are the main source of regular, published and audited financial information about regulated companies."*[54] (see section 2.2)

5.41 It is ComReg's preliminary conclusion that the information contained in the Separated Accounts must be of sufficient granularity so as to enable operators with SMP to demonstrate its compliance with its legal obligations and to facilitate NRA's in monitoring such compliance.

5.42 The guidance note from ICAEW[55] states:

> *"there is no precise definition of Regulatory Accounts, either in law or in practice, although they are commonly referred to by Regulatory Bodies, Regulated Entities and accountants and within RAGs and the Regulated Entities' licence arrangements."* (see Appendix A)

5.43 It goes on further to state that Regulatory Accounts typically include:

- *"a profit and loss account;*
- *a balance sheet or statement of mean capital employed;*
- *detailed/segmental analyses of operations, costs and income, as defined in the Regulatory licence; and*
- *a reconciliation between the results and net assets reported within the Regulatory Accounts and those reported within the statutory financial statements prepared in accordance with the Companies Act 1985."* (See Appendix A)

5.44 If a regulated entity were to apply the ICAEW guidance to derive the format and content for its regulated accounts, it would have a large degree of choice. The format chosen may therefore not present the information in the manner required by the regulator. It is ComReg's preliminary view that it is good practice for the format and content of the regulatory accounts to be specified by the regulator. In the UK this is often done within the Regulatory Licence Conditions.

54 For a more detailed discussion of this topic see The role of Regulatory Accounts in regulated industries A final proposals paper by the Chief Executive of Ofgem; Director General of telecommunications; Director General of water services; Director General of electricity and gas supply (Northern Ireland; Rail Regulator; Civil Aviation Authority; and Postal Services Commission, April 2001.

55 ICAEW Technical Release 'Reporting to Regulators of Regulated Entities Audit 05/03'.

5.45 In addition, the European Commission in its recommendations on the implementation of the Directive relating to Accounting Separation, stated that:

> "*It is recommended that national regulatory authorities require from the notified operators the disaggregation of their operating costs, capital employed and revenues to the level required to be consistent with the principles of proportionality, transparency and regulatory objectives mandated by national or Community law."* (see Point 2)[56]

5.46 The level of disaggregation provided in regulated accounts varies from operator to operator e.g. BT Plc provides disaggregated accounts for 25 markets and more than 100 different services[57], whereas Eircom provides Separated Accounts for the Local Access Network Business, Core Network Business, Retail Business (and disaggregated accounts for 12 groups of retail services) and Other Business (disaggregated into 5 groups of other business services)[58].

5.47 Based on the above, and taking into account the fact the BT UK and Eircom are clearly of very different scales, it is ComReg's preliminary view that the level of disaggregation in Eircom's Separated Accounts on its own is insufficient to enable it demonstrate its compliance with its legal obligations and ComReg monitor such compliance.

5.48 With regard to the inclusion of non regulated services in the published Separated Accounts, Ofcom for example[59] although identifying the importance of monitoring BT Plc's compliance with its no undue discrimination obligation was of the opinion that the:

> *"AFI contains information on BT's unregulated downstream (retail) activities"* and it considered that *"...it would be disproportionate for this AFI to be published."* (See section 3.32)

5.49 In the case of New Zealand Telecom, the Telecommunications Act of 2001 sets out the mandatory regulatory reporting disclosure for Accounting Separation, requiring that the:

> *"The Commission must require Telecom to prepare and disclose information about the operation and behaviour of all or any of its network, wholesale, or retail business activities as if those activities were operated as independent or unrelated companies."* (See Section 69ZB (1))

---

56 European Commission Recommendation of 19 September 2005 on Accounting Separation and cost accounting systems - http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2005:266:0064:0069:EN:PDF

57 http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2008/Regulatoryfinancialstatements2008.htm

58 This level of disaggregation was set by the ODTR in 1999. Document 99/52 'Accounting Separation and Publication of Financial Information for Telecommunications Operators http://www.comreg.ie/_fileupload/publications/odtr9952.pdf

59 Changes to BT's and KCOM's regulatory financial reporting – 2008/09 update Explanatory Statement and Notification.

5.50 These information disclosure powers are not limited to regulated services but extend to unregulated network, wholesale and retail services i.e.

> *"The Commission may require Telecom to prepare and disclose separate information about all or part of separate prescribed business activities or separate prescribed services, within the network, wholesale, or retail categories."* (See Section 69ZB (2))

5.51 Based on the UK and New Zealand precedent, it is reasonable that accounting information relating to non regulated (competitive) services should be provided to the NRA. However given the commercial sensitivity of such information there should be no requirement for such information to be published. Instead it should be provided as part of the Additional Financial Information (determined annually by the NRA).

5.52 The ERG identified that:

> *"The information contained in an undertaking's financial statements is considerably more useful if it can be compared with similar information for other reporting periods in order to identify trends and differences."* (see section 6.4)

5.53 BT Plc for example includes a review of its Access Market in its Separated Accounts which includes details of:

- *trends in volumes and revenues;*
- *trends in internal and external revenues;*
- *impact of changes in methodologies;*
- *details of adjustments (for CCA purposes).*

5.54 The accounting Direction issued to An Post recognised the importance of trend analysis and detailed commentary by requiring that:

> *"Regulatory Accounts shall contain:*
> *(a) a commentary on the performance that shall explain at a minimum:*
> - *trends relating to products, expected significant future events and how these might impact An Post's business;*
> - *trends relating to revenue, by service;*
> - *trends relating to the mail volumes, by service;*
> - *significant year on year movements in the reported performance and balances;*
> - *one-off or exceptional events in the year;*
> - *large adjustments made to produce the Regulatory Accounts; and*
> - *the impact of changes in accounting policies, methodologies and estimation techniques;"* (See section 3.1 of the accounting Direction to An Post)

5.55 Given the lack of narrative explanations in the Separated Accounts of Eircom and the difficulties encountered by ComReg in its assessment of its performance, it is ComReg's preliminary assessment that it reasonable based on precedent identified above that ComReg require a commentary on its performance at the market and service level.

5.56 With regard to the basis of preparation of the regulated accounts, the ERG stated that:

> *".... accounting principles that apply to the preparation of general purpose financial statements under national or international accounting standards can form the basis of regulatory reporting. One way for an NRA to ensure this happens is to explicitly require International Accounting Standards (IAS) or International Financial Reporting Standards (IFRS) in accordance with European regulations to apply in the absence of regulatory accounting guidelines."* (See section 6.1)

5.57 With regard to accounting policies, the ERG identified that:

> *"Regulatory accounting information should be prepared in accordance with a set of principles, policies and procedures set out by NRAs…."* (see section 6.1)

5.58 It identified that these principles and procedures could include the following (See section 6.1 of that document):

- regulatory accounting principles
- methods of attributing costs, revenues, assets and liabilities
- basis of transfer charging
- accounting policies
- costing methodologies.

5.59 An Post (as part of the accounting Direction) is required to include as part of its regulated accounts:

> *"a comprehensive explanation of the basis of preparation of the Regulatory Accounts, including an explanation of the key regulatory accounting policies adopted by An Post. This shall include, inter alia, details of An Post's income recognition policy, depreciation policy, capitalisation policy, and its approach to dealing with issues such as cost allocation, prior year adjustments and changes in accounting policy. This list is not exhaustive and shall be agreed between An Post, ComReg and the competent body conducting any review of the Regulatory Accounts;"* (See section 3.1 (b)).

5.60 BT Plc discloses details of the basis of preparation of its Regulatory Financial Statements as part of its DAM (Detailed Attribution Methods) document and on the face of its Regulatory Financial Statements. These include:

- *Process of allocation of revenues, costs, assets and liabilities;*
- *Regulatory accounting principles;*
- *Use of Financial Capital Maintenance Concept in CCA accounts;*
- *Valuation Methods;*
- *Calculation of LRIC and stand alone costs.*

5.61 Based on the above precedent and in the interest of transparency, ComReg is of the preliminary view that Eircom should disclose as part of its Separated

Accounts (and Accounting Documents) the basis of its preparation of its Separated Accounts.

Preliminary Conclusion

5.62 ComReg is of the preliminary view that the proposals set out in this consultation (see recommendation section below) with regard to the format and content of the Separated Accounts are consistent with the practices employed in the countries considered in our benchmarking analysis, with other regulated sectors (e.g. Postal) and with the European Commission Recommendations.

Preliminary Recommendations and Consultation Questions

5.63 ComReg considers that there is a need for greater clarity as to the format and content of the published and audited Separated Accounts and Additional Financial Information that should be provided in confidence to ComReg on an annual basis.

5.64 It is proposed therefore, that in addition to specifying in the accounting Direction the principles to be applied in the preparation of its Separated Accounts (and Additional Financial Information) and cost accounting systems, that the accounting Direction also include a description of the format and content of the Separated Accounts i.e. the markets and services for which accounting information should be provided in the published and audited Separated Accounts and the markets, services and product accounts that should be provided as part of the Additional Financial Information.

5.65 So as to enable ComReg fulfil its regulatory responsibilities, it is proposed that the Separated Accounts (profit and loss accounts and balance sheets) be initially prepared at the market level. The markets where Eircom has currently been designated with SMP are as follows:

- *Wholesale unbundled access (including shared access) to metallic loops and sub-loops; Decision D8/04, ComReg Document Number 04/70*
- *Wholesale Terminating Segments of Leased Lines; Decision D06/08 ComReg Document Number 08/103*
- *Wholesale Fixed Wholesale Call Termination, Decision D06/07, ComReg Document Number 07/109*
- *Wholesale Call Origination and Transit Services, Decision D 04/07, ComReg Document Number 07/80*
- *Retail minus wholesale price control for the WBA market Decision D01/06, ComReg Document Number 06/01*
- *Wholesale Broadband Access Decision D03/05, ComReg Document Number 03/05 05/11r*

- *Retail Price Cap Remedy Fixed Narrowband Access Markets. Decision D 03/07, ComReg Document Number 07/76*

- *Market Analysis: Retail Fixed Narrowband Access Markets, Decision D07/61, ComReg Document Number 07/61.*

5.66 As the obligation for accounting separation is not in force for 'Voice call termination on individual mobile networks', ComReg is of the preliminary view that a separate profit and loss account and balance sheet need not be prepared for it below the market level.

5.67 ComReg also considers that Separated Accounts be prepared for all other non-regulated markets so the regulated and non regulated Separated Accounts can be reconciled to Eircom's statutory financial statements.

5.68 As already noted above, ComReg engaged with Eircom in recent months with the objective of determining:

- the list of services (for each regulated market) that should be included as part of the published and audited Separated Accounts
- the list of services and products (for each regulated market) that should be part of the Additional Financial Information (provided in confidence) to ComReg and as determined annually (by ComReg following discussion with Eircom prior to the financial year end).

5.69 ComReg however considers it needs also to reserve the right to determine the level of detail that needs to be disclosed as part of the Separated Accounts and Additional Financial Information.

5.70 In addition to the issue of confidentiality, ComReg needed to ensure that the reporting requirements are not overly burdensome while at the same time ensuring that they are sufficient to enable Eircom's demonstrate its compliance with its legal obligations and ComReg monitor such.

5.71 Having considered all the above factors and bearing in mind the practices within the UK and New Zealand together with Commission Recommendations, ComReg proposes that each regulated market be further analysed by service and product, with specific service profit and loss accounts be included as part of the published and audited Separated Accounts (see Appendix B for examples).

5.72 ComReg, based on Eircom's price lists, has prepared a full list of all services and products and this will be forwarded to Eircom in conjunction with the publication of this consultation document. Eircom will be required to discuss and agree with ComReg a final list of services and products within the consultation period. Once this exercise is complete it will then be possible to finalise whether any additional services should be included in the Separated Accounts or whether services already included (as set out in Appendix A) should be provided as part of AFI's in addition to agreed product accounts. The final accounting Direction (should this consultation proceed to a final decision) will therefore reflect this completed list at that time. For the moment it can be noted that the Decision Instrument can refer only to "The

Service/Product List" as appears within the proposed defined terms for Products and Services.

5.73 For those services and products which have not been included as part of the annual Separated Accounts, it is proposed that profit and loss accounts be prepared as required by ComReg (following discussion with Eircom prior to the financial year end) on an *ad hoc* basis as part of its Additional Financial Information. This will be informed but not limited to ComReg's own work programme for the coming year. This process should also be applicable to non regulated markets, services and products.

5.74 ComReg envisages that this accounting process will reduce the number of *ad hoc* information requests each year and so improve regulatory processes. ComReg also considers that the proposed accounting Direction is proportionate.

5.75 In the appendices ComReg has suggested formats for financial statements for consideration and comment:

- Appendix B – separated accounts
- Appendix C – reconciliation statements
- Appendix D - additional financial information.

5.76 While ComReg does not expect that Eircom will be able to achieve full compliance with all requirements of the accounting Direction in the first year (i.e. 2009/2010), it is proposed that all material changes should be fully implemented, with a target of two years for full implementation (i.e. no later than 30 June 2011).

5.77 Bearing in mind the above proposals together with proposals set out in other sections of the consultation document, it is proposed that Eircom be required to prepare and submit to ComReg draft schedules for the Separated Accounts and the Additional Financial Information. It is proposed that these be submitted within four months of the effective date of this Direction.

Q. 14. Do you agree or disagree with the preliminary proposals regarding the level of disclosure in the published and audited Separated Accounts and the Additional Financial Information? Do you agree or disagree that Eircom be required to prepare and submit to ComReg for approval draft schedules within four months of the effective date of the Direction? Please detail your response in full.

Q. 15. Do you agree or disagree with the format and content of the draft Separated Accounts Schedules and the draft Additional Financial Information Schedules as set out in Appendices B, C, and D? Please detail your response in full.

5.78 Given the ICAEW Guidance (see Best Practice section above), it is proposed that the HCA Separated Accounts shall be reconciled with the statutory financial accounts, identifying all items (revenue and costs) relating to non regulated businesses and other items which are not relevant to the accounting period that have been excluded from the Separated Accounts. It is envisaged that this will increase confidence in the allocation/apportionment of costs, revenues identification and volumes measurement processes across markets and services and better ensure compliance with Eircom's regulatory obligations.

Q. 16. Do you agree or disagree with the preliminary proposal that the Separated Accounts be reconciled with the statutory financial statements identifying all items (revenue and costs) relating to non regulated businesses and other items which are not relevant to the accounting period that have been excluded from the Separated Accounts? Please detail your response in full.

5.79 Following discussion with Eircom with regard to the appropriateness and relevance of its inclusion of a 'Regulated Rate of Return Adjustment', ComReg is of the initial opinion that the Separated Accounts should not include a 'Regulated Rate of Return adjustment'. Instead ComReg proposes that Balance Sheets should be prepared on an "as at" basis, replacing the current statements of Mean Capital Employed.

5.80 However, and so as to facilitate comparison of actual returns with regulated returns for regulated services and products, ComReg proposes in addition to the disclosure of the actual return on Capital Employed, that Mean Capital Employed (as currently calculated) and the return thereon is shown as supplementary information by way of note to the Separated Accounts. This will allow for a comparison of the actual return Eircom earns on its regulated services against its regulated return. Any actual returns in excess or less than the regulated rate of return will reflect efficiencies or inefficiencies of Eircom.

Q. 17. Do you agree or disagree with the preliminary proposal that the Separated Accounts no longer include a "Regulated rate of Return Adjustment", that Balance Sheets are prepared on an "as at" basis and that Mean Capital Employed and the actual return on Mean Capital Employed are shown as supplementary information as a note to the Separated Accounts? Please detail your response in full.

5.81 Given the concerns of ComReg with regard to the lack of detailed commentary in Eircom's Separated Accounts, it is proposed that Eircom be required to include detailed commentary and explanations in its Separated Accounts. It is initially proposed that the commentary (based on precedent identified above) should at a minimum include details with regard to:

- trends relating to markets and services, expected significant future events and how these might impact Eircom's business and the extent to which (if any) this explains Eircom's Separated Accounts
- trends relating to revenue, by market and service and the extent to which (if any) this explains Eircom's Separated Accounts
- trends relating to volumes, by market and service and the extent to which (if any) this explains Eircom's Separated Accounts
- significant year on year movements in the reported performance and balances and the extent to which (if any) this explains Eircom's Separated Accounts
- one-off or exceptional events in the year and the extent to which (if any) this explains Eircom's Separated Accounts
- significant or large adjustments made to produce the Separated Accounts and the extent to which (if any) this explains Eircom's Separated Accounts
- the impact of changes in accounting policies, methodologies and estimation techniques and the extent to which (if any) this explains Eircom's Separated Accounts. This will involve the restatement of specific prior year results so as to ensure comparability.

5.82 It is thought likely that this increased level of disclosure should increase ComReg's understanding of the results, so reduce the need for *ad hoc* information requests (or make these more specific and focused) and so improve regulatory process and ensure compliance with Eircom's regulatory obligations.

Q. 18. Do you agree or disagree with the preliminary proposal that Eircom be required to provide commentary and narrative explanations as part of its Separated Accounts? Please detail your response in full.

5.83 Based on the precedent identified above, ComReg initially proposes that the Separated Accounts (and Accounting documents) include a description of the basis of its preparation. While it is proposed that its contents be agreed between Eircom and ComReg, it is envisaged that it should include details of Eircom's:

- income recognition policy
- depreciation policy
- capitalisation policy
- its approach to dealing with issues such as cost allocation, prior year adjustments and changes in accounting policy.

5.84 ComReg however proposes that it reserves the final right to amend this final list from time to time where agreement cannot be reached.

5.85 Currently non current assets (such as property) are charged to regulated services via depreciation charges. From time to time these non current assets may be sold at either a profit or loss. Further transparency is required in relation to such transactions, in particular where the cost of asset has been recovered from regulated markets. The treatment of profits or losses on disposal should be consistent year on year. In this regard, it is proposed that profit/losses on disposal of non-current assets should be recognised at the market level (where the cost has been recovered) and disclosed on the face of the HCA profit and loss accounts.

5.86 This increased disclosure will improve the transparency of the Separated Accounts.

5.87 Given the recommendations of the ERG, ComReg initially proposes that the Separated Accounts be prepared in accordance with the following Regulatory Accounting Principles (some of which, can in any event can be recalled as being similar from ODTR decision 99/35[60]) and included in the Primary Accounting document:

- **Cost Causality**: Revenue (including transfer charges), costs (including transfer charges), assets and liabilities shall be attributed to markets, services, products and 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.

60 ODTR decision 99/35 will be superseded by the new draft Decision Instrument.

- **Objectivity**: The choice of attribution methods shall be objective and not be intended to benefit the SMP operator or any other Operator, market, service product, or component.

- **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 Markets, the parts of the previous year's Financial Statements affected by the changes shall be restated.

Q. 19. Do you agree or disagree with the preliminary proposals regarding the basis of preparation of the Separated Accounts and the Regulatory Accounting Principles that should be applied? Please detail your response in full.

Q. 20. Do you agree or disagree with ComReg's preliminary conclusion that any profits or losses on disposal of non current assets should be recognised at the market level (where the cost has been recovered) and disclosed on the face of the HCA profit and loss accounts? Please detail your response in full.

5.88 **Historical Cost Accounting (HCA) versus Current Cost Accounting (CCA) & Long Run Incremental Costs (LRIC)**

Issues identified by ComReg

5.89 Eircom currently produces two sets of regulatory accounts – Historical Cost Separated Accounts (HCA) and Current Cost Separated Accounts (CCA). While all of Eircom's services are included in its Historical Cost Separated Accounts it is only the activities of its Core Network Business (i.e. Call Origination, Call Termination and Leased Lines) that are included in its Current Cost Statements.

5.90 For pricing purposes, NRA's tend to refer to forward-looking costs. As a starting point, current costs are often used as a proxy for forward-looking costs, with appropriate adjustments made where for example future costs are expected to differ from current costs. ComReg does not however have visibility of the current costs associated with its Access business unit (i.e. wholesale access, LLU and WBA) and this has created difficulties for it in reconciling the LRIC (Long Run Incremental Costs) information provided by Eircom as part of price reviews/ applications back to the HCA Separated Accounts (as there is no intermediate step in the form of CCA accounts available).

5.91 Three relevant cost bases are generally referred to in price setting and regulatory accounting i.e. historic costs, current costs and forward-looking costs.

5.92 HCA reflect the actual costs incurred in delivering a service. In particular, the depreciation charge and cost of capital in HCA is based on the original purchase or construction cost of assets. Where assets were constructed many years ago (e.g. trenches, ducts etc), the historic cost of the asset is likely to be much lower than the cost of constructing a similar network today, primarily because of the impact of inflation on the key input costs of labour, construction and copper wire. On the other hand, the cost of certain types of equipment has fallen in recent years as a result of improving technology and falling equipment prices. ComReg considers that the costs associated with this equipment may, consequently, be lower in current cost accounts (which values assets at their current replacement cost, rather than the amount actually paid for them), compared to that in the historic cost accounts.

5.93 In preparing CCA accounts, the primary adjustments in ComReg's initial view are therefore:

- On the balance sheet, the revaluation of assets from the historic cost base to the current cost base.
- In the profit and loss account, a depreciation adjustment equivalent to the difference between the deprecation charge on the asset calculated on a historic cost and on a current cost basis (i.e. supplementary depreciation or depreciation adjustment), and a holding gain or loss reflecting the change in value of assets between the historic cost base and the current cost base.

5.94 In practical terms holding gains or losses may arise due to the appreciation or diminution in the replacement cost of the asset over the life to date of the asset. This is termed the life to date ("LTD") holding gain or loss. In subsequent years further gains or losses may arise depending on movement in asset pricing trends.

5.95 For example, within the last decade there were significant increases in the cost of certain assets (i.e. property) resulting in large year on year gains in values from the original cost. Within the last two years, however, this trend has been reversing with many property values falling significantly.

5.96 Within many regulatory pricing models assets are re-valued to their current cost and are written off over the remainder of their lives. As a result the resulting LTD holding gains or losses are reflected in regulated prices.

5.97 It is ComReg's view the LTD holding gains and losses can be accounted for in four different ways i.e.:

- Write off the LTD holding gains and losses, in full, to the Profit and Loss Account in the year of revaluation
- Amortise the LTD holding gains and losses over the remainder of the asset's life
- Amortise the LTD holding gains and losses over a defined period of time (e.g. 1 year, 3 years or 5 years)
- Ignore the LTD holding gains and losses.

5.98 ComReg is of the preliminary view that LTD holding gains and losses should be written off over the remainder of the asset's life.

5.99 **LRIC**

5.100 All of the services that are part of Eircom's current Local Access Network business (i.e. wholesale access, LLU and WBA) i.e. LLU, ULMP, Line sharing, Co-location and Sub-Loop and Bitstream are aggregated and included only in the Historical Cost Separated Accounts. With regard to the LLU service, ComReg in decision D8/04 required that Eircom:

> *"….offer cost oriented prices for LLU services, collocation, and associated facilities on the basis of forward looking long run incremental costs ('FL-LRIC') as provided for by Regulation 14 of the Access Regulations."*(see Section 9 of ComReg document 04/70[61])

5.101 In addition ComReg document 06/01 (decision No. 12) states that for the Wholesale Broadband Access Market it:

> *"will use a forward looking approach in assessing costs."*

5.102 In relation to some regulated prices, costs are derived using the forward looking long run incremental cost ('FL-LRIC') methodology with a bottom up model approach (i.e. reflects the efficient level of costs). The difference between the CCA costs and the FL-LRIC costs may be due to the inclusion of costs which may be currently incurred but which are inconsistent with a forward looking long run view and which should therefore be adjusted or excluded in the calculation of FL-LRIC.

5.103 These could include:

- Efficiency adjustments
- Volume adjustments – LRIC uses forecasted volumes
- Cost volume relationship adjustment – LRIC uses a more dynamic approach.

5.104 As identified above, current costs can be higher or lower than historic costs and the size of the differential can vary significantly between different network elements and from year to year. Therefore it is ComReg's initial opinion that HCA accounts do not provide robust data to use in a forward-looking pricing regime. The issue therefore is whether Eircom should be required to provide CCA Separated Accounts for the current Access business i.e. wholesale access, LLU and WBA Markets (which can be used as a baseline to reconcile with the FL-LRIC data) which can then be reconciled back to the HCA Separated Accounts. This will provide ComReg with added assurance as to the accuracy and reliability of the costing data used for pricing purposes.

5.105 Given that CCA accounts are prepared for the current Core Business (i.e. Markets: Call Origination, Call Termination and Leased Lines) with many assets being common to the Access Business (i.e. wholesale access, LLU and WBA), the task of preparing CCA accounts for the Access business is not

61 ComReg Document 04/70 'Market Analysis: Wholesale unbundled access (including shared access) to metallic loops and sub-loops'.

considered that onerous. The benefits (as outlined above) would exceed such a cost.

5.106 As identified above, Eircom produces CCA and HCA accounts for its current Core Network (i.e. for Call Origination, Call Termination and Leased Lines). This network is composed of three services i.e. Interconnection[62], Wholesale Leased Lines (WLL)[63] and Partial Private Circuits (PPC's)[64].

5.107 In accordance with ComReg document 07/109[65], costs for the *interconnection* service are required to be calculated using a pricing model based on FL-LRIC (see section 10.1).

5.108 Notwithstanding the need for cost orientation (and priced using a retail-minus mechanism), ComReg in document 08/103[66] required that for *Wholesale Leased Lines*:

- the prices charged by Eircom to any other undertaking for Wholesale Leased Lines of capacities up to and including 2Mb/s shall be cost orientated and no more than the prices in place at the effective date
- services and associated facilities in the Market, including the prices charged by Eircom to any other undertaking Wholesale Leased Lines of capacities above 2Mb/s shall be offered to other operators on terms and conditions equivalent to those offered to Eircom's retail arm. (see section 11.3 and 11.4).

5.109 In addition, ComReg outlines its intention to hold a consultation on how best to implement cost orientation in the market for wholesale terminating segments of leased lines.

5.110 Following a consultation process, ComReg in document 08/103 determined that for *Partial Private Circuits*:

> *"the prices charged by Eircom to any undertaking for PPCs shall be cost oriented and such costs shall be calculated using a pricing model based on forward looking long run incremental costs ("FL- LRIC") or an alternative pricing model, if ComReg decides, following consultation, to adopt such an alternative pricing model."*

5.111 Despite such obligations, ComReg encounters a number of difficulties in assessing Eircom's compliance, due to the following:

- The lack of transparency in the Separated Accounts (HCA and CCA) at the service level

62 Interconnection refers to the originating, terminating and transit of calls on Eircom's network on behalf of other operators.

