Commission for
Communications Regulation

Consultation Paper

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

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All responses to this consultation should be clearly marked:-
"Reference: Submission re ComReg 05/18" 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 on the 6th May 2005, to:

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Please note ComReg will publish all submissions with the Response to Consultation, subject to the standard confidentiality procedure.

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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 market in order to demonstrate compliance with certain regulatory obligations. In particular they can be used 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 cost accounting systems.

This paper concerns itself with the fixed telecommunications sector only. In Ireland, eircom, which is the dominant operator under the rules of the old framework, already prepares separated accounts. However changes will be necessary in order to comply with new rules. For example any areas of eircom's 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. In many cases more detail than has been available in the past will be required to achieve this goal. A corollary is that greater transparency as to how the accounts have actually been derived may be necessary. The paper also addresses other matters such as the audit of the accounts, timelines and frequency of reporting, and so on.

In summary, ComReg's initial view is that the scope of accounting separation may be somewhat narrower than in the past, but deeper, with more detail on regulated services. The proposals in the paper are preliminary. The market analysis is not yet complete so it has not been possible to identify which markets will attract which particular accounting obligations. Nevertheless, as the market analysis process draws close to completion, ComReg believes that it is useful to initiate a discussion on some of the general principles governing accounting matters and also to provide an indication of the type of information that might be required. However further consultation will be necessary once final decisions have been made under the market analysis process.

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. While the market review process is not yet finalised, ComReg believes that it is useful to issue this consultation paper at this time to provide visibility to those dominant operators who might be subject to an Accounting Separation and/or a Cost Accounting obligation.

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 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 fixed telephony market. This document sets out common principles that can be applied to fixed operators in all areas of their business where an obligation of accounting separation or cost orientation has been designated. Appendices are attached which contain examples of schedules that might apply to such a dominant fixed operator.

2.3 Summary of Proposed Obligations

2.3.1 Removal of obligations relating to certain business

Under the current regulatory framework, eircom currently produce Regulatory Financial Statements at a high level and on an end to end basis for their whole business. Under the new regulatory framework, dominant operators will only be required to report on those products/services where they have being designated with SMP. Therefore they will no longer be required to report on certain parts of their business e.g. such as apparatus supply.

2.3.2 Removal of the obligation to produce half yearly accounts.

In addition ComReg is proposing to remove the obligation to prepare half yearly Regulatory Financial Statements. Currently, eircom prepare unaudited half yearly accounts for presentation to ComReg but which have not been published. ComReg now proposes to remove this obligation.

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.

2.3.3 Alignment of the Accounting Separation and the Price Submission process

As discussed above, eircom produces separated accounts at a relatively aggregated level for much of its business but presents separated accounts for its entire business. Product pricing, apart form voice conveyance products have not, in general flow directly from the separated accounts but have often been derived from a variety of sources. One consequence of ComReg's proposal to report at the service level for all regulated services, and not just for voice, is that it should be possible to price more products using the separated accounts. Possible exceptions to this are where new products are being priced, where forecast data is used, or where efficiency adjustments are a material consideration. ComReg is ultimately proposing to align the Annual Accounting Separation process with the Price Submission process. This is likely to be a much more efficient and transparent means of pricing the products and services in question. However, it is likely that the current process will need to remain in place until the accounts have been prepared and documented to the required standard.

2.3.4 Maintenance of accounting records and systems

Although ComReg is proposing that accounts be prepared only once annually, it will 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 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 its compliance with relevant obligations in a reasonably timely manner. ComReg would implement this proposal subject to normal considerations of proportionality.

2.3.5 Preparation, delivery and publication of Annual Regulatory Statements

ComReg have proposed the financial statements that they consider should be produced by the Dominant Operators, the level to which these financial statements should be audited and whether or not they should be published. Examples of these proposals are contained in Annex B.

2.3.6 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 would resemble the existing Accounting Documents and would be intended for publication. The second would be more detailed and would be published subject to confidentiality considerations. It should be noted that eircom already prepare and publish accounting documentation on an annual basis and are currently working with ComReg with regard to producing a more detailed level of documentation. ComReg will continue this work and may recommend changes to the existing level of documentation. The transparency principle is proposed to help improve the quality of documentation. Therefore, for ease of reference to this documentation, further (secondary/detailed) accounting documents is being proposed.

2.3.7 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 consents is discussed in chapter 7.

2.3.8 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 greater flexibility in the use of audit opinions. Currently eircom's annual regulatory statements are audited to a high level/"Fairly Presents in Accordance with" (FPIA) style audit opinion and ComReg is proposing a more flexible audit opinion on the various financial statements as set out in Annex B.

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.

2.3.9 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 a Dominant Operator 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 Operator. This would provide a reasonable balance between responding to the reasonable needs of the Dominant Operator 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 this 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 identifies the financial statements/schedules, which ComReg is proposing should be published and those which should be provided 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 10 March 2005 to 6 May 2005 during which time ComReg welcomes comments on any issues raised in this paper.

