Commission for
Communications Regulation

Consultation Paper

Consultation on the Proposed Financial Reporting Obligations for Dominant Mobile Network Operators having Accounting Separation and/or Cost Accounting systems obligations.

Document No:	**05/56**
Date:	**18th July 2005**

All responses to this consultation should be clearly marked:- "Reference: Submission re ComReg 05/56" 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, 12th September 2005, to:

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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 05/24.

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1 Foreword

Accounting separation in telecommunications markets is the process whereby an operator prepares accounts which present information on its constituent parts as if they were separate businesses. As far as their regulatory use is concerned separated accounts that have been well designed can be used to provide sufficient information on the profitability and costs of a regulated business in order to demonstrate compliance with certain regulatory obligations. In particular they can be used inter alia to help make decisions about the prices of regulated products. They can also be used to ensure that wholesale customers of an incumbent are charged for services on an equivalent basis as the company's own retail arm.

The need for this consultation has arisen because of the new legal framework governing telecommunications regulation in Ireland which has been in force since July 2003. In essence, this framework requires regulators to impose obligations on dominant operators in telecommunications and broadcasting markets by reference to an economic analysis of the competition problems in those markets. These problems are identified under a process known as market analysis. Remedies must address the problems identified and must be proportionate. Two such possible remedies are the obligations to prepare separated accounts and to put in place appropriate accounting systems.

This paper concerns itself with the mobile telecommunications sector only. ComReg has recently entered into a similar consultation with the fixed telecommunication sector. In the recent market analysis consultations on the mobile call termination and access and call originations markets, Vodafone and O2 were designated as being dominant in both markets, while Meteor and "3" were designated with SMP in the mobile call termination market only. On the grounds of proportionality Meteor and "3" were not imposed with an Accounting Separation or Cost Accounting obligations.

The paper sets out proposed regulatory financial reporting requirements for O2 and Vodafone on foot of obligations imposed relating to Accounting Separation and Cost Accounting imposed in both the Mobile Access & Call Origination (MACO) and Mobile Call Termination (MTR) markets[1]. ComReg stated in D6/05 that only if commercial negotiations fail or other circumstances warrant it, would it direct SMP operators to implement supporting obligations relating to Accounting Separation, price control and cost orientation, including Cost Accounting. The financial reporting obligations for the MACO market proposed in this paper would only therefore apply only where these specific obligations are implemented in accordance with D6/05. In addition the paper also proposes that reporting on retail markets would not be required in the event that the relevant MACO obligations are not implemented.

1 2 &3 - D6/05, ComReg Document No 05/27- Market Analysis – Wholesale Access and Call Origination on public mobile telephony networks.

With regard to wholesale international roaming services, the European Regulators Group (ERG) is to undertake further research among member states and when this is completed, ComReg will update this consultation as appropriate.

As in the case of the fixed network certain areas of the dominant operators business which fall outside the scope of regulation under the new rules will not need to be reported upon. On the other hand, ComReg believes that, in principle, compliance with regulatory obligations of a financial nature should be easily ascertainable by reference to the accounts and achieving this requires appropriate detail and transparency. The paper also addresses other matters such as the audit of the accounts, timelines and frequency of reporting.

2 Executive Summary

2.1 Background

Four sets of Regulations for electronic communications networks and services entered into force in Ireland, via statutory instruments, on 25 July 2003. The basis for the new regulatory framework are five new EU Communications Directives that are designed to create harmonised regulation across Europe and aimed at reducing entry barriers and fostering prospects for effective competition to the benefit of consumers.

These new Regulations require ComReg, to carry out reviews of competition in communications markets, to ensure that regulation remains appropriate in the light of changing market conditions. ComReg believes that it is useful to issue this consultation paper at this time to provide visibility to those dominant operators who are subject to an Accounting Separation and/or a Cost Accounting obligation.

The paper sets out proposed regulatory financial reporting requirements for O2 and Vodafone on foot of obligations imposed relating to Accounting Separation and Cost Accounting imposed in both the Mobile Access & Call Origination (MACO) and Mobile Call Termination (MTR) markets[3]. ComReg stated in D6/05 that only if commercial negotiations fail or other circumstances warrant it, would it direct SMP operators to implement supporting obligations relating to Accounting Separation, price control and cost orientation, including Cost Accounting. The financial reporting obligations for the MACO market proposed in this paper would only therefore apply only where these specific obligations are implemented in accordance with D6/05. In addition the paper also proposes that reporting on retail markets would not be required in the event that the relevant MACO obligations are not implemented.

The primary objective of Accounting Separation and Cost Accounting is to enable the creation of meaningful financial information on products and services or groups of products and services within the relevant markets as define by the EU. More specifically, the information is designed to assist ComReg in relation to the following:

- Assessing the relationship between charges and costs i.e. to monitor the cost orientation obligation;
- Assessing if unfair cross subsidisation, including margin squeezes, exists between the wholesale and retail markets and non SMP markets;
- Assessing the profitability and the return on capital of individual services and groups of services within the relevant markets; and
- Examining the level of infrastructure sharing costs and revenues.

2.2 The aim of the Document

This document outlines the proposed financial obligations for Dominant Operators following the market review process in the mobile telephony market. This document sets out common principles that can be applied to mobile operators in all areas of their business where an obligation of accounting separation, cost orientation or cost accounting systems has been designated. Appendices are attached which contain examples of schedules that might apply to a dominant mobile operator.

2.3 Summary of Proposed Obligations

2.3.1 General

In summary the proposed obligations will ensure the transparent, timely and accurate publication of financial information with respect to services provided by MNO's. The proposed information/reporting requirements are Profit and Loss Accounts and Statements of Mean Capital Employed (together with supporting schedules) for the services i.e. mobile termination rates and possibly mobile access and call origination rates. The details of the proposed services to which these proposed obligations will apply are listed in Annex A. Annex B and C shows the appropriate Regulatory Financial Statements and other schedules which could be required.

2.3.2 Maintenance of accounting records and systems

ComReg is proposing that accounts be prepared annually. It may also require that systems be able to deliver accounts more frequently should this become a requirement in the future. In addition ComReg is likely to have ongoing information requirements e.g. in order to settle disputes or conduct investigations where this proves necessary. ComReg proposes that systems should be capable of providing sufficient information to demonstrate the SMP MNO's compliance with relevant obligations in a reasonably timely manner.

2.3.3 Preparation, delivery and publication of Annual Regulatory Statements

ComReg proposed the financial statements that it considers should be produced by the Dominant Operators. Further details of these schedules are set out in Annex B and C.

2.3.4 Accounting Documentation

ComReg considers that adequate transparency and disclosure of the basis of preparation of the financial statements is essential. ComReg is proposing that

Dominant Operators should adhere to a transparency principle for the financial reporting of the Dominant Operators. ComReg proposes two levels of documentation. The first level would be intended for publication. The second level would be more detailed and would be primarily for ComReg's use, although it is proposed to be published, subject to confidentiality considerations.

2.3.5 Amendment issues

ComReg is proposing that it should be able to direct changes to the financial reporting obligations by way of consents in the event of, for example, deficiencies being found. The issue of consent is discussed later in this paper.

2.3.6 Audit issues

ComReg believes that an assurance as to the reliability and relevance of the financial information can only be provided by a rigorous audit. ComReg also considers the issue of the duty of care to regulators.

Therefore, ComReg proposes that there is flexibility in the use of audit opinions. by using for high level Financial Statements a "Fairly Presents in Accordance with" (FPIA) style audit opinion and a more flexible audit opinion on the various financial statements as set out in Annex B and C;

ComReg also discusses if it should have a say in the appointment or re-appointment of the regulatory auditor. It also raises the issue as to whether it is appropriate or feasible that the regulatory auditor should owe it a duty of care.

2.3.7 Mobile Issues

There are a number of specific issues relating to Mobile Regulatory Financial Statements which are discussed in Chapter 14.

2.3.8 Implementation of proposals

ComReg accepts that some of the proposals for financial reporting will require time to implement. Therefore, ComReg proposes that it should discuss a realistic but rigorous timetable with the Dominant Operators for the implementation of the steps necessary for compliance with these obligations. ComReg proposes that this timetable should be formalised in conjunction with the Dominant Operators. This would provide a reasonable balance between responding to the reasonable needs of the Dominant Operators and ensuring that the timetable can be enforced. However ComReg believes that it should take no longer than 18 months from the date of the Directions for these proposals to be implemented.

2.4 Confidentiality Issues

ComReg is aware that there may be issues of commercial confidentiality in the accounting documentation and the level of disclosure in the financial statements. These issues are discussed later in this paper and Annex B and C identifies the financial statements/schedules, which ComReg is proposing should be published and those which should be provide to ComReg only.

In all cases, ComReg will have due regard to the issue of confidentiality as set out in Regulation 12 (4) of SI No. 35 of 2003 and is currently consulting on the issue of confidentiality in a separate consultation.

2.5 Consultation Process

All responses to this consultation are welcome. However it would make the task of analysing responses easier if comments were referenced to the relevant question number from this document. The Consultation period will run from 18th July 2005 to 12th September 2005 during which time ComReg welcomes comments on any issues raised in this paper. ComReg would be happy to discuss the contents of this consultation e.g. to clarify any issues prior to formal submissions being made.

3 Introduction

3.1 A New Regulatory Regime

This consultation paper sets out the regulatory financial reporting requirement on foot of an Accounting Separation and Cost Accounting obligations imposed on both the Mobile Access & Call Origination (MACO) and Mobile Call Termination (MTR's) markets. Chapters 6 to 10 set out the general obligations which could be applicable to both MTR and MACO markets. Chapter 11 and 12 sets out the specific cost accounting and accounting separation obligations which could also be applicable to both markets. Chapter 13 sets out retail reporting requirements. This paper proposes that these retail requirements would apply only where MACO specific obligations are implemented in accordance with Decision Notice D6/05.[4]

In addition, Annex B and C to this consultation sets out in indicative format the proposed financial statements and supporting schedules. Annex B deals specifically with MTR schedules, while Annex C deals with MACO schedules. Again, the provision of MACO related information will be contingent on the conditions set out in D6/05.

3.2 A New Regulatory Regime

Four sets of Regulations,[5] which transpose into Irish law four European Community directives on electronic communications and services,[6] entered into force in Ireland on 25 July 2003. The final element of the EU electronic communications regulatory package, the *Privacy and Electronic Communications Directive*, was into Irish law on 31 October 2003. The Minister for Communications, Marine and Natural Resources has consulted on the draft regulations.[7]

The new communications regulatory framework requires that ComReg define relevant markets appropriate to national circumstances, in particular relevant geographic markets within its territory, in accordance with the market definition

4 ComReg Document No 05/27- Market Analysis – Wholesale Access and Call Origination on public mobile telephony networks.

5 Namely, the European Communities (Electronic Communications Networks and Services) (Framework) Regulations 2003 (S.I. No. 307 of 2003), ("the *Framework Regulations*"); the European Communities (Electronic Communications) (Authorisation) Regulations, 2003 (S.I. No. 306 of 2003), ("the *Authorisation Regulations*"); the European Communities (Electronic Communications) (Access) Regulations 2003 (S.I. No. 305 of 2003), ("the *Access Regulations*"); the European Communities (European Communications) (Universal Service and Users' Rights) Regulations 2003 (S.I. No. 308 of 2003), ("the *Universal Service Regulations*").

6 The new regulatory framework for electronic communications networks and services, comprising of Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services, ("the *Framework Directive*"), OJ 2002 L 108/33, and four other Directives (collectively referred to as "the *Specific Directives*"), namely: Directive 2002/20/EC of the European Parliament and of the Council on the authorisation of electronic communications networks and services, ("the *Authorisation Directive*"), OJ 2002 L 108/21; Directive 2002/19/EC of the European Parliament and of the Council on access to, and interconnection of, electronic communications networks and services, ("the *Access Directive*"), OJ 2002 L 108/7; Directive 2002/22/EC of the European Parliament and of the Council on universal service and users' rights relating to electronic communications networks and services, ("the *Universal Service Directive*"), OJ 2002 L 108/51; and the Directive 2002/58/EC of the European Parliament and of the Council concerning the processing of personal data and the protection of privacy in the electronic communications sector, ("*the Privacy and Electronic Communications Directive*"), OJ 2002 L 201/37.

7 ComReg Document No. 03/99 outlines ComReg's response to the draft regulations.

procedure outlined in the *Framework Regulations*.[8] In addition, ComReg is required to conduct an analysis of the relevant markets to decide whether or not they are effectively competitive.[9] Where it concludes that the relevant market is not effectively competitive (*i.e.,* where there are one or more undertakings with significant market power ("SMP")), the *Framework Regulations* provide that it must identify the undertakings with SMP on that market and impose on such undertakings such specific regulatory obligations as it considers appropriate.[10] Alternatively, where it concludes that the relevant market is effectively competitive, the *Framework Regulations* oblige ComReg not to impose any new regulatory obligations on any undertaking in that relevant market, and withdraw any obligations that it may have imposed at an earlier stage[11].

Regulation 14(5) of the Universal Service Regulations require an undertaking that is subject to retail tariff regulation to operate and maintain a cost accounting system that based on generally accounting practices; suitable for ensuring compliance with the Universal service regulations and is capable of verification by the Regulator. Regulation 14(6) states that the regulator may specify the format and accounting methodology to be used.

This Consultation paper proposes the financial reporting requirements in relation to both Mobile Access and Call Origination (MACO) and Mobile Voice Call Termination Rates (MTR's). These obligations apply to O2 and Vodafone who have been found to be dominant in these markets. ComReg considers it to be appropriate and efficient to have one comprehensive consultation incorporating the reporting requirements for both markets as certain aspect of these would be similar and it would reduce the lead time for implementation should the proposals need to be implemented at a later date.

It is beyond the scope of this paper to assess whether remedies in relation to Cost Accounting Systems or Accounting Separation are appropriate to the particular competition problems in a particular market which has been found not to be effectively competitive. This assessment has been or is being carried out elsewhere as part of the market analysis process. The scope of this paper is to consult on the general requirements that are likely to be imposed on foot of the imposition of either or both of the obligations of accounting separation and cost accounting systems. In addition ComReg also presents its preliminary views on what information might be required for particular markets on the assumption that the proposals regarding market power and remedies in particular are maintained through to a final decision unchanged. This has been done in order to provide readers with a clear idea of the impact of ComReg's proposals but these are subject to modification or, indeed elimination.

[8] Regulation 26.
[9] Regulation 27.
[10] Regulation 27(4).
[11] Regulation 27(3).

3.3 Using this Document

The remainder of the Document comprises the following:

Chapter 4 discusses the requirements for regulatory financial information in general, the relationship of financial information obligations to other SMP obligations, describes the concepts of cost accounting and accounting separation and identifies the important characteristics required of financial information. This chapter explains why financial information is an essential part of regulation.

Chapter 5 discusses the ways in which financial performance can be monitored for economic and regulatory purposes. This chapter addresses the principles underlying financial and economic performance measurement for regulatory purposes. The majority of this chapter deals with relatively technical accounting and economic issues such as the regulatory requirements for different measures of cost e.g. incremental and stand alone costs.

Chapter 6 introduces and describes the proposed general obligations and the cost accounting and accounting separation obligations and how these obligations will be applied.

Chapters 7 to 10 discuss the proposed general obligations required in maintaining a Cost Accounting/Accounting Separation obligation. These chapters also set out the basis of preparation, audit, publication and accounting documentation requirements. The proposed obligations in these chapters support the Cost Accounting, Accounting Separation and Retail information obligations.

Chapter 11 sets out the proposals for Cost Accounting obligations.

Chapter 12 sets out the proposals for Accounting Separation obligations.

Chapter 13 sets out the proposals for retail accounting information.

Chapter 14 provides an overview of the attached annexes.

Chapter 15 deals with specific mobile issues.

Chapter 16 sets out the proposed implementation and transitional arrangements for dominant operators to comply with the proposed obligations.

4 The need for Financial Information.

4.1 Introduction

Financial reporting is an essential part of regulation as certain obligations, i.e. the obligation of cost orientation, will often depend on good quality financial data which can be easily traced back to the business as a whole. This information could take the form of:

- annual financial statements that enable ongoing monitoring to be carried out; or
- on request reports that are prepared and delivered in response to a particular regulatory interest, for example an investigation.

There is a considerable body of generally accepted literature relating to accounting, economics and law that covers the way in which accounting operates in telecommunications markets. The following chapters provide a summary of this as an introduction to the way ComReg proposes to implement this theory.

4.2 How financial information is used

ComReg may require financial information for a variety of reasons. These include:

- monitoring compliance for cost orientation and non-discrimination;
- investigations into alleged anti-competitive practices;
- own initiative investigations into potential anti-competitive practices;
- monitoring obligations to prevent anti-competitive practices;
- setting and monitoring price controls and caps;
- input into discounted cash flow calculations e.g. with respect to margin squeezes;
- Ensuring other remedies operate effectively;
- Assisting in the performance of retail minus calculations;
- Monitoring of excessive pricing at wholesale and retail level; and
- Reviewing prices and costs for unfair cross subsidisation;

4.3 Management Accounts v Regulatory Accounts

The purposes to which regulatory financial information is put are not necessarily the same as those used for managing a company. Management accounting information is prepared in order to help management run their business and often focuses upon the particular issues most relevant to them. On the other hand, if appropriately structured, and an appropriate accounting basis used, management accounts may be directly useable for some regulatory purposes.

However, this is often not the case because the management accounts structure, in both large and small organisations reflects organisational and responsibility structures rather than markets defined in economic terms as used in telecommunications regulation. The cost basis used may also be different. For example, the use of Long Run Incremental cost (LRIC) and Current Cost Accounting (CCA) on a market by market and service by service basis are not common commercial practice. The business issues that these tools attempt to represent are normally taken into account in different ways, using different techniques by commercial enterprises.

It is therefore necessary for ComReg to develop and establish a financial reporting regime that meets their requirements for regulatory financial information that can be used to make economic regulatory decisions and to monitor compliance with other obligations. However, although the purposes are different, many of the systems, processes and outputs will be similar to those used by the companies for normal commercial reasons.

4.4 Characteristics of high quality financial information

Before discussing the types of the regulatory financial reporting that ComReg needs to impose, it is worth considering the qualitative characteristics of good quality financial information. These should form a foundation for the sector specific, regulatory obligations. ComReg is proposing to impose. ComReg intends to follow the guidance set out by the Accounting Standards Board and detailed in the ERG Opinion on Accounting Separation and Cost Accounting[12] which requires that financial statements possess attributes which are listed below for illustrative purposes

- Relevance e.g. that the financial statements address particular components or services
- Reliability e.g. that the financial statements can be audited;

[12] ERG Opinion on proposed changes to the Commission Recommendation of 1998 on Accounting separation and cost accounting.- ERG (04) 15rev1 and the Annex to ERG (04) 15rev1 "ERG opinion on the proposed review of the recommendation on cost accounting and accounting separation"

- Comparability e.g. that one year is prepared on the same basis as another;

- Understandability; e.g. that the basis of preparation is clear and transparent; and

- Materiality e.g. that the numbers are fairly presented

Some of these characteristics have specific implications for regulatory reporting. In particular with respect to understandability it is necessary that the information is sufficiently granular. Granularity is a feature of all accounting systems, whether their output is used for regulatory or commercial purposes. It describes the level of detail at which information can be obtained from the accounting system. If an attempt is made to obtain information at a level of detail beyond a financial system's granularity, the information obtained may not be reliable. A key difficulty is that when the inherent granularity capability of a system is exceeded, this is not necessarily apparent to the user of the financial information because the financial information can still be compiled but may provide an impression of accuracy and reliability which is in fact spurious.

This is particularly problematic if the methods of preparation are not transparent. One way in which this problem can be overcome is to have transparent methods of valuation, attribution and accounting which would enable the user to assess whether, in their view, and for the purposes for which they are using this information the prepared numbers could be relied upon. Another means is to have an independent auditor express an opinion on the accounts. However, in practice, an auditor may not believe that it is possible to express an opinion to fully meet the needs of the regulatory authority. ComReg is of the view that both approaches have a part to play.

4.5 Types of financial reporting under the new framework

Two types of financial reporting obligations are defined in the Framework Regulations: Accounting Separation and Cost Accounting Systems. The two sub-sections below briefly describe the purpose of each type of financial reporting. The proposals relating to implementing cost accounting and accounting separation are dealt with in later chapters in this consultation.

4.5.1 Cost Accounting Systems

Cost Accounting systems can be necessary where there is an obligation on a Dominant Operator in relation to:

- cost oriented prices;
- price controls, including retail minus tariffs;

- recovery of costs;
- retail tariff financial information and / or
- on request financial reporting

Cost is an important issue in regulation. A Dominant Operator can be required to ensure that certain prices are derived from costs. ComReg can impose price controls which can force a Dominant Operator to cap or reduce prices. In both cases it is essential – if these obligations are to be meaningful – that there is a clear and comprehensive understanding of the costs of the Dominant Operator and how these are attributed to different parts of the Dominant Operator's activities. Given the prevalence for common costs in telecommunications, the cost accounting process is potentially complex.

4.5.2 Accounting Separation

Accounting Separation will be necessary where an obligation of non discrimination is imposed and/or there is a concern that a Dominant Operator may make unfair cross-subsidies or cause margin squeezes. Price discrimination can be revealed by making transparent all the wholesale prices and internal transfer prices of a vertically integrated company. Margin squeezes can be monitored by access to Retail Financial Information. Cross subsidy can be identified by:

- designating certain activities of the Dominant Operator as separate for accounting purposes;
- requiring the Dominant Operator to account for those designated activities in a manner which reflects, as closely as possible, the performance which those activities would have shown if they had been operated as separate businesses; and
- the use of audit opinions and notes to the accounts.

This is a similar concept to that which currently exists in the fixed telecommunication market in connection with parts of the "regulatory accounting businesses" for eircom. To enable comparable 'internal services' to be identified and the impact of their use to be quantified financially it is necessary to establish the nature of external services supplied and, to the extent that equivalent internal services are also supplied, to identify differences between the two. One way to do this is to show the components and routing/usage factors that make up both internal and external services.