63 The term "leased lines" refers to fixed, permanent telecommunications connections providing symmetric capacity between two points. A leased line is permanent, in that capacity is available between the two fixed points, although capacity could be reserved or shared through the associated network depending on the nature of the leased line.

64 PPC's (Partial Private Circuits) is a generic term used to describe a category of private circuits that terminate at a point of connection between two communications providers' networks. It is therefore the provision of transparent transmission capacity between a customer's premises and a point of connection between the two communications providers' networks. It may also be termed a part leased line.

65 Decision Notice & Decision Instrument Document No. 07/109 D06/07 – 'Market Analysis – Interconnection Market Review Fixed Wholesale Call Termination Service'.

66 ComReg document 08/103 Decision Notice & Decision Instrument 'Market Analysis Leased Line Market Review'.

- Difficulty to reconcile the FL-LRIC service data back to the CCA Separated Accounts
- Difficulty in assessing the extent of cost recovery for joint and common costs between the relevant services.

5.112 ComReg considers that these difficulties have led to delays in finalising rates for such services. As with the Local Access business (wholesale access, LLU and WBA), the issue for ComReg is whether the business accounts for the Core business (i.e. for Call Origination, Call Termination and Leased Lines) should be disaggregated and if so to what level (see section above 'format and content of Separated Accounts' for proposals).

5.113 ComReg considers that there is a requirement that the Separated Accounts reflect a true and fair view and therefore should be prepared to the highest standard possible. This is important for a number of reasons:

- The Separated Accounts can be used to assist in the setting of regulated prices
- The Separated Accounts can be used in a court of law where, for example a compliance action or competition case is taken
- It provides assurance to stakeholders that Eircom is complying with its various obligations including transparency and non discrimination (see section 9 below, Regulatory Impact Assessment).

<u>*Best Practice*</u>

5.114 A study by Andersen (July 2002)[67] for the European Commission identified that the HCA accounts suffers from some flaws i.e.:

- *"Evolution of the acquisition costs of assets is not taken into account. Purchase prices can significantly increase or decrease over time and affect the value of assets. As a new entrant, willing to build a network, would be paying the current price and not the historical price, existing assets should be reassessed at their current value.*
- *Historical accounts cannot incorporate the impact of continuously evolving technologies. Hence HCA cannot ensure that costs are those of an operator employing modern technologies.*
- *HCA, while focusing on the past, reflects all inefficiencies (i.e. regarding the company processes or organisation) that result from past decisions of the operator"* (see section 2.5.2)

5.115 It identifies that using a CCA cost base will tackle all these issues as it:

> *"…takes into account the costs that would have be incurred in the past to build a network using current technology"* (see section 2.5.2)

67 "Study on the implementation of cost accounting methodologies and Accounting Separation by telecommunication operators with significant market power"

5.116 For assets that are not available anymore, the "Modern Equivalent Asset"[68] ('MEA') methodology should be used.

5.117 Although HCA's do have a number of flaws (as recognised by Anderson above), they do however play an important role in recording actual transactions that have taken place over a period of time. Unlike CCA's, there is little room for manipulation of overall results as all transactions are based on actual costs which are supported by invoices, receipts etc. and are therefore reliable.

5.118 Despite the advantages associated with CCA's, there are obvious concerns surrounding the reliability of data. In CCA's assets are valued at their value to the business i.e. replacement cost of the asset, its net realisable value or its economic value to the business. The choice of valuation methods may therefore introduce a degree of bias into such accounts if this is not carried out in a proper manner.

5.119 A report prepared for the European Commission[69], attempted to analyse the differences in LLU charges across Europe. The report identified a number of factors contributing to the significant spread of cost oriented charges across different countries. The report found that:

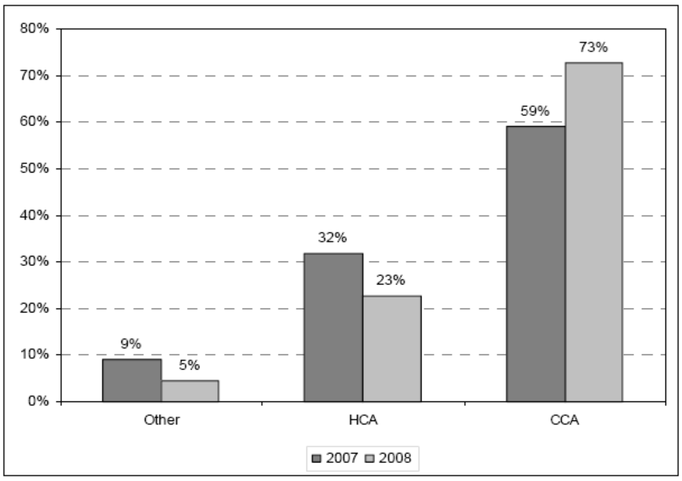
> *"The overall effect on asset valuation of moving from historic costs to current costs is ambiguous, although for an access network CCA can be expected to lead to a higher asset valuation."* (see section 4.2.2.2)

5.120 A study conducted by the ERG entitled 'Regulatory Accounting in Practice 2008' indicated that the most commonly used cost base is CCA for all markets still susceptible to *ex-ante* regulation. This is of particular significance in the case of wholesale access, LLU and WBA where 73% and 71% respectively of countries surveyed use CCA accounts whereas Eircom only produces HCA for such markets (see Figures 5 and 7 below from ERG study).

68 e.g. replacement cost.

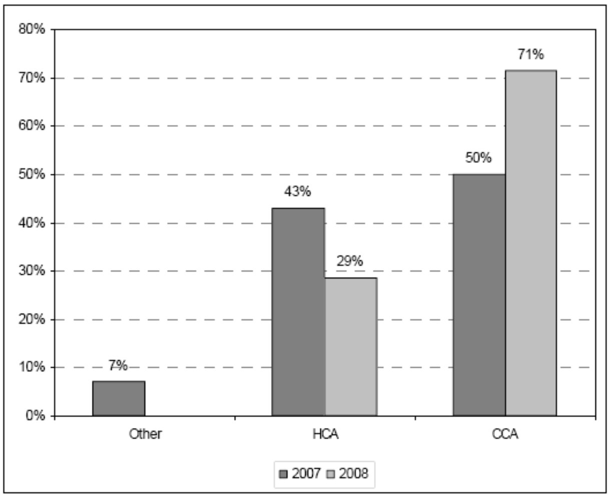
69 Pricing Methodologies for Unbundled Access to the Local Loop, Europe Economics, May 2004 http://ec.europa.eu/competition/sectors/telecommunications/archive/inquiries/local_loop/pricing_open_loop.pdf

Figure 5 - Cost Base Unbundled Access Wholesale (Mkt 4, previously Mkt 11)



Source: IRG 2008 RA database
Number of countries: 22

Figure 7 - Cost Base Wholesale Broadband Access (Mkt 5, previously Mkt 12)



Source: IRG 2008 RA database
Number of countries: 14

5.121 This study also identified that:

> *"even if in the past CCA was by far the most common method for fixed networks and HCA was primarily used for mobile networks regulation, a strong trend towards the adoption of CCA (including mobile) can be observed."*(see section 3.2.2)

5.122 Although the determination of appropriate price levels for individual services is not generally recognised as one of the functions of the Separated Accounts, the European Commission stated in its Recommendation (relating to interconnection) of January 8th 1998[70] that:

70 Commission Recommendation of 8 January 1998 on interconnection in a liberalised telecommunications market (98/195/EC).

> *"the use of forward-looking, long-run average incremental costs implies a cost accounting system using activity-based allocations of current costs rather than historic costs."* (see Point 6)

5.123 It recommended that NRA's set deadlines for their operators for the implementation of new cost accounting systems based on current costs, where such systems are not already in place.

5.124 ComReg considers in its preliminary assessment that it is reasonable to conclude, on the basis of the precedent set out above that ComReg should require Eircom to prepare CCA accounts for wholesale access, LLU and WBA (i.e. the current Access business).

5.125 Assuming a decision is made that Eircom should be required to produce CCA accounts, the next issue is to determine the most suitable approach i.e. 'Operating Capital Maintenance' (OCM) or 'Financial Capital Maintenance' (FCM).

5.126 The ERG Common Position paper identified that:

> *"OCM considers the operating capability of the company is maintained. Capital maintenance under this approach requires the company to have as much operating capability - or productive capacity - at the end of the period as at the beginning. In this approach, revenues become profits after a sufficient amount has been provided to maintain the physical capability of the asset"* (see section 3.2.3).

5.127 whereas:

> *"FCM considers the financial capital of the company is maintained in current price terms. Capital is assumed to be maintained if shareholders' funds at the end of the period are maintained in real terms at the same level as at the beginning of the period. In this approach, revenues become profits after a sufficient amount has been provided to maintain the financial value of the asset (or the business)"* (see section 3.2.3).

5.128 Given that these two concepts can produce significant differences in cost and profitability, it is important that ComReg is satisfied that the most relevant concept has been applied depending of course on the purpose to which the information will be put.

5.129 The study by Andersen identified that the OCM concept may incorporate:

> *"insufficient or excess returns into the level of allowed revenue (depending, respectively, on whether asset-specific inflation was expected to be lower than or higher than general inflation)."*(see section 2.5.2)

5.130 whereas:

> *"Under FCM, however, the returns to the providers of capital would equal the required return (as measured by the cost of capital) irrespective of whether replacement costs were rising or falling relative to general prices. Hence, if current cost accounting*

information is used as the basis to determine interconnection charges, FCM is the preferred capital maintenance concept." (see section 2.5.2)

5.131 BT Plc in its Primary Accounting Documents for 2008 state that its Current Cost Regulatory Financial Statements are prepared under:

> *"the financial capital maintenance convention …… Under this convention, current cost profit is normally arrived at by adjusting the historical cost profit to take account of changes in asset values and of the erosion in the purchasing power of shareholders' equity during the year due to general inflation. However, the inflation adjustment in respect shareholders' equity is not relevant to BT's regulatory reporting. Asset values are adjusted to their value to the business, usually equivalent to their net current replacement cost."*(see section 4.1)

5.132 Given the precedent set out above, it is reasonable to initially conclude that CCA accounts should be prepared using the FCM Concept.

5.133 **Example of Operating Capital Maintenance Concept**

> If we assume that Company A has an opening Balance Sheet made up of Capital of €100 and Inventories of €100 (10 units @ €10 each).
>
> During the year Company A sold all its inventories for €200 (i.e. 10 units @ €20 each).
>
> To replace the stock sold would now cost €150 (10 units @ €15 euro each).
>
> Under the OCM approach, profit is only recognised after the operating capital of the company is maintained. Profit is therefore (€200 revenue from sale of stock less €150 to replace stock) €50.

5.134 **Example of Financial Capital Maintenance Concept**

> If we assume that Company B has an opening Balance Sheet made up of Capital of €100 and Inventories of €100 (10 units @ €10 each).
>
> During the year Company A sold all its inventories for €200 (i.e. 10 units @ €20 each).
>
> To replace the stock sold would now cost €150 (10 units @ €15 euro each).
>
> Under the FCM approach, there is a need to maintain the financial capital of the company in real terms. Given that there has been a price increase of 50% (from €100 to €150), a profit will only arise if net assets is greater than €150.
>
> In these circumstances, profit recognised will also be €50.

Preliminary Conclusion

5.135 It appears that the proposals set out in this consultation (see recommendation section below) with regard to the need for CCA Separated Accounts together with the application of the FCM concept are consistent with the practices employed throughout Europe, the findings of the ERG and the Commission Recommendations.

Preliminary Recommendations and Consultation Questions

5.136 So as to increase transparency in the Separated Accounts of Eircom, to facilitate reconciliation with costing data at the service level and to ensure compliance with its regulatory obligations, ComReg proposes that Eircom should be required to:

- Produce CCA accounts for wholesale access, LLU and WBA (i.e. the current Access business) (in addition to HCA accounts) using the FCM Concept
- Reconcile the HCA to the CCA accounts for each of Markets Call Origination, Call Termination and Leased Lines (current Core business) and wholesale access, LLU and WBA (current Access business)
- Produce CCA accounts at a level of granularity which will facilitate reconciliation with the costing information provided to support price reviews/applications (i.e. at the market and service level).

ComReg considers that its preliminary recommendations are a proportionate response to the regulatory issues identified and are within its legal powers.

5.137 In light of the issues encountered by ComReg and having considered the advantages and disadvantages associated with alternative cost bases together with best practice, it is proposed that Eircom be required to produce HCA and CCA profit and loss accounts and balance sheets for each regulated market (i.e. including wholesale access, LLU and WBA). In addition to HCA accounts, it is proposed that CCA profit and loss accounts for each regulated service as identified by ComReg shall be included in the Separated Accounts.

5.138 With regard to the application of the FCM concept, it is worth noting that Eircom state in its Accounting documents for 2008 that:

> *"….to model forward looking costs, the LRIC calculations make use of current cost accounting (CCA) valuations according to the Financial Capital Maintenance (FCM) concept."*

5.139 On this basis and given conclusions of the Anderson report together with the practice employed by BT Plc, ComReg is of the opinion that the CCA accounts shall be prepared using the Financial Capital Maintenance concept.

5.140 It is not envisaged that this additional requirement will impose an excessive burden on Eircom over the medium to long term which cannot be offset by resulting gains and will have the effect of improving regulatory process as the number of ad hoc information requests will decline.

Q. 21. Do you agree or disagree that CCA Separated Accounts should be provided by Eircom for wholesale access, LLU and WBA (in addition to Call Origination, Call Termination and Leased Lines) as part of its Separated Accounts together with CCA profit and loss accounts for each regulated service? If yes, do you believe that the FCM approach is appropriate? Please detail your response in full.

5.141 ComReg is also of the preliminary view that reconciliations are required from the HCA to the CCA accounts for Call Origination, Call Termination and Leased Lines (current Core business) and wholesale access, LLU and WBA (current Access business).

5.142 So as to increase transparency and introduce clarity into the reporting process as envisaged under Eircon's accounting obligations, ComReg proposes that the CCA accounts for each market be fully reconciled to the HCA accounts (and included as part of the Separated Accounts). The primary adjustments being:

- On the balance sheet, the revaluation of assets from a historic cost to a current cost base
- In the profit and loss account, a depreciation adjustment equivalent to the difference in depreciation charged on an asset calculated on a historic cost and on a current cost basis and a holding gain/loss reflecting the change in value of the asset.

5.143 With regard to the choice of accounting treatment, ComReg's initial views with regard to each option is as follows:

- Option 1- Write off the LTD holding gains and losses, in full to the Profit and Loss Account in the year of revaluation

5.144 ComReg is of the initial view that if Option 1 is adopted it could distort the underlying CCA results and consequently the usefulness of the CCA financial statements in assessing profitability and return on capital employed. By writing off the holding gains or losses annually, the results of the underlying Profit and Loss Accounts could be distorted. ComReg is therefore of the preliminary view that LTD holding gains and losses should not be written off in full, to the Profit and Loss Account in the year of revaluation.

- Option 2 - Amortise LTD holding gains and losses over the remainder of the asset's life.

5.145 ComReg is of the initial view that if Option 2 is adopted it could spread the impact of the LTD holding gains or losses over many years reducing the level of distortion within the Profit and Loss Account. The holding gain or loss would be equated with the life of the asset. This is also consistent with the approach taken in many regulatory pricing models. This, in ComReg's preliminary view, would result in the CCA financial statements reflecting a more realistic level of profitability.

- Option 3 – Amortise the LTD holding gains and losses over a defined period of time (e.g. 1 year, 3 years or 5 years)

5.146 ComReg is of the initial view that if Option 3 is adopted while spreading the impact of the LTD holding gains or losses over a shorter period of time than with Option 2, could result in a significant distortion to the Profit and Loss Accounts and its usefulness as year on year there could be large adjustments required to account for the holding gains or losses. Furthermore choosing an appropriate time period over which to write off the holding gains or losses would require a certain amount of subjectivity. For example the lives of many assets within the core network are shorter than those within the access network. Applying a period shorter than the remaining life of the asset could result in distortion to the Profit and Loss Accounts. ComReg is therefore of the preliminary view that this is not an appropriate means of accounting for LTD holding gains or losses.

- Option 4 – Ignore the LTD holding gains and losses

5.147 ComReg is of the initial view that if option 4 is adopted, the Profit and Loss Accounts would not reflect the impact upon stakeholders of changes in asset values or the profitability of various markets. It is therefore in ComReg's view not an appropriate means of accounting for LTD holding gains or losses.

5.148 As identified earlier in the document, ComReg proposes that Eircom's HCA Separated Accounts shall be reconciled to the published financial accounts of Eircom, identifying and commenting upon all items not relevant and which have been excluded from the Separated Accounts.

5.149 Such reconciliations will provide ComReg with added assurance that costs, revenues and volumes have not been double counted while improving its understanding of the differences between different sets of accounts. It is not envisaged that this will create a significant cost for Eircom as the information should be readily available.

5.150 It is also envisaged that such proposals will have the effect of reducing the number of *ad hoc* information requests and so improve regulatory process.

Q. 22. Do you agree or disagree that life to date holding gains and losses should be amortised over the life of the asset? Please detail your response in full.

Q. 23. Do you agree or disagree with the preliminary proposal that Eircom be required to provide as part of its Separated Accounts a reconciliation of the HCA and CCA accounts (at the market level)? Please detail your response in full.

5.151 ComReg is also of the preliminary view that Eircom should produce CCA accounts at a level of granularity which will facilitate reconciliation with the costing information provided to support price reviews/applications.

5.152 As identified above, it is proposed that CCA profit and loss accounts for each regulated service as identified by ComReg shall be included in the Separated Accounts.

5.153 To clarify, it is proposed that this level of granularity be consistent with that of the HCA accounts.

5.154 It is also proposed that Eircom be required to submit a reconciliation statement of CCA costing data with costing data provided for pricing purposes (e.g. FL-LRIC for LLU) for specific regulated services/ products as required by ComReg on an *ad hoc* basis (i.e. as part of the Additional Financial Information). This will enable ComReg assess whether joint and common costs have been appropriately allocated/apportioned between relevant services and products and so reduce the number of clarification requests from ComReg. ComReg receives annually from Eircom schedules for interconnection charges which set out detailed cost calculations which are outside the regulated accounting process together with commentary on movements. An impact statement on actual results reconciled to actual charges for the year is also provided. This level of detail is an example of the type of additional financial information that is required year on year for regulatory purposes.

Q. 24. Do you agree or disagree with the preliminary proposal that the level of granularity of the CCA Separated Accounts (i.e. market and service levels) shall be consistent with that of the HCA Separated Accounts? Please detail your response in full.

Q. 25. Do you agree or disagree with the preliminary proposal that Eircom be required to submit a reconciliation of costing data (i.e. FL-LRIC) provided for pricing purposes with the CCA accounts by regulated service and/or product as part of the Additional Financial Information as required by ComReg (and consistent with when pricing reviews take place)? Please detail your response in full.

5.155 **Publication of Separated Accounts**

Issues identified by ComReg

5.156 Since 1999 when the ODTR, following a consultation process[71] and having considered the applicable National and EU legislation[72], the Commission Recommendation[73] and the views of respondents required that the:

> "*Separated Accounts shall be published annually and contain comparative information.*"[74] (see section 5(f))

5.157 The purpose of this early but high level obligation was to increase the level of transparency and provide other operators with the assurance that no discrimination takes place in the provision of services to Eircom's own retail arm compared with services to other operators (i.e. at the wholesale level).

5.158 Currently it takes Eircom five months to submit HCA accounts and six months to submit CCA accounts to ComReg and publish on its website its Separated Accounts. ComReg considers that this time period is unacceptable given the importance of the Separated Accounts. ComReg uses Eircom's Separated Accounts, *inter alia*:

- in monitoring Eircom's performance
- informing price control reviews
- assisting in the detection of unfair cross subsidisation and undue discrimination
- assessing compliance with its obligations e.g. transparency, cost orientation etc.

5.159 This time period has therefore had implications on the efficiency of ComReg in completing its own work programme (e.g. in monitoring Eircom compliance with its legal obligations).

---

71 Consultation document odtr 99/10 'Accounting Separation and Publication of Financial Information for Telecommunications Operators'.

72 Directive 97/33/EC of the European Parliament and Council as transposed into Irish law by Statutory Instrument No. 15 of 1998.

73 EU Commission Recommendation of 8 April 1998 on interconnection in a liberalised telecommunications market Part 2 – Accounting Separation and cost accounting.

74 Section 5 (f) of document odtr 99/35 & Decision 5/99 'Accounting Separation and Publication of Financial Information for Telecommunications Operators'.

5.160 The timeframe for submission and publication of Separated Accounts has been identified as a particular issue since 2005 at which time ComReg in its consultation document 05/18 proposed that Eircom:

> *"publish….accounts within 4 months of the year end to ensure more timely information to the market place."*(see section 9.2)

5.161 Eircom in its response to that consultation was of the view that:

> *".....deadlines of 4 months is totally unrealistic."*

> *"…… ComReg's proposals to oblige eircom to publish audited Regulatory Financial Statements and audit opinions, …. go beyond the requirements of the Directives."*

5.162 Regulation 12 of the Access Regulations however provides for the publication in certain circumstances subject to the protection of the confidentiality of the information and to the extent that ComReg considers that such information would contribute to an open and competitive market.

5.163 In addition, the Commission Recommendation[21]stated that:

> *"…the publication by a notified operator of sufficiently detailed cost statements .....will increase transparency and raise confidence on the part of competitors that there are no anti-competitive cross subsidies."* (see recommendation no. 5)

> And recommended the publication of an *"audit opinion (if required by the national regulatory authority."*

5.164 ComReg considers that publicly available information is essential to encourage competition and give confidence that the incumbent operator is complying with its legal obligations, including the transparency obligations.

5.165 Currently Eircom also provides draft Separated Accounts five months after its year end and final Separated Accounts one month later. Although drafts are relevant provided any changes between it and final accounts are identified and explained, Eircom does not however reconcile such accounts. This has therefore raised concerns about the level of adjustments that are made at such a late stage in the accounting process and which are not fully transparent to ComReg.

Best Practice

5.166 Article 11(2) of the Access Directive[75] provides that so as to facilitate the verification of compliance with obligations of transparency and non-discrimination, national regulatory authorities shall have the power to require that accounting records, including data on revenues received from third parties, are provided on request. It also provides that:

> *"National regulatory authorities may publish such information as would contribute to an open and competitive market, while respecting national and Community rules on commercial confidentiality."* (see Article 11)

75 Directive 2002/19/EC of the European Parliament and of the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities (Access Directive).

5.167 It is reasonable therefore to conclude and require that Eircom should be required to publish Separated Accounts to the level required to enable Eircom demonstrate its compliance with its legal obligations and ComReg monitor such compliance (while having regard to commercially confidentiality).

5.168 In relation to the timeline for publication, a paper produced by the Inter-Regulatory Working Group entitled 'The role of regulatory accounts in regulated industries' (October 2000)[76] identified that:

> *"…regulatory accounts should be published as soon as possible after the regulatory accounting year-end"* and *"…should be no more than four months after the regulatory accounting year end."* (see section 3.16)

5.169 In addition, the Commission Recommendation of 19 September 2005[77] stated that:

> *"Publication of regulatory accounts should take place annually and as soon as possible after the end of the accounting (reporting) year"* (see Annex). It also identified that the publication by the operator of *"…sufficiently detailed cost statements showing, for example, the average cost of network components will increase transparency and raise confidence on the part of competitors that there are no anti-competitive cross subsidies."* (see Point 5)

5.170 The ERG in its guidelines[22] for implementing the Commission Recommendation states that:

> *"NRA's should set guidelines on the timing and format of the publication according to EU and national laws."* (see section 7.3)

5.171 The New Zealand Commerce Commission in its guidelines[78] states that the regulatory accounts:

> *"must be completed within a timeframe approved by the Commission which will be no earlier than when the annual statutory financial statements are due.*" (see section 43)

5.172 For the year ended 30 June 2009, Telecom NZ is required to publish its regulated accounts on its website by 31 December 2009. For 2009, it must publish them by 1 December 2010 (i.e. 5 months after year end).

5.173 BT Plc is required under Condition OA6(b) to publish its regulatory financial statements and any corresponding audit opinions within four months of the period to which they relate.

---

76 Source: http://www.caa.co.uk/docs/5/ergdocs/joint_consultation_paper.pdf.

77 Commission Recommendation of 19 September 2005 on Accounting Separation and cost accounting systems under the electronic framework for electronic communications.

78 Draft Principles and Regulatory Reporting Requirements for the Accounting Separation of Telecom – 20 June 2008.

5.174 The table below sets out the time period within which separated/(regulated) accounts must be submitted to the regulator by a number of other regulated sectors – all less than four and half months.

Table 5: Timelines for other Regulated Industries

Other Regulated Industries	**Year End**	**Publication of Statutory Financial Accounts**	**Submission/ Publication of Regulatory Accounts to Regulator**	**Period from Year End to Submission of Regulated Accounts**
An Post	31 December	30 April	15 May	4.5 months
Royal Mail	30 March	13 May	31 July	4 months
ESB	31 December	29 April	29 April	4 months
National Grid – Electricity (UK)	31 March	5 June	25 July	4 months
National Grid – Gas (UK)	31 March	5 June	25 July	4 months

Source: Operators website's

5.175 Having regard to the Commission Recommendations, the ERG Guidelines together with the practices employed by NZ Telecom and BT Plc in addition to other regulated industries, ComReg is of the preliminary view that Eircom should submit to ComReg and publish on its website its Separated Accounts within 4 months of its financial year end.

Preliminary Conclusion

5.176 ComReg is of the initial view that the proposals set out in this consultation (see recommendation section below) with regard to the submission and publication of the Separated Accounts are consistent with the practices employed in the countries considered in our benchmarking analysis, with other regulated sectors and with the Commission Recommendations and ERG Guidelines.

Preliminary Recommendations and Consultation Questions

5.177 Given the wide range of parties; consumers, stakeholders and competitors who have an interest in the regulatory accounting information of Eircom together with the need for Eircom to demonstrate its compliance with its legal obligations (e.g. transparency obligations) and ComReg monitor such compliance, it is proposed that Eircom should publish its Separated Accounts on its website.

5.178 It is also proposed that the Additional Financial Information should be submitted to ComReg (in confidence) at the same time as the Separated Accounts are submitted and published.