3 Introduction

3.1 A New Regulatory Regime

Four sets of Regulations,[1] which transpose into Irish law four European Community directives on electronic communications and services,[2] 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.[3]

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 procedure outlined in the *Framework Regulations*.[4] In addition, ComReg is required to conduct an analysis of the relevant markets to decide whether or not they are effectively competitive.[5] 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.[6] 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 such obligations it may have imposed at an earlier stage[7].

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.

[1] 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*").

[2] 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.

[3] ComReg Document No. 03/99 outlines ComReg's response to the draft regulations.

[4] Regulation 26.

[5] Regulation 27.

[6] Regulation 27(4).

[7] Regulation 27(3).

Regulation 14(6) states that the regulator may specify the format and accounting methodology to be used.

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. On the other hand it is not possible to specify what the exact requirements within every market will be until all decisions regarding the market analysis process have been taken. 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, depending on the outcome of outstanding market analysis consultations.

3.2 Reasons for Changing the Accounting Separation Regime

3.2.1 The Impact of the New Regulatory Regime

Under the current regime eircom publishes regulatory financial information for the following Regulatory Businesses:

- Local Access Network business;
- Core Network Business;
- Retail Businesses; and
- Other Business.

These businesses cover all of the activities of eircom's business and not just SMP markets. For example, Apparatus Supply is not a market defined by the EU and a market review on this business has not been undertaken. Some of the current separated accounting structures will no longer be appropriate in the new framework since in future, the separated accounts must follow logically from market definitions and will need to be carefully designed to help address the competition problems identified and to support the implementation of other remedies such as non-discrimination and cost orientation.

3.2.2 The Need to Review the Effectiveness of Existing Arrangements

The current accounting framework has worked well in some respects and this has been noted by the EU Commission, which has described the Accounting Separation regime in Ireland as “best practice”[8]. Nevertheless there have been difficulties.

- The LRIC accounts, in particular, were designed around voice products. This has led to difficulties in pricing data products especially Partial Private Circuits;

- The accounts are not, in ComReg’s and other interested parties opinion, adequately transparent. This has led to delays and difficulties in finalising interconnection conveyance rates;

- While the accounts provide some information at the retail level that may not be entirely necessary for regulatory purposes, they are insufficiently detailed in many respects to provide detailed information regarding many wholesale products. Many products, such as process related charges or order handling charges are based on supplementary submissions based on reconciliations to the accounts or on bottom up estimates. This increases both the complexity and opacity of the price setting process where cost orientation is a remedy; and

- ComReg is of the view that the effectiveness of the accounts in policing non discrimination and margin squeeze where appropriate needs to be reviewed.

Therefore ComReg believes that the main priority areas for improvement are:

- greater granularity/level of detail within each of the designated SMP markets;

- alignment of the Annual Regulatory Financial Statements and the Price Submission Process;

- better alignment and accuracy between the information disclosed and the underlying regulatory objectives. In many instances this will mean more detailed information, in other cases less information will be required;

- greater transparency and disclosure of the policies, systems, procedures and processes that explain how the regulatory financial information has been prepared; and greater consistency in the treatment of some specific accounting matters and the presentation of comparative data; and

[8] EU Commission 8th Implementation Report

4 Using this Document

The remainder of the Document comprises the following:

Chapter 5 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 6 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. This chapter is relatively technical in nature and is directed mainly at accountants and economists.

Chapter 7 introduces and describes the proposed general obligations and the cost accounting and accounting separation obligations and how these obligations will be applied.

Chapters 8 to 11 discuss the proposed general obligations required in maintaining a Cost Accounting/Accounting Separation obligation. This chapter's also set out the basis of preparation, audit, publication and accounting documentation requirements. The proposed obligations in these chapters support the Wholesale Cost Accounting, Accounting Separation and Retail Cost Accounting obligations In addition the Wholesale or Retail Cost Accounting obligation is used to demonstrate Cost Orientation.

Chapter 12 sets out the proposed requirements to comply with a Wholesale Cost Accounting obligation.

Chapter 13 sets out the proposed requirements to comply with an Accounting Separation obligation.

Chapter 14 sets out the proposed requirements to comply with a Retail Cost Accounting obligation.

Chapter 15 provides an overview of the attached annexes.

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

5 The need for Financial Information.

5.1 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 intends to implement this theory.

5.2 How financial information is used

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

- monitoring compliance with conditions 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.

5.3 Management Accounts v Regulatory Accounts

As can be seen above, 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.

5.4 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 are 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[9] which requires that financial statements possess attributes which are listed below for illustrative purposes;

[9] 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"

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

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.

5.5 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.

5.5.1 Cost Accounting Systems

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

- cost oriented prices in both wholesale and retail areas;
- price controls, including retail minus tariffs;
- recovery of costs;
- retail tariff regulation 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.

5.5.2 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. Price discrimination can be revealed by making transparent all the wholesale prices and internal transfer prices of a vertically integrated company. 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 connection with parts of the "regulatory accounting businesses" for e.g. 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 accounting separation, 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 or 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.