Accounting Separation is also a prerequisite for Cost Accounting obligations, since these cannot be implemented without some form of separate accounts, to break out the profitability and/or costs of products or services which have the cost accounting obligation.

Finally, it is important to note that the two types of remedy can be mutually reinforcing. Accounting Separation can help ensure that costs used for pricing purposes reconcile to the business as a whole and that costs are neither double counted nor omitted. On the other hand cost accounting systems can help ensure that the costs allocated to activities within the separated accounts are accurate and reliable.

4.6 Links between Remedies:

As noted above, financial information needs to have a number of attributes. In order to achieve each of these attributes it is often necessary to use a combination of remedies. Accounting separation is necessary to divide the overall business into certain areas, as well as ensure non discrimination across certain boundaries. Cost accounting systems are needed to break down these area product or service costs so that their appropriate constituent costs can be seen. Finally transparency is necessary to understand how these service costs are calculated. Without all three remedies, the others lose much of their value and the major remedy, whether, for example, access on fair and reasonable terms or cost orientation of prices, may be impossible to implement and monitor.

Q. 1. Do you agree that ComReg has a requirement for financial information in the way set out in Chapter 5? If not, please suggest what you consider (i) the purposes for which it would need financial information are (ii) what other financial information is required and (iii) other methods ComReg could use to obtain robust data?

5 Financial Information in a Regulatory Context

5.1 Introduction

This chapter examines the principles which underlie financial and economic performance measurement for regulatory purposes. In particular it discusses and explains:

- the basis on which financial information for regulatory purposes needs to be prepared;
- why there may be more than one measure of cost for a service or combination of services and the particular measures of cost necessary for regulatory purposes;
- what information is required to calculate the particular measures of cost necessary for regulatory purposes and the implications for the conceptual framework of the financial accounting and reporting arrangements of the Dominant Operator, if it is to be capable of providing appropriate; financial information in relation to services regulated under the Statutory instruments; and
- alternative methods of calculating costs and prices.

In this chapter as the majority of the principles discussed apply equivalently to both 'retail products' and 'wholesale services', the word 'service' will be used generically to describe whatever the operator is supplying (to avoid repeated use of phrases like 'service and/or product') i.e. 'service(s)' may be products, goods or services, as the context requires.

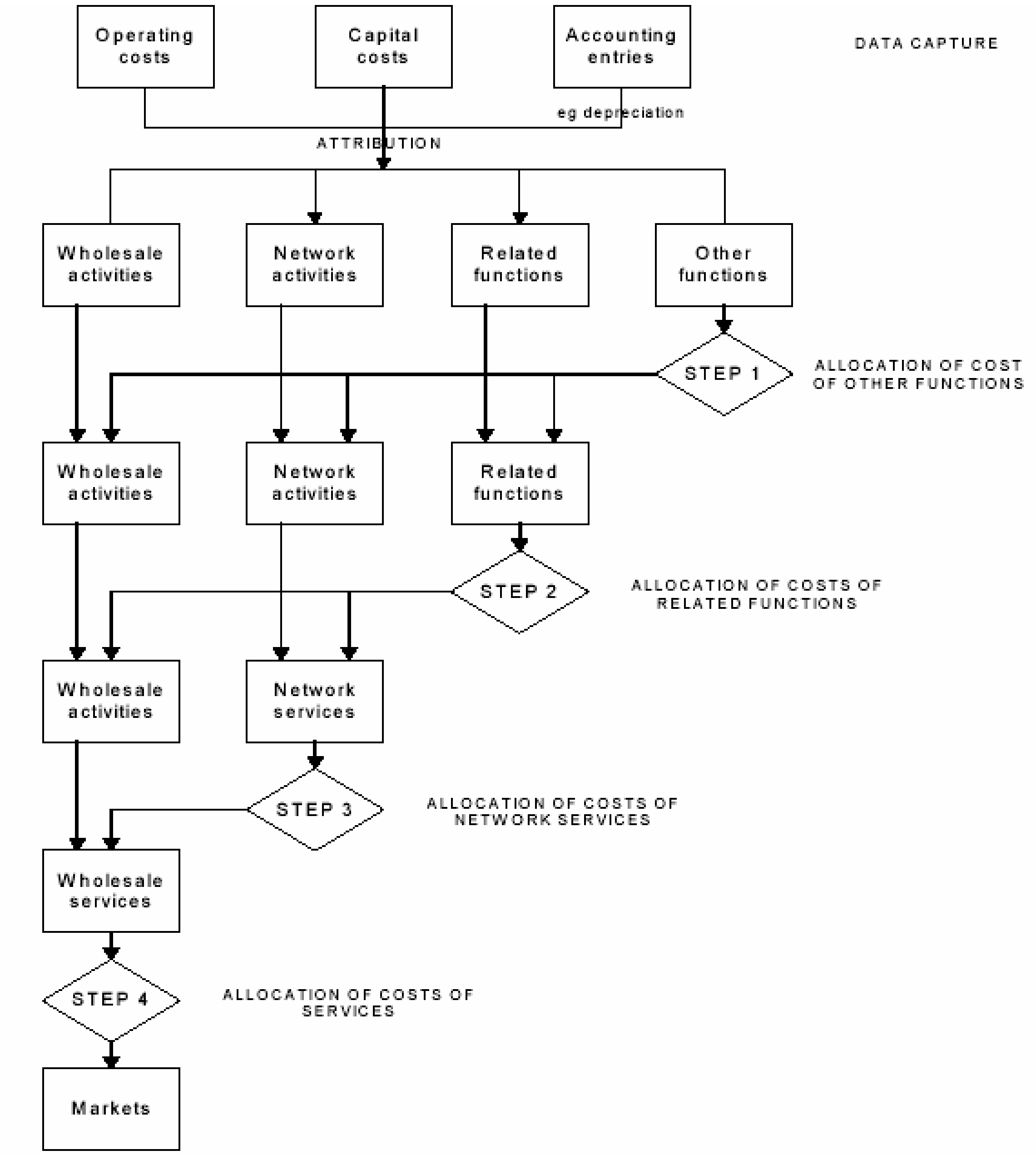
The following chapters will cover the specific implementation of these concepts with respect to MNO's which have been designated with an accounting separation and cost accounting obligation.

5.2 General Basis on which financial information needs to be prepared

ComReg will require a Dominant Operator to have financial accounting and reporting arrangements which have the integrity and reliability necessary to produce relevant, reliable, comparable and timely financial information in connection with a service or combination of services in SMP markets where cost accounting and/or accounting separation obligations are imposed. Without this level of information the cost measurements underpinning cost oriented prices or price controls for example could be erroneous. In particular, ComReg is proposing that a Dominant Operator maintain financial accounting and reporting arrangements capable of supplying financial information:

- on a historical and /or current/LRIC cost basis using the Financial Capital Maintenance concept;

- that attributes costs to the services supplied (both externally and, where there is accounting separation, internally) using an activity based 'causal' basis in which a cost is attributed to a service only if it is necessarily incurred in the course of providing the service (either alone or in combination with other services). This requires the activities undertaken in the course of supplying a service to be clearly identified and understood. The key issues revolve around the services undertaken, the identification of the activities underlying their provision and the matching of revenue, assets, liabilities and costs to those services via the activities undertaken in the course of supplying those services (a stylised illustration of this process is set out below).



5.3 Why there is more than one measure of cost for a service

Whenever services are produced in conjunction with each other, there is generally more than one measure of the cost of a service (or combination of services). Communications services, in particular wholesale communications services, have some distinctive features which need to be taken into account when determining the measure(s) of cost to be used for regulatory purposes, for example:

a) by providing a range of services in many economically distinct markets, communications operators often obtain economies of scale (where costs per unit fall as output increases, for example because certain of the costs of production are fixed); and/or economies of scope (where costs per unit fall when services are produced in conjunction with each other because activities undertaken to support a given service in one market also support other services in the same market and other services in other markets)

b) high levels of 'sunk cost' often exist (costs which, having been incurred, are of benefit to future activities but which may not subsequently give rise to any further expenditure), typically such costs could be incurred by developing and building networks capable of supplying a range of services.

Cost measurement is also made more complex by the fact that there is rapid technological progress in the goods and services which communications use and provide and that competing network operators need to be interconnected (features which are discussed below).

A number of cost measurement approaches using the companies own information have been developed to address these features of communications services for regulatory purposes and to enable the costs of activities carried out in the course of supplying the services to be calculated. Relevant cost measurement concepts include:

- *incremental cost* (IC) –is the amount by which the total cost for all the services supplied changes if a particular service, or combination of services, (the 'increment') is supplied in addition to all of the other services already being supplied;

- *stand-alone cost* (SAC) – this is the cost of providing a particular service or combination of services alone, in the absence of all of the other services actually supplied; and

- *fully attributed cost* (FAC) and *incremental cost plus* (IC+), including LRIC (Long Run Incremental Cost) – these are the costs of providing a particular service (or combination of services) when supplied in conjunction with specific other services and where the benefit from 'carrying out the service in conjunction with other services' (i.e. the common costs) is distributed amongst the services appropriately, so as to allow for full cost recovery. Although the 'fully attributed cost' (FAC) and the 'incremental cost plus' (IC+) both distribute this benefit of commonality of cost, they can do so by differing means and are not necessarily equal to each other. The use of common drivers between FAC and LRIC is recommended to provide consistency. FAC is also an important stepping stone since most top down models use it as an intermediate step to LRIC. If LRIC models are not developed it can be a useful measurement / proxy for cost oriented prices in its own right.

- *Avoidable Costs*. These costs are often used to support retail minus pricing arrangements. In this circumstance, the nature of the cost will depend on the precise service being offered and the information required will vary accordingly. In pricing a wholesale service it may be restricted to retail costs only. Where elements of the wholesale service are being provided by the wholesale customer information on the relevant wholesale product/services or groups of products/services may also be required. This is further discussed in Chapter 13.

- *Unavoidable Incremental Costs*. Often interpreted as the extra cost that *must* be incurred to bring a wholesale product to a point where it can be offered to a retail customer and to sell that product. This is an important concept in margin squeeze testing. Whether or not the incumbent's own costs are the relevant ones is an important question, but is beyond the scope of this paper. Nevertheless, margin squeeze testing may require the identification of certain costs to assist in this process.

5.4 Nature of Regulatory Information

In order to determine the information required for regulatory purposes (and the information which is not necessary), it is necessary to explore the nature of the costs incurred by activities undertaken in the course of supplying a service (or combination of services. Accordingly, to establish one or more of the measures of cost set out above for a given service it is necessary to:

- establish the costs, assets, revenues and liabilities associated with all of the activities underlying the supply of the service;

- have rules which, amongst other things, address how the costs associated with shared activities are distributed between the services ultimately supplied (since the majority of activities will be carried out in the course of supplying more than one service, or services to more than one market). In order to have certainty in the determination of cost, these rules must address complex practical issues; and

- document the costs and rules e.g. via Financial Statements and methodology documents.

This does not mean that complete detailed financial information is required in relation to services other than those in SMP markets having a financial reporting obligation. Detailed financial information relating solely to particular services supplied in markets not having SMP designation, or not having a financial reporting obligation, is of no relevance to ComReg for the purpose of accounting separation or cost accounting obligations. The exception to this is that ComReg will need to be sure that costs which are common to regulated and unregulated services are fairly attributed on a non discriminatory basis. Failure to do this could result in costs which should be allocated to a competitive market being allocated to a regulated market with the consequence increases in prices and loss in welfare for consumers, or if the reverse were true, could result in predatory prices or cross subsidies which could have a harmful effect on competition.

Furthermore, ComReg also believes that it is important to reconcile the costs of particular activities back to total costs in the statutory financial statements. If this is not done, there is an increased risk that costs might be double counted or omitted entirely.

As a consequence, the financial, management and regulatory accounting and reporting arrangements of the Dominant Operator must ensure that the activities undertaken in the course of supplying services to a market (and the costs assets and liabilities associated with those activities) are transparently and properly identified and accounted for and reported upon in a manner sufficient to meet the following requirements:

a) in relation to SMP markets where a cost accounting obligation has been imposed on the Dominant Operator, to enable the evaluation of whichever of the cost measures are necessary for services in those markets (be that e.g. Retail Minus, LRIC, SAC, LRIC+ and/or FAC); and

b) in relation to SMP markets where an Accounting Separation obligation has been imposed, to enable a separation for accounting purposes of that market, the services within it and any individually identified activities undertaken in the course of the supply of those services.

5.5 Essential Features of Regulatory Financial Information

The financial accounting and reporting arrangements of the Dominant Operator must ensure that:

a) it can demonstrate that:

- the resulting costs for a given service have been properly and appropriately derived from the entirety of financial information relating to all services;
- the separation for accounting purposes of the relevant market, its services and any individually identified activities has been properly and appropriately carried out;

b) the completeness of the financial data relating to services supplied in SMP markets is verifiable;

c) in order to provide assurance as to the reliability of financial information, an ‘audit trail’ exists that is sufficient to enable these matters to be verified and reported upon; and

d) it has sufficient, documented procedures, processes, checks and controls ('financial/internal controls') over the collection and processing of financial and operational information including control totals and reconciliations for the aggregate of services supplied to non SMP markets together with appropriate levels of transparency to show that Discrimination and other abuses are not taking place. Examples of such a financial control would be that the financial information related to services in SMP markets reconciles to the Dominant Operator's statutory financial Statements or that there are mechanisms to ensure that all volumes have been correctly accounted for and the customer correctly billed for all services or goods rendered.

A Dominant Operator may provide services in a number of markets and may, for organisational reasons, divide the activities required to supply those services amongst a number of 'business units'. However, the manner in which a Dominant Operator organises itself is, for regulatory purposes, irrelevant and consequently is of no interest to ComReg in setting SMP obligations.

The division of activities relevant to ComReg for regulatory purposes is the division of services, and the activities which underlie them, between economic markets. ComReg therefore does not consider that these operators, from the point of view of the provision of regulatory financial information are vertically integrated. Since large undertakings may supply services in a wide range of markets, the market in which a given service is supplied may be:

- a regulated telecommunications market in which it has SMP;
- a non regulated communications market; or
- a regulated or non regulated market outside communications.

Therefore, these services (and the activities underlying them) may be regulated to differing extents or, indeed, fall outside the scope of communications regulation. Consequently, if the relevance, reliability, comparability and understandability of the cost accounting information produced are to be sufficient for ComReg's purposes, it is necessary to ensure that:

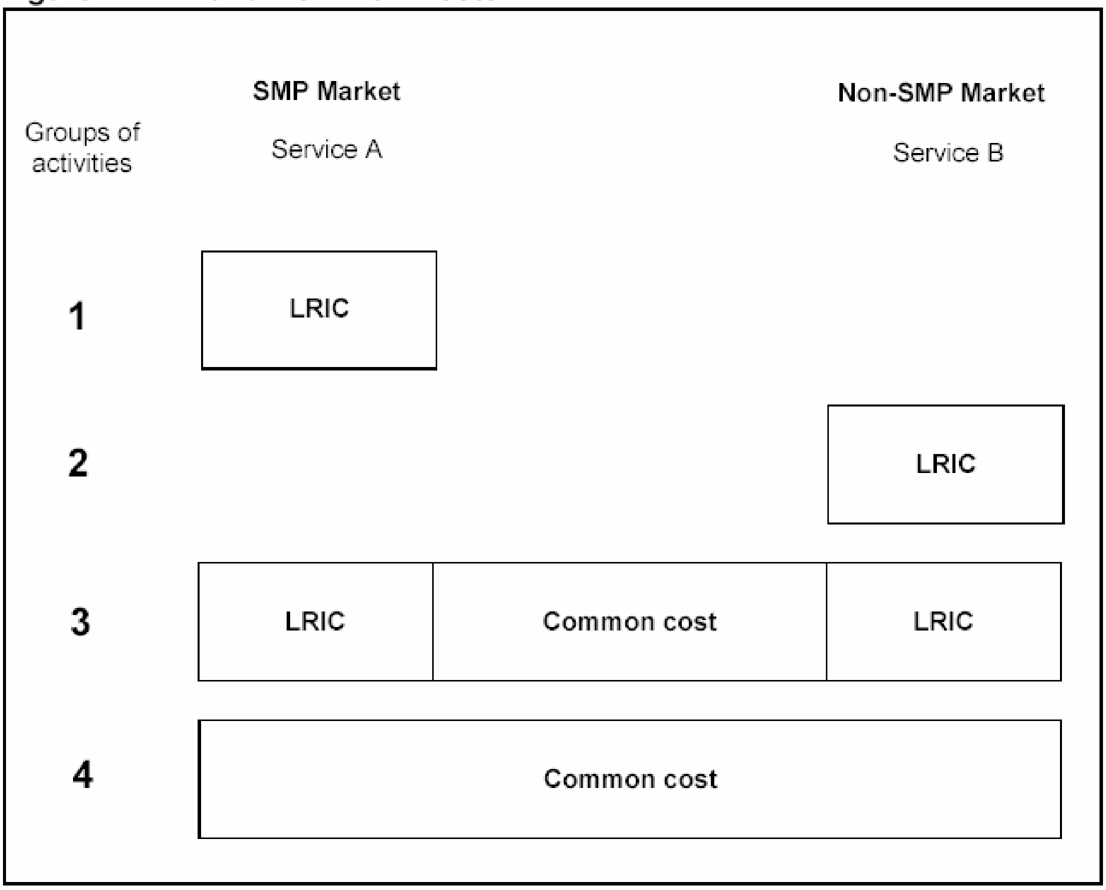
- the level of detail into which the market and the services carried out in that market is analysed is appropriate; and
- the activities underlying the provision of those services are identified in an appropriate level of detail. Where the services share underlying activities, any grouping of either aids understanding, and is useful.

5.6 The need for information in non SMP Markets

In providing a range of services in many markets, communications operators obtain economies of scale and scope if activities supporting services in one market also support other services in the same or other markets. This section considers some of the implications of the need to have LRIC, SAC and LRIC plus mark-up (referred to henceforth as LRIC+) cost information in such circumstances and also explains diagrammatically how such numbers can be derived.

The issue can be illustrated using a very simple example, which is depicted in Figure 1; the cost of a service is built up from the costs of the relevant groups of activities required to supply it. For simplicity the diagram shows only two services and four groups of activities undertaken in the course of supplying those services (in reality many hundreds of services and groups of activities may be involved).
Service A is assumed to be in a market in which SMP is designated and a cost accounting obligation is imposed, whereas service B is in a market in which there is either no SMP or no cost accounting obligation (for simplicity these are

Figure 1 LRIC and Common Costs



respectively abbreviated in this section to ‘SMP’ and ‘non SMP’). Activity groups 1 and 2 (and their costs, assets and liabilities) are assumed to be wholly incremental to

services A and B respectively (these costs correspond to the costs which in the FAC framework are ‘distinguishable’).
Activity group 4 (its costs, assets and liabilities) is assumed to be a pure ‘common cost’ between A and B - this is a major simplification for illustrative purposes, since it would be more typical for activities to have some costs that are incremental to the relevant services and some that are common between them. Activity group 3 (and its costs assets and liabilities) represents this more typical situation; its costs are incremental but in the FAC framework are not ‘distinguishable’. (This concept will be discussed in further detail later in this chapter)

By way of example, consider the activities of a Human Resource (HR) function: the larger the number of employees in the organisation, the greater the number of HR employees will be required (so some of the activities and associated costs are ‘incremental’); but to carry out the HR function a certain minimum number of employees will be required and, as the number of employees in the organisation increases, the number of HR employees required may not rise proportionately (so some of the activities and associated costs are ‘common costs’).

In order to obtain LRIC+ the common cost (arising in activity groups 3 and 4) is apportioned to services A and B, on an appropriate basis. The resulting LRIC+ of service A is depicted in Figure 2 as the cost within the dotted box (which is intended to depict the inclusion of an appropriate proportion of common costs, see below). In order to determine the LRIC+ of service A, it is:

- necessary to establish what activities, if any, support both it and service B and then for the costs, assets and liabilities associated with those activities to be determined;

- not necessary, once the LRIC of B has been derived, to establish any details of the activities incremental only to service B (supplied to the non SMP market), nor to determine any details of the LRIC associated with them. However, it is necessary to be able to show that the activities incremental only to service B are incremental only to that service. This involves assessing the relationship between the volume of its supply and the costs of its provision, in order initially to determine what the LRIC of B is for a suitably defined increment (and to be able to reconcile the financial information); in a transparent and documented way; and

- essential, in order to be able to determine the appropriate mark up for the purposes of LRIC+, to determine the amount of common cost associated with activity groups ‘3’ and’4’ that needs to be apportioned. Depending upon the mark up methodology appropriate to the circumstances further information may be required – for example, if EPMU is applied the ratio of the LRIC of service B to the aggregate LRIC of service A and service B together will be required.