5.179 As identified above, ComReg has concerns with the length of time it takes Eircom to finalise, submit and publish its Separated Accounts. It is normal business practice that once all entries including closing entries (i.e. accruals and prepayments) are posted to the general ledger accounts at the year end, a trial balance is prepared and all balances are transferred to the profit and loss account and the balance sheet which will form part of the statutory financial accounts. ComReg sees no reason why Eircom cannot prepare its statutory financial accounts and its Separated Accounts in parallel so reducing any duplication of work and leading to more timely submission of the Separated Accounts to ComReg. It is also the case that significant work could be undertaken prior to the year end with interaction with the auditor and/or regulator where necessary.

5.180 In this regard and so as to maintain the usefulness and effectiveness of the Separated Accounts, ComReg is of the opinion that the Separated Accounts should be published in a timely manner. ComReg considers that a six months timeframe to publish its Separated Accounts (HCA and CCA) is unsatisfactory as the information contained therein may no longer be relevant to current circumstances.

5.181 In this regard, ComReg now makes the preliminary proposal that Eircom publish its Separated Accounts and submit Additional Financial Information to it (in confidence) within 4 months of the year end. In the first year however, ComReg is of the preliminary opinion that a 5 month timeframe is appropriate so as to give Eircom sufficient time to amend its accounting systems. So as to avoid ambiguity, Eircom should only submit final Separated Accounts to ComReg.

5.182 While ComReg recognises that this will involve additional work for Eircom as the Separated Accounts will be provided to the level of specific service (and Additional Financial Information to the level of service and product), ComReg is of the initial opinion that this will be more than offset by improvements in the regulatory process.

Q. 26. Do you agree or disagree that Eircom be required to publish its Separated Accounts and submit its Additional Financial Information in confidence to ComReg within five months after the end of the first financial year and four months thereafter? Please detail your response in full.

5.183 **Next Generation Networks**

Issues identified by ComReg

5.184 Next Generation Network's (NGN's) refers to a new generation of communication networks based on Internet Protocol ('IP') technology. It provides a common platform for a variety of data and voice communications including other media services e.g. broadcasting. This platform however increases the complexity of the traditional market definition, as many services will no longer be sold as stand alone, rather on the basis of bundled services. In addition, they can change the assumptions, concepts, values, and practices that constituted an established way of viewing regulatory accounting. It can therefore challenge the way markets and services are reported e.g. ensuring that objective cost drivers and costing methodologies are applied.

5.185 The evolution of current PSTN toward NGN can impact on the choice of cost base, the cost structure and the cost accounting parameters:

- **Cost base -** While NGN's will generally be accounted for based on HCA, its introduction may lead operators to review amortisation periods to reassess economic / accounting asset lives. Given the potential for significant changes in the real cost of these assets, CCA remains a good basis of accounting. Many parts of an NGN network are already in place and may fall within the CCA methodologies currently used for preparing the regulatory accounts or related financial information of an operator. The identification and valuation of these assets should therefore be relatively straightforward as long as robust asset registers are maintained.
- **Cost structure –** It is envisaged that an NGN network will have a high portion of fixed costs, which cannot be directly assigned to a service, therefore resulting in large common costs. It will be necessary to identify whether such fixed costs are common to other services and products and whether and how they should be apportioned.
- **Accounting Separation –** Accounting Separation has traditionally been the accounting mechanism by which economically separable parts of an operator's business are accounted for as separate business entities. These entities are normally service/product based and are normally aligned to the actual service/products provided externally by an operator and can imitate internal transfer charging principles. NGN will however challenge this approach in that it may not be possible, to determine what service is using the NGN platform.

5.186 An NGN cost model can be developed starting from two assumptions:

- There is a network, based on PSTN technology and NGN gradually replaces PSTN equipment.
- The network is non-existent or an NGN is developed parallel to the PSTN

5.187 Where the network is gradually upgraded to NGN over a long period of time, two possible approaches to evaluate the underlying costs of the network and the relative operating expenditures can be employed:

- Parallel: recognizes that equipment within the same network coexists in parallel, and therefore costs for both technologies are calculated in the model.
- MEA: in modeling the network a modern equivalent asset of PSTN is recognized as being currently in use or will be shortly used in the network.

Best Practice

5.188 Ofcom in its explanatory statement and notification document 'Changes to BT's 2007/08 Regulatory financial statements' (of 26 June 2008) identified that the current reporting regime for British Telecommunications plc (BT):

> *"...has evolved over time in response to ongoing changes in the regulatory, technological and competitive environment, including.....technological changes to the nature of BT's business,*

> *including the move to the next generation network,….”* (see section 1.3)

5.189 With the objective of ensuring that the impact of BT's significant investment in its next generation network on regulated services is explained and disclosed appropriately, Ofcom requires BT Plc to add new network components specific to the NGN's and disclose the costs of these new components in the relevant statements. While this is the first stage of incorporating NGN's into BT Plc's regulatory financial statements, Ofcom envisaged that this will:

> *"give transparency to the costs"* and where they are being attributed it can *"formulate an effective reporting regime as the new network comes into use."* (see section 4.6)

5.190 Ofcom also state that it will:

> *"…review with BT the appropriateness of their cost attributions. As the cost data becomes more robust and our understanding improves we will be analysing the information and implementing changes to BT's costing methodology if necessary."* (see section 4.7)

Preliminary Recommendations

5.191 For the purposes of this consultation, ComReg needs to consider the impact that the introduction of Next Generation Networks will have on regulatory accounting and price review/submission processes.

5.192 ComReg will need to conduct a regular review of Eircom's cost accounting system to ensure that there is transparent accounting of costs, the choice of attribution method is appropriate and there is appropriate documentation (in the Accounting documentation) of the network components that make up the network.

5.193 With regard to the level of disclosure in the Separated Accounts, it is proposed that Eircom in devising its Separated Accounts should also consider and discuss with ComReg the level of information that needs to be disclosed in relation to NGN's (e.g. by network component) so as to ensure that they continue to remain 'fit for purpose'.

5.194 In addition, there will also be a need for Eircom to be transparent in relation to accounting for NGN within its regulated markets. How Eircom accounts for NGN should be included in its Accounting Document. Where Eircom proposes changes to accounting policies or accounting treatment for NGN these should be agreed in advance with ComReg and the Accounting Document should be updated accordingly.

6 Accounting Document

Background

6.1 Eircom publishes on its website an "Accounting Document" at the end of each financial year. This provides ComReg with an ex-post and high level account of the processes and procedures which have been applied by Eircom in the production of its most recent Separated Accounts.

6.2 ComReg has not to date inputted on a formal basis into the content and format of the Accounting Document or the basis of preparation of the Separated Accounts. ComReg is however of the opinion that open and transparent communication between it and Eircom in advance of the start of each financial year:

- Will help ensure that there are no surprises post year end that ComReg was not aware of and which only comes to ComReg's attention after the fact
- Will introduce greater clarity
- Ensure that expectations are met on all sides.

Issues identified by ComReg

6.3 The issues and difficulties that ComReg has identified have been set out in previous sections. ComReg is of the initial view that the Accounting Document should set out a detailed analysis of the procedures and policies used in the preparation of the Separated Accounts. Following a review of Eircom's Accounting Document, ComReg identified specific gaps in the information provided together with areas where the level of detail / process described might reasonably be improved including:

- the need for detailed schedules showing how operating costs (analysed into external costs, inter-segment costs and corporate overheads) are treated at the market level
- how each functional cost category/network element (and associated activities) are treated at the service and product levels
- the process of determining the bases of the allocation of costs (including identification of the activity, the associated tasks, list of relevant services/products, verification process of node managers decisions etc.)
- detail of changes (and reasons) made in attribution methodologies from one accounting period to the next
- the process of revenue and volume identification at the market, service and product levels
- the process of calculation and apportionment of the discounts for bundled services and products

- findings of the review of connection lives (driver used in the allocation of connection fee revenue)

- details of the basis use to calculate estimates applied in the identification of amounts receivable/payable, from/to, other operators

- service/product listing – analysed by regulated market

- details of and findings of recent network studies and samples.

6.4 This level of information will assist Eircom in the preparation of its Separated Accounts while facilitating ComReg in the effective discharge of its regulatory responsibilities, particularly with regard to monitoring Eircom's compliance with the cost orientation and non discrimination obligations.

6.5 It has been the practice of Eircom to publish its Accounting Documents on its website after the period to which it relates. It is however of vital importance that ComReg has visibility of its Accounting documents in advance of the commencement of each accounting period so that it can approve the proposed processes and procedures and ensure compliance with Eircom's regulatory obligations.

Best Practice

6.6 Article 13 of the Access Directive requires that:

> *"National regulatory authorities shall ensure that, where implementation of a cost accounting system is mandated in order to support price controls, a description of the cost accounting system is made publicly available, showing at least the main categories under which costs are grouped and the rules used for the allocation of costs."*

6.7 The ERG Guidelines recommended that the operator shall:

> *"ensure that any data, information, description, material or explanatory document prepared in respect of accounting and other methods used in the preparation of the accounting records and Cost Accounting Financial Statements shall be sufficiently transparent and prepared so that a suitably informed reader can easily gain a clear understanding of such data, information, description, material or explanatory document. This could include the overall structure of the SMP operator's financial and information systems from which regulatory accounting data is derived, and in particular the sequence of the processing and 'cascade' effect of the intermediate cost centres; be able to gain a detailed understanding of all the material, methodologies, surveys and drivers (e.g. systems, processes and procedures) applied in the preparation of the regulatory accounting data and make their own judgement as to the reasonableness of these methodologies and driver data and any changes to them."* (see section 7.1)

> *"Transparency of the bases of preparation of regulatory financial information is essential in order for NRAs to have confidence in the financial statements, and to allow them to make economic regulatory decisions based thereon. Therefore it is necessary to ensure the transparency of cost accounting system and the bases of preparation of the information so that the NRA can effectively monitor and enforce compliance with the SMP provider's obligations for non discrimination, cost-orientation, cost recovery and price controls."* (see section 7.1)

6.8 In addition the ERG requires that:

> "*all aspects of the cost attribution process including cost driver definitions and calculations, survey and sampling techniques and valuation methodologies must be made available to, and subject to review by the NRA."* (see section 2.4)

6.9 On the basis of the above precedent ComReg is of the preliminary view that Eircom should be required to document its processes and procedures (including methodologies of cost allocations) so that ComReg can make an assessment as to its appropriateness or otherwise and facilitate it in monitoring Eircom's compliance with its legal obligations.

6.10 The Commerce Commission of New Zealand requires that Telecom New Zealand prepare and publish Manuals for 2009[79], which include:

- An attribution methodologies manual
- An asset valuation manual
- An accounting policies manual.

6.11 An Attribution Methodologies Manual includes:

> *"descriptions of both the systems and processes used to implement the attribution methodology … as well as the development of the Network Component schedule …. This manual will also include detail of the calculation of WACC used for this regulatory reporting, and the procedures for managing changes to the systems and processes used in preparing these regulatory reports."*[80] (see section 38)

6.12 An Accounting Policies Manual:

> *"details the application of all other accounting principles and policies".* (see section 38)

6.13 If NZ Telecom is of the opinion that any such information is confidential it can make a submission to the Commission for exemption from publication.

6.14 Given the precedent of NZ Telecom, it is important to differentiate between the information that should be published and the information that should be provided in confidence to ComReg (due to its commercially confidentiality).

79 Telecom Accounting Separation Information Disclosure Requirements for Financial Years ending 2009 and 2010.
80 Draft Notification of Information Disclosure Requirements on Telecom New Zealand under Part 2B of the Telecommunications Act – October 2008.

6.15 BT Plc on the other hand is required to produce and publish the following detailed documentation:

- Primary Accounting Documents' setting out the Regulatory Accounting Policies, the Attribution Methods, the Regulatory Accounting Principles, the Transfer Charge Methodology, and the Long Run Incremental Cost Methodology

- 'Secondary Accounting Documents' setting out details of the policies, methodologies, systems, processes and procedures for deriving or calculating the costs, revenues, assets and liabilities underlying the Regulatory Financial Statements.

6.16 The Secondary Accounting Documents comprise the following :

- The Detailed Attribution Methods ('DAM') – this describes the processes used to derive the fully allocated costs of BT Plc's network components, SMP markets, Technical Areas and Disaggregated Activities.
- The Detailed Valuation Methodology – this describes the methods used to derive current cost valuations.
- The Long Run Incremental Cost Model: Relationship and Parameters – describes the calculation of the long run incremental values for the network.

6.17 Details of the volume measures (e.g. bill volume data, service volume, call volume, usage volume etc.) used by BT Plc are disclosed in its Accounting Documents. In addition and following a consultation process, Ofcom requires that BT Plc unambiguously set out the volume measure for transfer charge calculations.

6.18 The purpose of the DAM is to, *inter alia*:

- describe the costing principles used by BT Plc to prepare the Regulatory Financial Statements on a fully allocated cost basis

- describe the methods used in the Accounting Separation ('AS') process to attribute revenue, costs and capital employed to the Markets, Technical Areas and Disaggregated Activities in the Regulatory Financial Statements

- outline the systems and processes used by BT Plc to support Accounting Separation

- outline the methods for transfer charging from the BT Plc's Wholesale Markets to the BT Plc's Retail Markets and Residual

- outline the methods for preparing the Statement of Costs on a Current Cost Basis and the Statements of Costs and Charges for Internal and External Wholesale Services.

6.19 The DAM is over 1250 pages long and in summary it provides an overview of the BT Plc's business, explaining the main activities and functions performed by BT Plc's to deliver services to customers. It describes how the underlying financial transactions supporting the business activities and functions are recorded in the financial ledgers, and how the transactions are grouped to provide the starting costs, revenues, assets and liabilities used by the Accounting Separation ('AS') system. The AS system attributes the costs, revenues, assets and liabilities to defined products and components which aggregate into the Markets, Technical Areas and Disaggregated Activities to create a view of BT Plc's financial position and results against the regulatory Markets.

6.20 It then provides an overview of the AS solution, in terms of the underlying costing principles and the conceptual flow of costs and revenues from source financial systems to the separated Markets, Technical Areas and Disaggregated Activities to create a view of BT Plc. It also describes the system and processes, which underpin the flow of costs and revenues in the Accounting Separation process.

6.21 A base methodology dictionary is also provided which includes a complete description of the attribution base methodologies applied to attribute costs in the Accounting Separation system.

6.22 Given the comprehensive approach adopted in the UK, ComReg is of the preliminary view that it should recommend a consistent approach whilst having due regard to the confidentiality of some information. ComReg would obviously not expect documentation of the magnitude of BT Plc as they are clearly very different companies in terms of size. However, ComReg is of the preliminary view that the general approach to documentation should be similar.

6.23 Both NZ Telecom and BT Plc are only required to publish its accounting documents after the year end to which they relate but this is an issue for ComReg (as identified above). It is of the preliminary view therefore that Eircom submit to ComReg an Accounting Document in advance of the commencement of each accounting period for the first two years after the effective date of the accounting Direction and thereafter as part of the Separated Accounts submission.

Preliminary Conclusion

6.24 ComReg is of the view that the proposals set out in this consultation (see recommendation section below) with regard to the preparation of an Accounting Document are consistent with the practices employed in the countries considered in our benchmarking analysis together with the recommendation of the ERG and other regulations.

Preliminary Recommendations and Consultation Questions

6.25 As identified above, ComReg needs to have access to accurate and reliable data to enable it fulfil its legal responsibilities. However in order for ComReg to make an assessment as to the accuracy and reliability (or otherwise) of the data, ComReg needs to have access to an appropriate level of supporting information.

6.26 So as to increase transparency and give ComReg assurance as to the accuracy and reliability of its Separated Accounts, it proposes that Eircom produce an Accounting Document (and review and update it annually), which will (consistent with BT Plc UK) consist of two principal components i.e. a Primary Accounting Document and a Secondary Accounting Document. ComReg proposes that this be prepared in advance of the start of each accounting period and be submitted to it for its approval for the first two years from the effective date of the accounting Direction. For subsequent years, ComReg proposes that it be submitted to it for its approval with the Separated Accounts. ComReg envisages that its internal review process shall take no more than three months to complete, however this is dependent upon the level of co-operation from Eircom.

6.27 These should document in detail the processes and procedures to be applied by Eircom (in its next set of Separated Accounts) in relation to volumes, revenues, costs (amongst other things) i.e.:

- 'Primary Accounting Documents' should set out the Regulatory Accounting Policies, the Attribution Methods, the Regulatory Accounting Principles, the Transfer Charge Methodology and any other methodologies (CCA, LRIC etc.)

- 'Secondary Accounting Documents' should set out details of the policies, methodologies, systems, processes and procedures for deriving or calculating the costs, revenues, assets and liabilities (including details of attribution methodologies, valuation methodology and any other relevant methodologies) used to prepare the Separated Accounts.

6.28 Given the confidentiality and commercial sensitivity of some of this detailed information, it is proposed that only the 'Primary Accounting Documents' be published by Eircom on its website at the same time as the Separated Accounts.

6.29 It is proposed that the Primary Accounting Document should contain at least the elements listed below:

- a description of Eircom's business, explaining the main activities and functions performed by Eircom to provide telecommunications services to customers, clearly indicating which markets, services and products are regulated

- details of the accounting systems, in terms of the underlying principles and the conceptual flow of costs and revenues from source financial systems to the separated businesses

- a description of how the Separated Accounts differ from the Financial Accounts

- the format and content of the Separated Accounts and a description of what the regulatory accounting process entails (including the basis of preparation for the Separated Accounts)

- a description of the cost allocation methodology employed. Details of the internal safeguards that are incorporated to ensure that the cost allocation system is free from material error

- year on year changes to the Separated Accounts and changes to cost allocations, together with an assessment of the impact of these changes.

6.30 It is proposed that the Secondary Accounting document in addition to setting out details of the policies, methodologies, systems, processes and procedures for deriving or calculating the costs, revenues, assets and liabilities (including details of attribution methodologies, valuation methodology and other relevant methodologies) used to prepare the Separated Accounts shall contain at least the elements now set out:

- an explanation of how the underlying financial transactions supporting Eircom's business activities and functions are recorded in the financial ledgers, and how the transactions are grouped to provide the starting costs, revenues, assets and liabilities used within the internal system to apportion costs, revenues, assets and liabilities to the market, service and product levels
- the means by which Eircom identifies how costs are found to be directly or indirectly attributable or common
- the means by which Eircom identifies how avoidable, variable and fixed costs are defined
- cost driver definitions (i.e. basis of allocation) and calculations
- the means by which Eircom reviews, updates and verifies cost allocation drivers together with justifications of changes in basis of allocation/apportionment from year to year
- details of the sampling processes employed, including the design, scope, objectives, methodology, basis of calculation of sample sizes, level of precision and confidence levels
- accounting treatment of NGN's
- details of the network studies conducted during the year to apportion indirect common costs
- a list of the services and products as per the regulated price list.

6.31 In earlier sections of this consultation document (in particular Revenue Identification and Volume Measurement and Cost Allocation and Apportionment), while ComReg set out proposals in relation to processes and procedures that should be applied, no proposals were made with regard to disclosure in the Accounting Document.

6.32 It is ComReg's preliminary conclusion that clear and transparent procedures for the identification of revenues (at the market, service and product levels) are in place and documented in Eircom's Accounting Document, in particular with regard to:

- **Bundled Products** - Given the increase in bundled products offered by the incumbent (which offer discounts implicit in the bundle), there is a need for disclosure as to how this bundle discount has been calculated and assigned across markets, services and products. Given the confidentiality of such information, it is proposed that this should be disclosed in the Secondary Accounting document only.

- **Transfer Charges** - Where there is an arrangement in place for one market within the Eircom Group to provide another market with services, the Accounting Document should include details of the terms of supply and the basis of calculation of the arm's length transfer charge. Such revenues (as identified above) should be separately disclosed on the face of the Separated Accounts. It is proposed that details of the process employed be included in the Primary Accounting Document so as to facilitate assessment of compliance with the non discrimination obligations.

- **Sampling Processes** – Details of any sampling processes applied to apportion revenues should be disclosed in the Accounting Document as part of the Secondary Accounting document. In addition and so as to ensure that samples remain representative, ComReg is of the opinion that they should be subject to a review by a *competent* independent reviewer on an annual basis. Eircom may choose that the competent independent reviewer be its current auditor, however it is important that all relevant qualifications to perform such reviews are supplied. It is proposed that any alterations as a result of such review be disclosed in the Accounting Document as this will give stakeholders added assurance as to the accuracy and reliability of its results being presented.

6.33 While Eircom in its current Accounting Document refers to differing volumes e.g. call data volumes, recorded volume of usage, service volumes, network usage data etc., no details of the processes and procedures applied to identify or measure such volumes have been disclosed. So as to increase ComReg's confidence in the figures provided, it is proposed that Eircom include in its Secondary Accounting document details of the volume (by service/product) which can be directly obtained and volumes which are derived by statistical sampling. In addition, it is proposed that Eircom disclose (in its Primary Accounting document) details as to how the 'weighted average volumes' and 'total units' are derived together with details of the weightings applied to calculate the volume figures (disclosed on the face of the Separated Accounts/ Additional Financial Information).

6.34 With regard to Cost Allocation and Apportionment, it is proposed that the Accounting document contain schedules showing the proposed treatment for operating costs at the market level and the proposed process of allocation/apportionment of each functional cost category and network element at the market, service and product levels. This should also include an analysis of all activities associated with each functional cost together with its treatment as direct, indirect or common cost. Details and justifications of choice of cost driver should also be disclosed. Given the confidentiality of such information, it is proposed that this be included as part of the Secondary Accounting document.

6.35 ComReg proposes that all processes and procedures applied by Eircom (together with the Accounting Document) be subject to annual review by a competent independent reviewer so as to ensure that they remain appropriate and fit for the intended purpose. In this regard, it is important that the processes and procedures are explained in sufficient clarity to facilitate such a review and assessment.

6.36 While ComReg recognises that the development of an Accounting Document will be an additional burden on Eircom, it is of the opinion that this will be confined to year one, with only the need for review and update in subsequent years. It is envisaged however that the increase in cost, will be more than offset by an increase in the level of transparency, so reducing the need for further clarifications from Eircom. Given that it is proposed that the Accounting Document be reviewed and approved by ComReg, this will provide Eircom with greater certainty as to the acceptability of its processes and procedures to ComReg.

6.37 The increase in the level of supporting information provided to ComReg will also increase the confidence of other stakeholders by providing them with for example added assurance that as to the accuracy and reliability of its costing processes and therefore prices.

6.38 Please refer to Section 8 of the proposed draft Decision Instrument/accounting Direction as regards the proposed requirements for Eircom's Accounting Document.

Q. 27. Do you agree or disagree with ComReg's preliminary proposals to require Eircom to document the policies and procedures to be used in the preparation of its Separated Accounts in an Accounting Document and to submit it to ComReg for its approval in advance of the start of each of the two years following the effective date of the accounting Direction and subsequently as part of the Separated Accounts? Do you agree that only the 'Primary Accounting Documents' should be published by Eircom? Please detail your response in full.

7 Audit

Background

7.1 An audit provides added assurance to interested parties as to the quality, credibility and objectivity of the Separated Accounts, systems and processes.

7.2 Consistent with the International Standard on Related Services 4400[81], the term "auditor" is used in this section:

> *"when describing both audit, review, other assurance and related services that may be performed. Such reference is not intended to imply that a person performing review, other assurance or related services need be the auditor of the entity's financial statements."*

Issues identified by ComReg

7.3 Regulation 24(1) (a) of the Framework Regulations[82] requires that the Separated Accounts of Eircom be:

> *"audited in accordance with generally accepted auditing practices for the activities associated with the provision of that network or service,….."*

7.4 The audit opinion on Eircom's 2008 Separated Accounts[83] (as provided by PwC) however states that they cannot be relied upon by third parties as:

> "*This report, including the opinion, has been prepared for, and only for, the Company and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.*"

7.5 In addition, the audit opinion gives very limited comfort on the accuracy and reliability of the Separated Accounts as the report of the independent auditors (attached to Eircom's Separated Accounts for 2008), states that in conducting an examination of the Financial Statements and in providing its opinion of the Separated Accounts they:

> *"…have not performed any additional tests of the transactions and balances recorded in the general ledgers and other accounting records beyond those already performed, for the purpose of our audit of the Statutory Financial Statements."*

7.6 The audited opinion covering the Separated Accounts relates only to each of the 'businesses' and 'activities' of the firm and does not cover individual markets, services or products.

---

81 'Engagements to perform agreed- upon procedures regarding financial information'.

82 European Communities (Electronic Communications Networks and Services) (Framework) Regulations 2003 (S.I. No. 307 of 2003), ("the Framework Regulations").

83 See: http://www.eircom.ie/bveircom/pdf/2008_HCA_Financial_statements1.pdf

7.7 Section 8 of the ERG Common Position paper identified that the :

> *"audit scope for regulatory purposes is relatively wide and goes beyond the traditional audit scopes performed on the statutory financial statements."*

7.8 The main elements to be covered by the audit as set out in section 8 b) of the paper are:

- *"the scope of costs included in the model and the scope of costs allocated to individual regulated products (where appropriate);*
- *the reconciliation between the cost model and statutory accounts;*
- *correctness of figures, including operational data: volumes, technological parameters;*
- *methodologies used regarding amortisation, cost capitalisation, allocation and for the evaluation of the assets (e.g. current costs);*
- *transfer charges in Separated Accounts;*
- *reconciliation between the cost model and the Separated Accounts;*
- *Cost Volume Relationship and accounting system information."*

7.9 It appears from the statement made by the auditors of Eircom that its audit is not consistent with the guidelines of the ERG.

7.10 In this regard, the scope of the audit conducted by Eircom's auditors is in ComReg's initial view insufficient to give ComReg the assurance it needs as to the accuracy and reliability of its Separated Accounts that should form the basis of ComReg's regulatory decisions.

7.11 As already identified (in previous sections of this paper) and given that the Separated Accounts are not provided to a sufficient level of granularity to enable ComReg fulfil its regulatory responsibilities and Eircom demonstrate its compliance with its regulatory obligations, it has been the practice of ComReg to request additional information from Eircom to support price submissions/reviews. Such information is not however audited and ComReg has therefore had to conduct its own tests in addition to the retention of the assistance of specialised consultants to verify the accuracy and reliability of the figures provided. This is all at a considerable cost to ComReg and Eircom.