5.6 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 none 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 legitimate requirement for financial information as set out in Chapter 5? If not, please suggest what you consider (i) the purposes for which it would need financial information (ii) what other financial information is required and (iii) other methods ComReg could use to obtain robust data?

6 Financial Information in a Regulatory Context

6.1 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.

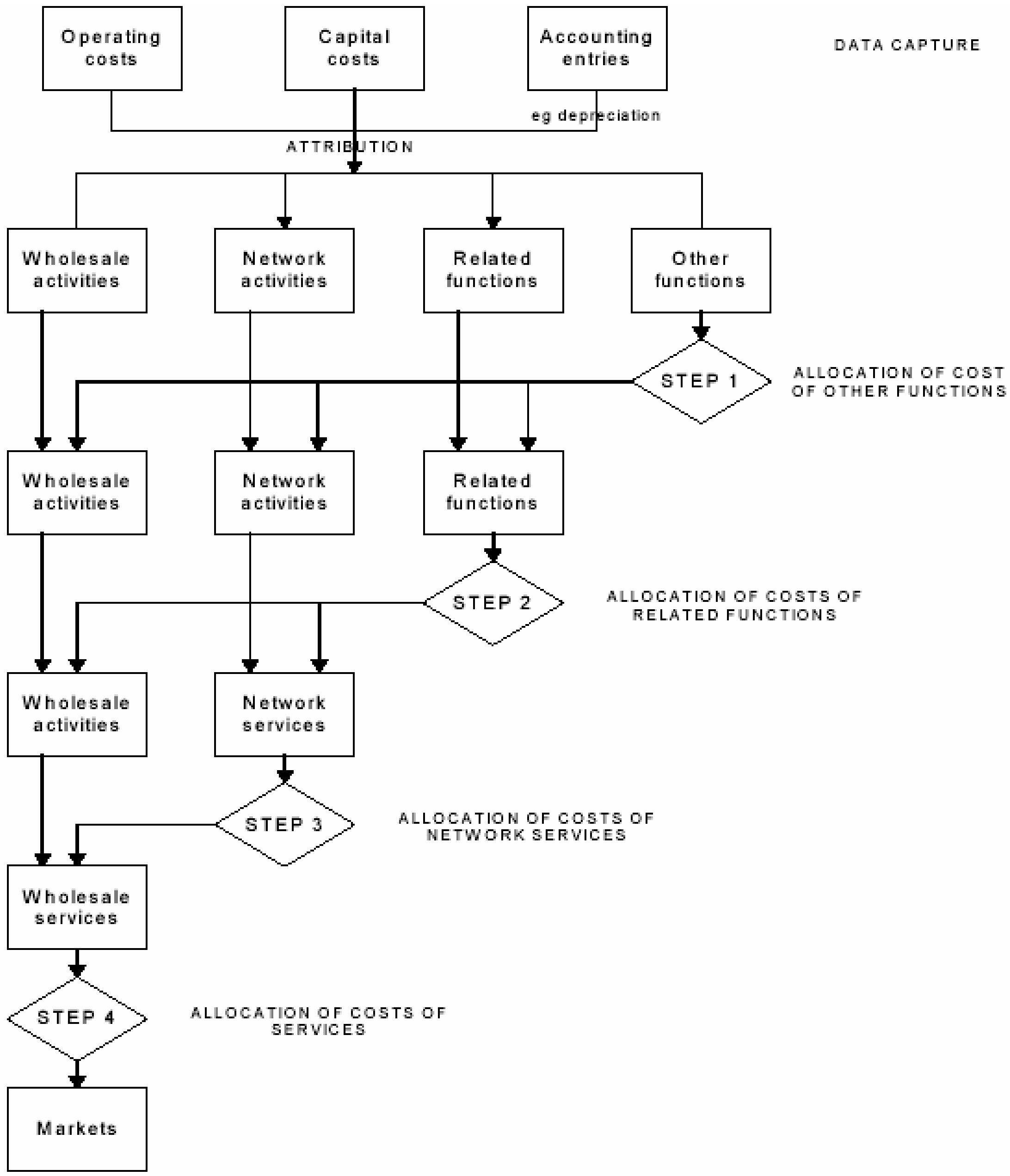
In this chapter as the majority of the principles discussed apply equivalently to both 'retail products' and 'wholesale services', the word 'service' will be used generically to describe whatever the operator is supplying (to avoid repeated use of phrases like 'service and/or product') i.e. 'service(s)'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

6.2 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).



6.3 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 (other methods are discussed below) 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 give 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*. This is an approach 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.

6.4 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 appropriate 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.