Figure 2 LRIC+

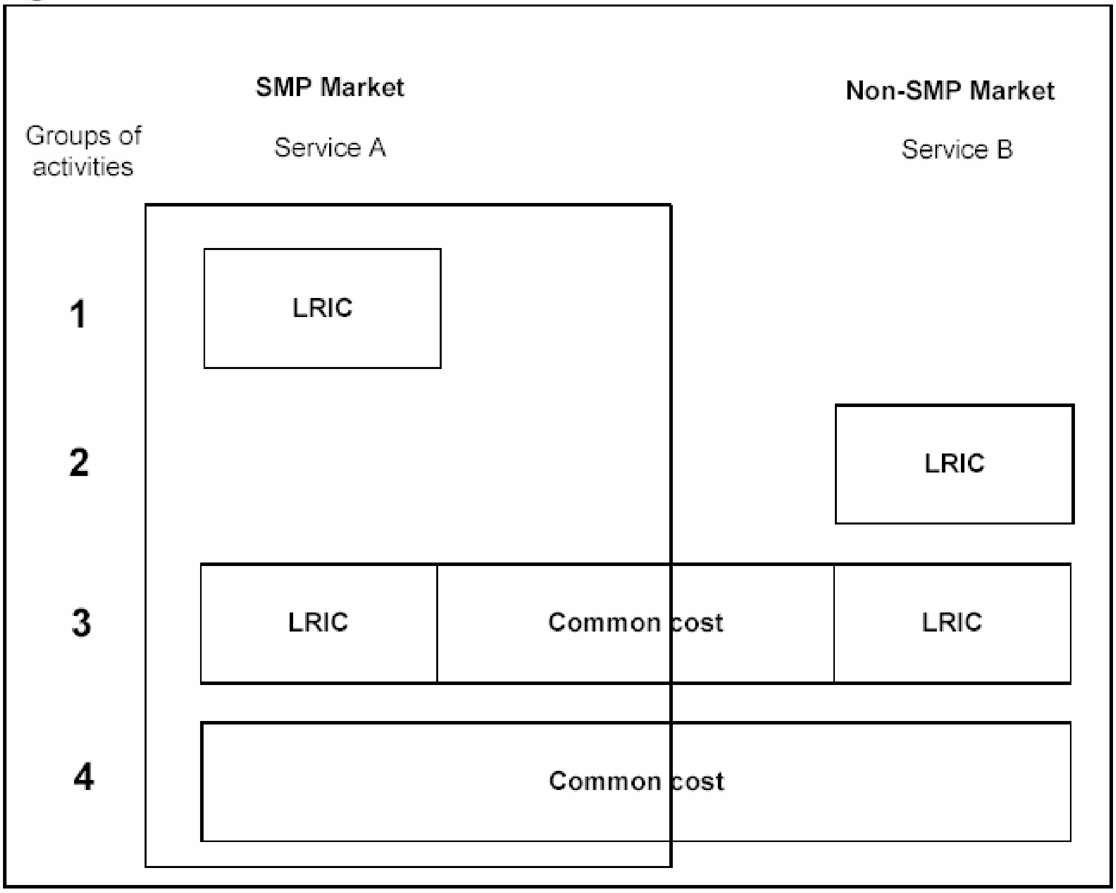
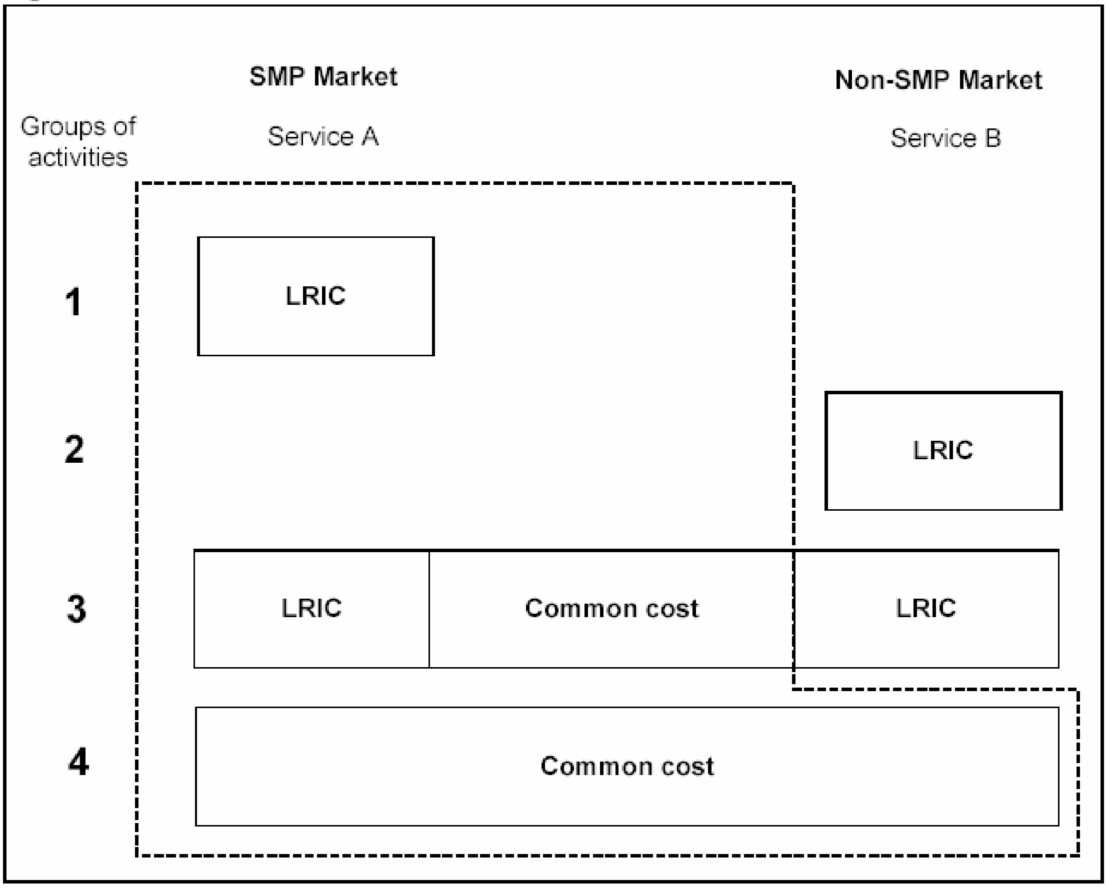


Figure 3 illustrates the derivation of SAC. The SAC of service A is depicted as the cost within the dotted box and comprises the cost incremental to A (activity group 1 and part of activity group 3) and the whole of the cost that is common between A and B (part of activity group 3 and all of activity group 4). Therefore, detail of an activity used by service B, which is supplied in a non SMP market, is necessary to obtain the SAC of service A, supplied to the SMP market (see the comparison between Figures 3 and 4).

Figure 3 SAC



For the reasons set out above, where SAC information is required in relation to a service supplied in SMP markets, it is necessary for the activities (and associated costs, assets and liabilities) to be visible and transparent - not merely those underlying the LRIC and allocated 'common costs', but also the whole of the costs that are common among a group of services where at least one of those services is supplied to an SMP market.

Q. 2. Do you agree with ComReg's analysis of the need for information with respect to non SMP markets? If not please provide reasoned argument. If you disagree, state how ComReg could otherwise fulfil its responsibilities? Please elaborate on your response and provide details of alternatives you consider appropriate.

5.7 Distinguishable Costs and Cost Allocations

Distinguishable Costs are defined here as costs wholly and exclusively related to non SMP markets.

For ComReg not to be interested in costs in non SMP markets all the activities in the non SMP markets must be 'wholly and exclusively' driven by those markets and that no other costs must be affected by those markets'. In particular:

a) the services supplied in the non SMP markets and the activities supporting them must not:

- be used by any other activities or resources used in the course of supplying services in an SMP market;
- directly or indirectly use or share the use of other activities or resources used in the course of supplying services in an SMP market; and

b) the financial accounting system used by the provider must separately identify and record the financial effect of activities carried out in non SMP markets.

In these circumstances, the financial effect of the services carried out in SMP markets and those carried out in non SMP markets can be 'decoupled' in a straightforward manner. This is because the costs, assets and liabilities of the activities underlying the services supplied in the non SMP markets may be matched uniquely to the services in that market i.e. allocated entirely to that market.

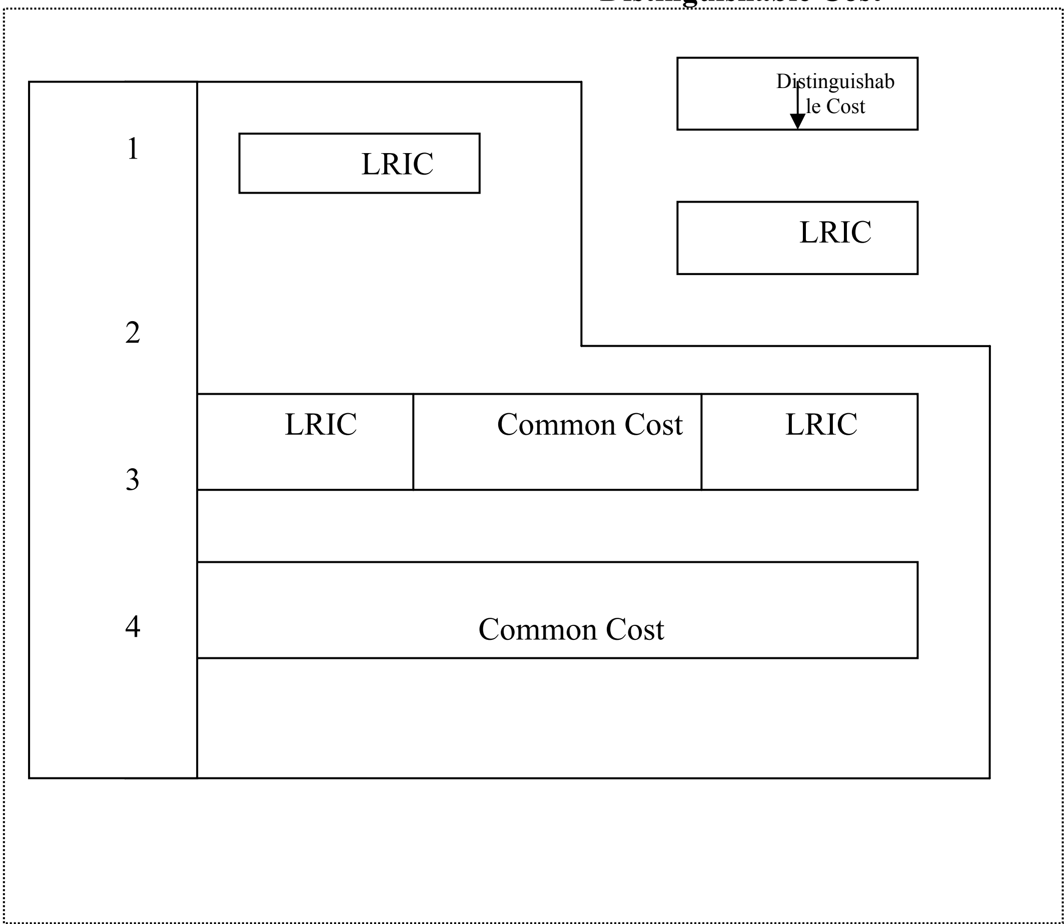
However, whilst this situation is straightforward it is unlikely to apply to many of the services carried out by communications operators in Ireland. This is because, in providing a range of services in many economically distinct markets, communications operators often obtain economies of scale and scope of supporting services in multiple markets.

Consequently, it is seldom likely that the situation where services in non SMP markets (and the activities supporting them) are wholly distinguishable from services in the SMP markets and the services that support them would be relatively unusual. Although there may be a significant number of services in non SMP markets and activities supporting them that are distinguishable, many of the services in SMP markets and non SMP markets rely to some extent on shared activities used in the course of supplying services to both markets. The diagram set out below illustrates this situation.

Figure 4- Distinguishable Costs

SMP Market A **Non-SMP Market B**

Distinguishable Cost



For the reasons set out above, where FAC information is required in relation to a given service in an SMP market, in order to derive that FAC it is:

- necessary to establish what activities, if any, support both the services supplied in SMP markets and services supplied in non SMP markets and then for the costs, assets and liabilities associated with those activities to be determined;
- not necessary to establish details of 'distinguishable' activities which support only the services supplied in the non SMP market, nor to determine any details of the directly allocated costs, assets and liabilities associated with them (but it is necessary to be able to show that the activities supporting the 'distinguishable' activities relate only to those activities and to be able to reconcile the financial information); and

- essential, in order to be able to determine the apportionment of costs (where the costs of activities used in the course of supplying several services are to be 'shared' by way of apportionment), to determine the underlying factors 'driving' the costs (the 'cost causality' including for example appropriate component volumes) and the extent to which service B drives such costs compared to services A and B in aggregate (this is because for something to be apportioned, there must be something over which to apportion).

Q. 3. Do you agree with ComReg's concept of distinguishable cost? If not please provide reasoned argument and state how you consider that such costs should be dealt with.

5.8 When distinguishable costs and LRIC are the same

There is only one circumstance where the distinguishable FAC and the LRIC are equal, this is where the increment causes no change in the costs of any activity other than those activities which are directly incurred. This is unlikely because it would mean that the new service has no synergies whatsoever with the existing business. In terms of figures 1 to 3, this would be equivalent to saying that all costs fall into the categories described by activity groups 1 and 2 and that none of the costs fall into the categories described by activity groups 3 and 4. Consequently, for all appropriately defined increments, the LRIC of a service is greater than or equal to the distinguishable costs associated with its provision.

By way of example, consider the activities of a Human Resource (HR) function once again: if an additional service or set of services is provided, additional employees will almost certainly be required to supply those additional services and, consequently, a greater number of HR employees are likely to be required. However, due to the economies of scale referred to earlier, when the number of employees in the organisation increases, the number of HR employees required to support them is unlikely to rise proportionately - some of the activities and associated costs are 'common costs', there is a benefit from the increasing 'scale'. Consequently, the activities in the HR function would not be 'distinguishable' because there is a benefit from increasing scale that cannot be 'decoupled' from the remainder of the organisation.

5.9 Cost accounting in non SMP markets

Financial information on activities undertaken in the course of supplying services in SMP markets does not require cost accounting information on 'distinguishable' activities i.e. those activities which relate only to the supply of services in the non SMP market. Accordingly, ComReg will not be proposing any cost accounting obligations relating solely to distinguishable activities subject, however, to the requirements of Regulation 24 of the Framework Regulations. (This regulation refers to the case where certain telecommunications providers also have a separate business on the basis of special or exclusive rights.)

Similarly, in the more usual case that services supplied to an SMP market and a non SMP market are not 'distinguishable' (because they share underlying activities and have common costs), provided it can be established to the satisfaction of ComReg that calculation of any LRIC, LRIC+ Retail Minus or SAC calculations, as appropriate, has been performed correctly for the services supplied to the SMP market, the LRIC of services supplied in the non SMP market are not required for cost accounting obligations. The Access and Framework Regulations do not provide for financial information, beyond that necessary and appropriate to enable ComReg to fulfil its role in relation to SMP markets, to be provided to ComReg. Accordingly, ComReg will not be proposing any accounting obligations solely associated with either distinguishable FAC or the pure LRIC of services in non SMP markets, subject to the discussions on Retail Accounting Information in Chapter 13.

If ComReg were not to have information on other costs in non SMP markets then ComReg could not have confidence that e.g.:

- costs are not overstated in the SMP markets;
- accounting judgements are appropriate and consistent for, and between, SMP and non SMP markets;
- the numbers are properly reconciled back to audited statutory accounts; and
- the audit had been carried out in a way in an appropriate manner.

In conclusion ComReg considers it appropriate to propose the collection of appropriate information for non SMP services.

5.10 Impact of non SMP markets on Accounting Separation for SMP markets

In the absence of Accounting Separation, the supply by a vertically integrated organisation of wholesale inputs to its retail arm:

- May not be identified by it as a 'supply' of a service at all; and
- if they are identified, may be supplied at an 'internal price' (known as a transfer charge) that does not adequately reflect the usage of the network or the price at which such a service could be sold, or is sold, to an unrelated third party operator (i.e. on 'arms length commercial terms').

Consequently, if the retail services rely on 'internal wholesale services' as inputs in either of these ways the retail services (and their underlying activities) could either:

- obtain the inputs it needs without any reflection in the retail services provided to end users, of the cost and usage of the network (if the inputs used are not adequately identified); and/or

- reflect in the retails services provided to end users (referred to as 'products') an amount other than the cost of the inputs had the downstream services been provided without the benefit of vertical integration.

In these cases, the consequence would be a distortion of the apparent financial performance of both the downstream retail services and the upstream activities as a result of the recording by the retail services of input costs at amounts different from those which would be charged if the inputs were supplied by the entity to an unrelated third party.

The following are examples of competitive abuses that could also occur:

- margin squeezes;
- restriction of competition; and
- predatory pricing.

If the internal wholesale services are supplied and used without adequate identification, or the cost recorded in the downstream service is less than the price which would be paid by an unrelated party for an equivalent input, the vertically integrated provider would be discriminating against competitors in the downstream retail markets and so either unfairly keep competition out of the market or discourage it. If the vertically integrated supplier has SMP in the market for the wholesale service to which the internal wholesale service is equivalent and the discrimination does not reflect some objective factor (for example differing costs of provision), ComReg considers there to be a rebuttable presumption that this is [price] discrimination of some form. Differential pricing could also lead to cross subsidies and margin squeezes both of which would have a detrimental effect on competition

Similar issues arise if a vertically integrated company operates in two wholesale markets one of which is 'downstream' from the other and the vertically integrated supplier has SMP in the 'upstream' wholesale market which acts as an input to the other. In such circumstances competition in the downstream 'wholesale' market may be distorted.

5.11 *How Non discrimination relates to Accounting Separation*

Accounting Separation may be used to ensure non-discrimination in charges, i.e. that a vertically integrated supplier with SMP in a wholesale market charges itself and downstream competitors reliant on equivalent wholesale inputs the same amount for use of equivalent services (or, to the extent it does not, the difference is objectively justifiable). This is achieved by requiring the equivalent services, their transfer charges and their financial performance to be separately identified. This issue will be discussed in further detail in chapter 12.

In the case of the fixed telecommunication network, eircom's separated accounts have used the routing factors method of ensuring that the input into the downstream activities is the same or equivalent to that charged outside the company (i.e. to OAO's). Achieving this end by routing factors means that the wholesale services provided to the dominant operator's retail market have different routing factors to the wholesales service provided to external wholesale customers. Normally the wholesale services provided to the dominant operator's retail market pick up much more usage of components because for example, a call to the downstream activity has to both originate and terminate whereas one to an OLO network merely originates. Using this method a thorough understanding of the basis of preparation of routing factors for internal and external services is required to ensure that charges for internal and external services are equivalent. ComReg proposes to use this method for MNO's designated with an accounting separation and cost accounting obligation.

5.12 *Implementation of Accounting Separation and Non Discrimination*

The first practical step is to identify the 'internal service(s)' which are, in practice, equivalent to the services supplied externally to other communications providers. In establishing internal services that are 'equivalent' it is necessary to ensure that any definition or identification of internal services is 'like for like'. Amongst other things this requires that they must:

- exist at an equivalent position in the supply chain;
- be similarly unbundled; and
- be equivalent in scope.

The second practical step is then to isolate the impact that particular 'internal service(s)' have on the downstream activities by 'ring fencing' the 'internal service' as if it were an independent entity. This is achieved by requiring the specific 'internal service(s)' to be accounted for as if it were undertaken by an independent third party. Amongst other things, this requires that:

- where the internal service is supplied, a transaction is identified and in the financial accounting system a transfer charge flows from it (This is the revenue for the internal service concerned and the cost of the input to the downstream activities using it);

- the amount at which this transfer charge is recorded reflects the price that would have been charged (or is charged) if the user of the internal service were an unrelated third party;

- the goods or services used in the course of carrying out the activities and components underlying the internal service are identified and appropriately attributed to it (which requires that when activities are used in the course of providing several services, the same amount is attributed to differing services where the usage is equivalent);

- in recording the financial performance of the activity or service, the accounting methods applied render the result comparable to that of an unrelated third party if it had provided the internal service (and its underlying activities);

- the extent to which the internal service is used by downstream activities and is an input cost for other services (and the extent to which the internal service itself relies on other internal services further upstream) is clear, in order that the nature, extent and impact of 'internal services' and transfer charging can be summarised and, if necessary, verified. This includes establishing appropriate 'routing factors' for shared elements of the network, in order to render their use transparent; and

- finally, it must be considered whether any internal service which has no external service equivalent does not constitute a refusal to supply or reflect discriminatory behaviour in any way.

Thirdly, a similar process needs to be applied for external services.

5.13 *Differences and similarities between Accounting Separation and Cost Accounting Systems*

ComReg may specify the format and accounting methodology to be used for accounting separation. Additionally, with a cost accounting systems remedy the burden of proof that charges are derived from costs, including a reasonable rate of return lies with the operator concerned. ComReg therefore considers that the recording of costs in detail and in a transparent manner is important in both cases.

The output from Accounting Separation is used mainly to help prevent non discrimination in a variety of forms e.g. by monitoring transfer prices (outputs from the 'separated activities' are recorded in the downstream activities at an 'internal price', equivalent to the amount at which they are sold to an unrelated third party) or by providing profitability information on retail products or groups of product.

With the Cost Accounting Systems remedy the way in which costs are calculated can be, and is proposed by ComReg to be, recorded in equal detail as accounting separation i.e. the calculation of the whole of the cascade becomes visible as well as the output numbers at the end of the cascade. However, the output of the cost accounting information has a different purpose i.e. to provide information for price control or price caps either on its own or in conjunction with the use of bottom up models or benchmarking.

The recording of costs in detail helps transparency of the calculation of costs and also enables any inappropriate discrimination in allocations to be made visible. It is necessary that ComReg has visibility of the allocations of shared and common costs right across the SMP operator's business, including both regulated and non regulated areas.

In practice both requirements usually imply the necessity for elements of the other, e.g. for accounting separation to meaningful there must be some understanding of the way in which costs are derived and for the cost accounting remedy to work there must be some form of separation of the products which are being costed.

ComReg proposes to ensure the relevance, reliability and comparability of financial information in relation to SMP markets where either cost accounting or accounting separation SMP obligations exist (referred to in this section, for simplicity, as 'SMP markets') by reference to the adequacy of the provider's financial processes, checks and controls. In particular, ComReg proposes that such processes are transparent and will examine, (mainly by review of the documentation), and monitor (e.g. by way of audit,) the extent to which:

- The appropriate costs revenues assets and liabilities are recorded in each financial statement

- The way in which the costs, revenues, assets and liabilities are recorded between financial statements, both in SMP and non SMP markets i.e. that the non SMP markets are correctly compiled. ComReg must be assured that costs going into SMP markets should not have been included in SMP markets and so sufficient visibility of costing methods in the non SMP markets is required to achieve this objective

- Where LRIC is applied, the way in which common costs are allocated and recovered

- That reconciliation statements operate at an appropriate level, with appropriate eliminations e.g. by way of reconciliation to statutory financial statements.

5.14 *Other methods of Costing and Calculation of Prices*

There are various ways of obtaining information to facilitate the determination of regulated prices. A brief discussion of different methods follows below.

5.14.1 Top Down

The term "top-down" usually is taken to mean cost analysis which use techniques such as current cost accounting or LRIC which are not normally required as part of normal statutory reporting but which nevertheless takes as its starting point a firm's historical cost accounts. The aim of the top-down modelling exercise is to provide information which could be used to set prices at economically efficient levels, starting from the operators own costs. Where appropriate it may also provide information as to the appropriate approach to get charges to that level e.g. via a price control.