7.12 As identified above and while the Framework Regulations provide that Eircom keep audited Separated Accounts:

> *"…in accordance with generally accepted auditing practices"*[84],

84 Regulation 24(1)(a).

7.13 There is in ComReg's view a need for further clarification, particularly with regard to the following:

- Auditor independence
- Duty of care of the auditor
- Letter of engagement
- Audit report and opinion.

7.14 **Auditor Independence**

7.15 ComReg initially considered that it is important that a qualified body, independent of Eircom be appointed to verify its compliance with its Cost Accounting and Account Separation obligations.

7.16 The use of qualified personnel should provide ComReg and other interested parties with greater assurance as to the accuracy and reliability of Eircom's Separated Accounts together with compliance with its regulatory responsibilities. In the case of an audit of the cost allocation system, a 'cost' auditor should be appointed to perform such an audit. The cost auditor will need to have a detailed knowledge of the markets, service and products of Eircom to enable it perform its audit tasks e.g. review of cost allocation and apportionment at the market, service and product levels.

7.17 **Duty of care of the auditor**

7.18 The section "I*ssues identified by ComReg*", relating to audit, sets out the auditor's opinion as contained in Eircom's Separated Accounts for 2008.

7.19 Given the reliance placed by ComReg on the opinion of the auditor, ComReg considers in its initial view that it is important to clarify the auditor's duty of care to it.

7.20 **Letter of Engagement**

7.21 A letter of engagement formalises the expectations of the audit, outlining the scope of the audit and the terms and conditions of the auditor's engagement.

7.22 Eircom for the year ending 30 June 2008 incurred 'audit related regulatory reporting' costs. Such audits relate to the Separated Accounts, which in their current format and for the reasons set out in this document are of very limited use to ComReg or the wider industry.

7.23 From ComReg's initial perspective, it appears that the letter of engagement should explicitly identify the responsibilities of the auditor, in particular the need to:

- *verify* Eircom's compliance with the processes and procedures outlined in its Accounting Document
- *verify* Eircom's compliance with the requirements of the accounting Direction and the Regulations
- *verify* that the Separated Accounts have been produced in accordance with the processes and procedures set out in the Accounting Document

- *Review and verify* the appropriateness of the cost allocation/apportionment processes as set out in the Accounting Document.

7.24 As ComReg is a significant user of Eircom's Separated Accounts there is also the question as to whether it should be a party to the agreement, (i.e. in the form of a tri-partite arrangement) which is also discussed below.

7.25 **Audit Report and Opinion**

7.26 There are two types of audit opinion that can be provided, a 'Fairly Presents in Accordance with audit opinion' ('FPIA') and a 'Properly Prepared in Accordanc**e** with audit opinion' ('PPIA'). A FPIA audit opinion gives a different level of assurance than compared with a PPIA audit opinion. The FPIA audit opinion provides a high level of assurance and as identified by Ofcom in its consultation document[85]

> *"in the context of regulatory financial reporting, is broadly equivalent to the "true and fair" opinion seen in statutory financial statements."* (see section 9)

7.27 The PPIA audit opinion on the other hand (and as identified by Ofcom):

> *"only provides assurance that the figures contained in the financial statements have been properly prepared in accordance with an agreed process without any assurance that the overall impression which they convey represents the underlying performance and financial position in a 'fair' manner. Therefore, the assurance provided by a PPIA audit opinion is dependent largely on the quality and transparency of the bases of preparation."* (see section 9)

7.28 While PwC in its audit opinion states that:

> *"…each of the financial statements of each of the Businesses and each of the Activities for the year ended 30 June 2008:- fairly presents in accordance with the Accounting Documents,….the result and mean capital employed of, and costs incurred by, each of the Businesses and each of the Activities"* (see Eircom's Separated Accounts 2008, paragraph 14)

7.29 It is however ComReg's preliminary position that the opinion provided by the auditors does not provide it with adequate comfort as PwC has not performed any tests over and above that which is required for the Statutory Financial Accounts e.g. audit of cost allocation system at the market, service and product levels. This issue could, in ComReg's initial view, be dealt with in the context of the letter of engagement (by setting out the audit tasks that need to be performed).

Best Practice

7.30 Regulators typically require operators to have their regulated accounts audited. However, ComReg considers that in considering the extent to which

85 'The regulatory financial reporting obligations on BT and Kingston Communications in markets where SMP has been demonstrated'.

the audit can give users of the accounts confidence that the information contained in the accounts is accurate, it is important to understand the nature of the audit work undertaken and the resulting opinion.

7.31 **Auditor Independence**

7.32 The ERG Guidelines identified that when verification of the operator's compliance with a cost accounting system is mandated:

> *"the compliance should be confirmed by a qualified body, independent from the operator concerned."* (see section 8)

7.33 It also provides that the NRA may itself undertake the review, provided it has the necessary qualified staff available to do. The guidelines recognised that The Commission Recommendation on statutory auditors' independence establishes a sound framework against which independence can be tested.

7.34 Despite the fact that the NRAs are independent by their constitution, CTcon[86] recommended

> *"that the accounting principles shall be checked by an expert e.g. an auditor or consultant approved by the national regulatory authority"*.

7.35 CTcon also in the course of its study found that

> *"several universal service providers would have much more confidence in opening their systems and accounts to an expert who does not have an own interest in the process of price approval."* (see section 7.2.3)

7.36 Given the findings of the CTcon report, it is reasonable to propose that the expert chosen should be approved by ComReg.

7.37 The New Zealand Commerce Commission (in its Draft Notification of Information Disclosure Requirements) is of the view that New Zealand Telecom must

> *"engage an independent auditor(s)"*

to audit information and processes which are not audited as part of the standard statutory reporting process. It also requires that Telecom may engage the same firm to audit both the information disclosed for regulatory purposes and for statutory purposes.

7.38 While NZ Telecom may engage the same auditor to perform the statutory and the regulatory audit, it is however important that the auditor chosen has the right skill to perform all the required tasks.

86 'Study on the cost accounting systems of providers of universal postal service' CTcon July 2001.

7.39 **Duty of Care of the auditor**

7.40 The ICAEW Technical Release Audit 1/01 'Reporting to Third Parties'[87] provides guidance as to how to agree the auditors terms of reference and whether the auditor has a duty of care to the regulator when it provides its opinion on the Separated Accounts. It states that:

> *"when accountants know that their report has been requested by a third party and that the third party will rely on the report, there is a risk, in the absence of an effective disclaimer, that the accountants owe the third party a duty to take reasonable care in preparing and providing the report. If the accountants do owe the third party such a duty, they could be liable to that third party if they were negligent and the third party suffered loss in reliance on the report".* (see section 8)

7.41 In 2006, the Institute of Chartered Accountants in Ireland, in an effort to assist auditors meet certain obligations, issued The Miscellaneous Technical Statement M46 'Reporting to the Financial Regulator under The Central Bank and Financial Services Authority of Ireland Act 2004'. It identified that:

> *"Auditors of entities regulated by the Irish Financial Services Regulatory Authority ("IFSRA", the Financial Regulator) have* ***a statutory duty to report specified matters to the Financial Regulator****."* [emphasis added] (see section 1)

7.42 For example, Regulation 7, 8 and 9 of the Supervision of Credit Institutions, Stock Exchange Member Firms and Investment Business Firms Regulations 1996 sets out the statutory duties of the auditor as follows:

> 7 *"The auditor of a financial undertaking shall communicate to the relevant supervisory authority any fact or decision concerning that financial undertaking of which the auditor becomes aware while conducting an audit of that financial undertaking which –*
>
> *(a) is liable to constitute a material breach of the laws, regulations or administrative provisions which lay down the conditions under which the financial undertaking was authorised or any laws, regulations or administrative provisions which specifically govern pursuit of the activities of financial undertakings or of any condition or requirement imposed by the supervisory authority on that financial undertaking, or*
>
> *(b) is liable to affect the continuous functioning of the financial undertaking, or*

87 An Irish equivalent M39 Reporting to third parties – 'Accounting Standards and Guidance Miscellaneous Technical Statements' was issued by the ICAI in June 2002.

(c) is liable to lead to a refusal by the auditor to certify the accounts of the financial undertaking or to the expression of reservations by the auditor.

8 *The auditor referred to in regulation 7 shall communicate to the relevant supervisory authority any facts or decisions of which that auditor becomes aware while conducting an audit of an undertaking where it is established that there are close links resulting from a control relationship with the financial undertaking for which the auditor conducts an audit*.

9 *Any communication by an auditor under regulation 7 or 8 shall not constitute a breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative provision and shall not involve the auditor in liability of any kind."*

7.43 In addition the Miscellaneous Technical Statement M46 clarified that the regulatory auditor is required (under section 27B of the Central Bank Act 1997) to submit an annual statutory duty confirmation to the Financial Regulator. This should clarify that there is no matter other than that already reported that has come to the attention of the auditor that gives rise to a duty to report[88] to the Financial Regulator.

7.44 In 2005 Ofcom[89] implemented a duty of care on BT Plc's Regulatory auditor requiring that the letter of engagement appointing the Regulatory Auditor shall:

a) *include an express obligation on the Regulatory Auditor that, in forming and/or expressing any audit opinion….., the Regulatory Auditor shall owe a duty of care to Ofcom (but not directly or indirectly to any other third party) subject only to such qualifications or limitations as are set out by the Regulatory Auditor to Ofcom in writing and acknowledged by him in writing prior to the expression of any audit opinion …..and*

b) *shall give effect to such duty of care by expressly acknowledging Ofcom's interest pursuant to the Contracts (Rights of Third Parties) Act 1999 and dis-applying any provision, term or condition of the Provider's letter of engagement that could otherwise exclude his interest.* (see Annex A).

7.45 In addition, the New Zealand Commerce Commission requires that the audit report state that:

"the auditor owes a duty of care to the Commission in respect of the audit opinions and assessments."

88 Such matters being determined by statute for each category of financial institution.

89 Proposal for setting access-related conditions under section 45(5) of the Communications Act 2003 as authorised by section 74(2) of the Communications Act 2003.

7.46 On the basis of the precedent in BT Plc and NZ Telecom, it is ComReg's preliminary view that a duty of care should be owed by the auditor to ComReg, through the letter of engagement and audit opinion being provided to ComReg.

7.47 **Letter of Engagement**

7.48 The New Zealand Commerce Commission in its Draft Notification of Information Disclosure Requirements stated that it was of the view that:

> *"The scope of the audit report will be subject to approval by the Commission in advance of the auditor(s) being engaged*[90]*."*

7.49 Having considered the precedent employed in NZ Telecom, it is reasonable to conclude that ComReg should at a minimum be involved in overseeing the scope of the audit to ensure that it meets its own requirements.

7.50 **Report and Opinion**

7.51 It can be noted that the ICAEW Guidance Paper[91] states that

> *"Regulatory Accounts are analogous to financial statements prepared under the Companies Act, but are usually prepared under some variation of, or other basis to, UK GAAP*[92] *and therefore a* ***'fairly presents in accordance with' opinion is more appropriate in the circumstance of Regulatory Accounts.*** *Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 1985."* [emphasis added] (see Appendix A)

7.52 BT Plc UK is required to:

> *"publish the Regulatory Financial Statements and corresponding audit opinion as directed by Ofcom from time to time."* (condition 6(b) and (c))[93]

7.53 Prior to 2006 a FPIA opinion was required for each of the separately defined markets for which BT Plc's accounts were prepared (27 in total). In addition a PPIA opinion was provided for the group of wholesale markets and the group of retail markets. In its 2006 consultation document, Ofcom noted that the auditors were not able to provide a full set of unqualified opinions for individual markets. For example, for 2004/05, FPIA opinions were required on 27 market statements, but the auditors were only able to provide such opinions on 21 markets. Of the other six markets, the auditors were only able to provide a PPIA opinion on four statements and an even more limited, "negative" assurance (to the effect that nothing had come to their attention that the statements were not properly prepared) on the other two. Ofcom

90 See Section 39 of the New Zealand Commerce Commission draft notification.

91 ICAEW Guidance 'Reporting to Regulators of Regulated Entities Audit 05/03'.

92 Except as specified by the Regulatory Accounting Guidelines.

93 See: http://www.ofcom.org.uk/consult/condocs/obligations/statement/statement.pdf (section 2.37).

found that BT Plc's Regulatory Accounts at the individual market level had typically been qualified not because the statements were not fairly presented, but that the assurance that can be achieved through the audit was limited.

7.54 Ofcom's view was that where the audit opinion had been qualified by way of a lesser opinion the reasons provided could not easily be addressed by improvements in BT Plc's cost accounting systems. Rather, the problems related to the inherent difficulties of attributing relatively small proportions of large shared and common costs to relatively small market or product groups.

7.55 In its statement following the initial consultation, Ofcom in 2006 implemented various changes in the regulatory reporting and auditing regime for BT which resulted in a reduction in the amount of information presented and also a reduced level of audit assurance (to a 'PPIA with' audit opinion) for some markets.[94]

The extract provides an example of some of the required audit opinions for part of BT Plc's Wholesale Market for 2008/09. (see page 108)[95]

Table 6 – Extract of Audit Opinions of BT Plc's Wholesale Market for 2008/09

Wholesale markets and illustrative services 2008/09	**Opinion**
Traditional interface symmetric broadband origination (up to and inc. 8Mbit/s)	FPIA
Traditional interface symmetric broadband origination in the Hull (above 8mbit/s up to and inc 45Mbit/s)	FPIA
Traditional interface symmetric broadband origination in the Hull (over 45Mbit/s and up to and incl. 155Mbit/s)	FPIA
Alternative Interface symmetric broadband origination (up to and including 1 Gbit/s)	FPIA
Technical areas (as necessary)	FPIA
Wholesale broadband access in hull area	FPIA

7.56 ComReg sets out below proposals for the level of audit opinion required going forward at the market, service, and product level.

Preliminary Recommendations and Consultation Questions

7.57 Given that it is ComReg's preliminary view that very limited comfort, assurance or utility can be derived from the current review arrangements of Eircom's auditors, it is of the initial view that the auditor's report and opinion on the Separated Accounts and a statement confirming Eircom's compliance with processes and procedures set out in its Accounting Document and the requirements of the accounting Direction should be included with the Separated Accounts.

7.58 **Auditor Independence**

7.59 While ComReg does not object to the regulatory auditor also being the statutory auditor, it is however important that the appointed auditor has the right skills to perform the specific audit tasks set out in the letter of engagement. Whereas the statutory auditor needs to have a good understanding of the company and the telecom industry, performance of the

94 Changes to BT's regulatory financial reporting and audit requirements, Explanatory statement and notification 16 August 2006.

95 See: 'Changes to BT and KCOM's regulatory financial reporting – 2008/09 update Explanatory statement and notification'.

regulatory audit may require different skills, such as a detailed understanding of the regulations, economic, regulatory and cost allocation expertise. Such skills therefore need to be assessed as part of the appointment process.

7.60 It is a preliminary proposal that Eircom before appointing/reappointing the regulatory auditor shall consult with ComReg and provide assurance to it that its regulatory auditor has the necessary expertise and that it fully understands what is required by the audit process in terms of Eircom meeting its regulatory obligations and indeed the consequences for non-compliance.

7.61 The consultation with ComReg should enable it assess the auditor's skills, its capability to perform the regulatory audit as well as gain assurance over the auditor's independence.

7.62 **Duty of care**

7.63 ComReg is of the preliminary opinion that it needs assurance as to the accuracy and reliability of the Separated Accounts particularly as they form the basis of price applications and reviews.

7.64 Recently and at the request of ComReg the ICAI[96] set up a working party (on behalf of its Audit and Assurance Committee) to develop an Information Sheet which will deal with this topic (amongst other audit issues). ComReg has retained consultants to assist ComReg with a review of this document and it is envisaged that this document will be finalised by the ICAI later in 2009 and will provide guidance to ComReg on audit related issues. It is envisaged that the final accounting Direction will be consistent with this guidance. However, ComReg proposes to reserve the right to set out principles and/or guidance in relation to the duty of care and the applicable audit opinions.

7.65 **Letter of engagement**

7.66 As ComReg is a significant user of Eircom's Separated Accounts, it is of the initial opinion that it should be a party to the letter of engagement.

7.67 It is proposed that the letter of engagement should set out the terms of reference for the auditor, including the scope of their work. It is proposed that this should include a requirement for the auditor/competent body to:

- verify compliance with the requirements of the accounting Direction
- review the Accounting Document on an annual basis
- audit the Separated Accounts and the Additional Financial information
- conduct an audit of Eircom's cost allocation system in accordance with the principles and guidance set out by bodies representative of the Irish accountancy profession

96 Institute of Chartered Accountants in Ireland.

- review processes and procedures employed by Eircom
- review statistical sampling processes employed to identify volumes and/or revenues.

7.68 **Audit report & opinion**

7.69 As identified above, the ICAEW (Audit 05/03) states that:

> *"a 'fairly presents in accordance with' opinion is more appropriate in circumstances of Regulatory Accounts."*

7.70 While ComReg needs to be provided with the necessary assurance that the information provided in Eircom's Separated Accounts is relevant, reliable and of a high quality, it is not its intention to impose an excessive burden on Eircom, in the form of high audit costs.

7.71 ComReg is of the preliminary opinion that the a "*Fairly presents in accordance with*" audit opinion would be the most suitable form of audit opinion for both the Separated Accounts and the Additional Financial Information in that it would give a high level of audit assurance. ComReg notes that Eircom's current Separated Accounts have an audit opinion, albeit not addressed to ComReg, to the equivalent of service level for "Retail" and "Other". ComReg, however, before making any final decision will, of course, consider the guidance from the ICAI in addition to the views of respondents.

7.72 It is however important to note that if the company appointed auditor cannot offer any opinion (FPIA or PPIA) other than at the market level, ComReg may have to appoint an independent body to perform such an audit for any particular area, for example due to upcoming price reviews.

7.73 In addition to an opinion on the Separated Accounts and the Additional Financial Information, Regulation 14(5) of the Access Regulations provides that ComReg or a suitably qualified independent body shall verify Eircom's compliance with the cost accounting obligations and ComReg shall ensure that a statement should be published annually (in its annual report) concerning such compliance. For this reason, and given the effect on its decision making process (as it increases reliance it can place on such information) ComReg proposes that Eircom should obtain such an opinion to this effect from its auditor in addition to an opinion on Eircom's compliance with the accounting Direction.

7.74 In addition and given ComReg's initial concerns with the wording of Eircom's audit report, it is proposed that the audit report should set out in greater detail the specific tasks undertaken by the auditor to satisfy itself that Eircom is complying with its obligations (e.g. the accounting Direction) including details of the systems testing undertaken to verify the appropriateness of its cost allocation/apportionment process, assessment of estimates and judgements made, application of accounting policies etc.

Q. 28. Do you agree or disagree with ComReg's preliminary proposals with regard to Auditor Independence, Duty of Care, Auditors Letter of Engagement? Please detail your response in full.

Q. 29. Do you agree or disagree with the preliminary proposal that a "Fairly Presents in Accordance with audit opinion" is appropriate for both the Separated Accounts and Additional Financial Information? Do you agree or disagree with the preliminary proposal that there is a need for ComReg to obtain an opinion with regard to Eircom's compliance with its cost accounting obligations, in addition to its compliance with the requirements of the accounting Direction? Please detail your response in full.

Q. 30. Do you agree or disagree that the audit report should set out details of the systems testing conducted, auditor assessment of estimates and judgements and the application by Eircom of accounting policies? Please detail your response in full.

8 Other Matters

Corporate Governance

8.1 Corporate governance is generally understood to refer to the set of processes, policies regulations/legal requirements affecting the way in which an organisation is administered and controlled. ComReg considers that an important aspect of corporate governance is the need to ensure the accountability of certain individuals in the organisation e.g. directors.

8.2 In the interests of maintaining good corporate governance, Eircom should clarify and make publicly known the roles and responsibilities of the Board of Directors. It is important that the Board of Directors are accountable to the stakeholders and they should be required to implement procedures to independently verify the company's financial reporting.

8.3 In this regard, it is a preliminary proposal that the Directors of Eircom include a statement in its Separated Accounts acknowledging their responsibility to prepare the Separated Accounts and verify Eircom's compliance with its legal obligations (e.g. the accounting Direction). This it is thought that this should give ComReg greater assurance as to Eircom's compliance with its regulatory responsibilities and so will improve regulatory process.

Q. 31. Do you agree or disagree that the accounting Direction should include an obligation on the Board of Directors to include a statement in the Separated Accounts acknowledging their responsibilities for the preparation of the Separated Accounts and verifying Eircom compliance with the requirements of the accounting Direction? Please detail your response in full.

Timeframe for Compliance

8.4 It is proposed that the draft accounting Direction be applicable to accounting periods commencing on and after 1 July 2009, with full compliance achieved no later than 30 June 2011.

8.5 It is initially proposed that Eircom be required to submit to ComReg its timed programme for compliance by 28 February 2010 and indicate the extent to which it can comply with each element of the Direction for the accounting period ending on 30 June 2010 and the reasons why it can't comply with any specific item.

Q. 32. What is your view of the preliminary proposed timelines for compliance? Please detail your response in full.

Draft accounting Direction

8.6 ComReg's proposal for a draft accounting Direction is set out in section 12 of this document.

Q. 33. Do you agree or disagree with the content of the proposed accounting Direction (including Annex's attached) and whether it is proportionate and justified? Please detail your response in full from a commercial, practical and legal perspective.

9 Regulatory Impact Assessment (RIA)

9.1 A Regulatory Impact Assessment (RIA) is an analysis of the likely effect of a proposed new regulation or regulatory change. The RIA should help identify regulatory options, and should establish whether proposed regulation is likely to have the desired impact. The RIA is a structured approach to the development of policy and analyses the impact of regulatory options on different stakeholders.

9.2 ComReg's approach to RIA is set out in the Guidelines published in August 2007, in ComReg Document No. 07/56 & 07/56a. In conducting the RIA, ComReg will take into account the RIA Guidelines[97], adopted under the Government's Better Regulation programme. Section 13(1) of the Communications Regulation Act 2002, as amended, requires ComReg to comply with Ministerial directions issued. Policy Direction 6 of February 2003 requires that ComReg before deciding to impose regulatory obligations on undertakings shall conduct a RIA in accordance with European and International best practice and otherwise in accordance with measures that may be adopted under the Government's Better Regulation programme.

9.3 In conducting the RIA ComReg will, as stated, have regard to the RIA Guidelines, (while recognising that regulation by way of issuing decisions e.g. imposing obligations or specifying requirements may be different to regulation exclusively by way of enacting primary or secondary legislation). In conducting RIAs, ComReg takes into account the six principles of Better Regulation - necessity, effectiveness, proportionality, transparency, accountability and consistency. To ensure that a RIA is proportionate and does not become overly burdensome, a common sense approach will be taken towards a RIA. As decisions are likely to vary in terms of their impact, if after initial investigation a decision appears to have relatively low impact, then ComReg would expect to carry out a lighter RIA in respect of those decisions.

9.4 In determining the impacts of the various regulatory options, current best practice appears to recognise that full cost benefit analysis would only arise where it would be proportionate, or in exceptional cases where robust, detailed and independently verifiable data is available. Such comprehensive review will be taken when necessary.

9.5 ComReg would like to point out that as it is not imposing a new regulatory obligation on an undertaking here, it is not mandatory therefore for it to provide a RIA. However it has decided to set out a RIA in order to demonstrate that it has considered and evaluated the alternative options available.

97 See "RIA Guidelines: How to conduct a Regulatory Impact Analysis", October 2005, www.betterregulation.ie

9.6 ComReg is of the preliminary opinion that the specification of the requirements to be complied with, relating to Accounting Separation and Cost Accounting obligations proposed to be imposed on Eircom under the Access Regulations, is appropriate, proportionate and justified given the need for 'fit for purpose' Separated Accounts, the need for Eircom to demonstrate its compliance with its legal obligations (i.e. transparency, non discrimination, price control e.g. cost orientation) and to facilitate ComReg in monitoring of such compliance.

9.7 ComReg throughout this consultation document sets out the reasons why, in its preliminary assessment, it considers that there is a need to specify the Accounting Separation and Cost Accounting obligations that should be required.

9.8 This section, together with the rest of this document represents a RIA. It sets out ComReg's preliminary assessment of the potential impacts of each proposal. ComReg has taken into account the potential impact of each proposal (see table below) on consumers, competitors and on Eircom.

9.9 **Preliminary assessment of the Regulatory Options**

9.10 ComReg is of the initial view that there are two options. Option 1 would be to do nothing and maintain the status quo. Option 2 is to impose the obligations on Eircom as now set out in the Decision Instrument/accounting Direction and as explained throughout the consultation document (which would also include superseding certain of Eircom's existing accounting obligations).

9.11 In ComReg's preliminary view Option 2 is considered a more appropriate option for the reasons set out throughout the document and as summarised below and represents the best regulatory option in terms of achieving compliance with Eircom's regulatory obligations pursuant to Regulation 12 and 14 of the Access Regulations. Option 1 cannot, in ComReg's preliminary view, be considered appropriate or justified for the reasons explained throughout this document and as summarised below. Bearing in mind ComReg's initial opinion, that it is necessary to improve and refine the current Accounting Separation and Cost Accounting obligations - in particular with a view to increasing the level of transparency of the current Separated Accounts of Eircom, by better making available adequate information on the profitability and costs of the various parts of Eircom's regulated business. ComReg considers it must amend Eircom's current regulatory accounting obligations so that Option 1 is not appropriate. ComReg is of the preliminary opinion that Option 2 should however allow Eircom's to better demonstrate its compliance with its regulatory obligations and furthermore better facilitate ComReg in monitoring such compliance than Option 1.

9.12 As with the rest of the consultation ComReg welcomes interested parties views on the RIA.

9.13 **Appropriateness/ Necessity**

9.14 Without the existence of proper accounting systems it is not possible for ComReg to ensure that the obligation of Accounting Separation is adhered to correctly and accurately. In addition, the availability of transparent accounts which ensures a proportionate distribution of all costs between markets, services and products (regulated and non-regulated) plays a vital role in enabling effective assessment of compliance with other regulatory obligations (i.e. transparency, non discrimination, price control e.g. cost orientation).

9.15 ComReg therefore considers that it is appropriate that it should issue an accounting Direction to Eircom to further specify the requirements to be followed relating to Accounting Separation and Cost Accounting obligations. It is envisaged that this will lead to the production of a set of accounts which are 'fit for purpose' while increasing ComReg's confidence in the accuracy and reliability of the results.