6.5 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. 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 is 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

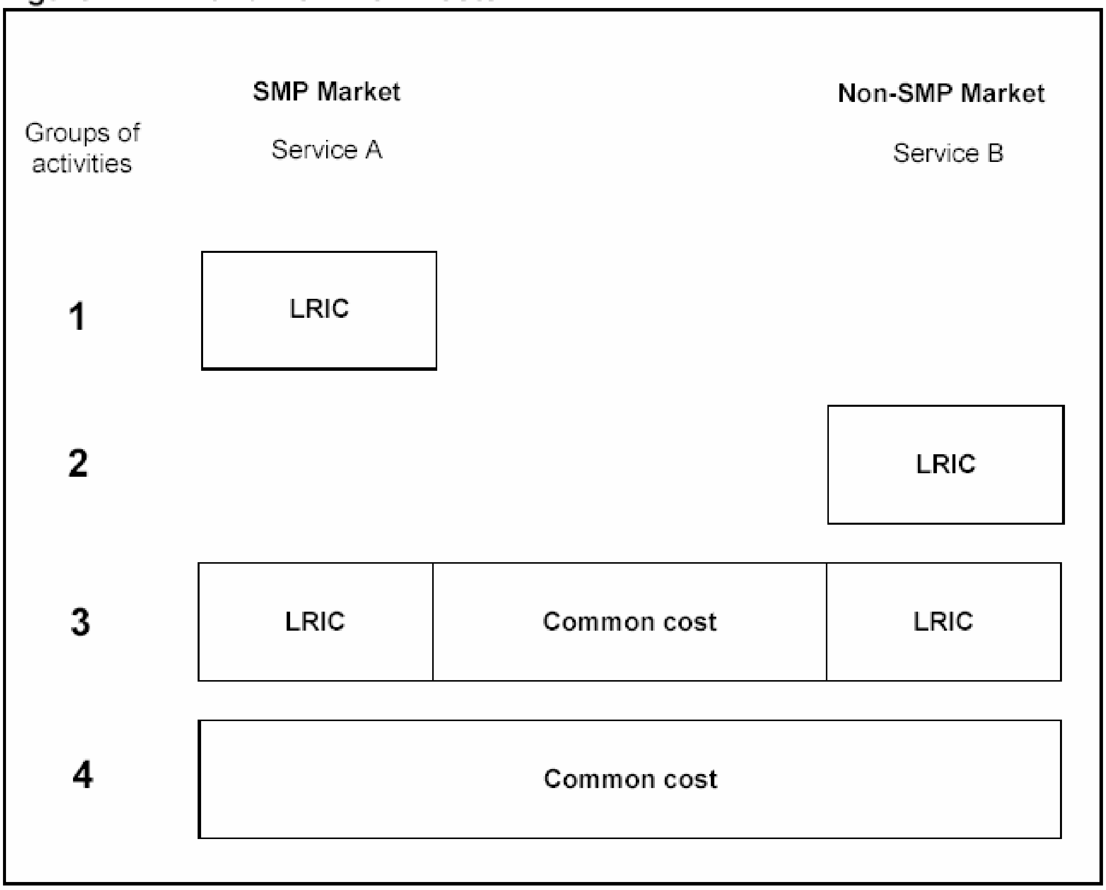
- the activities underlying the provision of those services are identified in an appropriate level of detail. Where the services share underlying activities, any grouping of either aids understanding, and is useful.

6.6 The need for information in non SMP Markets

In providing a range of services in many markets, communications operators obtain economies of scale 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).

Figure 1 LRIC and Common Costs



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 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'.

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'). Duct could also be an example here, particularly for level 3.

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 – see above;