One benefit from using a top-down model is that cost based prices are set using actual costs; this reduces the scope for margin squeezes and benefits end users. The disadvantage is that it may take more time than the alternatives of benchmarking or a bottom up modelling exercise to implement. Also, top down models are more easily audited and reconciled to statutory accounts.

5.14.2 Current Cost Accounting

The main aim of current cost accounting is to value the costs of the business as if the were incurred in the current period. For example, under the HCA convention buildings are valued in the accounts at their cost when purchased. This could have been decades ago and their current value could be many times their historical cost value. Other adjustments required in the calculation of CCA include, inter alia, revaluing assets on a Modern Equivalent Assets basis and adjustments for efficient Capital and Operating Expenditure (CAPEX and OPEX)

However if CCA results are not carried out correctly under a top-down approach, it is more difficult to provide any information on whether an operator is efficient or not. For example, the CCA calculation may not be performed fully (e.g. operating expenses adjusted and modern equivalent assets included, spare capacity evaluated and an overall system valuation performed) with the result that efficiency adjustments may not have been fully carried out.

5.14.3 Bottom Up Cost Modelling

Charges can be set without reference to a Top-Down model by using the alternative of a Bottom-Up Cost Model (BUCM). The principle advantage to a BUCM is that it is based on efficient operator costs and can be useful where there is limited data on operators' actual costs, minimising any potential time delay in determining cost-orientated termination charges via option of a Top-Down approach. ComReg reserves the right to use such models where appropriate.

5.14.4 Benchmarking

Benchmarking prices for a particular product involves using data from other countries or operators and uses this to determine what the price should be in the relevant market place. It can be relatively quick to implement but does not necessarily ensure cost orientation. Nevertheless, where the matter is urgent ComReg reserves the right to use benchmarking as it considers appropriate. This method of setting prices should not be confused with benchmarking of particular costs or operative inputs which are often used to assess if costs are genuinely forward looking or efficient. This form of benchmarking is perfectly legitimate in a cost based pricing exercise.

5.14.5 Marginal Costing

Marginal cost is the cost resulting from a very small change, in output. Short run marginal costs are generally extremely low. If a longer run marginal cost is used it would effectively be LRIC. For these reasons ComReg does not propose the use of marginal costs.

5.15 Other aspects of preparing Financial Information

5.15.1 Other Data requirements.

There is a need for data other than pure cost data for regulatory purposes. For example, unit cost calculations, upon which many regulated prices depend, require robust information about volumes. Accurate and transparent volume data is therefore very important.

5.15.2 Implementing the methods

There are several ways in which accounting information can be prepared, many of which could be acceptable to ComReg. For this reason ComReg proposes to allow a dominant operator with an Accounting Separation and Cost Accounting Systems obligation to prepare, at least initially, the information in the way that best suits them, subject to ComReg outlining the outputs and the basic methods. This method allows flexibility for operators to achieve the requirements in the most efficient manner possible and reduces levels of intrusiveness and yet allows ComReg to make changes if required later.

5.16 Retail Minus Pricing

This method of pricing involves setting a wholesale price by reference to a retail price less certain costs, including retail costs. There are a number of differences with this approach, compared to cost based pricing. In particular, in order to obtain a wholesale price it is necessary to understand retail costs and it may therefore be necessary to impose obligations of cost accounting systems and accounting separation in a retail market in order to obtain retail costing data, even if the remedy relates to a competition problem in a wholesale market. The allocation of revenues, the calculation of discounts and the accounting for marketing expenses in this case are likely to be key requirements. This method is discussed further in Chapter 14.

5.17 Proposed Costing Methodology

The main argument for developing accounts in historical cost terms is that historical valuations represent an objective benchmark of costs and that they tie back to the actual values in the companies report and accounts. In addition historic cost measures are easier to develop since they require neither asset re-valuation nor the development of new depreciation calculations.

However, where there has been significant cumulated general price inflation and/or where there have been large movements in specific asset prices, historical cost measures may provide a very misleading view of the replacement values of assets in the network. Further distortions may be caused by improvements in equipment quantities and the existence of fully depreciated assets.

While general price inflation has been relatively low in recent years, the cumulative impact of this inflation over the lifetimes of assets may not be negligible. More significantly, there is some evidence that the prices of specific assets have changed over recent years. Hence, ComReg believes that if separated accounts are only developed in historic cost terms they could provide an inaccurate view of the actual costs of operators. As a result, ComReg proposes to also require asset values to be presented in terms of Current Cost Accounting (CCA) values.

On the other hand, ComReg also recognises that historic cost statements can be related back to the companies' asset registers and that the companies' accounts are presented in historic cost terms. Thus, historic cost accounts also have a role to play.

Therefore ComReg proposes that the Annual Regulatory Financial Statements of Mobile Operators designated with an Accounting Separation and a Cost Accounting obligation be prepared on a CCA basis and reconcilable to the HCA accounts. ComReg also proposes that these financial statements will also be prepared on a LRIC basis, however with due regard to proportionality, ComReg proposes that the relevant mobile operators be given extra time to prepare and publish the LRIC financial statements. This issue is further discussed in Chapter 13.

Q. 4. Do you have any other observations on ComReg's analysis of Financial Information in a Regulatory Context? If so please provide a reasoned response. Please elaborate on your response.

Q. 5. Do you agree that the Annual Regulatory Financial Statement be prepared on a Current Cost Basis (CCA) and reconciled to the Historical Cost Accounts (HCA) statements? Please elaborate on your response.

6 Introduction to the Proposed Directions to Impose Accounting Separation and Cost Accounting Obligations

6.1 *Introduction*

In the next chapters, ComReg sets out proposals for the imposition of the obligation of Accounting Separation and Cost Accounting. Chapters 6 to 10 set out the general obligations which could be applicable to both MTR and MACO markets. Chapter 11 and 12 sets out the specific cost accounting and accounting separation obligations which could also be applicable to both markets. Chapter 13 sets the retail reporting requirements. This paper proposes that these retail requirements would apply only where MACO specific obligations are implemented in accordance with Decision Notice D6/05 (See Chapter 13)

In addition, Annex B and C to this consultation sets out in indicative format the proposed financial statements and supporting schedules. Annex B deals specifically with MTR schedules, while Annex C deals with MACO schedules.

In this Chapter, ComReg introduces proposals for Cost Accounting Systems and Accounting Separation. Chapters 7 to 10 contain the general proposals that would apply to Dominant Mobile Operators having an accounting separation obligation and cost accounting systems obligations. In addition to these general proposals, Chapters 11 to 13 covers the specific requirements for the Cost Accounting obligation, Accounting Separation obligation and Retail Accounting Information requirements.

The attached annexes to this consultation set out the detailed information required to be produced and inform the proposals contained in Chapter 7 to 13.

- Annex A sets out an indicative list of products/services within the EU designated markets;
- Annex B and C sets out the proposed financial statements for the MTR and MACO markets which ComReg requires as part of the Accounting Separation/Cost Accounting obligation;

As has been discussed in earlier chapters, there is a considerable body of literature relating to accounting, economics and law that covers the way in which accounting operates in telecommunications markets. The aim in the following chapters is to implement this literature, and build on its justifications with respect to the operators who have an SMP designation. Note that there are several links in the chain of robust financial reporting and a weakness in any one of them e.g. audit, or transparency can render the whole extremely weak or worthless and these directions aim to tackle all the links in this chain.

The aim of these proposals is to require the construction of Accounting Separation and Cost Accounting Systems regimes which are objectively justifiable, transparent, proportionate and non discriminatory.

The proposals are set out in the following manner:

6.1.1 *General Requirements*

- Maintenance of accounting records and systems (Chapter 7);
- Preparation, Audit and Delivery of Regulatory Financial Statements (Chapter 8);
- Accounting Documentation (Chapter 9); and
- Auditor, Audit Reports and Audit Opinions (Chapter 10);

6.1.2 *Implementation of Specific Obligations*

- Wholesale Cost Accounting (Chapter 11);
- Accounting Separation (Chapter 12); and
- Retail Accounting Information (Chapter 13).

6.1.3 *How the Proposed Obligations will work:*

Chapters 7 to 10 are general requirements which are proposed to be applicable to the Cost Accounting and Accounting Separation obligations and Retail Information requirements and as such act as a foundation for the additional obligation proposed in Chapters 11 to 13 which will be applicable to dominant operators.

6.2 *General Proposals*

Currently for the fixed telecommunication network, when either ComReg or the Dominant Operator proposes to make amendments to the Regulatory Financial Statements, it is necessary to consult with the industry on the proposed change and issue a new or revised direction. ComReg considers that in certain circumstances (e.g. when the amendment does not have a significant impact) it may not always be necessary to enter into a consultation.

As an alternative, ComReg considers that the introduction of consents to be an effective method of effecting routine and acceptable changes to the (finalised) Regulatory Financial reporting obligations, which otherwise may be too rigid and may cause delays in implementing minor changes. Examples of situations where a consent could be used include the removal or withdrawal of products or services, the addition of new products or services, changes to accounting systems to improve accuracy or efficiency, changes to additional financial information, and/or the impracticability (e.g. due to timing) of obtaining an audit opinion.

ComReg proposes that consents would take the form of a document sent by the dominant operator to ComReg indicating their request in writing and justifying their reasoning for a consent. ComReg would then evaluate the consent (which may involve further clarification with the relevant operator) and then endeavour to form a judgement on the consent and inform the operator of its findings at the earliest point. It is not possible to describe all the circumstances where consent could be used, but the alternative to consents would be for ComReg to consult and issue a Direction on the issue as it arises. Consents granted would be referred to in the Financial Statements or ComReg Statement as appropriate. Equally, ComReg could also initiate changes by way of consents and will seek to ensure that it deals with all consents in a manner which does not unfairly discriminate between different undertakings and in a manner which is transparent.

6.3 *Proposed Definitions*

A variety of specific terms need to be attached to words when implementing cost accounting and accounting separation requirements in order to both understand and define the actual implementation. These definitions are set out in Appendix B.

Q. 6. Do you agree with ComReg's approach (a) to imposing obligations, including the use of consents and (b) the proposed definitions as set out in appendix C? Please elaborate your response and provide details of any alternatives you consider appropriate.

7 Maintenance of Accounting Records and Systems.

7.1 *Introduction*

This chapter includes proposals on the manner in which accounting records shall be maintained by dominant operators required to comply with an Accounting Separation and/or Cost Accounting obligation. The proposed obligations in this chapter support any Cost Accounting, Accounting Separation and Retail Accounting Information obligations.

7.2 *Production of Data*

ComReg proposes that where either remedies relating to Accounting Separation or Cost Accounting Systems are mandated that the Dominant Operator should maintain accounting records and systems that are capable of producing financial statements that are in accordance with the Accounting Documents. (Chapter 9 deals with the accounting documentation required as part of an accounting separation and cost accounting obligation). This is a fundamental requirement to ensure compliance with the appropriate obligation.

7.3 *Granularity of Accounting Records*

ComReg is proposing that the accounting records should be sufficient to provide information, where designated, on a Historic Cost Accounting basis (HCA) and, if mandated, on a Current Cost Accounting basis (CCA)/Long Run Incremental Cost (LRIC) and that these accounting records should be able to identify the costs, revenues, assets and liabilities of each market or service where the obligations applies. Additionally, these records should enable the identification and calculation of the costs, revenues, assets and liabilities of each service or activity for both Accounting Separation and Cost Accounting Separation purposes.

7.4 *What level of granularity is required?*

ComReg proposes to implement Accounting Separation and Cost Accounting obligations on a by service and/or product basis. ComReg believes it is not sufficient to implement such an obligation at a market level as it is important to discourage possible unfair cross-subsidisation of pricing at a service level. Preparing accounts on a routine basis at a level of detail that supports individual product prices will enhance transparency, speed up the regulatory price setting process and help prevent the omission or double recovery of costs.

It is not sufficient for information to be held solely at the market level because the obligation of cost orientation must be given effect at an individual service level. Costs and prices in a market may lie within the acceptable ranges at an aggregate level whilst failing to do so on a service by service level but it is not sufficient for information to be held solely at the market level because it would not be sufficient to demonstrate that the inputs to these individual services had been appropriately costed. Therefore, the cost accounting system must be capable of separately identifying and attributing the revenues, costs, assets and liabilities of these individual/services and/or activities.

A further consideration is that operators dominant in relevant markets may provide services in a number of markets and may divide the activities required to supply these services among a number of business units. The division of activities relevant to ComReg for regulatory purposes is the division of services, and the activities which underlie them, between relevant markets. These relevant markets may be a regulated market designated with SMP or a non SMP designated market. Therefore ComReg needs to be able to ascertain to what extent services in non SMP markets may impact on services supplied in SMP markets. In order to determine the information required for regulatory purposes, it is necessary to explore the nature of the costs incurred by activities undertaken in the course of supplying a service (or combination of services). If ComReg were to impose accounting separation at the market level (rather than at a service level), it would not be able to identify whether products and services were provided on a non discriminatory basis.

7.5 *Proposed level of Granularity for Wholesale and Retail Markets*

Following the logic above the cost accounting system should also be capable of separately identifying the transactions building up to these activities and services. It should in the case of wholesale markets for example, provide information regarding the following categories:

- wholesale services – which are services related to network access used by or offered to any communications provider; (Annex A sets out an indicative list of services within each of the designated markets);

- wholesale segments – which are groups of wholesale services as agreed between ComReg and the Dominant Operator (Annex A sets out an indicative list of segments within each of the designated markets;

- wholesale activities – these are any activities used solely for the purpose of providing wholesale services or any activities used solely in the course of such activities. The key is that the cost accumulation and allocation processes and procedures are transparent. ComReg has not given a list of such activities since to do so could be intrusive and introduce too much rigidity into the process. However, the Statement of Cost schedules in Annex B & C give a guide to the proposed components / elements;

- network activities – these are any activities related to network access used directly or indirectly in the provision of wholesale services and any activities used in the course of such activities, except for those that are wholesale activities;

- network services – these are groups of network activities used directly in the course of supplying wholesale services; and

- network components and elements – i.e. combinations of e.g. activities that combine to make wholesale services.

Similarly for the Retail Markets the cost accounting system should also be capable of separately identifying the transactions building up to these activities and services.

ComReg proposes that the accounting records and systems, with respect to regulatory financial information of the dominant operator and all associated documentation should be:

(a) maintained in accordance with the Accounting Documents;
(b) sufficient to enable the Regulatory Financial Statements to have expressed upon them an appropriate Audit Opinion;
(c) sufficient to ensure that charges for designated wholesale and retail services can be shown to be fair and reasonable and not to be discriminatory;
(d) sufficient to provide a complete justification of the Dominant Operators charges for designated wholesale and retail services; and
(e) sufficient to enable non discrimination and margin squeezes to be shown and verified.

7.6 *Time period for Retention of Accounting Records*

ComReg proposes that the Dominant Operator shall preserve records sufficient to provide an adequate explanation of each Regulatory Financial Statement for a period of six years from the date on which each Regulatory Financial Statement is delivered to ComReg. This will enable investigations to take place and trend information to be prepared if necessary.

7.7 *Periodic Reporting and Reporting for Investigations*

Information to support regulatory decisions is necessary both on a periodic basis and to support investigations and queries that may arise on an ad hoc/request basis. The accounting systems must be capable of performing both functions. The Regulatory Financial Statements would be provided annually and would be used inter alia to monitor the impact of price controls/caps and also to monitor the Dominant Operator's compliance with its cost-orientation and non discrimination obligations.

Regulation 12 (3) of the Access Regulations places a requirement on operators to provide information on request in order to facilitate the verification of compliance with obligations imposed. ComReg's view is that on-request reporting may be required for investigating specific cases into potential breaches of obligations. The amount of detail that can reasonably be requested in either circumstance will vary. It is likely that periodic information (e.g. annual accounts) can be planned to produce more comprehensive information than reports based on a specific request. In framing an on demand requests, ComReg will consider its practicality, but also will have regard to the seriousness of whatever issue is at hand.

ComReg therefore proposes that in framing individual requests it will consider their practicality and will also will have regard to the seriousness of the issue at hand and proposes to consider each request for on request information on a case by case basis and is therefore proposing not to set out criteria (i.e. categories and type of information required and basis of preparation) for such dominant operators at this time. ComReg reserves the right to review this position if it considers that more formal arrangements are required

Q. 7. Do you agree with the proposed obligations for the Maintenance of Accounting Records and Systems? Please elaborate on your response and provide details of any alternatives you consider appropriate

8 Preparation, Audit and Delivery of Regulatory Financial Statements.

8.1 *Introduction*

This chapter contains proposals that will allow ComReg to require dominant operators to publish Regulatory Financial Statements, and obtain and publish an audit opinion. The proposed financial schedules are set out in Annex B & C to this consultation.

8.2 *Preparation, Audit and Publication*

This section deals with the preparation, audit, and publication of the financial statements and the obtaining and publication of an audit opinion on these statements. It also ensures that significant changes in methodology are noted. It is necessary for ComReg to be able to see outputs in order to monitor and enforce the Dominant Operators' obligations for non discrimination, cost-orientation, cost recovery or price controls. These outputs are the Regulatory Financial Statements. It is also necessary for the Regulatory Financial Statements to be prepared and delivered on a proper, appropriate, reliable, consistent and understandable basis. Therefore, ComReg is also proposing that the Regulatory Financial Statements are produced in compliance with the Accounting Documents and that independent audit reports and opinions be prepared.

In addition ComReg proposes that the Dominant Operators will publish a Directors' Statement of Responsibility with the accounts which would serve inter alia to confirm the Directors' responsibility for the Regulatory Financial Statements.

ComReg is also proposing to present Historical Cost Accounts and Current Cost Accounts on an integrated basis which should help to simplify the accounts to a certain degree, reduce an administrative burden on dominant operators and publish these accounts within 4 months of the year end to ensure more timely information to the market place. It is also proposing that the regulatory financial statements be prepared on a Long Run Incremental Cost basis at a later date.

ComReg accepts that at times it will be necessary for each Dominant Operator to make changes to its systems, processes, methodologies or the form and content of the financial statements. In these cases, ComReg is proposing that each Dominant Operator has to inform it of these changes where they have a material impact on the financial statements and also proposes each Dominant Operator delivers a report detailing any changes in the Accounting Documents, any Process and any other methodology which caused any figure presented on any one of the Regulatory Financial Statements to change by more than 5% from the figure that would have been presented had such a change not been made. This report will allow for more effective evaluation of the implication of changes in methodologies used.

ComReg's detailed proposals for accounting documentation and audit will be dealt with in more detail below and in later chapters.

The publication of annual Regulatory Financial Statements provides assurance to other communications providers that the services they are buying from Dominant Operators are priced appropriately and that ComReg has sufficient information to monitor the Dominant Operators' compliance with relevant obligations. This regulatory certainty is important for ensuring efficient and effective competition in communications markets. However, constraints imposed by commercial confidentiality will mean that not all the information ComReg needs can be published. ComReg is therefore proposing that additional information be delivered to it in order to make decisions and monitor compliance with the proposed obligations. The index to Annex B & C indicates which schedules are proposed to be published.

Annex B & C sets out the proposed financial statements that ComReg considers should be published. As stated above, the annual Regulatory Financial Statements would be required for ongoing monitoring of the Dominant Operators' compliance with its cost-orientation and cost recovery obligations, to inform the review of its price control obligations and to support non discrimination obligations.

In summary, ComReg proposes that the Dominant Operators should in respect of the relevant Markets, Segments, Services, and Activities (where appropriate)

(a) prepare in accordance with the Accounting Documents, the Regulatory Financial Statements (as per Annex B & C);

(b) secure an expression of an audit opinion upon the Regulatory Financial Statements; and

(c) deliver to ComReg and publish the Regulatory Financial Statements and Documentation and corresponding audit opinion within 4 months of the financial year end;

(d) deliver to ComReg a report detailing any changes in the Accounting Documents, any Process and any other methodology which caused any figure presented on any one of the Regulatory Financial Statements to change by more than 5% from the figure that would have been presented had such a change not been made.

8.3 *General Regulatory Financial Statements to be Prepared and Published*

ComReg proposes the following Regulatory Financial Statements (as per Annex B & C) be prepared:

- Introduction;

- Directors Statement of Responsibility;
- Report of the Regulatory Auditors;
- Profit and Loss statements and Mean Capital Employed Statements reconciled to the Historical cost accounts; where appropriate these will also be presented on a CCA basis
- Reconciliation Statements; (to the statutory accounts and within the various markets i.e. services to segments and segments to markets);
- Statements of Costs and Charges for wholesale/network services for both the mobile network;
- Statements of activity costs on a current / LRIC / fully allocated cost basis; (Note : ComReg proposes that these statements will be produced in year 2)
- Additional information by way of notes;
- Other supporting schedules;
- Additional Financial Information (Note :This information will prepared for ComReg only and will not be published); and
- Information with respect to Related Party Transactions.

In general the above Regulatory Financial Statements are those normally required by generally accepted accounting practices, plus, some additional statements. . LRIC is normally needed to set boundaries for prices. This would be particularly useful if a price control is set in order to set limits on the price floors and ceiling within a basket of services.

These statements/schedules along with transparency of the documentation allow ComReg to be satisfied with the numerical appropriateness of the cost allocation which is essential for monitoring the compliance of the Dominant Operator with its obligations. In particular, ComReg considers that a profit and loss statement and a matching statement of mean capital employed are necessary for the monitoring of the regulatory financial performance of wholesale and retail services, segments (i.e. groups of products/services) and markets. Additionally, ComReg believes that statements of charges and costs for services are necessary to ensure that charges for services are cost orientated and to monitor non discrimination. ComReg considers that, to provide assurance to it that the information, on which it must base decisions on, is appropriate, reliable and of a high quality, it is essential that the regulatory financial statements be meaningfully reconciled to each other and to the Dominant Operators' statutory accounts. ComReg considers that, to ensure understandability and transparency, such reconciliations should include such intermediate stages or steps as necessary.