9.16 **Effectiveness**

9.17 The imposition of and compliance by Eircom with an accounting Direction which will clearly specify the Accounting Separation and Cost Accounting requirements to be followed will eliminate ambiguity and enable Eircom demonstrate and ComReg monitor compliance with its legal obligations more effectively. The implementation of the proposed changes will in ComReg preliminary view result in improved regulation by reflecting current best practice.

9.18 **Proportionality**

9.19 ComReg is of the opinion that its proposals (as outlined above) are not unreasonable and would not place a disproportionate burden on Eircom. In the absence of an accounting Direction, there is a risk that Eircom may increase prices of specific services/products to the detriment of other operators and consumers. Without accurate and reliable information difficulties will be encountered by ComReg in determining whether such prices are reflective of for example, the 'cost orientated' price.

9.20 In addition and given developments at international level together with developments in other regulated sectors, ComReg takes the preliminary view that Eircom needs to be issued with an accounting Direction.

9.21 It should also be noted that this accounting Direction will supersede a number of older Decisions and Directions previously imposed by the ODTR and ComReg. The effect of the accounting Direction will therefore be to impose new requirements in addition to amalgamating previous Decisions/Directions into one Decision Instrument/accounting Direction. In some instances, ComReg has relaxed specific obligations previously placed on Eircom e.g. there will no longer be a requirement for Eircom to produce half yearly accounts.

9.22 **Transparency**

9.23 ComReg considers that it has met the condition of transparency by setting out in a draft accounting Direction the proposed requirements on Eircom. It has set out in this consultation document its justification for each proposed measure and it now seeks responses from interested parties before making any final decision. ComReg will also pre-notify the European Commission of its proposals before any final decision is made.

9.24 **Accountability**

9.25 ComReg considers that it has been accountable in its assessment. It has clearly outlined its issues with existing practices, set out best practice and outlined its preliminary conclusions and recommendations. ComReg will also carefully consider the views of all respondents, will summarise these views in its Response to Consultation & Decision document and publish such submissions (subject to confidentiality).

9.26 **Consistency**

9.27 ComReg considers that it has thus far been consistent in its review by, for example paying attention to best practice.

9.28 The table below summarises the likely costs, benefits and impacts of ComReg's proposals on stakeholders.

Table 7: Summary Impact Assessment based on ComReg's preliminary assessment and initial views

	Impact on Stakeholders			
Proposal	**ComReg**	**Eircom**	**Other Operators/ Competitors**	**Consumers and End Users**
1. Accounting Separation				
Disclosure of weighted average volume figures / unit volumes on face of Separated Accounts (by market and service) and Additional Financial Information (by market service and product) together with a review of process of measurement by competent independent body.	Greater assurance as to the accuracy and reliability of the volume information (e.g. implications on unit cost calculations) as the figures (in the Separated Accounts) will be reviewed by the auditor Improved transparency.	Review of the Separated Accounts/AFI volume information will in ComReg's initial view increase costs for Eircom. Regulatory processes will improve by reducing the need for liaison with and verification/explanation by Eircom. More detailed Separated Accounts will have implications on its internal processes.	Improve confidence in accuracy of unit cost calculations and therefore price calculations.	Improve confidence in accuracy of unit cost calculations and therefore price calculations.
Disaggregation of revenues by service in the context of the Separated Accounts (and products in case of AFI's) with further analysis into direct/indirect and external revenues.	Increase disclosure in the Separated Accounts and AFI will increase transparency. Proposed collaborative approach (for the AFI) will encourage more proactive discussion with Eircom.	Facilitates a more detailed exchange of views. Don't envisage significant additional work for Eircom as this information should already be available to it	n/a	n/a
Disclosure of discounts in context of bundled services and products in the Additional Financial Information)/ Inter and intra segment transactions.	Facilitate assessment of Eircom compliance with cross subsidisation and non discrimination obligations.	Reduce the number of *ad hoc* information requests from ComReg and so improve regulatory process.	The knowledge that this information has been provided to ComReg will aid to increase confidence that no cross subsidisation or price discrimination has taken place.	The knowledge that this information has been provided to ComReg will aid to increase confidence that no cross subsidisation or price discrimination has taken place.
Level of disclosure requirements for Separated Accounts and AFI's and requirement for submission by Eircom of draft schedules to ComReg within four months of the effective date of this Direction.	Increase transparency. Provides a baseline from which to reconcile LRIC data provided for pricing purposes.	Increase level of disclosure in the Separated Accounts. More collaborate approach.	Increase in the level of information that is publicly available so increase transparency. The publication of the Separated Accounts will increase the level of transparency for OAO's especially in relation to the transfer charges incurred by Eircom (so ensure no discrimination between internal and external customers). This in turn may incentivise them to invest further in their networks as they will be better able to assess how they might compete with Eircom.	Increase in the level of information that is publicly available and so increase transparency.

	Impact on Stakeholders			
Proposal	**ComReg**	**Eircom**	**Other Operators/ Competitors**	**Consumers and End Users**
Accounting Separation Contd….				
Reconciliation of CCA Separated Accounts with HCA Separated Accounts for each market and reconciliation of HCA Separated Accounts with the statutory financial accounts, identifying all items relating to non regulated businesses and other items which are not relevant to the accounting period that have been excluded from the Separated Accounts.	Assurance that costs, revenues and volumes have not been double counted. Improve understanding of differences between accounts. Increase transparency.	Information should be available from Eircom's accounting system so don't envisage any significant cost for Eircom. Reduction in number of *ad hoc* information requests	n/a	n/a
Elimination of the need for disclosure of the Regulated Return Adjustment on the face of the Separated Accounts. Balance sheet should be prepared on an 'as at' basis with MCE and actual return been shown as supplementary information by way of note to the Separated accounts.	Facilitate comparison of actual returns with regulated returns. Reflect under/over returns of Eircom. Increased transparency of accounts.	Information should be available from Eircom's accounting system so don't envisage any significant cost for Eircom.	n/a	n/a
Disclosure of information in the Separated Accounts with regard to the basis of preparation, commentary and narrative explanations etc.	Improve understanding of results. Reduce the need for *ad hoc* information requests.	Improve ComReg understanding of Eircom processes and so reduce the number of *ad hoc* information / clarification requests.	n/a	n/a
Separated Accounts to be prepared in accordance with Regulatory Accounting Principles (based on odtr document 99/35).	Greater clarity of rules by which accounts are to be prepared.	Eircom is already required to comply with this obligation (as per 99/35) so there would be no further impact.	Improve understanding of accounts.	Improve understanding of accounts.
Disclosure of profit /loss on disposal of non current assets at the market level where the depreciation was charged.	Ensure compliance with the cost causality principle. Prevent cross subsidisation.	Need for Eircom to change its accounting treatment of such items but don't envisage any significant cost in doing so.	Greater confidence in the accuracy and reliability of accounts and therefore pricing decisions.	Greater confidence in the accuracy and reliability of accounts and therefore pricing decisions.

	Impact on Stakeholders			
Proposal	**ComReg**	**Eircom**	**Other Operators/ Competitors**	**Consumers and End Users**
Accounting Separation Contd….				
CCA Accounts for the Access unit (i.e. Wholesale access, LLU and WBA markets) together with CCA accounts for each regulated service using the FCM approach.	Facilitate reconciliation with the LRIC costing data provided to support price applications. Improve transparency of the Separated Accounts. FCM is the more relevant concept.	Improve regulatory process by reducing the number of *ad hoc* information requests. Eircom is already applying FCM so no additional cost is envisaged.	n/a	n/a
Reconciliation of CCA and other costing data (e.g. LRIC) information by service/product as part of the AFI's.	Reduction in the number of *ad hoc* information /clarification requests. Improve processes.	Reduces the need for *ad hoc* requests.	n/a	n/a
Life to date holding gains/losses to be amortised over the remainder of asset's life.	Reflects more appropriately the impact on stakeholders and the profitability of markets. More objective approach.	Impact on Eircom's accounting policy.	Implications on pricing decisions.	Implications on pricing decisions.
Level of granularity of CCA accounts to be consistent with HCA accounts.	Facilitates reconciliation of accounts. Facilitate ComReg in assessing Eircom compliance with its legal obligations.	Reduce the need of ad hoc information requests. Improve efficiency and effectiveness of regulatory process.	n/a	n/a
Statement of Directors	Greater assurance as to Eircom compliance with the proposed accounting Direction.	Improve regulatory process.	Greater assurance as to Eircom compliance with the proposed accounting Direction.	Greater assurance as to Eircom compliance with the proposed accounting Direction.

	Impact on Stakeholders			
Proposal	**ComReg**	**Eircom**	**Other Operators/ Competitors**	**Consumers and End Users**
Accounting Separation Contd…. Submission to ComReg and publication of Separated Accounts and submission of AFI's within five months after the end of the first financial year from the effective date and four months for all subsequent financial years.	Maintains usefulness of accounts. Improve efficiency of monitoring compliance.	Timeline from second year onwards may be an issue for Eircom. This will involve additional work for Eircom in producing its Separated Accounts but it will be more than offset by improvements in regulatory process.	n/a	n/a
Eircom shall consult with ComReg before the appointment/reappointment of the regulatory auditor and provide assurance that the regulatory auditor has the necessary expertise.	Enable ComReg assess skills of auditor, capability to perform audit and gain assurance as to the capability of the auditor.	Process of auditor appointment will change but don't envisage significant extra cost or work for Eircom.	n/a	n/a
Before deciding on the duty of care of Eircom auditors to ComReg, ComReg shall take account of guidance from bodies representative of the Irish accountancy professions from time to time.	Impact will depend on decision.	Impact will depend on decision.	n/a	n/a
The choice of audit opinion will be determined following consideration of the ICAI proposals Such opinions shall be included as part of the accounts and should include details of the tasks performed and conclusions reached by the competent body.	An audit opinion will give ComReg greater confidence in the accuracy and reliability of the Separated Accounts and Eircom's compliance with its obligations. Increased transparency.	Depending on the level of audit opinion, this may be at an additional cost to Eircom but will be offset by a reduction in the number of *ad hoc* requests from ComReg and the associated labour costs. Improve regulatory process.	n/a	n/a

	Impact on Stakeholders			
Proposal	**ComReg**	**Eircom**	**Other Operators/ Competitors**	**Consumers and End Users**
Accounting Separation Contd….				
Inclusion of reconciliation statement of quarterly report volume figures with that contained in the Separated Accounts in the AFI together with explanations of differences.	Increase transparency of information. Improve ComReg understanding and so reduce the need for ad hoc information requests.	Improve regulatory process by reducing number of ad hoc information requests.	n/a	n/a
Non regulated accounts (market, service and/or product levels) to be provided as part of AFI's.	Enables ComReg assess whether there are any cross subsidisation, margin squeeze or predatory pricing issues. Increase confidence in Separated Accounts and so improve regulatory process.	This information should be readily available to Eircom so it is not envisaged that there will be significant additional cost. Improve regulatory process.	The knowledge that this information is provided to ComReg will increase confidence in the costing data which provides a baseline for reconciliation with LRIC information.	The knowledge that this information is provided to ComReg will increase confidence in the costing data which provides a baseline for reconciliation with LRIC information.

	Impact on Stakeholders			
Proposal	**ComReg**	**Eircom**	**Other Operators/ Competitors**	**Consumers and End Users**
2. Accounting Document				
Document the processes and procedures to be used in the preparation of the Separated Accounts and obtain ComReg's advance approval for the first two years following implementation and as part of the Separated Accounts thereafter. Only the Primary document being published.	Increase transparency.	In the first year it is envisaged that this may be a lot of work for Eircom however it should only require update and review thereafter. Maintaining confidentiality by only requiring the Primary document to be published.	The provision of such information and the consequential review by ComReg should in ComReg's initial view aid to increase confidence in the accuracy of the costing data at the service and product levels which drives wholesale and retail pricing.	The provision of such information and the consequential review by ComReg will give added assurance that retail prices are cost orientated.
Level of statistical reliability should be consistent with ComReg requirements.	Increase confidence and understanding of process of unit cost calculations at the service and/or product levels.	Reduction in the number of *ad hoc* information/clarification requests.	n/a	n/a
Sampling Principles to be applied.	Increase reliability that sample results are representative of the population being sampled.	ComReg does not envisage any additional cost as this is something that should be considered as part of Eircom's sampling prices.	Increase confidence in accuracy and reliability of data which forms a base line for pricing decisions.	Increase confidence in accuracy and reliability of data which forms a base line for pricing decisions.
Inter /intra segment transactions should comply with the Transfer Pricing Principles.	Greater assurance that there is no cross subsidisation between markets, services and products.	ComReg does not envisage any additional cost as this has been broadly based on Decision 3.11 of odtr document 99/35.	Compliance by Eircom with these principles will increase confidence in the accuracy and reliability of costing data and therefore pricing.	Compliance by Eircom with these principles will increase confidence in the accuracy and reliability of costing data and therefore pricing.

	Impact on Stakeholders			
Proposal	**ComReg**	**Eircom**	**Other Operators/ Competitors**	**Consumers and End Users**
3. Cost Allocation & Apportionment				
Analysis of network elements and functional costs into costs directly allocated, common costs which have been allocated on the basis of indirect analysis and common costs which have been allocated on the basis of an EPMU (this should be disclosed in the Accounting Document and included as part of the Additional Financial Information provided in confidence to ComReg).	Facilitates assessment of appropriateness of cost allocations and apportionments including relevance of cost drivers. Facilitate assessment as to whether there are any issues of cross – subsidisation or price discrimination between markets, services or products.	Increased level of disclosure will improve transparency and therefore reduce the number of *ad hoc* information requests from ComReg. Improve regulatory process.	Greater confidence in the appropriateness of Eircom's processes given that they are subject to review by ComReg.	Greater confidence in the appropriateness of Eircom's processes given that they are subject to review by ComReg.
Fully Distributed Cost base shall be applied	Increase ComReg confidence that all services and products receive its direct cost and its share of indirect and common costs. Improve transparency. Facilitate assessment of any issue of cross subsidisation or non discrimination.	Reduce number of ad hoc information requests. Improve regulatory process.	Increase confidence in accuracy of unit cost calculations which would impact pricing decisions.	Increase confidence in accuracy of unit cost calculations which would impact pricing decisions.
Choice of functional cost categories and listing of manual journal entries	Facilitate a greater analysis of costs Greater transparency.	May need to amend the process in which information is extracted from the general ledger accounts. This cost would however be offset by improved transparency and therefore improved regulatory process. Reduce number of clarification requests	n/a	n/a
Development of a 'Schedule of Network Components', 'Network Statement of Costs' and a 'Usage by Service Schedule' for all markets, services and products and submit to ComReg within 4 months of effective date of the Direction for ComReg's review. Submission thereafter as part of AFI's.	Improve ComReg understanding of Eircom's attribution methodologies. Facilitate ComReg's assessment of the allocation and apportionment of the cost of network elements to the service and product levels.	This information should be readily available to Eircom so don't envisage significant additional costs to Eircom. Greater transparency will improve regulatory process.	n/a	n/a

	Impact on Stakeholders			
Proposal	**ComReg**	**Eircom**	**Other Operators/ Competitors**	**Consumers and End Users**
4.Timeline for Compliance	Eircom provide 'fit for purpose' Separated Accounts. Positive implications for regulatory process.	Will give directors assurance that compliance is achieved in a timely manner.	n/a	n/a

9.29 ComReg invites comments from interested parties on the above regulatory impact assessment and its underlying analysis.

Q. 34. Respondents are requested to provide views on whether there are other factors (if any) that ComReg should consider in completing its Regulatory Impact Assessment? Please detail your response in full.

Q. 35. Respondents are requested to provide views on the likely cost of full compliance with the proposed accounting Direction. Please detail your response in full.

10 Submitting Comments

10.1 All comments are welcome, however it would make the task of analysing responses easier if comments were referenced to the relevant question numbers from this document.

10.2 The consultation period will run from 5 October 2009 to 4 December 2009 during which time the Commission welcomes written comments on any of the issues raised in this paper.

10.3 Having analysed and considered the comments received, ComReg will review the Accounting Separation and Cost Accounting obligations and will publish a report on the consultation which will, *inter alia* summarise the responses to the consultation and attach a final accounting Direction to Eircom.

10.4 In order to promote further openness and transparency ComReg will publish all respondents' submissions to this consultation, subject to the provisions of ComReg's guidelines on the treatment of confidential information – ComReg 05/24. We would request that electronic submissions be submitted in an unprotected format so that they can be appended into the ComReg submissions document for publishing electronically.

Please note

10.5 ComReg appreciates that many of the issues raised in this paper may require respondents to provide confidential information if their comments are to be meaningful.

10.6 As it is ComReg's policy to make all responses available on its web-site and for inspection generally, respondents to consultations are requested to clearly identify confidential material and place confidential material in a separate annex to their response

10.7 Such Information will be treated subject to the provisions of ComReg's guidelines on the treatment of confidential information – ComReg 05/24.

11 Legal Background

The legal basis allowing for the establishment of specific requirements relating to Accounting Separation and Cost Accounting Obligations of Eircom is set out as follows:

Access Regulations

Regulation 12 of the Access Regulations includes obligations relating to accounting separation. It provides:

> "*12 (1) The Regulator may in accordance with Regulation 9 impose on an operator obligations for accounting separation in relation to specified activities relating to interconnection, access or both interconnection and access.*
>
> *(2) without prejudice to the generality of paragraph (1), the Regulator may require an operator which is vertically integrated to make transparent its wholesale prices and its internal transfer prices, inter alia, to ensure compliance with any obligation imposed under Regulation 11 or, where necessary, to prevent unfair cross subsidy and, where it does so, may specify the format and accounting methodology to be used.*
>
> *(3) A requirement upon an operator under Regulation 17 of the Framework Regulations may, in order to facilitate the verification of compliance by an operator with any obligations of transparency under Regulation 10 and non-discrimination under Regulation 11, include a requirement that accounting records, including data on revenues received from third parties, are provided by any such operator to the Regulator on request.*
>
> *(4) Subject to the protection of the confidentiality of any information which the Regulator considers confidential, the Regulator may publish any information obtained by it under paragraph (3) to the extent that the Regulator considers that such information would contribute to an open and competitive market."*

Regulation 14 of the Access Regulations includes obligations relating to cost recovery and price controls and the obligation for cost oriented prices. It also provides for obligations concerning cost accounting systems. It provides:

> "*14. (1) The Regulator may in accordance with Regulation 9 impose on an operator obligations relating to cost recovery and price controls, including obligations for cost orientation of prices and obligations concerning cost accounting systems, for the provision of specific types of interconnection, access or both such interconnection and access in situations where a market analysis indicates that a lack of effective competition means that the operator concerned might sustain prices at an excessively high level, or apply a price squeeze to the detriment of end-users.*
>
> *(2) When considering the imposition of obligations under paragraph (1), the Regulator shall, take into account any investment made by the operator in electronic communications networks or services or associated facilities which the Regulator considers relevant and allow the operator a reasonable*

rate of return on adequate capital employed, taking into account the risks involved.
(3) The Regulator shall ensure that any cost recovery mechanism or pricing methodology that it imposes under this Regulation serves to promote efficiency and sustainable competition and maximise consumer benefits. In this regard, the Regulator may also take account of prices available in comparable competitive markets.
(4) Where an operator has an obligation under this Regulation regarding the cost orientation of its prices, the burden of proof that charges are derived from costs, including a reasonable rate of return on investment shall lie with the operator concerned. For the purpose of calculating the cost of efficient provision of services, the Regulator may use cost accounting methods independent of those used by the operator. The Regulator may issue directions requiring an operator to provide full justification for its prices, and may, where appropriate require prices to be adjusted.
(5) The Regulator shall ensure that, where implementation of a cost accounting system is imposed under this Regulation in order to support price controls, a description of the cost accounting system is made publicly available, showing at least the main categories under which costs are grouped and the rules used for the allocation of costs. Compliance with the cost accounting system shall, at the choice of the Regulator, be verified by the Regulator or by a suitably qualified independent body.
(6) The Regulator shall cause to be published annually a statement concerning compliance with any cost accounting system imposed under this Regulation."

Regulation 17: Direction

Under Regulation 17 of the Access Regulations ComReg may:

"…for the purposes of specifying requirements to be complied with relating to an obligation imposed by or under these Regulations, issue directions to an undertaking to do or refrain from doing anything which the Regulator specifies in this direction"

SMP obligations:

Eircom has been designated with significant market power (SMP) on various markets and has had various SMP obligations, including obligations pursuant to Regulations 12 and 14 of the Access Regulations imposed on it following a market analysis including the following:

- *Wholesale unbundled access (including shared access) to metallic loops and sub-loops; Decision D8/04, ComReg Document Number 04/70;*
- *Wholesale Terminating Segments of Leased Lines; Decision D06/08 ComReg Document Number* 08/103*;*
- *Wholesale Fixed Wholesale Call Termination, Decision D06/07, ComReg Document Number 07/109;*
- *Wholesale Call Origination & Transit Services, Decision D 04/07, ComReg Document Number 07/80;*

- *Retail minus wholesale price control for the WBA market Decision D01/06, ComReg Document Number 06/01;*
- *Wholesale Broadband Access Decision D03/05, ComReg Document Number 03/05 05/11r;*
- *Retail Price Cap Remedy Fixed Narrowband Access Markets. Decision D 03/07, ComReg Document Number 07/76; and*
- *Market Analysis: Retail Fixed Narrowband Access Markets, Decision D07/61, ComReg Document Number 07/61.*

Universal Service Regulations

Regulation 14 of the Universal Service Regulations includes obligations relating to accounting separation. It provides:

Regulation 14: Regulatory controls on retail markets

14. "*(1) Where - (a) the Regulator determines, as a result of a market analysis carried out by it in accordance with Regulation 27 of the Framework Regulations, that a given retail market identified in accordance with Regulation 26 of the Framework Regulations is not effectively competitive, and (b) the Regulator concludes that obligations imposed under the Access Regulations or Regulation 16 of these Regulations would not result in the achievement of the objectives set out in section 12 of the Act of 2002, the Regulator shall impose such obligations as it considers appropriate to achieve those objectives on undertakings identified by the Regulator under Regulation 27(4) of the Framework Regulations as having significant market power on a given retail market.*

(2) Any obligations imposed by the Regulator pursuant to paragraph (1) shall be based on the nature of the problem identified pursuant to the market analysis and be proportionate and justified in the light of the objectives set out in section 12 of the Act of 2002 and may include requirements to ensure that the undertaking concerned does not –

(a) charge excessive prices,
(b) inhibit market entry or restrict competition by setting predatory prices,
(c) show undue preference to specific end-users, or
(d) unreasonably bundle services.

(3) The Regulator may require an undertaking to which paragraph (1) applies to comply with -

(i) measures to control individual tariffs, or
(ii) measures to orient tariffs towards costs or prices on comparable markets,

in order to protect end-users' interests whilst promoting effective competition.

(4) The Regulator shall, on request, provide information to the European Commission concerning any retail controls applied and, where appropriate, the cost accounting systems used by the undertakings concerned.

(5) An undertaking that is subject to retail tariff regulation or other relevant retail control shall operate and maintain a cost accounting system that is-

(i) based on generally accepted accounting practices,
(ii) is suitable for ensuring compliance with this Regulation, and
(iii) is capable of verification by the Regulator.

(6) The Regulator may specify the format and accounting methodology to be used by an undertaking to which paragraph (5) applies.

(7) Compliance by an undertaking with a cost accounting system referred to in paragraph (5) shall be verified by a qualified independent body. For this purpose, the Regulator may carry out an audit itself , provided it has the necessary qualified staff, or it may require an audit to be carried out by another qualified body, independent of the undertaking concerned.

(8) An undertaking to which paragraph (5) applies shall publish in its annual accounts a statement concerning compliance by it with a cost accounting system referred to in paragraph (5).”

Regulation 31: Directions
31. (1) The Regulator may, for the purpose of further specifying requirements to be complied with relating to an obligation imposed by or under these Regulations, issue directions to a person to do or refrain from doing anything which the Regulator specifies in the direction.

Framework Regulations:

In addition it can be noted from Regulation 24 of the Framework Regulations that Eircom has a duty to maintain Separated Accounts in accordance with that provision.

Regulation 24: Accounting separation and financial reports
“24 (1) An undertaking providing a public communications network or a publicly available electronic communications service, that is also engaged in an activity other than the provision of such network or service on the basis of special or exclusive rights for the provision of that activity whether in the State or in another Member State shall -

(a) keep separate accounts audited in accordance with generally accepted auditing practices for the activities associated with the provision of that network or service, to the extent that would be required if those activities were carried out by one or more legally independent companies, so as to identify all elements of cost and revenue, with the basis of their calculation and the detailed attribution methods used, related to its activities associated with the provision of electronic communications networks or services including an itemised breakdown of fixed asset and structural costs, or

(b) have structural separation for the activities associated with the provision of electronic communications networks or services."

Regulation 34: Directions

34. (1) The Regulator may, for the purpose of further specifying requirements to be complied with relating to an obligation imposed by or under these Regulations, issue directions to an undertaking to do or refrain from doing anything which the Regulator specifies in the direction.

Ad hoc Decisions and Directions

Various ad hoc Decisions and Directions have also been imposed on Eircom.