- 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+

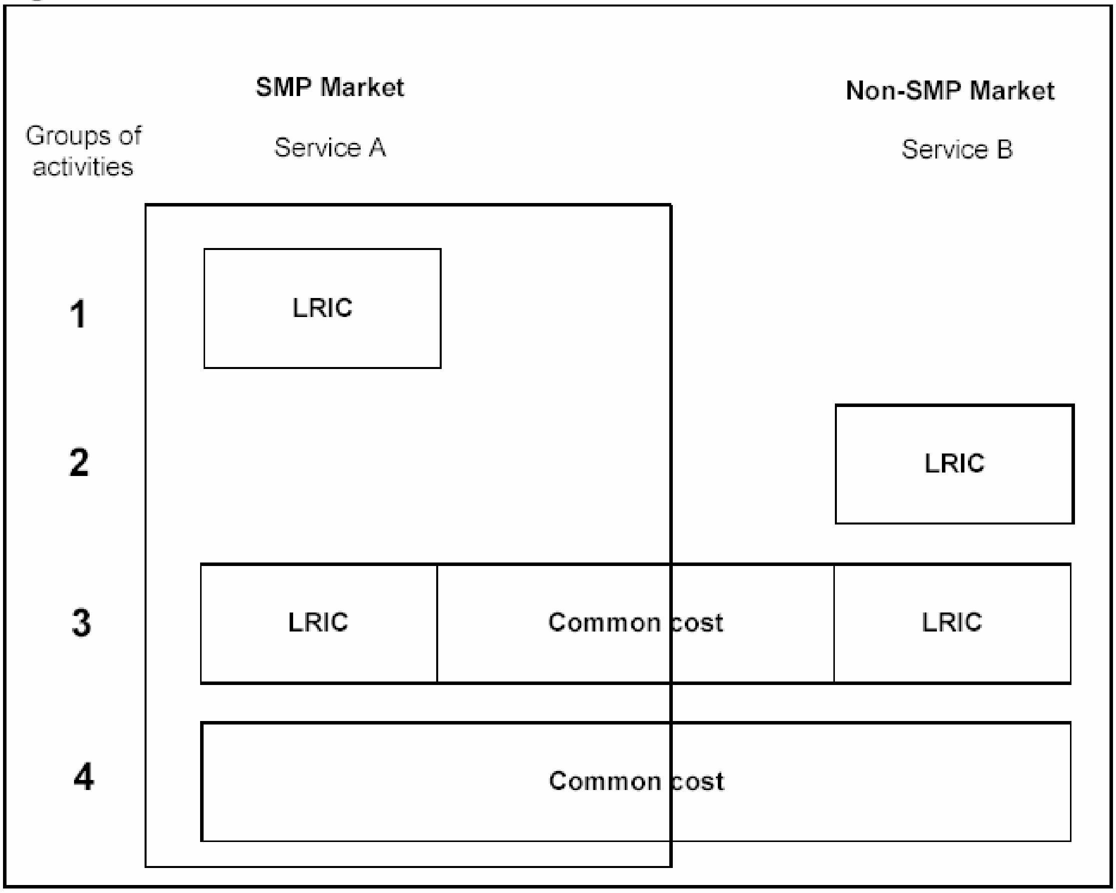
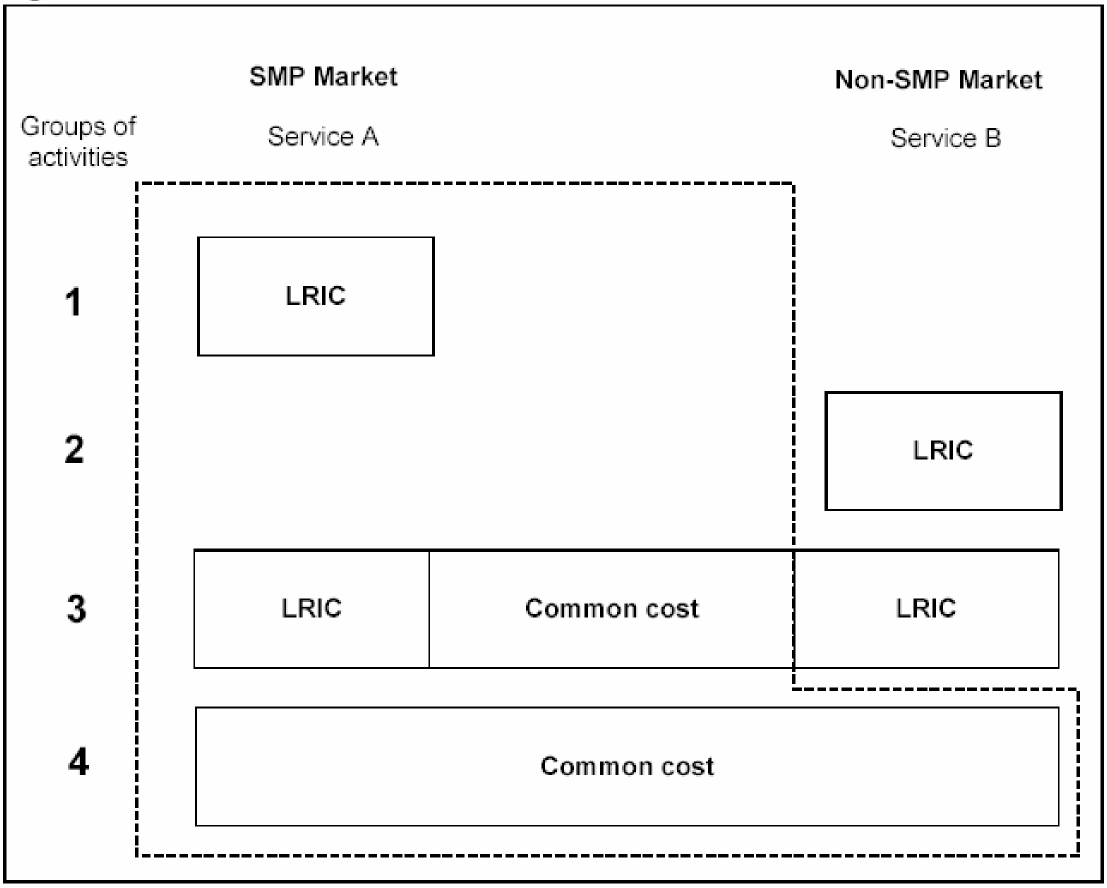


Figure 3 illustrates the derivation of SAC. The SAC of service A is depicted as the cost within the dotted box and comprises the cost incremental to A (activity group 1 and part of activity group 3) and the whole of the cost that is common between A and B (part of activity group 3 and all of activity 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?