8.4 *Form and content of financial statements*

ComReg considers that the Dominant Operators should prepare, consistent with normal accounting practice, prior year comparative statements on a consistent basis to the current year figures and that where there are no specific regulatory principles the Dominant Operators should follow Accounting Standards and generally accepted accounting practices as applicable to companies in Ireland. ComReg considers the ability to compare regulatory financial information with previous years' statements is essential. Comparing year on year figures can provide an important understanding of the factors relevant to the ComReg for regulatory purposes. Additionally, consistency of presentation and preparation is also important for the same reasons.

A particular issue at this time is that of migration to International Financial Reporting Standards (IFRS). From 1 January 2005 publicly quoted companies in the EU must prepare their accounts in compliance with IFRS. Additionally, UK and Irish GAAP is being progressively harmonised with IFRS. Where an organisation has migrated to the application of (IFRS) in a particular period, ComReg proposes that the impact of this should be disclosed separately. Where a company uses IFRS and there are material differences between it and the application of domestic Irish GAAP, the impact of these differences should be disclosed. Because of the harmonisation process referred to above it can be expected that this particular issue will be transitional in nature

In summary ComReg proposes that the Dominant Operators should ensure that Accounting Policies shall be applied consistently within and between the Financial Statements from one financial year to the next within a financial year and that each Financial Statement shall include prior year comparatives which shall be prepared on a basis consistent with current year figures. The Dominant Operator may depart from this requirement in preparing the Financial Statements for a financial year if there are reasons for doing so provided that the particulars of the departure, the reasons for it and its effect are stated in a note in the Financial Statements in accordance with Accounting Standards and GAAP.

8.5 *Consequential Updating of Financial Statements by Dominant Operator*

ComReg proposes that each of the Dominant Operators should make such amendments to the form and content of the Regulatory Financial Statements as are necessary to give effect fully to the requirements of these proposals. The Dominant Operators shall provide to ComReg particulars of any such amendment, the reasons for it and its effect, when it delivers the Regulatory Financial Statements to ComReg. This proposal is to ensure that any material amendments as a result of regulatory decisions or other considerations are made by the dominant operators.

8.6 *Additional information required by ComReg*

In addition, ComReg may also require the dominant operator to submit other more detailed information for ComReg's use only which would not be published**.** ComReg requires this information so as to effectively monitor and enforce compliance with the Dominant Operators' obligations for cost-orientation, cost recovery and price controls. ComReg has identified a non exhaustive list of additional information in Annex B & C. The exact format of these schedules will be subject to further discussion/agreement between ComReg and the Dominant Operators and will generally be presented to ComReg on a confidential basis.

8.7 *Related Party Transactions*

ComReg considers it appropriate to prevent an undertaking where Accounting Separation and Cost Accounting obligations have been applied which is part of a group of companies, exploiting the principle of corporate separation. The Dominant Operators should not use another member of its wider group of companies to which it belongs to carry out activities which would otherwise render the Dominant Operators in breach of its obligations. ComReg is proposing to require that a statement showing the transfers with other companies in the group and the parent company is prepared. A draft of such a statement is set out in Annex B.

This requirement would apply to companies which are controlled by the regulated entity's ultimate parent but which are not controlled by the regulated entity itself. This is a somewhat greater degree of disclosure that that required by the relevant accounting standard FRS 8 which exempts all common group subsidiaries from its requirements.[13] However, in ComReg's case, where the focus is on the regulated entity and not the ultimate parent, the exceptions provide for in FRS 8 would defeat the purpose of the disclosure requirement.

Transfers between legal entities within the consolidated group in the separated accounts should not require special treatment since any regulatory impact should be clear from the normal separation exercise.

[13] FRS 8 Para 3

Q. 8. Do you agree with the proposed obligations for the Preparation, Audit and Delivery of Regulatory Financial Statements as set out in Chapter 9? Your response should address the following: (a) ComReg's proposals for preparation, audit and publication of the Regulatory Financial Statements; (b) General financial statements to be prepared (c) Additional Information required by ComReg (d) Related Party Transactions Reports. Please elaborate on your response and provide details of any alternatives you consider appropriate.

9 Accounting Documentation

This chapter covers the requirements for Accounting Documentation and proposes that the Regulatory Financial Statements are prepared in line with the Accounting Documents. ComReg considers that documentation is an essential part of the financial reporting requirements as it allows ComReg and other interested users to understand the basis of preparation of the Regulatory Financial Statements. It also allows for the monitoring of cost orientation and allows users to have confidence that costs are non discriminatorily allocated, and be confident that granular, by service, outputs are appropriately calculated.

The financial information that ComReg would need in order to monitor cost orientation, cost recovery and price control obligations are not necessarily common in all respects to commercial financial information. For example, LRIC and CCA would not typically be used for statutory or management accounting purposes. Therefore, ComReg considers it even more necessary that the bases of preparation of the Regulatory Financial Statements are transparent and understandable.

ComReg also proposes that the standard of documentation should be in line with the Transparency Principle which is introduced later in this chapter

9.1 Accounting Documents

ComReg is proposing that two levels of documentation should be prepared. The first level involves the preparation of a high level of accounting documentation (known as primary documentation). In the fixed telecommunication market, eircom currently prepares this level of documentation under the following headings.

- Regulatory Accounting Principles; - This section should set out the principles applied in the production of the regulatory statements, in the application of the attribution methods, of the transfer charging systems and of the accounting policies.

- Definitions of the markets; - This section should define the market and set out the relevant products/services within the market.

- Attribution Methods; - This section should describe the attribution methodologies used to allocate costs, revenues, assets and liabilities to the products/services within the markets.

- Transfer Charges; - This section should set out and describe the basis for transfer charging.

- Historical Accounting Policies; -This section should describe the Historical accounting policies.

- Current Cost Valuation Methods (where CCA information is required); This section should set out the basis of preparation of the current cost financial statements. and

- Long Run Incremental Cost Methodology (where LRIC information is required). This section should set out the basis of the preparation of the LRIC statements.

ComReg is proposing that the same primary level of documentation be produced and published by the relevant mobile operators.

9.2 Documentation of the Dominant Operators Cost/Accounting Systems- Secondary Documentation

In addition to the first/primary level of documentation (as described above), ComReg also proposes that the Dominant Operators prepare and publish (subject to confidentiality) comprehensive end to end documentation of its systems, which will allow ComReg to evaluate the effectiveness of such systems. This is effectively a second layer of documentation (secondary documentation), which would be more detailed than the primary level documentation.

ComReg proposes to work with the relevant operators in ensuring that this secondary documentation will meet its requirements in evaluating the effectiveness of the systems.

ComReg also proposes that a catalogue be maintained of all the wholesale and retail products/services sold within each designated SMP markets. ComReg believes that these product descriptions/catalogues are necessary to ensure that, when a given 'service' is supplied, it is clear what is actually being supplied (and what activities are carried out in the course providing the service), to ensure that there is no ambiguity in relation to similar services or services having similar names, to establish what has (and has not) been included within the ambit of particular services or particular markets and to assess whether those inclusions (and exclusions) are appropriate.

In relation to the full description/catalogue for wholesale products, ComReg proposes that the documentation would contain the following information for each SMP market in which cost accounting obligations were imposed:

- all internal wholesale services;

- all external wholesale services; and

- an accurate description of all internal wholesale services, external wholesale services, wholesale activities, network services used in the provision of wholesale services.

Similarly, on the retail side ComReg proposes that the documentation would contain the following information for each SMP market in which cost accounting obligations were imposed.

While ComReg does not want to unduly add to the administrative burden on operators, it considers that this additional documentation is necessary to enable it and other interested parties to know and understand exactly which products and services are in which market and/or group of services and to know and understand the exact nature of each service.

ComReg is open to suggestions as to how this aspect of the documentation can best be achieved. One method would be to create stand alone product descriptions/catalogues which are linked into the Annual Regulatory Financial Statements. Alternatively, the existing product documentation of the operators could be refined and a direct link made between it and the regulatory financial statements. ComReg considers that this information should already exists in a well run organisation and it will ensure that information is synchronised between different sets of existing documentation and the Regulatory Financial Statements.

9.3 Priorities within the Accounting Documentation

ComReg considers that the Primary Accounting Documents, as produced in a dominant operators Regulatory Accounts should have the following order of priority:

(a) Regulatory Accounting Principles;
(b) Attribution Methods;
(c) Transfer Charge System Methodology;
(d) Wholesale and Retail catalogues;
(e) Accounting Policies;
(f) Irish GAAP/IFRS.
(g) LRIC

ComReg proposes that insofar as there is any inconsistency between any or all of the Primary Accounting Documents, produced in the Regulatory Accounts, these Documents should have the order of priority in the index above. To enable consistency to operate, and for the avoidance of doubt, these proposals would also apply to the Secondary Accounting Documentation as appropriate.

9.4 Irish GAAP

Normally Statutory Accounts are prepared in accordance with a set of rules knows as Generally Accepted Accounting Practice (GAAP). These rules have been built up over the years, hence they are practicable accounting and normally have been consulted on within the accounting profession, industry and government, hence they are generally accepted. In the fixed telecommunication market, the current Regulatory Financial Statements prepared by eircom are based on the Accounting Documents, but these Accounting Documents are far too brief to cover all the issues involved in GAAP. Given that the Regulatory Financial Statements are derived from/closely related to the statutory accounts it would not seem unreasonable to ComReg that these too should be generally based on GAAP, so that the overall basis of preparation is known and followed. Therefore ComReg proposes that the addition of a short section confirming that the basis of preparation of the Regulatory Financial Statements is GAAP (subject to the hierarchy in 10.3) should be included in the Primary Accounting Documents

9.5 Changes where Deficiencies in the Accounting Documents or Financial Statements occur

When ComReg has reasonable grounds to believe that any or all of the Regulatory Financial Statements and/or Accounting Documentation are deficient, it proposes that the Dominant Operator amend and restate the Regulatory Financial Statements and/or Accounting Documents in order to remedy the deficiencies identified, secure the expression of an audit opinion on the restated Regulatory Financial Statements; and publish the restated Regulatory Financial Statements and corresponding audit opinion.

9.6 Transparency of Accounting Documentation

ComReg considers that the documentation is prepared in order to ensure that the data, information, descriptions, material or explanatory documents prepared for the cost accounting systems is sufficiently transparent so that a suitably informed reader can easily gain a clear understanding of such documentation. A suitably informed reader should be able to understand the overall structure of the Dominant Operator's financial and information systems from which regulatory accounting data is derived and that the accounting documents and the supporting documents are prepared in a way that fully discloses the basis of preparation of the accounting information.

As noted in Chapter two, the Accounting Standards Board identified "understand ability" as one of the key characteristics of financial information. ComReg considers that transparency of the bases of preparation of regulatory financial information is essential in order for ComReg to have confidence in the financial statements, and for it to make regulatory decisions based on that information.

ComReg proposes to introduce a "Transparency Principle" in the following terms:

"Any data, information, description, material or explanatory document, prepared in accordance with directions determined by ComReg in respect of accounting and other methods used in the preparation of the accounting records and Regulatory Financial Statements should be sufficiently transparent and prepared such that a suitably informed reader can easily gain a clear understanding of such data, information, description, material or explanatory document, and, if necessary, 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; gain a detailed understanding of all the material, methodologies and drivers (e.g. systems, surveys, Processes and procedures) applied in the preparation of regulatory accounting data; and make their own judgement as to the reasonableness of these methodologies and driver data and any changes to them."

ComReg proposes that the separated accounts and the associated accounting documentation should be subject to a test to ensure it complies with this Transparency Principle.
A final consideration is that a dominant operator would_need to keep their cost accounting systems, Accounting Documentation and form and content of the financial statements up to date.

9.7 Publication of Accounting Documentation

ComReg is also aware that there may be issues of commercial confidentiality in the documentation it is requesting to be published. If operators consider this to be the case, ComReg would propose that the operator submits to ComReg a version for publication that excludes such confidential data. If ComReg agrees with such a request it will issue a consent authorising the publication of versions of the Accounting Documentation which do not contain such commercially confidential data. Such consents may lead to either public and/or private versions of documents or public versions with deleted items or sections.

On all matters, ComReg will have due regard to the issue of confidentiality as set out in Regulation 12 (4) of SI No. 35 of 2003.

ComReg proposes that the Dominant Operator should normally publish the Accounting Documentation (consisting of Primary and Secondary Documentation), on an annual basis within four months of the financial year end.

Q. 9. Do you agree with the proposed obligations for Accounting Documentation? Your response should address the following: ComReg's proposals for enhanced documentation and the introduction of the transparency principle.

10 Auditor, Audit Reports and Audit Opinion

10.1 Introduction

This chapter covers the audit requirements for the Financial Statements and Accounting Documentation. This chapter applies to those operators having Cost Orientation, Wholesale Cost Accounting, Accounting Separation, or Retail Accounting Information obligations, for which specific proposals are made in Chapters 11 to 13.

10.2 Appointment of and changes to the Auditor

10.2.1 Why have an audit?

As noted in an earlier Chapter, the Accounting Standards Board has identified "reliability" as one of the key characteristics of good quality financial information. ComReg considers that effective and rigorous auditing is necessary to ensure that regulatory financial information is reliable.

Additionally, an adequate audit will provide ComReg with assurance about the quality of the regulatory financial information when making decisions based on that information. Without such audits, user's confidence in the numbers would be more limited.

10.2.2 Who should do the audit?

As it is the principal user of the separated accounts ComReg believes that it has an interest in, and should have some influence over, the appointment and re-appointment of the regulatory auditor.

ComReg proposes that each Dominant Operator should notify ComReg in writing of the Auditor appointed before the Auditor carries out any work for that purpose. The Dominant Operator shall notify ComReg of any proposed change of Regulatory Auditor as soon as a management decision is taken or a proposal for board approval tabled, but in any event, at least 28 days before effect is given to that change.

10.2.3 Proposals for changing the auditor

ComReg also proposes that in the event that the Regulatory Auditor is in the opinion of ComReg unsatisfactory, the Dominant Operator shall appoint and instruct an Alternative Regulatory Auditor that is at all times satisfactory to ComReg having regard to such reasonable matters as ComReg considers appropriate.

10.3 Duty of Care and Cooperation

10.3.1 Duty of Care

As ComReg is a significant user of and relies heavily on a Dominant Operator's Regulatory Financial Statements there is a case that the Regulatory Auditor of such an operator should owe a duty of care to ComReg. This could be achieved by the Dominant Operator's letter of engagement appointing the Regulatory Auditor including an express condition that it owes a duty of care to ComReg.

Currently in the UK, discussions regarding the duty of care owed to Regulators are taking place within various accountancy bodies[14]. ComReg also notes that OFCOM has implemented a duty of care on BT's Regulatory Auditor which is consistent with the ICAEW Guidance. Therefore ComReg would therefore welcome informed views of the practicality and enforceability of any such obligation.

Given that the Regulatory Auditor does not currently offer a duty of care to ComReg, there are a number of potential means to address the issue. These include:

- use of bipartite audit arrangements with a side letter;
- use of tripartite audit arrangements; and
- attempting to have privity to the contract under other legislation

A bipartite arrangement would, in this case, involve an agreement between the dominant operator and its Regulatory Auditor. The side letter related to this would set out the terms of the Duty of Care owed to ComReg.

A Tripartite agreement, on the other hand, would involve ComReg being a direct party to the audit contract. Having privity to the contract would attempt to enable ComReg to have rights under the contract if ComReg was affected by the contract as it could be if incorrect audit opinions were issued and ComReg relied upon them.

ComReg's understanding is that Irish law does not currently permit privity on a tripartite basis. Additionally the use of a tripartite audit agreement would require ComReg to enter into a contractual relationship with the dominant operator, which would be unusual.

[14] Reporting to Regulators of Regulated Entities- Audit 05/03- Published by the Institute of Chartered Accountants in England & Wales & ICAEW technical release Audit 1/01.

Q. 10. Do you believe that ComReg should have any influence in the decision of a dominant operator to appoint a Regulatory Auditor? If so, how should this can be exercised?

Q. 11. What are your views regarding the duty of care of Regulatory Auditors to Regulators? Do you consider that ComReg should have a duty of care for the regulatory auditors and how could this be achieved? Please provide practical and legal justification for your point of view.

10.4 Audit Reports and Opinion

10.4.1 Audit Opinions

It is proposed that for each of the Regulatory Financial Statements ComReg should be provided with the necessary assurance that the information with which it is being provided is relevant, reliable and of a high quality. ComReg proposes that the most appropriate manner by which this assurance can be provided is for the Dominant Operators to secure an audit opinion by the Regulatory Auditor. This would either be:

- Fairly Presents in Accordance with (FPIA) audit opinion; and
- Properly Prepared in Accordance with (PPIA) audit opinion.

Appendix E to this Consultation sets out an unqualified FPIA and PPIA audit opinion.

By proposing that there are two levels of audit opinion, ComReg is introducing a degree of flexibility to the audit process. Annex B and C sets out the financial statements, which ComReg is proposing might be covered by the FPIA audit opinion and which by the PPIA audit opinion.

A FPIA audit opinion is an audit opinion which provides a high level of assurance, whereas a PPIA audit opinion provides substantially less assurance. Annex B & C identifies the financial statements for each of the markets and the audit opinion requires. A FPIA audit opinion provides comfort that the overall impression created by the financial statements 'fairly presents' the underlying performance and financial position, including its presentation. This level of audit opinion is the general standard for industry and is equivalent to the standard required for statutory accounts

By contrast, PPIA only provides assurance that the figures contained in the financial statements have been properly prepared in accordance with an agreed process/ methodology without any assurance that the overall impression which they convey represents the underlying performance and financial position in a 'fair' manner. Therefore, it will only be permitted where it would not be possible or it would be disproportionate to gain a standard audit opinion. Because of the lower assurance which a PPIA audit opinion provides, it is less costly to obtain than an FPIA opinion.

The flexibility proposed by the two levels of audit opinion is intended to provide a degree of assurance for all financial statements, with the lesser audit opinion required where the standard audit opinion would be disproportionate.

ComReg also has a responsibility under the Access Regulations to ensure that a statement should be published annually concerning compliance with any cost accounting system obligation. For this reason, as well as for the purposes of ensuring that systems underpinning separated accounts are fit for purpose ComReg proposes that the dominant operator should procure the annual opinions to this effect from the auditor

A corollary of the proposals regarding audit is that the Dominant Operator would be obliged to ensure that the systems and processes are employed are sufficient to ensure that the Regulatory Auditor can in their opinion conclude whether the Regulatory Financial Statements comply with the Accounting Documents; and enable the Regulatory Financial Statements to be audited and audit opinion be expressed on them which shall conform to Auditing Standards.

Q. 12. Do you agree with the obligations for Auditors, Audit Reports and Audit Opinions? Please elaborate your response and provide details of any alternatives you consider appropriate

11 Cost Accounting Obligations

11.1 Introduction

This Chapter outlines the proposed obligations for Mobile Dominant operators with a Cost Accounting or Cost Orientation obligation arising from a market review. The proposals in this chapter are supplemented by those in Chapters 7 to 10, which will also need to be followed by a dominant operator having these obligations.

At the date of publication of this paper, ComReg either has imposed or has consulted on the possibility of imposing Cost Accounting obligations on the following markets:

- Mobile Voice Call Termination.
- Mobile Access and Call Origination.

11.2 Preparation of the Regulatory Financial Statements related to the Wholesale Markets for which SMP obligations apply

ComReg proposes that a Dominant Operator should prepare, secure an appropriate audit opinion in respect of, deliver to ComReg and publish the Regulatory Financial Statement in accordance with Annex B and C to this document on an annual basis.

ComReg proposes that the financial statements should be prepared on a Current Cost basis with the Current Cost financial statements reconcilable to the historical cost financial statements. ComReg proposes that these accounts will also be prepared on a LRIC basis at a later date.

Annex B & C sets out the templates for the financial statements which would be required as part of the Accounting Separation/Cost Accounting obligations for the relevant wholesale markets. Note that that in the Annexes it is proposed that CCA numbers be presented in the format of Profit and Loss accounts and Statements of Mean Capital Employed, while LRIC information is presented in tabular format.

11.2.1 Network Components

It is essential that ComReg understands the way in which costs are attributed to non SMP markets and that the attribution of these costs is on the same basis as for SMP markets. Additionally the basis of the amounts attributed during the cost cascade should be consistent and non discriminatory.

Operators dominant in relevant markets may provide services in a number of markets and may divide the activities required to supply these services among a number of business units. The division of activities relevant to ComReg for regulatory purposes is the division of services, and the activities which underlie them, between relevant markets. ComReg needs to be able to ascertain to what extent services/activities in non SMP markets may impact on services supplied in SMP markets e.g. the volumes of services in non SMP markets affects the costs of services in SMP markets. In order to determine the information required for regulatory purposes, it is necessary to understand the nature of the costs incurred by activities undertaken in the course of supplying a service (or combination of services) e.g. the accumulation and allocation of building costs.

ComReg therefore proposes that where a component or activity cost is used in any wholesale service, then that cost should be the same irrespective of the end use of that service, i.e. whether used in different services or by different end users.

Q. 13. Do you agree with ComReg's proposals for Wholesale Cost Accounting? Please elaborate on your response and provide details of any alternatives you consider appropriate.

12 Accounting Separation

12.1 Introduction

The ERG Opinion[15] on Cost Accounting and Accounting Separation defines Accounting Separation as "a comprehensive set of accounting policies, procedures and techniques that can be applied to the preparation of financial information that demonstrates compliance with non-discrimination obligations and the absence of anticompetitive cross-subsidies. The outputs from such a system must be capable of independent verification (auditable) and fairly present the financial position and relationship (transfer charge arrangements) between product and service markets. Using accounting separation, a National Regulatory Authority (NRA) imposes on the notified operator a set of rules on how accounting information should be collected and reported." Therefore ComReg is of the view that in order to monitor compliance with non discrimination obligations, it will be necessary for dominant operators to provide NRA's with in formation which allows the extent of any price non discrimination to be monitored in order to determine its competitive effects.

Accounting separation provides a systematic division of costs, revenues and capital employed between disaggregated regulatory entities and services. It should also ensure that each single account includes only costs, revenues and capital employed that are relevant to the regulatory entities and services.