12 Draft accounting Direction

The Secretary

Eircom Limited

1 Heuston South Quarter

St. John's Road

Dublin 8

Direction addressed to Eircom Limited

NOTE: ***This Draft Direction is for information purposes only and is not the final Direction. Respondents to the consultation are asked to provide their detailed views from a commercial, practical and legal perspective in relation to the Draft Direction.***

1. Statutory and Legal Powers

1.1 This Direction is made by the Commission for Communications Regulation:

i. Pursuant to Regulations 9, 10, 12, 14 and 17 of the European Communities (Electronic Communications Networks and Services) (Access) Regulations 2003[1]; and/or pursuant to Regulations 24 and 34 of the European Communities (Electronic Communications Networks and Services) (Framework) Regulations 2003[2]; and/or or pursuant to Regulations 14 and 31 of the European Communities (Electronic Communications Networks and Services) (Universal Service) Regulations 2003[3]; and/or pursuant to the functions set out under Section 10 of the Communications Regulations 2002[4];

ii. Having particular regard to the Significant Market Power (SMP) designations on Eircom Limited which found Eircom Limited to have SMP under the provisions of Regulations 25, 26 and 27 of the European Communities (Electronic Communications Networks and Services) (Framework) Regulations 2003 from time to time, and the cost accounting and price control obligations imposed on Eircom Limited further to Regulations 12 and 14 of the European Communities (Electronic Communications Networks and Services) (Access) Regulations 2003, including as contained in:

1 European Communities (Electronic Communications Networks and Services) (Access) Regulations 2003 (S.I. No. 305 of 2003), amended by the European Communities (Electronic Communications Networks and Services) (Access) (Amendment) Regulations 2007 (S.I. No. 373 of 2007).
2 European Communities (Electronic Communications Networks and Services) (Framework) Regulations 2003 (S.I. No. 307 of 2003), amended by the European Communities (Electronic Communications Networks and Services) (Framework) (Amendment) Regulations 2007 (S.I. No. 271 of 2007)
3 European Communities (Electronic Communications Networks and Services) (Universal Service) Regulations 2003 (S.I. No. 308 of 2003), amended by the European Communities (Electronic Communications Networks and Services) (Universal Service) (Amendment) Regulations 2007 (S.I. No. 373 of 2007).
4 Communications Regulation Act, 2002 as amended by the Communications Regulation (Amendment) Act 2007.

a) *Wholesale unbundled access (including shared access) to metallic loops and sub-loops; Decision D8/04, ComReg Document Number 04/70;*

b) *Wholesale Terminating Segments of Leased Lines; Decision D06/08 ComReg Document Number* 08/103*;*

c) *Wholesale Fixed Wholesale Call Termination, Decision D06/07, ComReg Document Number 07/109;*

d) *Wholesale Call Origination and Transit Services, Decision D 04/07, ComReg Document Number 07/80;*

e) *Retail minus wholesale price control for the WBA market Decision D01/06, ComReg Document Number 06/01;*

f) *Wholesale Broadband Access Decision D03/05, ComReg Document Number 03/05 05/11r;*

g) *Retail Price Cap Remedy Fixed Narrowband Access Markets. Decision D 03/07, ComReg Document Number 07/76;* and

h) *Market Analysis: Retail Fixed Narrowband Access Markets, Decision D07/61, ComReg Document Number 07/61.*

iii. Having, where appropriate, pursuant to section 13 of the Communications Regulation Act, 2002 complied with Policy Directions made by the Minister[5];

iv. Having taken account of the submissions received in relation to Document No. []

v. Having had regard to the analysis and reasoning set out in ComReg Document No. [] which shall, where necessary, be construed together with this Direction;

vi. Having had regard to the provisions of and the individual decisions in the Response to Consultation and Decision in ComReg Document No. [ ] (Decision No. [ ]), which shall, where necessary, be construed together with this Direction;

vii. Having notified the draft measure to the European Commission, further to Regulation 20 of the Framework Regulations, whereby it was also made accessible to national regulatory authorities in other EU Member States, and the European Commission having informed the Commission for Communications Regulation that it had examined the draft measure and that it had no comments in relation thereto and that pursuant Article 7 of the Framework Directive[6], ComReg could adopt the resulting draft measure; and

viii. Having regard to its functions and objectives under sections 10 and 12 respectively of the Communications Regulation Act, 2002.

5 Policy Directions made by the Minister for Communications, Marine and Natural Resources on 21 February, 2003 and 26 March, 2004.

6 Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive) (2002/21/EC, OJ L 108, 24.4.2002, p.33).

2. Definition and Interpretation

2.1 In this Direction, unless otherwise indicated:

- "Access Regulations" means the European Communities (Electronic Communications and Network Services) (Access) Regulations, 2003 (S.I. No. 305 of 2003) as amended by the European Communities (Electronic Communications Networks and Services) (Access) (Amendment) Regulations 2007 (S.I. No. 373 of 2007)

- "Accounting Policies" means the specific policies and procedures used by a company to prepare its accounts

- "Accounting Separation Obligation" means the obligations set out in Regulation 12 of the Access Regulations

- "Act" shall mean Communications Regulation Act 2002

- "Additional Financial Information" means the accounting information that shall be provided by Eircom as determined by ComReg on an annual basis

- "Attribution Methods" refers to the method employed to allocate and apportion costs to the market, service and product levels

- "CCA" means Current Cost Accounts

- "ComReg" means the Commission for Communications Regulation established under section 6 of the Communications Regulation Act, 2002 as amended by the Communications Regulation (Amendment) Act 2007

- "Confidence level" informs of the accuracy of the results of any sample

- "Consistency" means that 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 Markets, the parts of the previous year's Financial Statements affected by the changes shall be restated

- "Cost Causality" means that revenues (including transfer charges), costs (including transfer charges), assets and liabilities shall be attributed to markets, services, products and cost components 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

- "Non-Discrimination Obligation" means the obligations set out in Regulation 11 of the European Communities (Electronic Communications and Network Services) (Access) Regulations, 2003 (S.I. No. 305 of 2003) as amended by the European Communities (Electronic Communications Networks and Services) (Access) (Amendment) Regulations 2007 (S.I. No. 373 of 2007)

- "Effective Date" shall have the meaning prescribed in Section 12 of this Direction

- "Equi-Proportional Mark Up" is a method of allocating the joint or common costs to a service or product in proportion to the costs already assigned

- "Financial Accounts" means the statutory accounts of Eircom

- "Financial Statements" means the records of the company which records its activities over a period of time and which include its profit and loss accounts and balance sheet

- "Financial Capital Maintenance Concept" means that the financial capital of the company is considered as maintained in current price terms. Capital is assumed to be maintained if shareholders' funds at the end of the period are maintained in real terms at the same level as at the beginning of the period[7]

- "Framework Regulations" means the European Communities (Electronic Communications Networks and Services) (Framework) Regulations 2003, S.I. No. 307 of 2003) as amended by the European Communities (Electronic Communications Networks and Services) (Framework) (Amendment) Regulations 2007 (S.I. No. 271 of 2007)

- "FDC" means fully distributed cost

- "HCA" means Historical Cost Accounts

- "LRIC" means long run incremental cost

- "Markets" shall mean relevant markets, i.e. those markets where Eircom Limited has obligations under Regulations 12 and 14 of the Access Regulations, and Regulation 14 of the Universal Service Regulations (as appropriate) pursuant to various SMP Decisions from time to time

- "Mean Capital Employed" means the average of fixed assets less short term liabilities at the beginning and end of the relevant period

7 ERG Common Position Paper, paragraph 3.2.3.

- "Network Activity Statement" refers to a statement which details the average unit cost (amongst other things) for each network component/element listed in the Schedule of Network Components

- "Network Element" (network components) means the functional link between the network plant and equipment and the services that are provided to customers using that network plant

- "Objectivity" means that the choice of attribution methods shall be objective and not be intended to benefit the SMP operator or any other Operator, market, service product, or component

- "ODTR" means the Office of the Director of Telecommunications Regulation, which was dissolved under Section 8 of the Communications Regulation Act, 2002

- "Regulated Price List" means the price list as per Eircom's Wholesale website

- "Price Control and Cost Accounting Obligations" means the obligations set out in Regulation 14 of the Access Regulations

- "Primary Accounting Documents" means those documents now set out at sections 8.2.1 and 8.4 herein

- "Product" for the purpose of this Direction shall mean a sub-set or part of a "Service" or shall have its ordinary English meaning and as set out herein

- "regulated" means subject to *ex-ante* or *ex-post* regulation by ComReg

- "Regulatory Accounting Principles" refers to the principles that should be adhered to when preparing the Separated Accounts set out in section 6.1.2 herein

- "Schedule of Network Components" refers to a schedule setting out a detailed description of Eircom's network components (and which description shall include but is not limited to details of the component name, location, cost, utilisation and similar related matters)

- 'Secondary Accounting Documents' means those documents now set out at sections 8.2.2 and 8.5 herein

- "Separated Accounts" means the regulatory accounts, reflecting the actual costs incurred in the provision of a service and or product in a particular accounting period and meeting the requirements set out in the section 5 of this Direction entitled 'Fundamental requirements and Further Specification of SMP Obligation now imposed'

- “Service” for the purposes of this Direction shall mean any service provided by Eircom Limited and includes “Product” and as set out herein

- “SMP Decisions” mean ComReg Decisions from time to time which found or finds Eircom to have SMP under the provisions of Regulations 25, 26 and 27 of the Framework Regulations and which imposed from time to time obligations in relation to accounting separation, price control and cost accounting pursuant to Regulations 12 and 14 of the Access Regulations and include, for example:

  a. *Wholesale unbundled access (including shared access) to metallic loops and sub-loops; Decision D8/04, ComReg Document Number 04/70;*

  b. *Wholesale Terminating Segments of Leased Lines; Decision D06/08 ComReg Document Number 08/103;*

  c. *Wholesale Fixed Wholesale Call Termination, Decision D06/07, ComReg Document Number 07/109;*

  d. *Wholesale Call Origination and Transit Services, Decision D 04/07, ComReg Document Number 07/80;*

  e. *Retail minus wholesale price control for the WBA market Decision D01/06, ComReg Document Number 06/01;*

  f. *Wholesale Broadband Access Decision D03/05, ComReg Document Number 03/05 05/11r;*

  g. *Retail Price Cap Remedy Fixed Narrowband Access Markets. Decision D 03/07, ComReg Document Number 07/76; and*

  h. *Market Analysis: Retail Fixed Narrowband Access Markets, Decision D07/61, ComReg Document Number 07/61;*

- “Transparency Obligation” means the obligations set out in Regulation 10 of the European Communities (Electronic Communications and Network Services) (Access) Regulations, 2003 (S.I. No. 305 of 2003) as amended by the European Communities (Electronic Communications Networks and Services) (Access) (Amendment) Regulations 2007 (S.I. No. 373 of 2007)

- “Usage by Service Schedule” refers to a schedule which sets out the usage made of each network component/element by each service or product.

3. Scope and applications

3.1 This Direction applies to Eircom Limited and its subsidiaries, its successors and assigns and any undertaking which it owns or controls and any undertaking which owns or controls Eircom Limited, and its successors and assigns (“Eircom”).

3.2 This Direction is binding upon Eircom and Eircom shall comply with it in all respects.

3.3 If any section, clause or provision or portion thereof contained in this Direction is found to be invalid or prohibited by the Constitution, by any other law or judged by a court to be unlawful, void or unenforceable, that section, clause or provision or portion thereof shall, to the extent required, be severed from this Direction and rendered ineffective as far as possible without modifying the remaining section(s), clause(s) or provision(s) or portion thereof of this Direction, and shall not in any way affect the validity or enforcement of this Direction.

4. Accounting Separation, Price Control and Cost Accounting

4.1 The regulatory obligations owed and the SMP Decisions imposed inter alia ex ante regulatory obligations pursuant to Regulations 12 and 14 of the Access Regulations, Regulation 14 of the Universal Service Regulations and the obligations pursuant to Regulation 24 of the Framework Regulations. The obligations in particular imposed from time to time on Eircom under Regulations 12 and 14 of the Access Regulations include obligations relating to accounting separation, price control, cost orientation of prices and cost accounting.

4.2 Pursuant to Regulation 17 of the Access Regulations; and/or Regulation 34 of the Framework Regulations; and/or Regulation 31 of the Universal Service Regulations ComReg may issue Directions to Eircom to do or refrain from doing anything which ComReg specifies in the Direction, for the purpose of further specifying requirements to be complied with by Eircom relating to its obligations under the respective Regulations.

4.3 This Direction is issued pursuant to Regulation 17 of the Access Regulations, and/or Regulation 34 of the Framework Regulations; and/or Regulation 31 of the Universal Service Regulations for the purpose of further specifying requirements to be complied with by Eircom relating to obligations imposed on Eircom, under Regulation 12 and Regulation 14 of the Access Regulations; and/or Regulation 24 of the Framework Regulation; and/or Regulation 14 of the Universal Service Regulations.

4.4 Eircom is hereby directed to meet the obligations now imposed at Sections 5 to 12 (inclusive) herein for the purposes of the preparation of Eircom's Separated Accounts and for the purposes of its obligations under Regulation 12 and Regulation 14 of the Access Regulations; and/or Regulation 24 of the Framework Regulation; and/or Regulation 14 of the Universal Service Regulations.

4.5 Annex 1 to this Decision Instrument sets out the previous individual Decisions or Directions on accounting separation, price control and cost accounting either adopted by ComReg or the ODTR which are hereby withdrawn and/or superseded in respect of the accounting separation, price control and cost accounting obligations now imposed. The obligations at Sections 5 to 12 of this Direction shall now apply.

4.6 Annex 2 to this Decision Instrument sets out the previous individual Decisions or Directions on accounting separation, price control and cost accounting either adopted by ComReg or the ODTR which are hereby maintained.

4.7 This Decision Instrument shall apply 28 days after the Effective Date.

4.8 For the avoidance of doubt, this Direction applies *inter alia* in all circumstances where ComReg finds, from time to time, Eircom to have SMP under the provisions of Regulations 25, 26 and 27 of the Framework Regulations (or such equivalent provision) and imposes, from time to time, an obligation in relation to accounting separation pursuant to Regulation 12 of the Access Regulations and/or price control and cost accounting pursuant to Regulation 14 of the Access Regulations and/or pursuant to Regulation 24 of the Framework Regulation and Regulation 14 of the Universal Service Regulation.

5. Fundamental Requirements and Further Specification of SMP Obligation now imposed

5.1 Pursuant to Regulations 12 and 14 of the Access Regulations, Regulation 14 of the Universal Service Regulations and Regulation 24 of the Framework Regulations, Eircom's financial records and accounting systems shall be sufficiently detailed to ensure that:

a) all decisions (accounting separation, cost accounting and pricing) are supported by sufficient data to enable Eircom management ensure that they comply with the Transparency, Non-Discrimination, Accounting Separation, Price Control and Cost Accounting obligations

b) ComReg can monitor compliance with the Transparency, Non-Discrimination, Accounting Separation, Price Control and Cost Accounting obligations

c) Separated Accounts can be maintained for each of the regulated Markets and Services.

5.2 The financial records and accounting information shall be maintained in sufficient detail to facilitate a detailed analysis, on a Market, network element, Service and Product basis (regulated and unregulated), to demonstrate compliance with its obligations, including obligations of transparency, cost orientation and non-discrimination.

6.Reporting and Transparency

6.1 Separated Accounts

6.1.1 Without prejudice to the generality of Section 5, Eircom shall in accordance with Regulation 12 and Regulation 14 of the Access Regulations, provide to ComReg audited final Separated Accounts, disaggregated to the level of regulated Service(s), and shall publish such accounts on its web site five months after the end of the first financial year from the effective date and for all subsequent financial years, four months after the financial year end.

6.1.2 Eircom's audited final Separated Accounts shall contain:

a) explanations (such as by way of notes or longer form narrative as may be necessary) setting out and clarifying, at a minimum:

- trends relating to Markets and Services, expected significant future events and how these might impact Eircom's business and the extent to which (if any) this explains Eircom's Separated Accounts
- trends relating to revenue, by Market and Service and the extent to which (if any) this explains Eircom's Separated Accounts
- trends relating to volumes, by Market and Service and the extent to which (if any) this explains Eircom's Separated Accounts
- significant year on year movements in the reported performance and balances and the extent to which (if any) this explains Eircom's Separated Accounts

- one-off or exceptional events in the year and the extent to which (if any) this explains Eircom's Separated Accounts
- significant or large adjustments made to produce the Separated Accounts and the extent to which (if any) this explains Eircom's Separated Accounts
- the impact of changes in accounting policies, methodologies and estimation techniques and the extent to which (if any) this explains Eircom's Separated Accounts.

b) a comprehensive explanation of the basis of preparation of the Separated Accounts, including an explanation of the key accounting policies adopted by Eircom. This shall include, *inter alia*, details of Eircom's income recognition policy, depreciation policy, capitalisation policy, and its approach to dealing with issues such as cost allocation, prior year adjustments and changes in accounting policy. This list is not exhaustive and further detail in relation to same shall be agreed between Eircom and ComReg. ComReg however reserves the final right to amend this list therefore from time to time where agreement cannot be reached

c) a statement of the Regulatory Accounting Principles followed when preparing the Separated Accounts which shall include defined terms, Cost Causality, Objectivity, and Consistency of Treatment

d) HCA and CCA profit and loss accounts and balance sheets for each Market. The accounts shall be prepared in accordance with applicable accounting standards and the CCA accounts shall be prepared using the Financial Capital Maintenance Concept. These accounts shall show data for Eircom's last complete financial year as well as the previous financial year and where these figures are not comparable, the figure for the preceding financial year must be adjusted. The CCA accounts for each Market shall be fully reconciled to the HCA accounts, with the HCA accounts being reconciled to the published financial accounts of Eircom, identifying all items (revenues and costs) relating to non regulated businesses and other items which are not relevant to the accounting period that have been excluded from the Separated Accounts

e) HCA and CCA profit and loss accounts at the Market and Service levels shall provide details of external, inter-segment and intra-segment revenues and costs where relevant

f) HCA and CCA profit and loss accounts for each Service as identified by ComReg to be included in the Separated Accounts [8]

g) profit/losses on disposal of non-current assets should be recognised at the Market level (where the cost has been recovered) and disclosed on the face of the HCA and CCA profit and loss accounts

h) HCA and CCA balance sheets prepared on an "as at" basis (i.e. relevant financial year end basis). The Mean Capital Employed and associated

8 The Services within the regulated Markets being finalised following discussion with Eircom within this consultation period and which shall be incorporated in final accounting Direction. ComReg reserves the right to determine this list where agreement cannot be reached.

return shall, however, be provided as supplementary information by way of note to the Separated Accounts

i) volume information that shows weighted average volume/total units by Market and Service, analysed into volumes directly attainable and volumes derived by statistical means

j) information relating to the revenue attributed to each Service, distinguishing between revenues which have been directly allocated to a specific Service, and other revenues which have been allocated or apportioned on the basis of statistical sampling or other accounting allocator

k) details of expenditure by network element and functional cost category

l) life to date holding gains/losses (which shall be amortised over the remainder of the asset's life)

m) a signed statement from the Directors of Eircom acknowledging their responsibilities for the preparation of the Separated Accounts and confirming their compliance with the requirements of this Direction

n) a report and opinion by a competent body on the Separated Accounts and Eircom's compliance with the requirements of this Direction

o) a list of manual journals/adjustments made to prepare the Separated Accounts together with justifications.

6.1.3 Eircom shall prepare and submit draft Separated Accounts schedules and Additional Financial Information schedules to ComReg within four months of the effective date of this Direction for ComReg's review. Eircom and ComReg shall endeavour to agree these schedules insofar as possible. ComReg however reserves the final right to determine and amend these schedules therefore from time to time where agreement cannot be reached.

6.2 Additional Financial Reporting

6.2.1 In addition to the Separated Accounts, Eircom shall submit Additional Financial Information with the Separated Accounts. Such Additional Financial Information shall include the following schedules:

a) specific regulated Service or Product profit and loss statements not included in the Separated Accounts (in a format consistent with that of the Separated Accounts)[8]

b) an analysis of functional costs and network element costs into costs which have been directly allocated to Markets, Services and Products, common costs which have been apportioned on the basis of the associated cost driver, and common costs which have been allocated on the basis of an Equi-Proportional Mark-Up

c) a schedule of Network Components together with a Usage by Service Schedule and Network Activity Statement for each network component (by Market, Service and Product)

d) a reconciliation of CCA costing data with other costing data (e.g. LRIC) provided for pricing purposes for specific regulated Services and Products

e) HCA and CCA profit and loss accounts and balance sheets for unregulated markets, Services and Products (in a format consistent with that of the Separated Accounts) [8]

f) HCA and CCA (regulated and unregulated) profit and loss accounts shall provide details of external, inter-segment and intra-segment revenues and costs were relevant

g) volume information that shows weighted average volumes /total units by market (unregulated) and Service and Product (regulated and unregulated)

h) reconciliation of Quarterly reports volumes with volumes disclosed in the Separated Accounts together with detailed explanations of differences

i) details of the bundled discounts allocated/apportioned at the Service and Product level for both regulated and unregulated markets.

6.2.2 The format and level of detail shown in the Additional Financial Information shall be determined by ComReg on an annual basis following discussion with Eircom prior to the financial year end.

6.3 Eircom shall submit a draft Schedule of Network Components, a Usage by Service Schedule and Network Activity Statement within four months of the effective date of this Direction for ComReg's review. Eircom and ComReg shall endeavour to agree these schedules insofar as possible. ComReg however reserves the final right to determine and amend these schedules from time to time where agreement cannot be reached.

7. Accounting Principles

7.1 The collection of data and the basis on which it is to be allocated and apportioned between regulated and unregulated markets, Services and Products shall be in accordance with the following principles:

- Inter-company/inter-segment transactions
- Volume and Revenue Identification and Sampling
- Cost Allocation and Apportionment Principles
- Cost Allocation and Apportionment Rules

as now more particularly described.

7.2 Inter-company/inter-segment transactions

7.2.1 In meeting its obligations the following transfer charging principles shall be followed by Eircom:

a) transfer charges (revenues and costs) shall be attributed to cost components, for regulated and unregulated Services, Products and markets in accordance with the activities, which cause the revenues to be earned, or costs to be incurred

b) the attribution shall be objective and not intended to benefit any market, regulated or unregulated

c) there shall be consistency of treatment of transfer charges from year to year

d) the transfer charging methods used should be transparent. There should be a clear rationale for the transfer charges used and each charge should be justifiable (with supporting calculations available)

e) the transfer charges for internal usage should be determined as the Service/Product (regulated and unregulated) of usage and unit charges

f) the charge for internal usage should be equivalent to the charge that would be levied if the product or service (regulated and unregulated) were sold externally rather than internally.

7.3 Volume and Revenue Identification and Sampling

7.3.1 Eircom shall allocate volumes and revenue to each of the services and products, as follows:

a) volumes and revenues which can be directly assigned to a particular Service or Product shall be so assigned

b) volumes and revenues that cannot be directly assigned to their use for specific Services or Products shall be apportioned on the basis of statistical sampling accurate to +/-1% at the 95% Confidence Level.

7.3.2 Eircom shall ensure that the sample data is based on either generally accepted statistical techniques or other methods. This should result in an accurate allocation of revenue (including transfer charges), costs (including transfer charges), assets and liabilities. In this regard, **a**ny sampling processes used to apportion volumes and revenues shall take account of the following:

a) the sample data is unbiased and objective

b) the sample size has been assessed in a statistical manner and is statistically significant

c) the sample data is representative of the entire population

d) the sample data is not obscured by seasonal or other factors

e) the sample data is updated annually.

7.4 Cost Allocation and Apportionment Principles

7.4.1 Eircom shall, allocate costs to each Service or Product on a fully distributed cost basis, in the following manner:

a) costs which can be directly assigned to a particular Service or Product shall be so assigned

b) common costs, which are costs that cannot be directly assigned to a particular Service or Product, shall be allocated as follows:

i. whenever possible, common costs shall be allocated on the basis of direct analysis of the origin of the costs themselves

ii. when direct analysis is not possible, common cost categories shall be allocated on the basis of an indirect linkage to another cost category or group of cost categories for which a direct assignment or allocation is possible, the indirect linkage shall be based on comparable cost structures

iii. when neither direct nor indirect measures of cost allocation can be found, the cost category shall be allocated on the basis of an Equi-Proportional Mark up, computed by using the ratio of all expenses directly or indirectly assigned or allocated, to each Service or Product.

7.5 Cost Allocation and Apportionment Rules

7.5.1 Eircom shall ensure that costs shall be apportioned between the various Services and Products on the basis of factors/drivers which reflect the different impact of each item on the network elements and functional costs.

7.5.2 As a minimum, Eircom shall ensure that the hierarchy of costs (which shall be analysed into pay and non-pay) to be applied to each Service and Product shall enable the cost of the following activities to be calculated:

a) Product Development & Management

b) Marketing & Sales

c) Repair/Maintenance

d) Finance & Billing

e) Installation/ Provisioning

f) Supply of customer lines

g) Connections

h) Network Support

i) General Support

j) General Management

k) Accommodation

l) Information Technology (IT)

m) Transport

n) Personnel & Administration

o) Other operating expenses.

Accounting items not involving the movement of funds (e.g. depreciation) shall also be separately identified by Eircom.

7.5.3 Eircom shall for cost allocation purposes ensure that the access network boundary shall remain at the switch side of the line card.

8. Accounting Documentation

8.1 Eircom's Accounting documentation shall be sufficiently transparent and shall explain inter alia the regulatory principles used, methodologies applied and procedures used to prepare the Separated Accounts and the Additional Financial Information.

8.2 The Accounting documentation shall consist of two principal documents:

8.2.1 'Primary Accounting Documents' which shall set out the Regulatory Accounting Policies, the Regulatory Accounting Principles, the Attribution Methods, the transfer charge methodology and any other methodology (CCA, LRIC etc.)

8.2.2 'Secondary Accounting Documents' which shall set out details of the policies, methodologies, systems, processes and procedures for deriving or calculating the costs, revenues, assets and liabilities (including details of attribution methodologies, valuation methodology and other relevant methodologies) used to prepare the Separated Accounts.

8.3 Eircom shall:

a) review and update the Accounting Document annually

b) submit to ComReg (in confidence) and obtain its approval for each annual edition of the Accounting Document. For the first two years from the effective date, this should take place in advance of the start of each relevant regulatory period and for subsequent years it should be submitted with the Separated Accounts

c) publish the Primary Accounting Document on its website following ComReg's approval and at the same time as the Separated Accounts.

8.4 Without prejudice to the generality of Section 8.2.1, the Primary Accounting Document shall contain at least the elements listed below:

a) a description of Eircom's business, explaining the main activities and functions performed by Eircom to provide telecommunications services to customers, clearly indicating which Markets, Services and Products which are regulated

b) details of the accounting systems, in terms of the underlying principles and the conceptual flow of costs and revenues from source financial systems to the separated businesses

c) details of the terms of supply and the basis of calculation of any inter/intra segment transactions

d) a description of how the Separated Accounts differ from the Financial Accounts

e) the format and content of the Separated Accounts and a description of what the regulatory accounting process entails (including the basis of preparation for the Separated Accounts)

f) a description of the cost allocation methodology employed. Details of the internal safeguards that are incorporated to ensure that the cost allocation system is free from material error

g) the process of deriving 'total unit' and 'weighted average volumes' including the basis of derivation of the relevant usage factors applied

h) year on year changes to the Separated Accounts and changes to cost allocations, together with an assessment of the impact of these changes.