6.7 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.

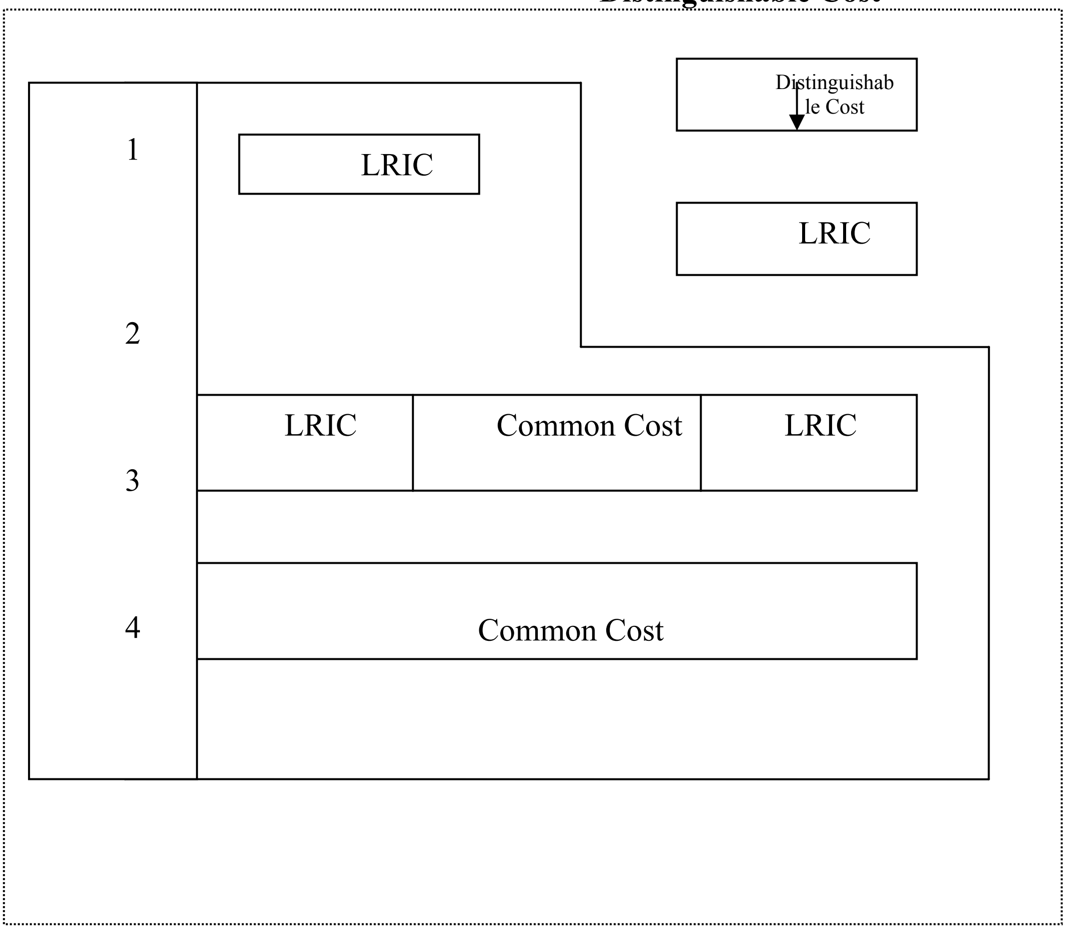
However, whilst this situation is straightforward it is unlikely to apply to many of the services carried out by communications operators in Ireland. This is because, in providing a range of services in many economically distinct markets, communications operators often obtain economies of scale and scope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

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.

6.8 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.

6.9 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 be withdrawing all 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.) It should also be noted that in the case of HCA information in the CCA accounts, ComReg proposes to require a reconciliation statement to the Statutory Accounts for HCA information in the CCA accounts

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 Retail Minus, LRIC, LRIC+ 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 be withdrawing, subject to the qualification above, all cost accounting obligations solely associated with either distinguishable FAC or the pure LRIC of services in non SMP markets.

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.

6.10 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.

6.11 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.

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.

6.12 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.

A similar process needs to be applied for external services.

6.13 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. A possible example of this would be if buildings were allocated on floor space occupied for some products, but on the basis of costs for others. This also shows why it is important 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; and
- That reconciliation statements operate at an appropriate level, with appropriate eliminations e.g. by way of reconciliation to statutory financial statements.

6.14 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

6.14.1 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.

6.14.2 Current Cost Accounting

Top Down models may be prepared on both a Current Cost (CCA) and Long Run Incremental Cost (LRIC) basis. 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.

In the particular case of SMP markets and services provided over the access network, ComReg proposes to mandate only HCA accounting at least for the time being. This is because prices have already been set using a bottom up LRIC model for the period up to 31 December 2007. It is still essential that accurate costs relating to this area are recorded in appropriate cost pools to ensure that no double counting occurs in the pricing of access services (such as co-location) which are not primarily a function of the actual metallic path.