This chapter outlines the proposed obligations for Dominant Mobile Operators with an Accounting Separation obligation arising from a market review. The proposals in this chapter are supplemented by those in Chapters 7 to 10, which will also need to be followed by SMP operators having these obligations.

12.2 Scope of Accounting Separation.

As discussed in the various market analysis consultations on the designated markets, ComReg intends to implement accounting separation on a by service and/or product basis. ComReg believes it is not sufficient to implement such an obligation at a market level as it is important to monitor possible cross-subsidisation of pricing at a service level. Operators dominant in particular markets may provide services across multiple markets. The activities required to supply these services may straddle a number of business units. The division of activities relevant to ComReg for regulatory purposes is the division of services, and the activities which underlie them, between relevant markets. These relevant markets may or may not be regulated. ComReg needs to be able to ascertain to what extent services in non SMP markets may impact on services supplied in SMP markets. In order to determine the information required for regulatory purposes, it is necessary to explore the nature of the costs incurred by activities undertaken in the course of supplying a service (or

[15] Annex to ERG (04) 15rev1 – "ERG Opinion on the proposed Review of the Recommendation on cost accounting and accounting separation"

combination of services). This means that it is necessary to examine costs at the level of particular services, rather than at the market level. If ComReg were to impose accounting separation only at the market level, it would not be able to identify whether products and services are being provided on a non discriminatory basis.

12.3 Proposed Accounting Separation Obligations

These proposals would apply to operators with Accounting Separation obligations and consist of obligations related to Transfer Charges and Non Discrimination. Accounting Separation could also be used to monitor and identify and help prevent anti competitive practices such as cross subsidy or margin squeezes which were identified in the market review process. This topic is covered in further detail in Chapter 13.

12.4 Transfer Charges

A well-defined, transparent and verifiable transfer charging system is necessary for ComReg to monitor non-discrimination and calculate internal costs and revenues for both cost-orientation and non-discrimination purposes. They typically reflect the vertically integrated nature of notified operators and will enumerate the wholesale/retail relationships between the economic markets and services within the undertaking's scope of activity.

ComReg is proposing that Dominant Operators should secure and be able to demonstrate that the charges for all services provided are based on an objective and fair incorporation of the costs of the underlying activities used in the course of their supply and that these charges are made in a non discriminatory manner.

In particular, this means that where the same activity is used for a number of differing services, the cost incorporated into the charge for a service for a given activity is identical irrespective of whether the activity is carried out in the course of providing an internal or external service and irrespective of which service is being supplied. That is, it reflects the cost of the underlying activities regardless of the ultimate destination.

The amount incorporated in the cost of a service for given activities carried out in the course of the supply of those services must not differ regardless of whether the service is internal (supplied to the Dominant Operator's own retail arm) or external (supplied to an OAO) or the nature of the service supplied.

Therefore, ComReg's preliminary view is that:

- all transfer charges should, in principle, reflect their actual price in the market, whether subject to regulatory control or not.

- transfer charges in the Regulatory Financial Statements should be restated to reflect amendments to various price submissions.

12.5 Non Discrimination and the need for Reconciliations

The next two sections, relating to non discrimination in the cost cascade and reconciliations apply across all retail, wholesale cost accounting and accounting separation areas and are included here for convenience.

12.5.1 Non Discrimination for Cost Allocation in the Cost Cascade.

As noted in Chapter 6 it is essential that ComReg understands the way in which costs are attributed to non SMP markets and that the attribution of these costs is on the same basis as for SMP markets. Additionally the basis of the amounts attributed during the cost cascade should be consistent and non discriminatory.

ComReg therefore proposes that where an activity cost is used in any retail service that cost shall be the same irrespective of the end use of that service.

The amount applied and incorporated in the charge for Retail Products in respect of the use of Wholesale Services should be the Transfer Charge of those Wholesale Services. Where no external Transfer Charge exists in which event it should be the cost (including a reasonable return) of those Wholesale Services.

12.5.2 Reconciliations

ComReg considers that it is important that financial statements are reliable and are consistent amongst each other. In addition to ensuring that cost allocations are the same it is important that the numbers reconcile to the statutory accounts.

Therefore ComReg proposes that the Dominant Operator shall secure that sufficient checks, controls and meaningful reconciliations are performed between figures contained in the Regulatory Financial Statements and the accounting records to (a) enable the Regulatory Auditor and ComReg to conclude that, in their opinion, the Cost Accounting System complies with the Accounting Documents; and (b) Enable the Regulatory Financial Statements to be audited and an audit opinion expressed upon them in accordance and c) Reconcile to the Dominant Operator's Statutory Accounts.

12.6 Preparation of Financial Statements for Accounting Separation

ComReg proposes that the dominant Operator should prepare, secure an appropriate audit opinion in respect of, deliver to ComReg and publish the Regulatory Financial Statement in accordance with Annex B & C to this document.

Q. 14. Do you agree with the obligations for Accounting Separation? Please elaborate your response and provide details of any alternatives you consider appropriate?

13 Retail Accounting Information Obligations.

13.1 Introduction

Note: ComReg proposes below that the obligations proposed in this chapter be applicable only if the cost accounting and accounting separation obligations for the Mobile Access and Call Origination market are implemented in accordance with Decision Notice D6/05.

The purpose of these obligations is to identify the specific requirements relating to the areas of a dominant operator where Retail Accounting Information is required e.g. to monitor and help identify and prevent anti competitive practices such as cross subsidy or margin squeezes which have been identified in the market review process. The proposals in this chapter are supplemented by those in earlier chapters, which will also need to be followed by Dominant Operators having these obligations.

In the market analysis on wholesale mobile access and call origination[16], ComReg in defining the market stated *"Because the demand for wholesale access and call origination principally derives from the equivalent retail service, competitive conditions at the retail level are highly relevant in determining the scope for which types of "access" and "call origination" services are required at the wholesale level. Therefore prior to defining the relevant market at the wholesale level, ComReg is examining the scope of the associated mobile retail market. Furthermore, as the Commission has noted, if the level of competition at the retail level is sufficiently high, ex ante regulatory intervention at the wholesale level might not be warranted"* ComReg went on to discuss than when mobile operators are dominant in the retail market and that wholesale anti competitive behaviour could affect the retail market.

Although it is critical to distinguish between wholesale and retail markets on the basis of the functional level at which products and services are traded, ComReg is of the view that it is necessary to have access to information in the retail market as it is necessary to take into account and monitor the possibility that these markets might interact so as to competitively constrain each other. For example, high wholesale prices may cause margin squeezes which could restrict the entry or force the demise of competition to the detriment of end users.

ComReg considers that Framework Regulations Paragraphs 17 and 25[3] and the Access Regulations Paragraph 12 and 13 give ComReg adequate powers to implement the provisions contained in this Chapter by enabling the collection of retail cost information in a non SMP market where e.g. price squeezes may be applied.

[16] ComReg Document No 04/05.

13.2 Justification for Retail Accounting Information.

13.2.1 Monitoring of Margin Squeeze

A margin squeeze, also referred to as price squeeze, occurs when:

- a dominant provider supplies an 'upstream' i.e. retail product A which is itself (or is closely related to) a component of a 'downstream' i.e. wholesale product A+B (product B is supplied by the dominant provider only to itself: those who compete against A+B will supply their own alternative to B); and

- the implicit charge by the dominant provider to itself for B (i.e. the difference between the prices at which it supplies A+B and A only) is so low that a reasonably efficient competitor cannot profitably compete against A+B.[17]

A margin squeeze can be effected in three ways:[18] (i) The dominant operator can charge a price above costs for the wholesale product to its competitors but (implicitly) a lower price to its own retail arm; (ii) it can charge a cost-based price to all retail undertakings but may set a predatory price on the retail market; finally (iii) it might charge a price above costs on the wholesale market, and at the same time charge a predatory price on the retail market. This behaviour may also result in cross-subsidisation.

Although the dominant undertaking may set a margin between its downstream retail price and upstream wholesale charge (paid by downstream competitors) that is insufficient to cover its downstream costs, on an 'end-to-end' basis, i.e. aggregating across the firm's upstream and downstream activities, the firm may be profitable (in contrast to the case of predatory pricing where the firm suffers short-term losses). An equally (or more efficient) downstream competitor could be unable to compete, because, in effect, it is being charged a higher price for the upstream input than its competitor, the vertically integrated firm's own downstream arm.

Exposed to a margin squeeze, a retail competitor in general will not be able to cover its costs and will be driven out of the market. If the competitor has some market power on the retail market (for example because of product differentiation) or if it is sufficiently more efficient than the dominant undertaking, a margin squeeze might result in foreclosure.

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[17] In the event that the price paid for A is not transparent, accounting separation might be needed to establish the price paid by the incumbent's retail arm.

[18] see Canoy, et al (2002, pp. 26-31)

13.2.2 Monitoring of Cross Subsidy

The issue of cross subsidisation in a retail area is quite complex. It could arise by

a) by a direct cross subsidy from the wholesale division,
b) on an individual retail product by over pricing another retail product, but the total of the bundle being unsubsidised and
c) by an indirect cross subsidy coming from a products outside the SMP bundle of designated product or products which impacts on the overall retail offering of the Dominant Operator, other MNO's and other MVNO's. The product where the cross subsidy arises are not directly related to the retail end of the regulated wholesale products.

In straightforward practical terms a) could be effectively the equivalent of items above; b) could be the high retail pricing of say off net calls and the low retail pricing of on net calls. In b) because there is adequate margin in the bundle of on net and off net calls taken together, there is no anti competitive effect for competing MNO's and MVNO's if they are purchasing these services at the same price as the Dominant Operator's Retail arm. The required monitoring for a) and b) is a Profit and Loss Account (and associated Statement of Mean Capital Employed) that shows that the retail group of products has sufficient margin to attain a normal profit.

Pertaining to c), a cross subsidy could come from other products such as handsets or accessories which are sold at a loss. Generally, if prices are set at a cost oriented level, it should not be possible for a firm to create margin squeezes. However, if one operator is more efficient than others, given a non cost oriented price[19], that operator could use its excess profits in the wholesale market to subsidise retail markets, thereby effectively predatorily pricing, creating margin squeezes and eliminating/foreclosing competition to the detriment of end users.

ComReg therefore believes that it is necessary to have access to retail financial information on such additional designated product groups in the retail area to ensure that no inappropriate cross subsidy is taking place. Note that it is the source of the subsidy that is important here; if the subsidy in case c) came entirely from products in case b) there may not be a problem. The separate reporting of case c) products enables the source of the subsidy to be more easily verified.

The risk of unfair margin squeeze or unfair cross subsidy would be reduced as wholesale prices move towards cost. ComReg will monitor the appropriateness of this requirement as wholesale rates evolve.

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[19] e.g. A non cost orientated price could be based on a glide path to tend to a cost oriented price or at a price set above the cost base of the lowest operator to maintain or encourage sustainable competition, or to encourage the climbing of the ladder of investment, be such a price related to either termination or origination services

On the other hand ComReg has stated that it will forbear from implementing accounting separation and cost accounting systems remedies for the MACO market if commercial negotiations are successfully concluded. In these circumstances the usefulness of retail information would be more limited, since ComReg will have access to cost data for a much smaller percentage of operators' wholesale costs. This will make price squeeze evaluation much more difficult. On balance ComReg's preliminary view is that retail accounting separation obligations may not be the best way of policing margin squeeze at the retail level. It therefore proposes to refrain from imposing retail accounting separation obligations where no corresponding obligations have been implemented for the MACO market. ComReg would welcome respondents' views on this matter.

13.3 Preparation of Regulatory financial information to monitor margin squeeze and cross subsidy.

Following the above discussion, therefore, when an obligation for accounting separation is imposed on an operator with SMP in one or more markets, the imposition of accounting separation may, in certain circumstances, address non-SMP markets. The imposition of accounting separation on non-SMP markets is possible only so far as an NRA can justify that the provision of such information is necessary to carry out its regulatory tasks; the imposition of such an obligation must be based on the nature of the problem identified and proportionate. ComReg is of the view for the reasons set out above that it is necessary for the following proposed retail cost information obligations:

- Preparation of information related to margin squeezes or non discrimination may be required
- Preparation of financial statements relating to services and groups of services where price control based on retail minus obligations may be imposed;
- Preparation of financial statements relating to groups of services for which Retail Cost Accounting Information obligations apply.

13.4 Preparation of regulatory financial information where a Price Control obligation of Retail Minus is proposed

ComReg may be required to determine prices on retail minus basis and could set a charge by setting a price somewhere between cost plus and retail minus, and under some circumstances at either extreme, depending on the individual factors in the case.

There are a number of ways in which a retail margin calculation can be calculated. These include using some form of LRIC or avoidable cost and also data from the entering/competing operator. ComReg's view is that the least intrusive way of obtaining data, although it will not necessarily be restricted solely to this mechanism, is to obtain data from the dominant network operators on a Fully Allocated Cost Basis. This is less intrusive and consistent with the other requirements for Retail reporting and would not require the development of a retail LRIC model.

This means that the obligations imposed in practice need to be very close to the obligations which are imposed on an operator in the retail market as if it had retail SMP. Also, given the complexity of the decision, and the many possible permutations in selling prices, (which means that the calculating of the minus part could be very complex and depend on the end user e.g. business or prepaid, resulting in the setting of different prices for such segments which would be extremely difficult to monitor), ComReg considers that it should have access to the best possible information available in order to make an informed decision.

The level at which this information is provided would be by individual product (at sales and Gross Profit level at least) within the groups of products. In order to obtain this information ComReg proposes that the information by product is given at sales and gross profit level, but would consider the use of consents if this ceased to be appropriate.

13.5 Preparation of financial statements relating to retail services and groups of services for which Retail Accounting Information obligations apply.

Subject to the considerations set out at 13.3.2 above, ComReg proposes that the dominant operator will prepare and publish the Financial Statements as set out in Annex B & C on an annual basis, depending if the MACO requirements are triggered as is indicated in Annex A.

ComReg proposes that the dominant operator shall prepare, secure an appropriate audit opinion in respect of, deliver to ComReg and publish the Regulatory Financial Statement in accordance with Annex B & C to this document.

ComReg proposes that the Retail Financial statements will be prepared on a Historical Cost Accounting basis only because ComReg considers that the need for Current Cost Accounting adjustments in this area should be limited, given the relatively small asset base.

A retail product group reflects the way the MNO's package their offerings to the market. ComReg proposes to define retails product groups as residential post-paid, business post-paid and prepaid. The following individual retail products/services may be included in the retail bundle:

- Periodic Subscription
- Free Minutes
- Retail Product Call Types
- Roaming charges

ComReg proposes that the Retail services are disaggregated as shown in the schedules in Annex A. Should new products be launched, for these markets they should be included in the appropriate group of services.

Q. 15. Do you agree with ComReg's proposals for Retail Cost Accounting? Please elaborate on your response and provide details of any alternatives you consider appropriate

Q. 16. Do you agree with ComReg's proposal not to impose Retail Accounting Information obligations unless it implements the obligations of accounting separation and cost accounting systems for the MACO market? If not, please give reasons and elaborate on your response.

14 Specific Mobile Issues

14.1 Introduction:

In order to keep the mechanics of the regimes for Fixed and Mobile Cost Accounting Systems and Accounting Separation closely aligned, the first 13 Chapters of this consultation have closely followed the Consultation of Financial Obligations for Fixed Operators[20]. However, whilst the Accounting Separation and Cost Accounting Systems regimes can be closely aligned and the principles involved can and do remain the same, there are a number of specific issues that need to be discussed with respect to the mobile networks and this chapter will therefore discuss these issues and propose how ComReg proposes that each issue should be treated with respect to the initial preparation of Regulatory Financial Statements.

14.1.1 Issues to be discussed in this chapter:

- General Disaggregation of Mobile Networks
- Blended treatment of routing factors
- Formulation of routing factors
- Treatment of Handset and Procurement and Provisioning Costs
- Subscriber costs
- Customer Acquisition and Customer Servicing Costs
- External Interconnection Costs
- Spectrum and Licence Fees
- Common Costs
- Debtors and Creditors
- Network externalities
- Ramsey Pricing
- Treatment of Cost Differences
- Cost of capital and calculation of ROCE

[20] ComReg Document No 05/18.

- Treatment of holding gains and losses
- Two Part Charging
- 3G

14.2 General Disaggregation of Mobile Services/Granularity

This section relates to the level of granularity at which both costs and revenues should be traced or disaggregated. The need for disaggregated information has been discussed in Chapters 4 and 5. This section describes the specific application to mobile operators designated with an Accounting Separation and Cost Accounting obligation. ComReg proposes that the reporting for dominant operators be broken down into two main areas- Retail and Wholesale. These areas are further divided into product, product groups and network components. The network components are then rebuilt to generate wholesale products as discussed below.

Network Products are sold to the Retail arm of the business who bundle them as necessary to supply existing retail tariff plans to retail customers. The network will also sell Network Products to the Wholesale arm of the business who will also bundle as necessary to provide competitive wholesale offerings. Components belong to the network business and offered in combination as network products to both the retail and the wholesale arm of the business.

It is envisaged that new products may come on line and if the new products are covered within the scope of the market definition for e.g. the Mobile Voice Call Termination market or Mobile Access and Call Origination market, then they should be included, as appropriate, in that market.

Network Components: A network component may be defined as a piece of equipment which is usually separately priced by the equipment vendors and performs specific functions within the mobile network. The main network components are HLR, MSC, BSC, BTS and transmission links between them. A minimum list of the proposed network components is shown in Annex B & C. It may be necessary for certain network components may need to be further disaggregated depending on the service being provided.

Q. 17. Do you agree with this general level of disaggregation as regards network products and components? Please elaborate your response.

14.3 Calculation of Routing Factors

Routing or usage factors are distributions of network components to individual network products. This approach presents a simple, straightforward and efficient costing approach leaving the actual detailed determination and justification of routing factors to the mobile operators that produce the Regulatory Financial Statements, but with transparent disclosure of the detailed methods used to make the calculations. A simple example of the use of routing factors to calculate Regulatory Financial Statements is included in Appendix D.

ComReg considers that routing factors should be calculated based on network events (e.g. minutes, calls, and SMS messages) which relate to the underlying elements being analysed rather than using a peak minute's load which does not provide any indication of the total volume of events to which costs should be allocated. (Using peak minutes load for calculating required capacity is a feature of bottom up models and not top down.)

ComReg is of the opinion however that, in order to remove any possible confusion between the treatment of routing factors used for mobile accounting separation and the routing factors used to allocate costs for the fixed network, the terminology and calculation principles of both types of network should be consistent.

Therefore ComReg proposes that routing factors should be calculated and disclosed in the financial statements according to a weighted average, based on individual product calculations. This will help ensure the cost orientation of network products and services and show that components are used in different product groups on a non discriminatory basis.

14.3.1 Blended Treatment of Routing Factors

Routing factors are based on analysis of the usage of the network component by the full range of network products and should be specific to each call type, both incoming and outgoing. There are two potential options for calculating routing factors. The first option is to blend the traffic and signalling usage of the component to arrive at a 'blended rate'. The second option is to calculate the traffic and signalling load by each network component and then calculate the routing factors.

There are inherent weaknesses in the blended approach because some network products, such as SMS and termination, carry a much higher signalling load than traffic load in percentage terms. In fact SMS uses only the signalling channels and signalling processing element. Likewise aggregating signalling and traffic ignores the fact that some network components may use 80% of their capability to serve signalling jobs and only 20% to serve the traffic conveyance. However, given the workloads involved with separating signalling and traffic capabilities for each network component, ComReg considers that not to impose full segregation of the network routing factors between traffic and signalling would give misleading signals to competing MNO's and MVNO's, , since MVNO's will have to have SMS offerings in order to compete. This being the case, SMS needs to be costed which implies that the signalling layer needs to be separated from the conveyance layer of the network.

Therefore, ComReg is of the view there should be full segregation of routing factors and MNO's are required to provide appropriate details, in line with the principle of transparency, in the documentation, of the calculation methodology behind each routing factor.

ComReg also considers that routing factors must be calculated to the same level of detail for all network products that use the mobile network, whether they are included in the market definitions or not. Only in this way is it possible to verify whether network costs are fairly and proportionally allocated to each individual network product in a non discriminatory manner. This means that a description of the calculation of routing factors that covers all network products and not only for the network products underlying regulated services is required, although it is proposed that the routing factors of individual products in non SMP areas will not be published. This will demonstrate that components are costed in a non discriminatory manner and that their usage, in other parts of the network is at the same price. Calculating costs at this level will also help to avoid one set of consumers subsidising another, or them paying too much for one type of call.

Q. 18. Do you agree with ComReg when it considers that the best option to calculate routing factors is to calculate the traffic and signalling load by each component and then calculate the routing factors?

Q. 19. Do you agree with the documentation requirements associated with routing factors should provided to ComReg?

Q. 20. Do you believe that the signalling layer should be separately analysed before routing factors are calculated, or have specific views on how it should be done? Please provide alternative suggestions on the methodology that could be used. Please elaborate your response and give reasons.

14.4 Proposed Treatment of Subscriber Costs

Subscriber costs are costs that are directly attributable to the number of subscribers and do not include any costs that are driven by capacity demands. ComReg is of the view that subscriber costs should not be charged to network products and should be included in the Retail Product Group statements using e.g. subscriber numbers as the allocation key.

If these costs are not, treated in this manner, the principles of cost orientation (or cost causality) would not be adhered to and market development may be retarded since new competitors would have to pay both their own and the MNO's subscriber costs, which would not allow efficient and effective competition. Additionally, interconnection can be defined as the "physical and logical linking of telecommunication networks used by the same or a different organisation in order to allow the users of one organisation to communicate with users of the same or another organisation or to access services provided by another organisation". Subscriber costs are incurred downstream of the MTR and MACO services and are not incurred in the provision of interconnection services. Subscriber costs are therefore incurred in the delivery of services to customers, which is a retail activity and not covered in the definition in the previous sentence.

Therefore ComReg proposes that subscriber costs are not included in MACO and MTR service costs.

14.5 Proposed Treatment of Handset Procurement and Provisioning Costs

The costs associated with procurement and provisioning of handsets may be significant. However, as they are not part of the network, ComReg proposes that they should be charged, not to network markets, but to the retail markets. Similarly, handset procurement and provisioning costs also be charged to the retail markets.