8.5 Without prejudice to the generality of Section 8.2.2, the Secondary Accounting Document shall, contain at least the elements now set out:

a) an explanation of how the underlying financial transactions supporting Eircom's business activities and functions are recorded in the financial ledgers, and how the transactions are grouped to provide the starting costs, revenues, assets and liabilities used within the internal system to apportion costs, revenues, assets and liabilities to the market, Service and Product levels

b) a schedule showing how operating costs are treated at the market level and the proposed process of allocation/apportionment of each functional cost category and network element at the market, Service and Product levels. This should also include an analysis of all activities associated with each functional cost together with its treatment as direct, indirect or common cost. Details and justifications of choice of cost driver should also be disclosed

c) the means by which Eircom identifies how costs are found to be directly or indirectly attributable or common

d) the means by which Eircom identifies how avoidable, variable and fixed costs are defined

e) cost driver definitions (i.e. basis of allocation) and calculations

f) the means by which Eircom reviews, updates and verifies cost allocation drivers together with justifications of changes in basis of allocation/apportionment from year to year

g) the accounting treatment of bundled Services and Products, including how costs and discounts are allocated between Services and Products

h) details of the sampling processes employed, including the design, scope, objectives, methodology, basis of calculation of sample sizes, level of precision and confidence levels

i) details of alterations to samples following review by the competent body

j) details of volumes (by Service and Product) which can be directly obtained and volumes which are derived by statistical sampling

k) accounting treatment of NGN's

l) details of the network studies conducted during the year to apportion indirect common costs

m) a list of the services and products as per the regulated price list.

9. Review and Confirmation of Compliance

9.1 Eircom shall:

a) engage a competent independent body to verify compliance with this Direction, perform an audit of the Separated Accounts and conduct an audit of its cost allocation system, in accordance with the principles and guidance set out by bodies representative of the Irish accountancy professions from time to time

b) consult with ComReg before the appointment/reappointment of the regulatory auditor and provide assurance that its regulatory auditor has the necessary expertise

c) include the report and opinion of the independent competent body, on the Separated Accounts, Eircom's compliance with the requirements of this Direction and the audit of the cost allocation system, within the Separated Accounts. The report should set out details of the tasks performed and conclusions reached by the competent body.

9.2 Eircom shall ensure:

a) that the Accounting Document is subject to review by a competent independent body annually

b) that the processes and procedures used by Eircom be subject to a review by a competent independent reviewer on an annual basis

c) that any statistical sampling conducted to identify volumes and/or revenues be subject to an external and independent review on an annual basis. The review shall be conducted by a statistical expert. Any alterations to the procedure resulting from the review shall be disclosed in the Accounting Document.

9.3 ComReg reserves the right, notwithstanding the generality of Sections 9.1 to reasonably set out principles and/or guidance in relation to the duty of care owed by auditors to ComReg and the applicable audit opinions.

10. Timetable

10.1 This Direction will be applicable to accounting periods beginning on or after 1 July 2009. Full compliance should, however, be achieved no later than 30 June 2011. In this regard, Eircom is required to submit to ComReg its timed programme for compliance, no later than the 28 day of February 2010.

11. Statutory Powers not affected

11.1 Nothing in this Direction shall operate to limit ComReg in the exercise and performance of its statutory powers or duties under any primary or secondary legislation (in force prior to or after the effective date of this Direction) from time to time as the occasion requires.

12. Effective Date

12.1 This Direction shall be effective from the date of its publication and shall remain in force until further notice by ComReg.

Mike Byrne

Commissioner

Commission for Communications Regulation

Dated THE [] DAY OF [] 2010

Annex 1 to Decision Instrument: List of Directions now superseded and/or withdrawn.

Previous individual Decisions or Directions on Accounting Separation, Price Control and Cost Accounting either adopted by ComReg or the ODTR are hereby withdrawn and/or superseded:

Document No / Decision No	**Text of Decision**
Consultation Report and Issues for Further Consideration 99/35, Decision D5/99 'Accounting Separation and Publication of Financial Information for Telecommunications Operators'	
Decision 3.1	Accounting separation is applicable to TE as set out in Section 4 of this document
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.
Decision 3.3	The Definitions of the Disaggregated Activities to be reported on in the separated accounts are set out in Appendix II.
Decision 3.4	The Guiding Principles for Separated Accounts decided by the Director are set out in Section 5 of this document.
Decision 3.5	These principles are restated in Appendix III of this document. (as per 99/10)
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.
Decision 3.7	Telecom Éireann will publish additional information items as set out above, alongside its separated accounts.
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.

Document No / Decision No	**Text of Decision**
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
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.
Decision 3.11	The Transfer Charging Principles decided by the Director are as set out above
Decision Notice and Consultation Report 99/43 Decision D8/99 'Costing Methodologies for use in Accounting Separation	
Decision 3.1	A description of TÉ's costing system, together with its costs drivers will be made available to interested parties when it has been presented to the ODTR at the end of August. Telecom Éireann's cost, revenue and capital employed allocation principles should follow those high level principles as set out in the appendices attached. Alternative methods require prior approval by the ODTR before 31st August 1999.
Decision 3.2	The appropriate level of detail to be published in relation to Telecom Éireann's costing systems is to include the following:- • The cost standard being used (e.g. fully distributed costs, embedded direct costs, etc.) including the cost base(s) being used (e.g. historic costs, current costs, etc.); • General Principles; • A detailed analysis of the hierarchy of costs being used; • The allocation and apportionment rules being used to identify revenue, costs and capital employed of each service and network component; • Information on how each individual cost category is treated; • Identification of any deviations from the accounting policies used in TÉ's statutory accounts. • The degree to which sample data has been used in each of the apportionment bases. (This is discussed in Section 4.3)

Document No / Decision No	Text of Decision
Decision 4.1	Allocation of costs, capital employed and revenue will be done in accordance with the principles of cost causation, materiality, objectivity, consistency and transparency, as described above. The audit report shall state that the separated accounts have been prepared in accordance with the costing methodology documents published with the accounting separation statements.
Decision 4.2	Unattributable costs should be allocated to products and services using an Equal Proportionate Mark-Ups method.
Decision 4.3	Sampling data may be used to allocate certain indirect costs, which have no comprehensive allocation base, to products and services. The use of sample data shall be kept to a minimum. The degree to which sample data has been used in each of the apportionment bases shall be disclosed in the description of the costing methodology.
Decision 4.4	The principles governing the use of sample data are the following:- • it is unbiased\objective; • the sample size has been assessed in a statistical manner and is statistically significant; • representative of the entire population; • is not skewed by seasonal or other factors; • it is based on either generally accepted statistical techniques or other methods, which should result in the accurate allocation of revenue (including transfer charges), costs (including transfer charges), assets and liabilities; and • be updated annually.
Decision 4.5	Non relevant costs shall be excluded when determining charges for services and these will be judged on a case by case basis.
Decision 4.6	Non-relevant costs for regulatory decision purposes should be disclosed as reconciling items after the 1999/2000 separated accounts.
Decision 5.1	TÉ will develop an appropriate costing methodology for its operations in accordance within the framework and principles set out in the appendices to this document (and as amended in the future by the Director) to be approved by the Director.
Decision 5.2	The operating costs allocation and attribution methods are outlined in Appendix II. They are at a high level and individual operators should develop cost allocation procedures specific to the way in which they currently capture and record costs, in line with these high level allocation principles (and as amended in the future by the Director).
Decision 6.1	TÉ will develop an appropriate revenue allocation methodology for its operations in accordance with the framework and high level principles set out in this document (and as amended in the future by the Director) to be approved by the Director.

Document No / Decision No	Text of Decision
Decision 7.1	TÉ will develop an appropriate costing methodology for its operations in accordance with the framework and principles set out in this document (and as amended in the future by the Director) to be approved by the Director.
Decision 7.2	The principles to be applied when considering the treatment of individual items of working capital are: - consistency between the treatment of assets and their associated costs and revenues - inclusion or exclusion of individual items ought, in principle, to have a corresponding impact on the return on capital employed.
Decision 7.3	Asset lives should be set on the basis of a network element and component basis and should be thoroughly reviewed on a yearly basis. The assets lives used in the statutory accounts should also be used in the separated accounts. The Director may adjust for inappropriate asset lives, when regulatory decisions are being made based on historical costs.
Decision 7.4	Different asset lives should be calculated for similar assets based on different technology.
Decision 7.5	In the year of acquisition the depreciation of assets shall be in accordance with the policies adopted in the statutory accounts.
Decision 7.6	In the year of disposal the depreciation of assets shall be in accordance with the policies adopted in the statutory accounts.
Decision 7.7	The treatment of excess depreciation shall be in accordance with the policies adopted in the statutory accounts.
Decision 7.8	Assets in the course of construction shall be depreciated on the same basis as that adopted in the statutory accounts.
Decision 8.1	The financial capital maintenance approach will be used when calculating current cost information.
Decision 8.2	The Net Replacement Cost valuation method shall be used when valuing assets on a current cost basis.
Decision 8.3	The separated accounts shall be adjusted for current cost information for the year 1999/2000 at a minimum for call origination, termination and transit. As additional information becomes available the accounts shall be adjusted accordingly.
Decision Notice D10/99 (Document Number 99/52) 'Accounting Separation and Publication of Financial Information for Telecommunications Operators'	
Decision 3.1	The relevant subsidiary activities of TÉ (see Decision 3.2) shall be included as part of the "Other Activities" category. This information shall be included in the 1998/99 set of accounting separation statements.
Decision 3.2	The "Other Activities" category should be further disaggregated to show separately the subsidiary activities of TÉ as outlined above.

Document No / Decision No	**Text of Decision**
Decision 3.3	TÉ is required to publish a statement of network component costs, as part of accounting separation information and this should 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 III (Statement of Costs of Network Services – Transfer to Retail and Other Activities). A further confidential schedule on volume information must be provided to the ODTR only. This should be provided at the same time as the publication of separated accounts. The pro forma schedule for the Network Statement of Costs remains in the form outlined in ODTR 99/35.
Decision 3.4	The details of internal transfers that TÉ is required to publish along with the separated accounts are as set out in Appendix IV and V.
Decision 3.5	The amended and additional disaggregated activities defined in Appendix II shall be incorporated into the accounting separation statements. The remaining definitions are as originally detailed in Decision Notice 5/99 (ODTR 99/35).
Decision Notice D9/00 (Document Number 00/59) 'Accounting Separation and Publication of Financial Information for Telecommunications Operators'	
Decision 4.1.1	Decision 3.10 of ODTR 99/35 is replaced by the following text: "For the first year operation (1998/1999), Historical Cost Separated Accounting information is to be published within seven months after the end of the period to which it relates. For the second year of operation (1999/2000), Historical Cost Separated Accounting information is to be published within six months of the end of the period to which it relates. Current Cost Accounting and LRIC Separated Accounts are to be published within eight months after the end of the period to which they relate. Thereafter (2000/2001 and future years) Historic Cost Separated Accounts are 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. Current Cost and LRIC Separated Accounts are to be published within six months after the end of the period to which they relate."
Decision 4.1.2	eircom shall provide draft Separated Accounts for 1999/2000 to the ODTR as follows:- 1. HCA Separated Accounts by the 15th September 2000, 2. CCA Separated Accounts by the 31st October 2000, and 3. LRIC Separated Accounts by the 31st October 2000.

Document No / Decision No	Text of Decision
Decision 4.2	Principle (f) in Section 5 'Format of Accounting Separation Statements' in ODTR 99/35 is modified by replacing the text with the following text: "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." This principle shall apply except in the following cases: - The HCA Cost Separated Accounts for 1999/2000 shall contain the 1998/1999 results as comparative figures. These results do not have to be restated in accordance with the previous paragraph. The 1999/2000 CCA separated accounts and LRIC statements are not required to contain comparative information.
Decision 4.3.1	From 1999/2000 onwards, exceptional costs should be separately identified in the Separated Accounts statements.
Decision 4.3.3	The Network Statement of Costs should additionally identify the following network elements:- National Directory enquiries International Directory enquiries • Carrier Administration • Carrier Billing Intelligent Network (identifying deferred costs where relevant) National Operator Assistance International Operator Assistance Pro forma statements for the Network Statement of Costs for HCA, CCA and LRIC are set out in Appendix I, II and III.
Decision 4.3.5	The Statement of Costs of Network Services should additionally identify the following network elements:- Payphone Access Charge. Retail costs applicable to Number Translation Code services. All RIO Services that are included in the RIO in effect during the period of the Separated Accounts as set out above. All Retail Services should be included as set out above. The individual services provided to the retail disaggregated activities, Internet Services Supply and Supplemental Services. The National Operator assistance service provided to eircom's retail business. The International Operator assistance service provided to eircom's retail business. Pro forma statements for Statement of Costs of Network Services for HCA, CCA and LRIC are set out in Appendix IV, V and VI.
Decision 4.4	The "Other Activities" category in the 1999/2000 Separated Accounts shall be further disaggregated to show separately the activities of Indigo and shall include comparatives for 1998/1999.
Decision 4.5	The Current Cost Separated Accounts should be prepared in the format as set out in Appendix VII, where the information is available, which is consistent with the EU Recommendation. LRIC adjustments will be required to be shown on the face of the Profit and Loss statements.

Document No / Decision No	Text of Decision
Decision 4.6	The pro-forma schedules for transfer charges have been amended to incorporate decision 3.2 and decision 3.5 as detailed in decision notice 10/99 (ODTR 99/52). See Appendix VIII. The virtual access charge arising from the Dispute Resolution Determination Numbers 01/99 and 02/99, shall be included as part of the transfer charges to the Frame Relay retail division. Charges relating to the use of shared premises/exchanges inter-company loans seconded staff and other operating overheads compensation for expenditure incurred by one group company on behalf of another group company, etc. shall be included as part of the transfer charges shown in the Separated Accounts.
Decision 4.6.1	The Separated Accounts shall include a statement analysing the transfer charge to Retail - Public Payphones as set out in Appendix VIII.
Decision 5.1	The audit report on the separated accounts shall additionally state for the 2000/2001 separated accounts whether:- the separated accounts are fairly presented in accordance with eircom's Accounting Documents, • whether the Separated Accounts comply with the ODTR's Decision Notices in this area, as amended from time to time. whether the information specified by the Decision Notices to be published in the Separated Accounts has indeed been published in the separated accounts. Separate audit opinions should be issued on the HCA and the CCA/LRIC Separated Accounts.
Decision 5.2	eircom shall submit a list of appropriate independent persons/bodies to carry out the audit of the Separated Accounts to the ODTR at least 8 months before the Separated Accounts are due to be published, for the approval of the Director. This shall apply to Separated Accounts for 2000/2001 and onwards.
Decision 6.1	From 2000/2001 onwards, operating costs for the Core Network shall be the relevant costs as determined or agreed by the Director for the calculation of the rates in the RIO that is applicable to the accounting period. Non-relevant costs should be disclosed as a reconciling item in the statement of reconciliation between the Separated Accounts and the Financial Statements.
Decision 6.2	eircom shall publish a forecast Network Statement of Costs and a forecast Statement of Costs of Network Services which forms the basis of calculating the interim RIO rates currently in force. Only forecast relevant costs shall be included. These schedules shall be published in 1999/2000 for the first time at the same time as the publication of the Separated Accounts and shall be republished annually.
Decision 7	The costing system description should be extended to include CCA and LRIC.
Decision 8	The Separated Accounts shall include, where relevant, the following reconciliation statements:- • Reconciliation statement of HCA profits\losses before taxation to CCA profits\losses before taxation, • Reconciliation statement of HCA mean capital employed to CCA mean capital employed, • Reconciliation of Statement of Costs of Network Services CCA to Statement of Costs of Network Services LRIC.

Document No / Decision No	**Text of Decision**
Decision 9	Half-yearly Separated Accounts shall be submitted to the ODTR within four months of the end of the period to which they relate. The half-yearly Separated Accounts should be prepared as set out above.
Decision 9.1	Volume data for all types of PSTN traffic shall be submitted to the ODTR four months after the quarter end.
Decision Notice D10/00 (Document Number 00/72) 'Accounting Separation and Publication of Financial Information for Telecommunications Operators, Supplemental Information Referring to Decision D9/00	
	The Director considers that Eircom may discharge their obligations under Decision 4.1.1 of D9/00 by publication of the information as detailed in sections 2.2.1, 2.2.2 and 3 as unaudited Supplemental Information to the Separated Accounts on 15th December 2000, in addition to the publication of the Separated Accounts themselves on the 30th September 2000.
	The Director therefore requires Eircom to discharge its obligations under Decision 4.3.3 of D9/00 by publishing information on 15th December 2000 as Supplemental Information to the Separated Accounts relating to: Carrier Administration Carrier Billing Intelligent Network (identifying deferred costs where relevant) National Operator Assistance International Operator Assistance in addition to publishing information on National directory enquiries and International Directory enquiries as part of the Separated Accounts on 30th September 2000.
	Eircom may discharge their obligations under Decision 4.3.5 of D9/00 by publishing the costs of Network Services whose take-up was material during the year ended 31st March 2000, but for which data capture procedures were not in place in that period should be published as Supplemental Information to the Separated Accounts on 15th December 2000.
	Eircom can satisfy its obligations under Decision 6.2 of D9/00 by publishing a forecast Statement of Costs of Network Services together with the RIO rates that came into force in accordance with the Director's directions as set out in D7/00 (ODTR 00/31) as Supplemental Information to the Separated Accounts on 15th December 2000
Decision Notice D2/01 (Document Number 01/10) 'Accounting Separation for Internet Service Provision and Report on Investigation into Indigo and eircom.net'	
Decision 2.4.1	eircom will continue to present the business of Indigo as a disaggregated activity of the Other Activities business area.
Response to Consultation & Decision Notice D7/01 (Document Number 01/24) 'Eircom's Reference Interconnection Offer & Accounting Separation and Publication of Financial Information for Telecommunications Operators'	
Decision 7.1	For 2000/2001, operating costs for the Core Network as included in the Separated Accounts shall be the relevant costs as determined or agreed by the Director for the calculation of the rates in the RIO, applicable to that accounting period.

Document No / Decision No	Text of Decision
Decision 7.2	As indicated in D9/00, operating costs for the Core Network shall be the relevant costs as determined or agreed by the Director for the calculation of the rates in the RIO that is applicable to the accounting period. Non-relevant costs should be disclosed as reconciling items in the statement of reconciliation.
Decision 7.3	There are no alternative approaches to Accounting Separation which merit further consideration at this time.
Decision 8.3	The services listed in the published RIO applicable to the accounting period being reported should be accounted for separately in the published statements.
Decision 8.5	The statements described as (i) Inland Core Conveyance Network-Statement of Costs including CCA Adjustment Distributed LRIC, (ii) Inland Core Conveyance Network- Statement of Costs including CCA Adjustments Distributed Long Run Incremental Cost plus Recovery of Inter Increment Fixed Costs and Joint Costs and, (iii) Reconciliation of Incremental Cost Results above, are to be included in the Separated Accounts for 2000/2001 and subsequent years.
Decision 8.7	Eircom should submit detailed proposals for sub-divided Transit Call charges to the Director.
Decision 8.10	The Statement of Costs of Network Services shall be amended to include “Primary to Tertiary” links.
Decision 8.12	Internet Service Supply and Leased Lines shall be excluded from the Statement of Costs of Network Services
Decision 8.13	Eircom will be required to publish a memorandum note indicating the level of returns achieved by public payphones, including the returns earned elsewhere in Retail, Access and Core Network.
Decision 9	The access network boundary shall remain at the switch side of the line card. The definitions of the business areas will be those set out in Appendix II of this Decision Notice.
Decision 10.1	Notional Debtors and Creditors should not be included in the Separated Accounts. However, Debtors in respect of provision of interconnect services to wholesale customers (OLOs) is a real working capital requirement and should be included in the separated Accounts. Recovery by eircom of the cost of funding credit, provided to wholesale customers, will apply, except in exceptional circumstances, only to debtor levels based on standard credit terms.
Decision 11.1	The definitions of Disaggregated Activities are now as listed in Appendix III of this document.
Decision 11.2	The ISP business unit shall be separately disclosed in the Separated Accounts.
Decision 12.1	The Separated Accounts should contain a schedule in a format to be finalised but which will be similar to appendix IV, which will disclose the Return On Capital Employed in each of the business units, including retail businesses.

Document No / Decision No	**Text of Decision**
Decision 12.2	Allocation of core and access network assets to business activities should be based on a sufficient level of detail to ensure that the process generates a reasonably accurate attribution of costs. eircom is required to include the ROCE measure, calculated on the basis that the allocation criteria used, adequately reflect the cost components and the relationship of cost components to services.
Decision 13.1	Information in respect of the Network Statement of Costs in terms of National Operator Assistance, International Operator Assistance, Carrier Administration, Carrier Billing and Intelligent Network should be incorporated into the HCA Separated Accounts for 2000/2001
Decision 13.2	For reasons of commercial sensitivity, eircom is not required to publish a Forecast Network Statement of Costs.
Decision 13.3	eircom should continue to publish information on Payphone Access Charge in its current format, as outlined in Appendix V of this Decision Notice.
Decision 13.4	eircom will be required to identify retail costs applicable to Number Translation Services and 189X services in the format as outlined in Appendix VI of this Decision Notice.
Decision 14	For the year 2000/2001, eircom are directed to publish an Access Statement of Costs and a Statement of Costs of Access Services in respect of Local Loop Unbundling as supplementary information. Through consultation, the format of the statements will be refined during 2001/2002. The agreed format will be published in the Separated Accounts for year 2001/2002
Decision 15.1	HCA Separated are to be submitted to the ODTR by 31st July 2001. CCA and LRIC Separated Accounts are to be submitted to the ODTR by 30th.September 2001.
Decision 15.2	Draft HCA Separated Accounts are to be submitted to the ODTR by 30th.June 2001. Draft CCA and LRIC Separated Accounts are to be submitted to the ODTR by 31st.August 2001.
Decision 15.3	eircom are not required to produce half-year accounts for 2000/2001. Half-yearly Separated Accounts for the year 2001/2002 are to be submitted to the ODTR within four months of the end of the period to which they relate.
Decision Notice D12/01 (Document Number 06/61) ' Revision of Timetable for Publication of Separated Accounts and Financial Information by Eircom'	
Decision 1	The time-table for publication of Separated Accounts and Financial Information for the year ended 31st March 2001 is as follows: Historic Cost Accounts - 30th September 2001 CCA and LRIC Statements - 30th November 2001 In addition to the above draft accounts will be presented to ODTR at the end of the prior month, i.e. Draft Historic Cost Accounts - 31st August 2001 Draft CCA and LRIC Statements - 31st October 2001

Document No / Decision No	**Text of Decision**
Decision 2	The time-table for publication of Separated Accounts and Financial Information for the year ended 31st March 2002 will be: Historic Cost Accounts - 31st August 2002 CCA and LRIC Statements - 30th September 2002
Decision 3	Eircom will provide to ODTR, no later than 30th September 2001, a project plan relating to the process leading to the publication of the Separated Accounts and Financial Information for 2001/2002 and appointment of auditors.

Annex 2 to Decision Instrument: List of Directions maintained.

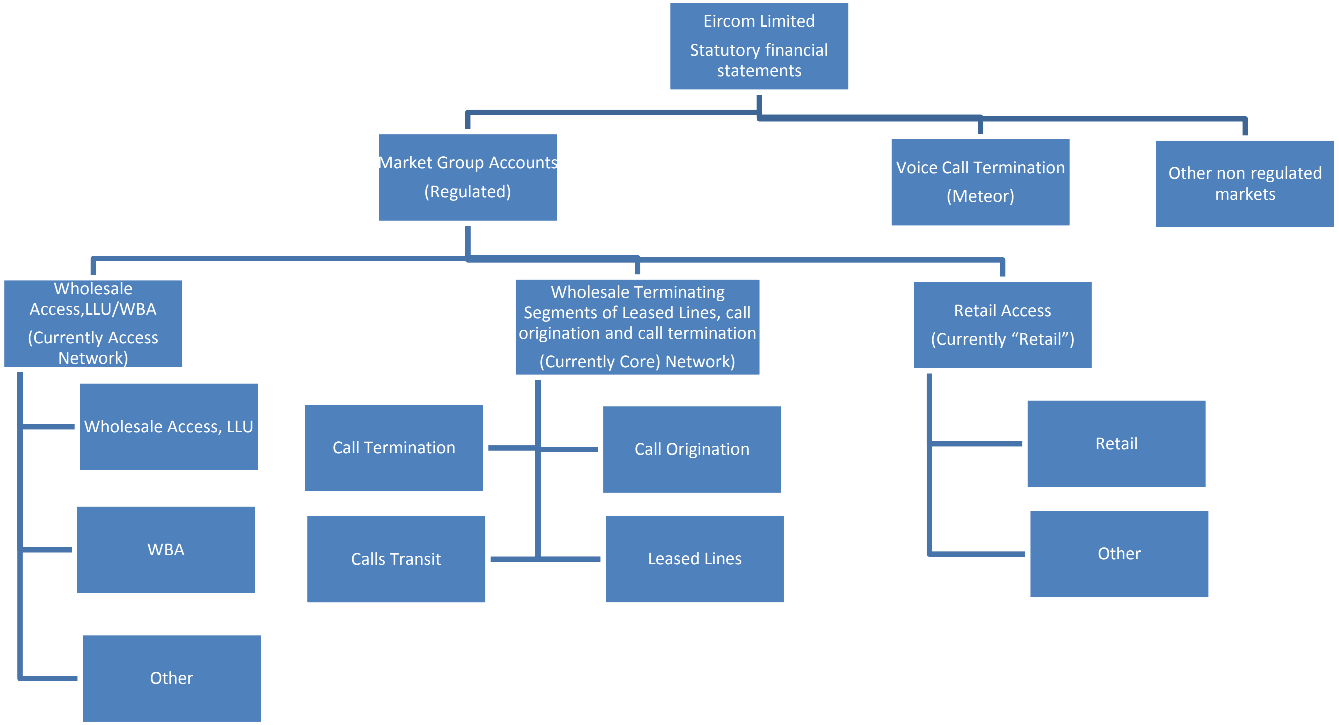
The following previous individual Decisions or Directions, as contained in the following Decisions or Directions, in respect of Accounting Separation, Price Control and Cost Accounting, either adopted by ComReg or the ODTR, are hereby maintained in their entirety:

Document No / Decision No	Text of Decision
Decision Notice D9/00 (Document Number 00/59) 'Accounting Separation and Publication of Financial Information for Telecommunications Operators'	
Decision 4.3.6	The same gradient as set out in D7/00 should be applied to all services included in the Statement of Costs of Network Services.