Given the relatively small proportion of assets in retail markets, ComReg does not propose to implement CCA or top down LRIC in this area.

6.14.3 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.

6.14.4 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.

6.15 Other aspects of preparing Financial Information

6.15.1 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.

6.15.2 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 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.

6.16 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.

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.

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

7.1 Introduction

In the next chapters, ComReg sets out proposals for the imposition of the obligation of Accounting Separation and Cost Accounting. These chapters have been designed to be as specific as possible at this time in order to allow readers to be clear about ComReg's proposals. On the other hand, it is not possible in this paper to provide a comprehensive view of accounting separation for all markets since ComReg's analysis of many of these markets is not yet complete.

In this Chapter, ComReg introduces proposals for Cost Accounting Systems and Accounting Separation. Chapters 8 to 11 contain the general proposals that would apply to Dominant Operators having an accounting separation obligation or either a wholesale or retail cost accounting systems obligation. In addition to these general proposals, Chapters 12 to 14 covers the specific requirement for each of the Wholesale Cost Accounting, Accounting Separation and Retail Cost Accounting obligations.

The attached annexes to this consultation set out the detailed information required to be produced and inform the proposals contained in Chapter 8 to 14.

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

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:

a) General Obligations

- Maintenance of accounting records and systems (Chapter 8);
- Preparation, Audit and Delivery of Regulatory Financial Statements (Chapter 9);
- Accounting Documentation (Chapter 10); and
- Auditor, Audit Reports and Audit Opinions (Chapter 11);

b) Specific Obligations

- Wholesale Cost Accounting (Chapter 12);
- Accounting Separation (Chapter 13); and
- Retail Cost Accounting (Chapter 14).

7.1.1 How the Proposed Obligations will work:

Chapters 8 to 11 are general requirements which are proposed to be applicable to all types of Cost Accounting Systems and Accounting Separation obligations. The extent of these requirements will depend on the actual obligations imposed. Thus if a market has an Accounting Separation obligation only it would be required to conform to the proposals as per Chapters 13 as well as the general obligations set out in Chapters 8 to 11. Likewise if a market has a Cost Accounting Systems obligation only, it would be required to conform to the proposals in Chapters 12 or 14 as well as those in Chapters 8 to 11 and paragraph 13.5.

If retail minus is used as a price control mechanism the output of accounting separation or a cost accounting systems obligation will be different to that of a wholesale cost orientation type price control. In this case the focus will be at the retail level, as per Chapter 14, but with the possibility of wholesale inputs if this is necessary. Therefore if an obligation of Retail Minus is imposed as a form of Cost Orientation, Dominant operators would be required to comply with the common obligations in Chapter 8 to 11 plus the Retail Cost Accounting obligation set out in Chapter 14 and the Accounting Separation obligations set out in Chapter 13.

Because these requirements may be imposed individually, there are common schedules between the different sets of obligations i.e. if SMP Markets A and B are to be reconciled to the Statutory Accounts, then in this case, the reconciliation schedule would only be required to be prepared, filed and published once and not for each particular market.

7.2 General Proposal

Currently, when either ComReg or the Dominant Operator propose 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.

7.3 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 C.

Q. 5. Do you agree with ComReg's approach (a) to imposing relevant obligations, including the use of consents and (b) the proposed definitions as set out in Appendix B? Please elaborate your response and provide details of any alternatives you consider appropriate.

8 Maintenance of Accounting Records and Systems.

8.1 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 obligations. The proposed obligations in this chapter support any Wholesale Cost Accounting, Accounting Separation and Retail Cost Accounting obligations.

8.2 Production of Data

ComReg proposes that where either remedies relating to Accounting Separation or Cost Accounting Systems are mandated, the Dominant Operator should maintain accounting records and systems that are capable of producing financial statements that are in accordance with the Accounting Documents. This is a fundamental requirement to ensure compliance with the appropriate obligation.

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8.3 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 Costing (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.

8.4 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, 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.

8.5 Proposed 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 wholesale 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 set s out an indicative list of wholesale 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 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 and therefore such a system needs to cover the following:

- Retail services – these are services used by or offered to any end users (including the dominant operator) (Annex A sets out an indicative list of retail services within each of the designated markets);

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

- Retail activities – these are any activities used solely for the purpose of providing retail 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 give a guide to the proposed components / elements.

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 to be shown and verified.

8.6 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.

8.7 Periodic Reporting and Reporting for e.g. 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 would 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 request ComReg will consider its practicality, but also will have regard to the seriousness of whatever issue is at hand.

Q. 6. Do you agree with the proposed obligations for the Maintenance of Accounting Records and Systems? Please elaborate your response and provide details of any alternatives you consider appropriate

9 Preparation, Audit and Delivery of Regulatory Financial Statements.

9.1 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 to this consultation. This chapter sets out support obligations for operators having Cost Orientation, Wholesale Cost Accounting, Accounting Separation, or Retail Cost Accounting obligations, for which specific proposals are made in Chapters 11 to 13.