In relation to (Network Terminating Points) NTPs, ComReg believes that the SIM card is not the only NTP from the call termination perspective and thus has considered expanding the definition to include other platforms on which calls can terminate such as the Voice Mail system and are treated as such in the appropriate statement of costs schedules (as per Annex B & C). However, it should be noted that the SIM can be regarded as a NTP. The analogy in the fixed network would be an answering machine or network voice mail system connected to a handset. In that case the handset is not considered as the NTP nor is the answering machine. From the network costing perspective the cost associated with non network equipment such as handsets is ignored.

It may be argued that a call or SMS cannot be initiated or received without a handset/PC/Laptop - this is broadly accepted as true with some notable exceptions such as internet based SMS origination services. The same is true of calls on the fixed network – they are generally initiated via handsets or faxes or even PCs, but this does not suggest that handset, faxes or PCs costs should be included in the network costs. Furthermore, an operator could sell network services to end users who had not purchased a handset from them. Inclusion of the costs of handsets in wholesale market costs could result in both the double recovery of costs and in the bundling of services so that end users / customers were made to pay for services they did not require.

Therefore ComReg proposes that handset procuring and provision costs should not be part of MACO and MTR product and service costs.

14.6 Proposed Treatment for Customer Acquisition and Customer Servicing Costs.

This grouping is similar to the Subscriber Costs group insofar as the drivers for these costs are also a function of subscribers. However, this category relates to costs that generally are incurred within the marketing and commercial functions of the MNO.

Customer Acquisition Costs- These costs relate to the activities associated with attracting potential customers to the network and in some cases are specific to customer segments.

Customer Servicing Costs – These costs relate mainly to the costs of running the customer help desks, customer complaint desks, customer billing and payments and ongoing general marketing. The MNO's should be able to allocate costs to the major segments; business post paid, residential post paid and prepaid, given that customer service centres generally have different access numbers per segment.

Therefore ComReg proposes that Customer acquisition and servicing costs should not be charged to network products, but allocated over Retail services.

14.7 External Interconnection Costs

14.7.1 Conveyance Charges

MNO's normally pay interconnection fees for calls that terminate or transit via the interconnecting partner's network (also known as outpayments). The fee payable is set by the call type and is built up from costs and the routing factors of the interconnecting partner for that particular call. ComReg proposes that these costs should be charged in detail to the retail call or product in the product group level, since these costs do not relate directly to MTR or MACO services.

14.7.2 POI set up costs & Interconnect Links

The Points of Interconnect are generally established such that the operator that sends the traffic pays for the links associated with the traffic stream. Consequently ComReg proposes that the costs for commissioning POI's and testing POI's, and periodic charges for the lease of links should not be charged to Termination products, but included in Access and Call Origination Services.

14.8 Spectrum and Licence Fees

There are a number of different types of Spectrum and Licence Fees:

Annual Wireless Telegraphy Fees for spectrum fees can be regarded as part of the cost of operating the network and ComReg proposes that these can legitimately be passed on to interconnecting parties, including the MNO’s retail arm. In order that these charges are picked up by all users of the network and all services ComReg proposes that these are charged initially into the base station component.

Annual Point to Point Radio Links Fees for links between base stations can’ for similar reasons, be treated in the same way as the annual Wireless Telegraphy Fees.

Spectrum Access charges which are up front licence fees are paid up front for the duration of the licence for the right to use spectrum. ComReg proposes that the historic cost of these fees be amortised over the life of the licence and charged to the base station component so that each service picks up its share.

Electronic Communications Levy. This should be split between network and retail markets depending on turnover. Each network service should pick up its share depending on its external turnover.

All these costs are legitimately incurred by a MNO and should be recovered in its charges for network services. If such costs were not charged e.g. to an MVNO the MVNO would have a competitive advantage because it would not be paying such costs and the MNO could not recover the proportion of these costs incurred on services provided to MNO’s.

14.9 Treatment of Extraordinary and Exceptional Costs

It is reasonable to assume that the activities of the mobile operators could give rise to extraordinary and/or exceptional items periodically. However, to ensure greater transparency and clarity in the presentation of information, ComReg proposes to disclose separately on the face of the appropriate P&L (which will be determined according to the facts of each case) the effect of each extraordinary and/or exceptional item. In addition a full explanation of both the item in question and its accounting treatment should be provided in a note to the accounts.

Q. 21. Do you agree with ComReg proposed treatment for (i) Subscriber Cost, (ii) Handset Procurement and Provisioning Costs, (iii) Customer Acquisition and Servicing Costs (iv) External Interconnection Costs (v) Spectrum & Licence fees and (vi) Exceptional Costs ? Please elaborate on your response and suggest alternatives if appropriate.

14.10 Common Costs

Common costs relate to costs which are common and not directly incurred as a result of any one product. The way in which common costs arise can depend on the view taken. For example, the allocation of common costs in a fully allocated cost system may be different to those calculated by a top down LRIC model.

ComReg believes that the categories of costs that should be treated as common costs should be kept to a minimum. For example, most accommodation costs can, in a fully allocated cost system, is traced directly to individual services, although for LRIC purposes they may be split into incremental and common costs via a Cost Volume Relationship (CVR).

ComReg has spent some time further analysing the problem of common costs. This can be broken down into a number of different areas:

- Fully Allocated Costs
- Access / Coverage
- LRIC
- Conclusions

14.10.1 Fully Allocated Costs:

A discussion of fixed costs has taken place in Chapter 5.

14.10.2 Access/ Coverage Costs

It can be argued that coverage costs should be viewed as being fixed common costs. In principle, ComReg can accept that there is a coverage product and that the provision of this product gives rise to fixed common costs. However, ComReg believes there are very significant difficulties in defining this product. In ComReg's view there are four essential problems in defining a coverage product.

1. A network provides coverage (access) if all customers can connect with the network in that place at all times. Under this definition, the network would require a huge capacity so that even if a great many subscribers are in the same area, perhaps at a major sports event, they can all make or receive a call. Probably no networks would provide coverage under this definition and indeed their license provisions do not require such an onerous obligation. Likewise the terms and conditions of service to customers do not guarantee this right.

2. Another view is that coverage relates to the network as it has been designed, since its design optimises the ability of a subscriber to connect with the network, recognising the trade-off between the costs of increasing capacity versus the desirability of being able to connect to the network at any time in any place.

3. Coverage could also be considered as the capability or option to make a single call from any point of the network at a point in time. All additional capacity is due to conveyance.

4. Coverage is the site locations necessary for an MNO to construct a network to which people within a defined area could connect to a network. All of the telecom equipment necessary to permit a connection is due to conveyance.

Other aspects of coverage include:

- Increasing coverage means increasing the area within which a connection is possible.
- It is also important to establish the quality of coverage being considered. This can defined in a number of different ways. For example, the costs of coverage would vary widely according to whether one is discussing outside coverage (coverage outside a building or car); in car coverage; in building coverage or perhaps some mix of the above. It can further be noted that these individual categories can themselves be categorised in a number of different ways. For example, there is a range of alternative definitions of in building coverage.
- As a result of the combined impact of the above, increasing the complexity of calculation, ComReg proposes not to define a coverage product, but would like respondents views as to whether or not there should be an access service and if so how such a service cost would be arrived at.

14.10.3 LRIC

To calculate LRIC, a fully allocated cost can be developed. This can, with the use of cost volume relationships (CVR), be used to calculate LRIC costs. Each defined collection of costs has its own CVR. This kind of model often works on an avoidable cost basis i.e. the concept of incremental cost is reversed so as to define it as the cost avoided over a certain output.

An avoidable cost LRIC works by each service being deemed to use the actual volumes back from the 100% point of the CVR curve. Thus this part of the curve is used many times. This means that each product takes the lowest incremental cost i.e. that of the deemed last volume up to 100%. Common costs are calculated as the difference between the total costs of the increments used less the total cost of that CVR. Total common costs are the total costs added up from all CVR's and as such can include all kinds of variable, fixed and joint costs, depending on the nature and slope of the CVR.

ComReg's view of LRIC is that it is an appropriate tool for mobile operators, but that in the short term, in order to process the initial Accounting Separation and Cost Accounting obligation, this methodology should not be followed initially. However ComReg proposes that LRIC should be implemented one year later.

Q. 22. How do you think common and overhead costs should be allocated and presented in the Regulatory Financial Statements? Please elaborate your response.

Q. 23. Do you agree that the Annual Regulatory Financial Statements should be prepared on a current cost basis and reconciled with the historical cost accounts? Do you agree that the basis of this information should be fully allocated costs?

Q. 24. Do you consider that an Access coverage component should be created? Do you agree that Dominant MNO's should prepare LRIC information? If not, please elaborate your response?

Q. 25. Do you believe that the Regulatory Financial Statements should be prepared on a LRIC basis? When and how do you think these should be prepared?

14.11 Treatment of Debtors and Creditors

14.11.1 Interconnection Debtors and Creditors

When the wholesale market sells to the downstream arm of a dominant operator, it could be argued that, if this downstream arm is treated as a separate business, a debtor owed by that retail arm to the wholesale business is created. ComReg considers that such a debtor is notional and does not exist in practice. ComReg therefore proposes that, in order to maintain consistency with the treatment in the fixed network, these types of debtors and creditors will be ignored.

14.11.2 Retail Debtors

External debtors should be traced directly to the retail bundle that they originate from.

Q. 26. Do you agree with the treatment of interconnection and retail debtors and creditors as described above?

14.12. Other Issues

14.12.1 Ramsey Pricing

Ramsey pricing involves marking-up prices above marginal cost in such a way as to minimise economic welfare losses while at the same time ensuring the recovery of fixed costs[21]. In the simplest case where only own-price demand elasticities are considered, this involves imposing the highest mark-up (relative to cost) on the service with the lowest demand elasticity and the lowest mark-up (relative to cost) on the service with the highest demand elasticity. More sophisticated models of Ramsey pricing take account of cross-elasticities and network externalities.

ComReg has a number of concerns with regard to Ramsey pricing. Firstly, the information requirements for implementing Ramsey pricing are extensive, encompassing, for example, own and cross-price elasticities and the extent to which these vary with prices. Further, while Ramsey prices should be based on market elasticities, MNOs are likely to focus on the elasticities that they face which may be very different. Hence, if the regulator were to impose a Ramsey based price for a service for which it deems that there is insufficient competitive pressure, there is no guarantee that the firm will impose Ramsey based prices, based on market elasticities, for other services.

In addition, there is no evidence to suggest that the relative elasticity functions can be easily ascertained especially in light of the level of customer segmentation. Price

[21] More strictly speaking this definition of Ramsey prices only applies to uniform pricing schemes. Where there are non-uniform pricing schemes, e.g. different combinations of rentals and call prices, these can yield higher welfare than simple Ramsey pricing.

elasticity at the product level is a function of the various consumers within the market all of whom may exhibit different utility factors at both the individual and customer class level for the product in question. These individual elasticities need to be measured, at least on a sampling in order to arrive at a meaningful elasticity factor.

Finally, as argued below, ComReg does not believe that network externalities are a factor which should be adjusted for. In consequence, and to maintain consistency with fixed network treatment, ComReg believes that there is little to be gained from using Ramsey pricing. However it would consider any actual evidence, including appropriate calculations of the amounts for Ramsey Prices, together with actual price effects from interested parties at the time ComReg has to make pricing decisions using these Regulatory Financial Statements.

14.12.2 Network Externalities

An externality arises where a decision is made by one party which conveys either costs or benefits to another party. As a result the social benefits of that decision differ from its private benefits. In order to achieve economic efficiency, prices should be adjusted in such a way that the individual consumes the socially optimal output. Where the externality is positive this will result in a reduction in the price of the product; where negative this will result in an increase in the price of the product.

In the case of telecommunications two types of externalities are generally considered, namely call and line externalities. In both cases the externality arises because two parties are affected by the party making a call or joining the network. Therefore, in principle, the social benefits could be double the private benefits where both parties benefit equally. However, where these benefits are fully internalised, as discussed below, the private and social benefits will be the same.

Call externalities arise because a call initiated by the originating party confers benefits (or costs) on the receiving party. However, call externalities can be largely internalised (for example, parties can take it in turns to call one another) although total internalisation may not be possible, e.g. for parties with no community of interest. Where full internalisation takes place private and social benefits will be the same[22].

Network externalities are the benefits obtained by fixed and mobile subscribers when a person decides to become a new mobile subscriber. Existing subscribers value the calls that they make to and receive from the new mobile subscriber. They may also obtain a benefit from the *ability* to contact and be contacted by the new subscriber – the so-called ‘option value’.

In ComReg’s view there is a high degree of uncertainty about the optimal level of any mark-up. However, it believes that the optimal mark-up is likely to be small, due to the combination of inelastic demand for subscription at current prices, low externality

[22] Note that where there is no internalisation social benefits will be double private benefits where the value of the link is the same for both parties.

factor and current prices and penetration rates and because of the MNO's ability to segment the market. ComReg notes that handset penetration for mobiles is now higher than that for fixed networks where no allowance is made for network externalities. As a result of these factors and given that any mark-up may not flow through the subscription charge, ComReg does not believe that a mark-up for externalities is warranted. However it would consider any actual evidence, including appropriate calculations of the amounts for Network Externalities, together with actual price effects, from interested parties at the time it make any pricing decisions.

Q. 27. Do you agree with ComReg's proposals on (i) Ramsey pricing and (ii) Network Externalities? Please elaborate on your response.

14.13 Treatment of Cost Differences

Given that two mobile operators have been designated with an Accounting Separation and Cost Accounting obligation, the issue of comparability of the cost levels arise. While ComReg believes that the extent of cost difference could be reduced through the application of standardisation in certain cases and that information should be provided at a sufficiently detailed level to provide an indication for the differences especially in relation to certain items of capital and operating costs.

However there are a number of disadvantages to this process e.g.: normalisation in these accounts would create a substantial level of work and risk, it may distort investment decisions since firms face different level of uncertainty and react in different ways to these uncertainties at different times and the technologies used by the firms may be different. It could also be considered heavy handed and intrusive regulation.

While ComReg considers that efficiency studies and bottom up models could possibly be used to address any differences created by different accounting policies or cost differences as and when required. ComReg therefore does not propose to impose procedures for normalisation of cost differences or MNO's assets lives.

Q. 28. Do you agree with the position taken by ComReg on this issue? Are there any other measures which can be taken to ensure cross comparability between operators?

14.14 Cost Of Capital Used in the Calculation of ROCE

ComReg proposes to deal separately on this later at a later date.

14.15 Treatment of Holding Gains/Losses and Supplemental Depreciation

Assets are normally revalued from a historical cost purchase date. In practical terms, in the first year of running the model revaluation, holding gains or losses may arise due to 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. As the model is re-run in future years a further gain/loss may arise depending on movements in asset pricing trends.

The LTD gains or losses up to the beginning of the first year of the Financial Statements being prepared can be treated in three different ways:

- Write off the LTD holding gain/loss to the P&L in the year of revaluation;
- Amortise LTD holding gain/loss and write it off over remainder of the assets' life; and
- Ignore the LTD holding gain/loss.

The first option would be appropriate in the event where CCA is being applied to the financial accounts. Holding gains or losses cannot be ignored, otherwise the accounts will not balance without an adjustment to either reserves or the current profit. However, this practice results in distortions to the underlying profit figures and consequently reduces the usefulness of the statements in assessing profitability and return on capital employed. Thus ComReg is of the view that LTD gains and losses should not be written off to the current year's P&L.

The second option is to amortise the gains or losses and write them off over the remaining life of the asset, thus spreading the impact over many years' results. This system is in effect subject to the same conceptual weakness as option 1. However, in real terms the outcome of option 2 is to defer the full impact to future periods.

The third option may cause fewer distortions, values assets at true current costs and may lead to greater transparency in the accounts and give entry and make or buy signals based on the current actual costs.

ComReg proposes that LTD holding gains or losses up to the beginning of the first year of Financial statements being prepared should not form part of the current years profit or loss i.e. they should treated as a separate line item as noted in Annex B &C.

Revaluations arising during first and subsequent years should be included in the profit and loss account as noted in Annex B & C.

Q. 29. What of the 3 options for the treatment of holding gains/losses is preferable? Please provide adequate justification for your response.

14.16Two Part Charging

Two Part Charging occurs when users are billed separately for the set up and duration of services e.g. calls. It could be argued it is more appropriate since it may more accurately reflect the underlying cost behaviour and provides more meaning full economic triggers to the market place

ComReg believes that this may well be applicable to the mobile sector, but does not consider that the market place to be as yet sufficiently developed to mandate its implementation, now. It may consider introduced it at a later date.

Q. 30. Do you agree with ComReg's view that two part charging is not appropriate at this time? If not please elaborate your response, when do you think such charging should be implemented.

14.17 3G Costs:

In principle, the market reviews do not distinguish between different technologies used to provide services. However, these different technologies do exist and this has implications for accounting e.g. current cost accounting for a 2G network and the attribution of costs. Given that the costs for particular services for each of these technologies could be quite different, ComReg considers that 3G costs, if not used for 2G CCA valuations, should be reported separately in a series of separate components as shown in Annex B & C.

Q. 31. Do you agree with ComReg's proposal for 3G- Please elaborate on your response?

15 Proposed Financial Statements and Schedules and Additional Financial Information

15.1 Introduction

The attached annexes A, B & C to this consultation, when backed by transparency of documentation and an audit opinion, contain much of the routine data required by ComReg to satisfy itself that a dominant operator is complying with its obligations for e.g. accounting separation, cost orientation and cost accounting.

The purpose of this chapter is to provide an overview of the annexes which are meant to be indicative only at this stage and to describe how they relate to the consultation and with each other.

15.2 Overview of Annex A

Annex A sets out an indicative list of segments and product/services for both the MACO and MTR markets. This annex identifies the products/services within each of these markets and groups similar products/services into segments. The annex then identifies the financial statements/schedules, audit opinion and publication details required at the market, segment and service level.

There is a worksheet for each of the relevant markets, identifying the products/services within each market and grouping the products/services in segments. The Purpose of Annex A is to demonstrate the level of granularity (i.e. to the service level) which ComReg requires ultimately in order to enforce and monitor the Accounting Separation/Cost Accounting obligations. The Services identified within each market is indicative only and the final list of services will be directed after discussions between ComReg and the Dominant operator, taking account comments received in the consultation processes from other interested parties.

15.3 Overview of Annex B & C

Annex B & C sets out an indicative form and content of financial statements and supporting schedules which it proposes to be prepared to comply with the financial reporting obligations. Annex B set out the proposed schedules for the MTR market while Annex C set out the proposed schedules for the MACO market. ComReg welcomes comments on these annexes and suggestions on alternative formats (i.e. tabular formats reporting all services within a market, rather than a specific statement for each service) which would also comply with the financial reporting obligations.

Both annexes can be grouped under the four following headings of Financial Statements, Statement of Cost Schedules and Memorandum Information and Additional Financial Information.

15.3.1 Financial Statements

These financial statements comprise profit and loss accounts, statement of mean capital employed and other reconciling and supporting schedules. Financial statements are required at the service, segment and market level as set out in Annex A. ComReg is proposing that the financial statements required at market and segment level will be prepared and published, whereas the financial statements at service level will be prepared for ComReg's purpose only and will not be published.

The annexes also sets out the level of Audit Opinion (i.e. FPIA and PPIA as appropriate) required for these statements at market, segment and service level.

In earlier chapters ComReg indicated reasons why financial information at the level of each individual service is required. However, ComReg understands that currently a single mobile termination rate is calculated and charged by the various mobile operators. However it is possible that different prices could be charged for different termination services. Possible examples of distinguishable termination services that may have different cost attributes are pre and post termination voice services (from fixed, on net mobile, off net mobile, international to handsets and voice mail platforms), termination of VPN services and the termination of Supplementary Voice Services such as call conferencing and call forwarding etc.

In the fixed telecommunication network, one termination rates is charged incorporating all the various services; however different rates apply over various parts of the network –i.e. at primary, tandem and double tandem level.

There are therefore two options available:

- A single rate based on an average rate of all the various termination services which would cover inter alia the above services

- Multiple rates depending on what termination services are defined.

ComReg's preliminary view is that it would focus at least initially, on obtaining information to monitor a single termination rate. ComReg is interested in the views of respondents on this matter. It should also be considered that if multiple rates are used, more financial information will be required.

15.3.2 Statement of Costs Schedules

These schedules of statement of Costs for the mobile network are required as they allow ComReg and other interested parties to satisfy themselves that no discrimination is taking place (i.e. that the dominant operator is charging an OAO for services on the equivalent basis to it own downstream retail arm). This is done for example by showing that the same amount of money is applied for the usage of a component in all services that use that component, even if the usage of the component appears in on a different statement of costs.

15.3.3 Additional Financial Information

Annex B & C also sets out the Additional Financial Information required along with a justification for its request. The precise format and content of these schedules will be discussed further at a later date with the relevant dominant operators. This information will be produced for ComReg's purposes and will be subject to the audit opinion.

Q. 32. Do you have any comments on the attached Annexes A, B & C to this consultation? ComReg is particularly interested in your views on the form and content of the proposed financial statements/schedules set out in annexes. Do you consider there to be other formats or forms in which the information could be presented? Please elaborate on your response.

15.4 Implementation Issues

The proposals contained in this document probably cannot be implemented immediately. ComReg proposes to discuss with the relevant operators involved a programme for implementation of these proposals. This chapter outlines ComReg's current thinking on the way in which the proposals can be implemented.

15.5 Current Status

There is currently no regulatory financial reporting regime in place.

15.6 Implementation Issues.

15.6.1 Preparation of Regulatory Financial Statements

ComReg proposes that the Regulatory Financial Statements will be prepared on a Current Cost (CCA) basis and reconciled to the Historical Cost Accounts. ComReg believes that the information related to CCA accounting should be available for the Financial Year 2006/07, with at least indicative prior year figures. ComReg is proposing that LRIC information would be due one year from this date.