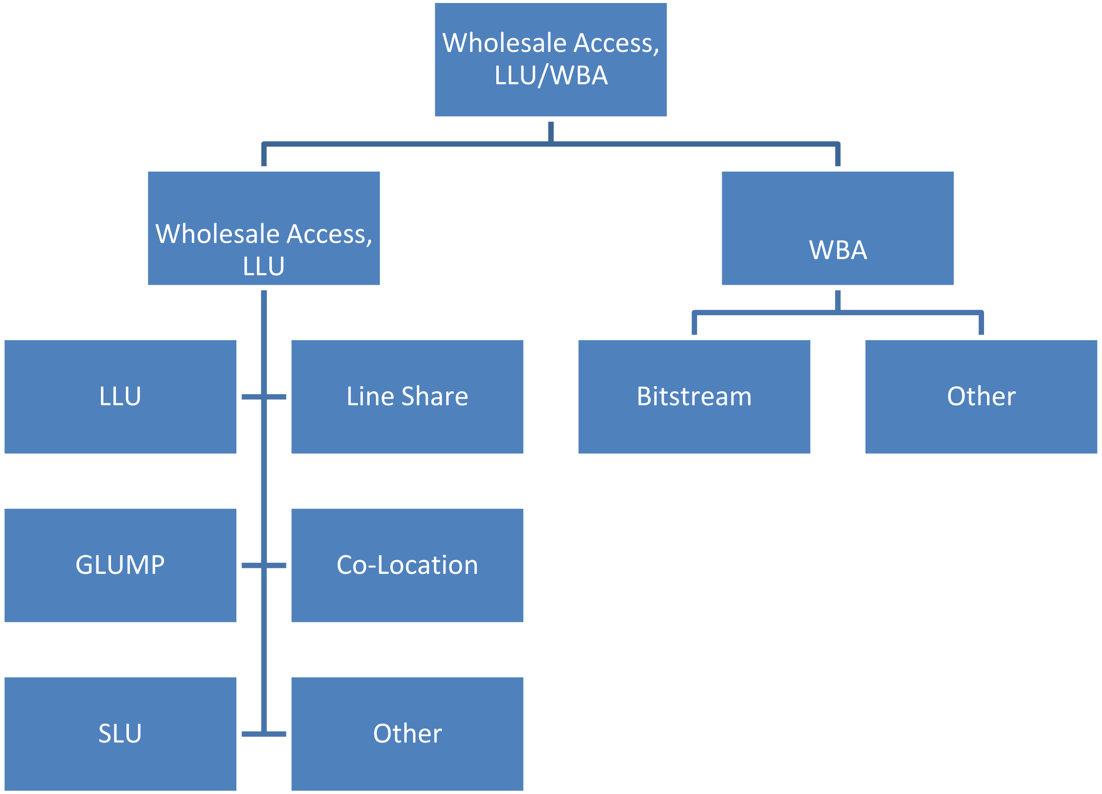
Document No / Decision No	Text of Decision
Response to Consultation & Decision Notice D7/01 (Document Number 01/24) 'Eircom's Reference Interconnection Offer & Accounting Separation and Publication of Financial Information for Telecommunications Operators'	
Decision 6	Eircom is required to calculate the core conveyance rates based on LRIC for the following periods: • 1 December 1999 to 31 March 2000, • 1 April 2000 to 31 March 2001, • from 1 April 2001 onwards, In determining whether to accept eircom's justification, the Director will take into account compliance with this decision notice, earlier decisions not updated by this Decision Notice, and other guidance provided to eircom by ODTR. eircom is to submit these rates and justification to ODTR no later than 9th May 2001.
Decision 8.1	Two part charging will be introduced on 1st October 2001. The RIO when republished shall include a one-part charge that will apply prior to 1st October 2001 and the two-part charge that will apply thereafter. When allocating costs to call set-up charges, only those components that are predominantly related to call set-up will be included.
Decision 8.2	Justification for separate termination and origination rates will be considered but may not be introduced before 1st October 2001. The revised RIO, with separate rates, will be published at least six weeks prior to this date. Proposals with justification should be presented to ODTR not later than mid-July 2001. When allocating costs to termination or origination, only those elements that are solely related to one service may be considered for separate treatment. In line with Decision 8.7 on routing factors, ODTR requires that forecast routing factors be used that assume efficient routing. This should be based on the assumption that all PoIs are available for use in either direction.
Decision 8.4	Appropriate non conveyance costs, subject to review by the Director, including appropriate carrier billing and carrier administration, should be apportioned by product and reflected in the RIO rates for each respective service / product.
Decision 8.6	The Separated Accounts for a given year and the finalised RIO rates relating to those accounts are to be based on the same Routing Factors. Routing factors on which interims are based will be forward looking and reflect an efficient operator approach. The routing factors used to finalise rates will be based on appropriate efficient principles but shall be updated to reflect actual costs and volumes.
Decision 8.9	When eircom proposes new prices the gradient should be recalculated and detailed workings submitted to the ODTR. If any element of the gradient is more than 5% different then revised interconnect prices should be published applying the contemporary gradient. Notification of the change shall take place at least 21 days in advance of the change being effected and at the same time as the publication of the retail price. The interconnect gradient change will be published no later than 21 days after the retail price has been published.

Document No / Decision No	**Text of Decision**
Decision 8.11	The Separated Accounts should reflect the underlying service provision and be consistent with the RIO. Therefore the Separated Accounts should use a single double tandem rate.

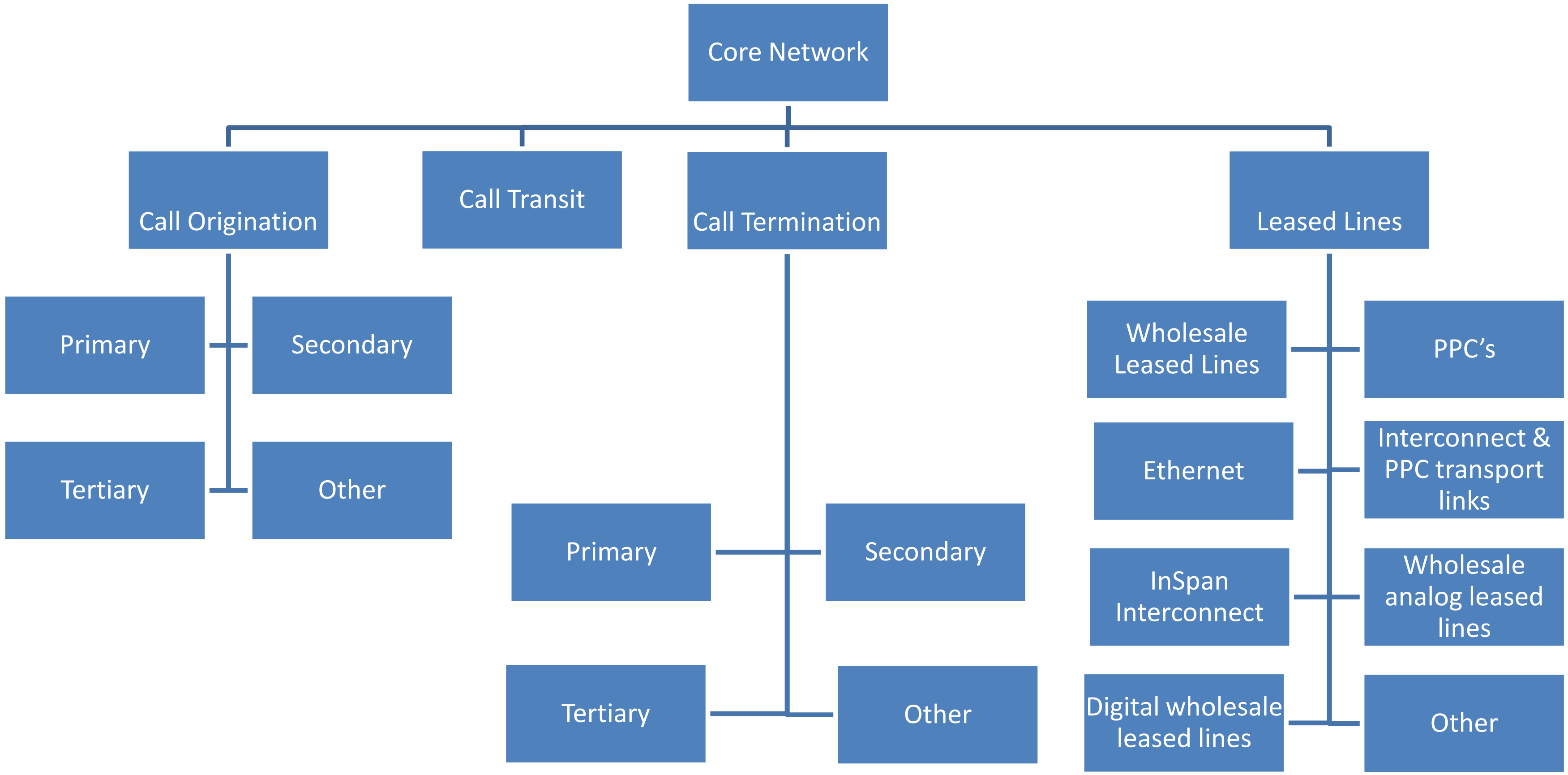
Appendix A – Overview of Eircom structure by market



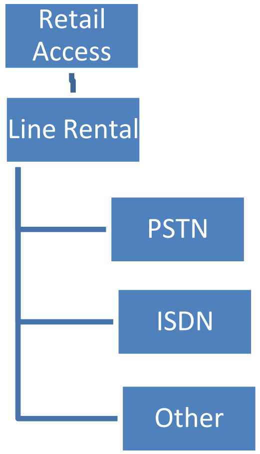
Overview of services and products: Wholesale Access, LLU/WBA (currently Access Network)



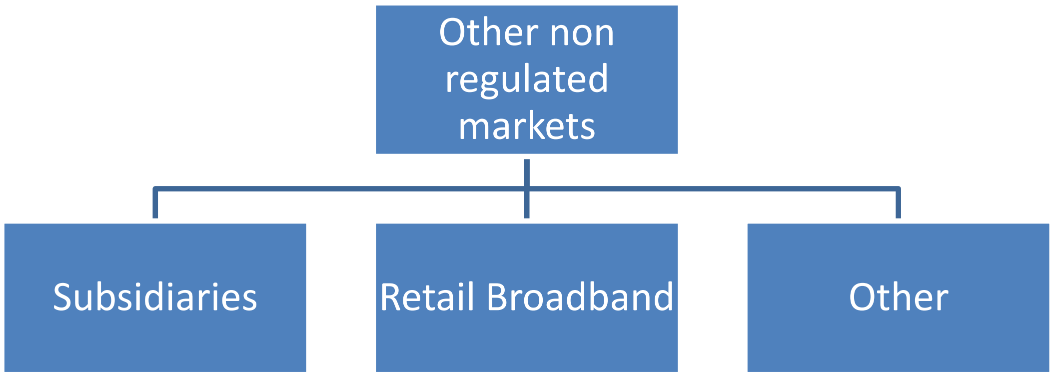
Overview of services and products: Wholesale terminating segments of leased lines, call origination, and call termination (currently Core Network)



Overview of services and products: Retail Access (Currently Retail)



Other non regulated markets



Appendix B - Suggested format of Separated Accounts

Market for Wholesale Access, LLU Profit and Loss Account for the year ended 30 June 20XX

		20XX	20YY
Revenue		€'000	€'000
External revenue (OAO's)	Volumes[1]	Actual[2]	Actual
LLU	X	X	X
LS	X	X	X
SLU	X	X	X
WLR	X	X	X
Total external revenue		X	X
Inter segment revenue (Eircom Retail)			
WLR	Volumes * WLR price	X	X
Connection fees			
External		X	X
Inter segment		X	X
Total Connection fees		X	X
Other revenue			
GLUMP		X	X
Order handling		X	X
Co-location		X	X
Repairs		X	X
Other		X	X
Total other revenue		X	X
Total Wholesale Access, LLU revenues		**X**	**X**
Costs			
Network costs[3]		X	X
Exchange costs			
Rental costs		X	X
Power, light and heat, and air con.		X	X
MDF and cabling costs		X	X
Other exchange costs		X	X
Total exchange costs		X	X
Corporate Overheads		X	X
Other costs		X	X
Exceptional costs		X	X
Total Wholesale Access, LLU costs		**X**	**X**
Wholesale Access, LLU Profit /Loss		**X**	**X**
Wholesale Access, LLU Profit / Loss as a % of Mean Capital Employed		**X%**	**X%**

1 Volumes are the weighted average volumes for the year.

2 Revenues are actual revenues based on regulated price(s) applied during the year.

3 It is proposed that a separate statement of network costs be prepared as part of the Additional Financial Information.

Market for Wholesale Access, LLU Balance Sheet for the year ended 30 June 20XX

	20XX	20YY
Non Current Assets	€'000	€'000
Property, Plant and Equipment	X	X
Intangible Assets	X	X
Other	X	X
Total Non Current assets	X	X
Current Assets		
Inventories	X	X
Trade and other receivables	X	X
Cash and cash equivalents	X	X
Other	X	X
Total Current Assets	X	X
Total Assets	**X**	**X**
Liabilities		
Trade and other payables	X	X
Interest bearing loans and borrowings	X	X
Provisions for liabilities and charges	X	X
Other	X	X
Total Liabilities	X	X
Net capital employed for the year	**X**	**X**
Mean Capital Employed for the year	**X**	**X**

Wholesale Access, LLU
<u>Notes</u>

Property, Plant, and equipment Note	**€'000**
Cost or valuation	
As at 1 July 20YY	X
Additions	X
Disposals/Retirements	<X>
As at 30 June 20XX	X
Accumulated Depreciation	
As at 1 July 20YY	X
Charge for year	X
Released on Disposals/Retirements	<X>
As at 30 June 20XX	X
Net Book Value as at 30 June 20XX	X
Net Book Value as at 30 June 20YY	X

Intangible Assets Note	
Cost or valuation	
As at 1 July 20YY	X
Additions	X
Disposals/Retirements	<X>
As at 30 June 20XX	X
Amortisation	
As at 1 July 20YY	X
Amortisation charge for year	X
Released on Disposals/Retirements	<X>
As at 30 June 20XX	X
Net Book Value as at 30 June 20XX	X
Net Book Value as at 30 June 20YY	X

Trade and other receivables note	Internal €'000	External €'000	Total €'000
20XX			
Amounts due within one year	X	X	X
Amounts due after one year	X	X	X
Total	X	X	X

	Internal €'000	External €'000	Total €'000
20YY			
Amounts due within one year	X	X	X
Amounts due after one year	X	X	X
Total	X	X	X

Profit and Loss Account for Retail Access for the year ended 30 June 20XX

Revenue		Volumes	20XX €'000 Actual	20YY €'000 actual
Internal revenue (Eircom customers)				
Retail line rental		X	X	X
Connection fees			X	X
Other revenue			X	X
Total Retail Access revenues			**X**	**X**
Costs				
Inter segment costs of supplying services[4]				
WLR	Volumes * WLR price		X	X
Other costs				
Fault reporting & related costs			X	X
Retail product management			X	X
Retail sales and marketing costs			X	X
Billing and collection costs			X	X
Total other costs			X	X
Corporate Overheads			X	X
Exceptional costs			X	X
Total Retail Access costs			**X**	**X**
Retail Access Profit / Loss			**X**	**X**
Retail Access Profit / Loss as a % of Mean Capital Employed			**X%**	**X%**

4 The cost of supplying services is derived directly from the Market for Wholesale Access, LLU revenues.

Retail Access Balance Sheet for the year ended 30 June 20XX

	20XX	20YY
Non Current Assets	€'000	€'000
Property, Plant and Equipment	X	X
Intangible Assets	X	X
Other	X	X
Total Non Current assets	X	X
Current Assets		
Inventories	X	X
Trade and other receivables	X	X
Cash and cash equivalents	X	X
Other	X	X
Total Current Assets	X	X
Total Assets	**X**	**X**
Liabilities		
Trade and other payables	X	X
Interest bearing loans and borrowings	X	X
Provisions for liabilities and charges	X	X
Other	X	X
Total Liabilities	X	X
Net capital employed for the year	**X**	**X**
Mean Capital Employed for the year	**X**	**X**

Retail Access notes

Property, Plant, and equipment Note	**€'000**
Cost or valuation	
As at 1 July 20YY	X
Additions	X
Disposals/Retirements	<X>
As at 30 June 20XX	X
Accumulated Depreciation	
As at 1 July 20YY	X
Charge for year	X
Released on Disposals/Retirements	<X>
As at 30 June 20XX	X
Net Book Value as at 30 June 20XX	X
Net Book Value as at 30 June 20YY	X

Intangible Assets Note	
Cost or valuation	
As at 1 July 20YY	X
Additions	X
Disposals/Retirements	<X>
As at 30 June 20XX	X
Amortisation	
As at 1 July 20YY	X
Amortisation charge for year	X
Released on Disposals/Retirements	<X>
As at 30 June 20XX	X
Net Book Value as at 30 June 20XX	X
Net Book Value as at 30 June 20YY	X

Trade and other receivables note	Internal €'000	External €'000	Total €'000
20XX			
Amounts due within one year	X	X	X
Amounts due after one year	X	X	X
Total	X	X	X

	Internal €'000	External €'000	Total €'000
20YY			
Amounts due within one year	X	X	X
Amounts due after one year	X	X	X
Total			

Appendix C – Suggested format of reconciliation statements

Reconciliation statement between Statutory Profit and Loss Account and HCA Profit and Loss Accounts

	Retail Access		Call Origination		Call Termination		Wholesale Access		WBA		Leased Lines		Mobile Voice Termination		Non regulated markets		Inter-segment transactions		Adjustments between Regulatory & Statutory Financial statements (note)		Total as per Statutory Accounts 'Profit for the financial year attributable to the equity holders of the parent'	
	20XX	20YY	20XX	20YY	20XX	20XX	20YY	20YY	20XX	20XX	20YY	20YY	20XX	20YY	20XX	20YY	20YY	20YY	20XX	20YY	20XX	20YY
	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000
Revenues																						
Internal																						
External																						
Total Revenues																						
Costs																						
Market related costs																						
Corporate overheads																						
Other costs																						
Exceptional Items																						
Total costs																						
Profit or Loss																						

Note: Commentary is required on each of the adjustments between Regulatory & Statutory Financial statements.

Reconciliation statement between Statutory Balance Sheet and HCA Balance Sheets

	Retail Access		Call Origination		Call Termination		Wholesale Access		WBA		Leased Lines		Mobile Voice Termination		Non regulated markets		Inter-segment transactions		Adjustments between Regulatory & Statutory Financial statements (note)		Total as per Statutory Accounts 'Total Liabilities and Equity'	
	20XX	20YY	20XX	20YY	20XX	20XX	20YY	20YY	20XX	20XX	20YY	20YY	20XX	20YY	20XX	20YY	20YY	20YY	20XX	20YY	20XX	20YY
	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000
Non Current Assets																						
Property, Plant & Equipment																						
Goodwill & Other Impairments																						
Other Intangible Assets																						
Other																						
Total non current assets																						
Current assets																						
Inventories																						
Trade and other receivables																						
Cash and cash equivalents																						
Other																						
Total current assets																						

Note: Commentary is required on each of the adjustments between Regulatory & Statutory Financial statements.

Reconciliation statement between Statutory Balance Sheet and HCA Balance Sheets (continued)

	Retail Access		Call Origination		Call Termination		Wholesale Access		WBA		Leased Lines		Mobile Voice Termination		Non regulated markets		Inter-segment transactions		Adjustments between Regulatory & Statutory Financial statements (note)		Total as per Statutory Accounts 'Total Liabilities and Equity'	
	20XX	20YY	20XX	20YY	20XX	20XX	20YY	20YY	20XX	20XX	20YY	20YY	20XX	20YY	20XX	20YY	20YY	20YY	20XX	20YY	20XX	20YY
	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000
Liabilities																						
Trade and other payables																						
Interest bearing loans and borrowings																						
Provisions for liabilities and charges																						
Other																						
Total Liabilities																						
Net capital employed for year																						

Note:

1. Commentary is required on each of the adjustments between Regulatory & Statutory Financial statements.
2. Goodwill, other intangible assets and impairments/write downs shall be separately identifiable on the face of the Balance Sheet

Appendix D – Suggested format of Additional Financial Information

PROFIT & LOSS ACCOUNT - RETAIL DSL - HCA																		
AFI		**Current Year**									**Prior Year**							
TURNOVER by retail product:		**1MB**	**3MB**	**7.1MB**	**7.6MB**	**12MB/1MB**	**12MB/2MB**	**24MB**	**TOTAL**		**1MB**	**3MB**	**7.1MB**	**7.6MB**	**12MB/1MB**	**12MB/2MB**	**24MB**	**TOTAL**
Rental																		
Connection																		
Other																		
Total turnover																		
COSTS by retail product:																		
Wholesale cost by retail product:		**1MB**	**3MB**	**7.1MB**	**7.6MB**	**12MB/1MB**	**12MB/2MB**	**24MB**	**TOTAL**		**1MB**	**3MB**	**7.1MB**	**7.6MB**	**12MB/1MB**	**12MB/2MB**	**24MB**	**TOTAL**
Rental																		
Connection																		
Other																		
Total wholesale cost																		
Retail cost by retail: product		**1MB**	**3MB**	**7.1MB**	**7.6MB**	**12MB/1MB**	**12MB/2MB**	**24MB**	**TOTAL**		**1MB**	**3MB**	**7.1MB**	**7.6MB**	**12MB/1MB**	**12MB/2MB**	**24MB**	**TOTAL**
Sales																		
Modem																		
Marketing																		
Product																		
Accommodation																		
Help Desk																		
Billing																		
Order handling																		
Servers and collocation																		
Corporate Overheads																		
IP Transit and Peering/ Internet																		
Backhaul																		
Other																		
Total retail cost																		
Other cost:																		
Depreciation																		
Total cost																		
Profit/(Loss)																		

BALANCE SHEET - RETAIL DSL - HCA			
AFI			
		Current Year	**Prior Year**
Non Current Assets			
Property, Plant and Equipment			
Intangible fixed assets			
Other			
Total non current assets			
Current Assets			
Inventories			
Trade and other receivables			
Cash and Cash equivalents			
Other			
Total current assets			
Liabilities			
Trade and other payables			
Interest bearing loans and borrowings			
Provisions for liablities and charges			
Other			
Total Liabilities			
Net capital employed for the year			

PROFIT & LOSS ACCOUNT - WHOLESALE DSL - HCA																
AFI	**Current Year**								**Prior Year**							
TURNOVER by Bitstream product:	**1MB**	**3MB**	**7.1MB**	**7.6MB**	**12MB/1MB**	**12MB/2MB**	**24MB**	**TOTAL**	**1MB**	**3MB**	**7.1MB**	**7.6MB**	**12MB/1MB**	**12MB/2MB**	**24MB**	**TOTAL**
Eircom Retail																
Rental																
Connection																
Other																
OAO																
Rental																
Connection																
Other																
Total turnover																
COSTS by Bitstream product:	1MB	3MB	7.1MB	7.6MB	12MB/1MB	12MB/2MB	24MB	TOTAL	1MB	3MB	7.1MB	7.6MB	12MB/1MB	12MB/2MB	24MB	TOTAL
Narrowband Access (Line Share price)																
Carrier Administration																
DSLAM																
Network Transmission																
Backhaul																
Provisioning																
Repair																
Accomodation																
Voluntary Leaving																
Other cost:																
Depreciation																
Total cost																
Profit/(Loss)																

BALANCE SHEET - WHOLESALE DSL - HCA		
AFI		
	Current Year	**Prior Year**
Non Current Assets		
Property, Plant and Equipment		
Intangible fixed assets		
Other		
Total non current assets		
Current Assets		
Inventories		
Trade and other receivables		
- inter segment		
- external		
Cash and Cash equivalents		
Other		
Total current assets		
Liabilities		
Trade and other payables		
Interest bearing loans and borrowings		
Provisions for liablities and charges		
Other		
Total Liabilities		
Net capital employed for the year		

DSL CUSTOMER NUMBERS - WHOLESALE									
AFI		**Current Year**							
Eircom Retail DSL Customer Numbers:		**1MB**	**3MB**	**7.1MB**	**7.6MB**	**12MB/1ME**	**12MB/2ME**	**24MB**	**TOTAL**
Opening									
Additions									
Cessations									
Closing									
OAO 1 DSL Customer Numbers:									
Opening									
Additions									
Cessations									
Closing									
OAO 2 DSL Customer Numbers:									
Opening									
Additions									
Cessations									
Closing									
OAO X DSL Customer Numbers:									
Opening									
Additions									
Cessations									
Closing									
Total number of DSL customers									

Appendix E – Glossary of Terms

"Bundling" means the practice of conditioning the sale of one product on the purchase of another product;

"Cost Accounting Obligation" means the obligations to be observed by Eircom as set out in Regulation 14 of the European Communities (Electronic Communications Networks and Services) (Access) Regulations 2003;

"Cost Orientation Obligation" means the obligations to be observed by Eircom as set out in Regulation 14 of the European Communities (Electronic Communications Networks and Services) (Access) Regulations 2003;

"GLUMP" means Geographic Number portability and Unbundled Local Metallic Path which enables OAOs to place one GLUMP order that will facilitate the co-ordinated delivery of a single/multi line unbundled local metallic path & geographic number portability to the end customer;

"ISDN" means Integrated Services Digital network which is the provision of dial up services at twice the speed of standard telephone connections;

"LLU" means local loop unbundling which is the regulatory process of allowing multiple telecommunications operators use of connections from the incumbents telephone exchange's to the customer's premises;

"PSTN" means Public Switched Telephone Network which refers to the international telephone system based in copper wires and carrying analog voice data. This is in contrast to newer telephone networks based on digital technologies such as ISDN;

"Regulatory financial statements" means separated accounts, reflecting the actual costs incurred and revenues generated from the provision of a service or product in a particular accounting period;

"SLU" means sub loop unbundling which is the process by which a sub-section of part of the local loop is unbundled.

"WBA" means Wholesale Broadband Access which enables OAO's to deliver a broadband offering to individual customers, under their own brand, via the Eircom network.

For further definitions of terms, see section 2 'Definitions and Interpretation' of the draft accounting Direction.

Appendix F – Consultation Questions

List of Questions

Area 1: Questions relating to proposals with regard to principles/processes

Area 2 : Questions relating to proposals with regard to disclosure in the Separated Accounts and Additional Financial Information

Area 3: Questions relating to documentation in an Accounting Document

Area 4: Questions relating to Audit proposals

Area 5: Other