15.6.2 Accounting Documentation

ComReg proposes that the Primary Accounting Documentation should be issued within 6 months of ComReg issuing a final direction on the financial reporting obligations and thereafter within 4 months for the financial year end (i.e. issued at the same time as the financial statements). With regard to the Secondary Accounting Documentation, ComReg proposes to work with Dominant Operators and this documentation.

Q. 33. Do you agree with ComReg's proposals for Transitional and implementation arrangements? Are these any other issues which ComReg should taken into consideration? Please elaborate on your response?

16 Regulatory Impact Analysis

The Ministerial Direction (issued by the Minister for Communications, Marine & Natural Resources in accordance with S13 of the Communications Regulation Act, 2002) published in February 2003, directs:

"The Commission before deciding to impose regulatory obligations on undertakings in the market for electronic Communications or for the purposes of the management and use of the radio frequency spectrum or for the purposes of the regulation of the postal sector, shall conduct a Regulatory Impact Assessment 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."

ComReg is obliged under Regulation 9(6) of the Access Regulations to impose obligations ' based on the nature of problem identified, proportionate and justified in the light of the objectives laid down in section 12 of the Act of 2002 and only be imposed following consultation in accordance with Regulations 19 and 20 of the Framework Regulations'. In the various market analysis consultations with the industry, ComReg has stated that it considers the obligations of Accounting Separation and Cost Accounting are appropriate remedies to address the potential competition problems in certain mobile telecom markets. ComReg in this paper consult as to how these remedies can be effectively implemented and furthermore considers the proposed reporting requirements to be proportionate and justified.

ComReg will conduct a Regulatory Impact Assessment which will form part of the decision making process and would invite comments on the proportionality of the means of achieving the Accounting Separation and Cost Accounting remedies listed in this consultation.

In the preparation of this consultation paper and in order to assess the regulatory impact of the proposed financial reporting obligations, ComReg considered the alternatives means of the implementation of financial reporting obligations. These alternative means include the following:

- Propose that the Dominant Operator prepare all Regulatory Financial Statements prepared at a fine level of granularity.
- Propose that certain Regulatory Financial Statements prepared at a fine level of granularity.
- Propose that ComReg specify detailed attribution methods, systems, processes, procedures and attribution methods as well as the specific accounting policies to be used to prepare regulatory financial information.

- Propose that the current reporting arrangements be maintained.

ComReg's preferred option is that certain Regulatory Financial Statements prepared at a fine level of granularity. Therefore the regulatory option appraisal will focus on the likely costs and benefits of that option.

In accessing the cost and benefits in the preparation of a RIA, ComReg proposes to evaluate the proposed reporting obligations under the following headings:

- Maintenance of accounting records and systems;
- Preparation, delivery and publication of Regulatory Financial Statements
- Accounting Documentation;
- Audit requirement; and
- Wholesale/Retail Cost Accounting and Accounting Separation obligations.

Q. 34. Respondents are asked to provide views on whether the proposed financial reporting obligations proposed to comply with an Accounting Separation and/or Cost Remedies are proportionate and justified and offer views on what factors ComReg should consider in completing it Regulatory Impact Assessment?

Q. 35. Are there any other issues or comments you would like to make on this Consultation Paper? If so please do here and elaborate on your response

17 Submitting Comments

The consultation period will run from 18th July 2005 to 12th September 2005 during which the Commission welcomes written comments on any of the issues raised in this paper.

Having analysed and considered the comments received, ComReg will review the subject matter of the consultation and publish a report in October on the consultation which will, inter alia summarise the responses to the consultation.

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.

Please note

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.

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.

Such Information will be treated subject to the provisions of ComReg's guidelines on the treatment of confidential information – ComReg 05/24

Appendix A – Consultation Questions

List of Questions

Appendix B – Selected text from the Access Regulations and Universal Service and Users' Rights Regulations.

17.1 Regulation 12 & 14 of the Access Regulations (S.I. 305 of 2003)

Accounting Separation

12. (1) The Regulator may in accordance with Regulation 9 impose on an operator obligations for accounting separation in relation to specified activities related 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.

Price control and cost accounting obligations

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.

17.2 Regulation 14 & 16 of the Universal Service and Users' Rights Regulations (S.I. 308 of 2003)

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).

(9) Without prejudice to Regulations 8(2) and 9, the Regulator shall not apply retail control mechanisms under paragraph (1) in a relevant market, in relation to which the Regulator is satisfied that effective competition exists.

Regulatory controls on the minimum set of leased lines

15. (1) Where 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 relevant market consisting of the provision of part or all of the minimum set of leased lines, as identified in the list of standards published in the Official Journal of the European Communities pursuant to Article 17 of the Framework Directive, is not effectively competitive, it shall impose obligations regarding such provision, and regarding the conditions for such provision which are set out in Schedule 3, on an undertaking designated under Regulation 27(4) of the Framework Regulations as having significant market power in such relevant market.

(2) Where, as a result of a market analysis referred to in paragraph (1), the Regulator determines that a relevant market for the provision of leased lines in the minimum set is effectively competitive, it shall withdraw the obligations referred to in Regulation 13 or, as appropriate, paragraph (1), in relation to that specific leased line market.

Carrier selection and carrier pre-selection

16. (1) Where 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 relevant market consisting of the provision of connection to and use of the public telephone network at a fixed location is not effectively competitive, the Regulator shall impose obligations to be complied with by an undertaking designated under Regulation 27(4) of the Framework Regulations as having significant market power in such relevant market for the purpose of enabling subscribers of such undertaking to access the services of any interconnected provider of publicly available telephone services-
(a) on a call-by-call basis by dialling a carrier selection code, and
(b) by means of pre-selection, with a facility to over-ride any preselected choice on a call-by-call basis by dialling a carrier selection code.

(2) The Regulator may, pursuant to a market analysis under Regulation 27 of the Framework Regulations, determine that user requirements for the facilities referred to in paragraph (1)(a) and (b) shall be implemented on other networks or in other ways and any such determination shall be implemented in accordance with Regulation 12 of the Access Regulations.

(3) An undertaking to which paragraph (1) refers shall ensure that pricing for access and interconnection related to the provision of the facilities referred to in paragraph (1)(a) and (b) is cost oriented and that direct charges to subscribers, if any, do not act as a disincentive for the use of these facilities

Appendix C –List of Definitions

The following definitions shall be used in the attached consultation paper:

'Accounting Documents' means together the Primary Accounting Documents and the Secondary Accounting Documents;

'Accounting Policies' means the manner in which the requirements of the Companies Act's 1963-2004, the Accounting Standards and the accounting policies whenever not superseded by the Regulatory Accounting Principles, are applied in each of the Financial Statements, as agreed in writing between ComReg and the Dominant Operator on or before the date on which these obligations/directions come into effect and as amended from time to time;

'Attribution Methods' means the practices used to attribute revenue (including appropriate Transfer Charges), costs (including appropriate Transfer Charges), assets and liabilities to activities or, insofar as those activities have been aggregated into Wholesale Segments in a given Market, to each Wholesale Segment, as agreed in writing between ComReg and the Dominant Operator on or before the date on which these obligations come into effect and as amended from time to time;

'Auditing Standards' The basis principles and essential procedures in the statement of auditing standards issued by the Auditing practice Board and adopted the accounting institutes , which are in force and which, unless otherwise indicated, auditors must follow when doing audit work;

'Auditor' means any auditor which could be appointed as the Dominant Operator's auditor in accordance with the requirements of the Companies Acts 1963-2004;

'Cost Accounting System' means a set of rules which supports the attribution of costs, revenues and capital employed to individual services;

'Dominant Operator' means any operator who has been designated with SMP as part of ComReg's review of the EU designated markets;

'External Wholesale Services' means services supplied or offered to any Communications Operator other than the Dominant Operator;

'Financial Year' means a financial year of the Dominant Operator in respect of which annual statutory accounts are required to be (or to have been) prepared and audited in accordance with the requirements of the Companies Act's. 1963-2004

'GAAP' (Generally Accepted Accounting Practice(s)) means conventions, rules and procedures that define currently accepted accounting practice;

'Internal Wholesale Services' means services equivalent to the External Wholesale Services which, in the absence of horizontal or vertical integration, could be supplied within the Dominant Operator;

'Long Run Incremental Cost Methodology' means the long run incremental cost principles, procedures and processes which form the framework under which long run incremental costs are determined, as agreed between ComReg and the Dominant Operator;

'Market' means the market and technical areas to which the SMP obligations apply;

'Network Activities' means any activities related to Network Access used directly or indirectly (or which in the absence of horizontal or vertical integration would be used directly or indirectly) in the course of supplying Wholesale Services and any activities used in the course of such activities, excluding those activities which are Wholesale Activities;

'Network Services' means those groups of Network Activities used directly (or which in the absence of horizontal or vertical integration would be used directly) in the course of supplying Wholesale Services;

'Primary Accounting Documents' means together the Regulatory Accounting Principles, Accounting Policies, the Attribution Methods, the Regulatory Accounting Principles, the Transfer Charge System Methodology and the Historical Cost, Current Cost, Long Run Incremental Cost Methodology;

'Process' means the series or inter-related activities or actions to obtain, record or hold data or information or to carry out any operation or set of operations on the data or information, including:
(i) organisation, storage, adaptation, or alteration of the data or information;
(ii) retrieval, consultation, computation or use of the data or information;
(iii) disclosure of the data or information by transmission, dissemination, or otherwise making available; or
(iv) alignment, combination, blocking, erasing or destruction of the data or information;

'Regulatory Accounting Principles' means the principles agreed between ComReg and the Dominant Operator;

'Regulatory Auditor' means the Auditor for the time being appointed by the Dominant Operator;

'Regulatory Financial Statement' means any of the Financial Statement as set out in Annex B & C;

'Relevant Financial Year' means the Financial Year in relation to which any given set of Financial Statements are required;

‘Retail Products’ – these are any services used by or offered to any end users (including the Dominant Operator);

’Retail Segments’ – these are groups of retail products as agreed between ComReg and the Dominant Operator and/or as directed by ComReg from time to time;

’Retail Activities’ – these are any activities used solely for the purpose of providing retail products or any activities used solely in the course of such activities;

‘Retail Catalogue’ means, a description of each service within each retail market, sufficient to enable the reader to understand inter alia. What the service is, what the service is made up of and how it links with other services;

Retail Support Activities – these are any activities used directly or indirectly in the provision of retail products and any activities used in the course of such activities, except for those that are retail activities or wholesale services;

‘Secondary Accounting Documents’ means a comprehensive documentation of the Dominant Operators systems and is more detailed than the Primary Documentation;

‘Statutory Auditor’ means the Auditor for the time being appointed by the Dominant Operator in accordance with the requirements of the Companies Act’s;

‘Transfer Charge’ means the charge or price that is applied, or deemed to be applied, by the Dominant Operator to itself for the use or provision of an activity or group of activities. For the avoidance of doubt, such activities or group of activities include, amongst other things, products and services provided from, to or within the Market and the use of Network Components in the Market;

‘Transfer Charge System Methodology’ means the methodology of the system which enables an activity to use a service or good from another activity and to account for it as though it had purchased that service or good from an unrelated party (including accounting for it an at appropriate amount), as agreed between ComReg and the Dominant Operator;

‘Usage Factor’ means the average usage by any Communications Operator (including the Dominant Operator itself) of each Network Component in using or providing a particular product or service or carrying out a particular activity;

‘Wholesale Activities’ means any activities wholly and exclusively used (or which in the absence of horizontal or vertical integration would wholly and exclusively be used) in the course of supplying Wholesale Services and any activities wholly and exclusively used in the course of such activities;

‘Wholesale Catalogue’ means, a description of each service with each wholesale market, sufficient to enable the reader to understand inter alia. What the service is, what the service is made up of and how it links with other services;

‘Wholesale Segments’ means groups of Wholesale Services as agreed between ComReg and the Dominant Operator and/or as directed by ComReg from time to time;

‘Wholesale Services’ means services related to Network Access used by or offered to any Communications Operator (including the Dominant Operator.

Appendix D –Example of the Calculation of Statement of Cost Schedules.

Introduction

The aim of this Annex is to show how the product and service costs are calculated showing the presentation of the results as they would occur in the Financial Statements. This annex is directed as those who need to understand how the mechanics of the calculation work and those who would have to implement systems to perform these calculations.

Assume that there are three products/services each using two network components. A component can be for example a base station or a mobile switching centre.

Calculation of Component Costs

Assume also that Service A uses 1 of component X and 3 of component Y, Service B uses 2 of component X and 8 of component Y and Service C uses 1 of X and 4 of Y.

This can be shown in Table 1 as follows:

Table 1: Component Usage by Service.

	Component X	Component Y
Service A	1	3
Service B	2	8
Service C	1	4

The numbers, 1,2,3,4 and 8 are known as routing or usage factors.

Assume that the volumes of services sold are 10 of service A, 15 of service B and 5 of Service C. This would mean a total usage of Component X of 45 (1*10 (the number of components X in Service a multiplied by the volume of Service A) plus, similarly, 2*15 plus 1* 5) and for component Y, similarly, of 170 (3*10 plus 8 *15 plus 4 * 5)

If we assume that the total operating costs of Component X are 120 and there is capital employed of 75, relating to Component X, then, if the ROCE is 20% the required cost recovery (assuming e.g. that this is an efficient producer) for component X is 135 (120 plus 75*20%), giving an average unit total cost of 3 per usage of the component - (135/45 – the total cost divided by the total usage).

Similarly for Component Y, assume total operating costs are 330 and capital employed is 50, then the required cost recovery would be 340 (330 plus 50*20%) and the average unit total cost is 2. (340/170)

Calculation of Selling Price:

Table 1 can now be represented as Table 2 as follows for Services A and B:

Table 2: Inclusion of Component Costs and Selling Prices in Table 1.

	Component X	Component Y	Selling Price
Component Cost	3	2	
Service A	1	3	9
Service B	2	8	22

The component cost, i.e. the operating cost and an allowance for the return on capital employed, is the amount the SMP operator needs to recover its costs for each use of a component and earn a reasonable return and to stay in business. This amount then becomes the selling price for that service to OAOs or to the downstream retail arm. In the table the selling price is, for Service A made up of 1*3 plus 3 * 2 i.e. the number of times a component is used in providing the service multiplied by the cost of the component.

Wholesale Services for OAOs and a Dominant Operator:

Let us assume that Services A and B are sold to the operators own retail arm. Let us also assume that Service C is the same as service B, but is sold to an OAO. The usage of components is much less in this case because the service is also carried on the OAO's own network.

This can be shown as in Table 3 which represents a similar data as Table 2 but for Service C can be represented as follows:

Table 3: Service C Data only:

	Component X	Component Y	Selling Price
Component Cost Recovery	3	2	
Service C	1	4	11

Assuming that the OAO understands (e.g. from the documentation of the systems) the compilation of the routing factors, he can see from Table 3, when it is read together with Table 2, that he is paying the same price for components, irrespective of in which service they are used, as the SMP operator and is therefore paying an equivalent price for the service. The purchaser can therefore be satisfied that no price discrimination is taking place. An important note is that, whilst the OAO can see this, if these two tables are published, he cannot see either the volumes or the total profitability of the services shown. Thus, the disclosure of this information in the public domain does not reveal confidential information, but does demonstrate non discrimination.

OAO Confidence

The OAO can therefore understand the basis of the calculation of the numbers, (from the documentation), be assured that this method of calculation has been followed (from the audit opinion), see that the same charge is made irrespective of the final usage of the component and use his specific business knowledge to assess the relative (between say Tables 2 and 3) of the routing factors.

Preparation of Wholesale Profit and Loss Statements

If we now prepare Profit and Loss Accounts for these products we have the results shown in Table 3. The calculations of the figures in Table 3 are shown below the table.

Table 3: Product Profit and Loss Statements.

	Service A	**Service B**	**Service C**	**Total**
Revenues	90	330	55	475
Costs:	84.9	312.9	52.2	450
Profit	5.1	17.1	2.8	25
Capital Employed	25.5	85.3	14.2	125
ROCE %	20	20	20	20

Revenue Calculation for Table 3:

Revenues are for Services are for:

- Service A, Price multiplied by volume 9 * 10 equals 90,
- Service B, 22 * 15 equals 330 and
- Service C, 11 * 5 equals 55

Operating Unit Cost and Capital Employed Calculation for Table 3

Total service costs are calculated by multiplying the unit component cost by the volume of components used in the provision of one service, and multiplying again by the total volumes of the service provided. Note that these calculations do not include the capital employed because it is an accounting Profit and Loss Account that is being produced and the Return on Capital employed, normally, in such circumstances is the profit divided by the capital employed. For regulatory pricing purposes, the return is, in accounting terms, artificially fixed at 20% (for this example) by adjusting the selling price of the service e.g. via a determination.

For component X the total operating cost is: 120 and the total usage is, 45 this works out and a cost per usage of 2.666

For component Y the total operating cost is: 330 and the total usage is, 170 this works out and a cost per usage of 1.941

For component X the total capital employed is: 75 and the total usage is 45, this works out and a capital employed per usage of 1.67

For component Y the total capital employed is 50: and the total usage is 170, this works out and a cost per usage of .29

Service Cost Calculation for Table 3

Therefore the total costs for service A are for the usage of component X is 1multiplied by the operating cost of component X, 2.666 equals 2.666, all multiplied by the volumes of service A, equals 26.66 plus the usage of component Y, 3, multiplied by the operating cost of component Y, 1.941, equals 5.823 all multiplied by the volumes of service A 10 which equals 58.23. In total this is 84.89 (26.66 plus 58.23)

Similarly for Services B and C

The profit figure in the above table can now be calculated as the differences between Revenues and Costs.

Capital Employed Calculation in Table 3

The Capital Employed figures for each service can be calculated in a similar fashion to the costs. It is necessary to calculate the Capital Employed for each service so that the ROCE can be calculated.

For service A, 1 (the usage of the component in a service) multiplied by 1.67 (the amount of capital employed in a service) multiplied by 10 (the total volume of the service equals 16.6.7 plus for component Y 3 * .29 * 10 equals 8.82. The total capital employed in the service is therefore 25.5 (16.67 plus 8.82)

Similar calculations are made for Services B and C

The right hand column in the table shows the totals for the SMP operator's retail arm and OAOs and shows totals for the wholesale business. To maintain confidentiality, only this latter column would be published, but the other columns would be delivered to ComReg and this demonstrates the total return to the wholesale business. Note that in this example we have taken a figure for capital employed. In practice the number taken is a mean capital employed, usually the addition of the opening and closing capital employed divided by two.

Retail Financial Statements.

The Retail Profit and Loss Statements are be simple for this example. If we assume a Retail selling price of 12 for service A and 25 for service B, then multiplying by the respective volumes (10 and 15) gives revenues of 120 and 375 respectively. Retail operating costs e.g., billing, advertising are for Service A are 20 and 30 for Service B. Costs from Network are the transfers from the wholesale business to the downstream retail markets i.e. the selling prices in the wholesale business calculated above, and represent the wholesales revenues for the service. The P and L can be presented in Table 4

Table 4: Retail Profit and Loss Statements

	Service A	**Service B**	**Total**
Revenues	120	375	495
Costs from Wholesale	90	330	420
Retail Opex	20	30	50
Total Costs	110	360	470
Retail Profit	10	15	25
Capital Employed	0	0	0

Appendix E –Unqualified FPIA & PPIA Audit Opinions.

FPIA- Audit Opinion

ComReg proposes that when a FPIA standard is imposed upon the Regulatory Financial Statement, (as set out in Annex C), the dominant operator shall ensure that the Regulatory Auditor shall state whether in his opinion:

(a) the Regulatory Financial Statement have been prepared, audited and delivered in accordance with ComReg's specifications (as set out in Chapter 8.) and the various Decisions issued by ComReg.

(b) each Regulatory Financial Statement fairly presents in accordance with the Primary Accounting Documents:

(i) in the case of the profit and loss account and profit and loss reconciliation statements, the results in the relevant Market, Disaggregated Activities23 and/or Accounting Separation Activities (as appropriate) for the Relevant Financial Year and Prior Year Comparatives;

(ii) in the case of the statement of mean capital employed and mean capital employed reconciliation statements, the mean capital employed in the relevant Market, Disaggregated Activities and/or Accounting Separation Activities24 (as appropriate) for the Relevant Financial Year and Prior Year Comparatives; and

(iii) in the case of the other statements of revenues, costs, assets, liabilities and other quantities, the revenues, costs, assets, liabilities and other quantities incurred or employed in the relevant Market, Disaggregated Activities and/or Accounting Separation Activities (as appropriate) for the Relevant Financial Year and Prior Year Comparatives;

PPIA- Audit Opinion

ComReg proposes that when a PPIA standard is imposed upon the Regulatory Financial statement, (as set out in Annex C), the dominant operator shall ensure that the Regulatory Auditor shall state whether in his opinion:

[23] Disaggregated Activites – refer to the relevant Markets, the Wholesale Segments, Wholesale Services, Wholesale Activities, Network Services, Network Activities, Retail Segments, Retail Products, Retail Activities and/or Retail Support Activities used or carried out in the Market as appropriate.

[24] Accounting Separation Activities- refers to Wholesale Services and those Wholesale Activities, Network Services and Network Activities used directly or indirectly in the course of supplying Wholesale Services; and the appropriate for Retail markets.

(a) the Regulatory Financial Statement have been prepared, audited and delivered in accordance with ComReg's specifications (as set out in Chapter 8).

(b) each Regulatory Financial Statement has been properly prepared in accordance with the Accounting Documents, including the Prior Year Comparatives;

(c) having reviewed the Accounting Documents in forming his opinion under (b) above, anything has come to his attention that would lead him to conclude that the Accounting Documents have not been properly applied in the preparation of the relevant Regulatory Financial Statement, disclosing where practicable any adjustments he considers to be required in respect of any such matter; and

(d) having reviewed the Accounting Documents, nothing has come to his attention that would lead him to conclude that the Secondary Accounting Documents are unreasonable in the context of the Primary Accounting Documents.

Appendix F –Overview of the attached annexes.

- Annex A sets out an indicative list of products/services within the Mobile Access and Call Origination and Termination markets.

- Annex B sets out the indicative financial statements proposed for the Mobile Voice Termination market.

- Annex C sets out the indicative financial statements proposed for the Mobile Access and Call Origination market.