9.2 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 Operator's 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 operator will continue to publish a Directors' Statement of Responsibility with the accounts which would serve inter alia to confirm the Directors' responsibility for the Regulatory Financial Statements.
Currently, eircom prepares and publish Annual Regulatory Financial Statements on a Historical Cost Accounting and Current Cost Accounts/Long Run Incremental Cost basis within 5/6 months of the financial year end. 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 and 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. The exceptions to this will be retail markets and also the market for Wholesale Narrowband Access.

ComReg accepts that at times it will be necessary for the 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 the Dominant Operator has to inform it of these changes where they have a material impact on the financial statements. ComReg also proposes that they dominant operator deliver 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 proposal for accounting documentation and audit will be dealt with in more detail below and in later chapters. Additionally, the financial statements themselves and the specified activities for which they must be produced are dealt with in Annex A.

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 indicates which schedules are proposed to be published.

Annex B set 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 Operator's 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 Operator should in respect of the relevant Wholesale & Retail Markets, Segments, Services, and Activities (where appropriate)

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

(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.

9.3 General Regulatory Financial Statements to be Prepared and Published

ComReg proposes the following Regulatory Financial Statements (as per Annex B) 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 Core and Access networks;
- Statements of activity costs on a current/LRIC fully allocated cost basis;
- 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, as appropriate, additional statements on LRIC and CCA which will aid the decision making process for price setting and the visibility of the costing processes. LRIC is normally needed to set boundaries for prices. This is particularly useful when a price control is being set in order to set limits on the price floors and ceilings 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 Operator's statutory accounts. ComReg considers that, to ensure understand ability and transparency, such reconciliations should include such intermediate stages or steps as necessary.

9.4 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 Operator should follow Accounting Standards and generally accepted accounting practices as applicable to the company 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, the 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 operator 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.

9.5 Consequential Updating of Financial Statements by Dominant Operator

ComReg proposes that the Dominant Operator shall 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 Operator 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.

9.6 Additional information required by ComReg

In addition, ComReg may also require the dominant operator to submit other more detailed information 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 schedule 44 of Annex B. 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.

9.7 Related Party Transactions

ComReg considers it appropriate to prevent an undertaking with SMP Accounting Separation and Cost Accounting obligations is applied which is part of a group of companies, exploiting the principle of corporate separation. The Dominant Operator 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 Operator 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.[10] 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.

[10] FRS 8 Para 3

9.8 On Request Reporting

On request reporting would be required for investigating specific cases of potential breaches of obligations and/or dispute resolution. ComReg has only four months to resolve the dispute under EU Law.

ComReg considers that these requirements could be quite onerous and is proposing that on request reporting should, where possible, rely on information already produced or that which most competitive companies would produce on a routine basis via their management accounting processes. 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 Preparation, Audit and Delivery of Regulatory Financial Statements as set out in Chapter 9? Your response should inter alia 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.

10 Accounting Documentation

This chapter covers the requirements for Accounting Documentation (and the amendment which ComReg proposes to the existing documentation) and proposes that the Regulatory Financial Statements are prepared in line with the Accounting Documents. This is one of the support Chapters for operators having Cost Orientation, Wholesale Cost Accounting, Accounting Separation, or Retail Cost Accounting obligations, for which specific proposals are made in Chapters 11 to 13.

10.1 Accounting Documents

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. ComReg considers it even more necessary that the bases of preparation of the Regulatory Financial Statements are transparent and understandable. Therefore, ComReg is proposing the continuation of the preparation of accounting documentation as currently published by eircom in their Regulatory Accounts (referred to in this paper as Primary Documentation). In addition, ComReg is proposing that a more extensive version of this documentation also be prepared which would provide more detail (referred to in this paper as Secondary Documentation).

The current accounting documentation for eircom (also know as Primary Accounting Documentation) comprises of the following:

- Regulatory Accounting Principles;
- Definitions of the businesses;
- Attribution Methods;
- Transfer Charges;
- Historical Accounting Policies; and (in the case of the HCA Regulatory Accounts);
- Current Cost Valuation Methods (in the case of the CCA/LRIC Regulatory Accounts); and
- Long Run incremental Cost Methodology (in the case of the CCA/LRIC Regulatory Accounts).

ComReg proposes to maintain these headings in the Accounting Documents except that definitions of the businesses would be deleted because the new regime operates on markets.

10.2 Documentation of the Dominant Operators Cost/Accounting Systems

In addition to the existing level of documentation which is already publish in the Current Annual Regulatory Statements, ComReg also proposes that the Dominant Operator 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 that which eircom currently publish.

While eircom have recently made some progress in the documentation their systems, ComReg is not yet fully satisfied that the documentation is complete and will continue to work with eircom in ensuring that this secondary documentation will meet its requirements in evaluating the effectiveness of the systems.

In addition to the detailed documentation of its systems, ComReg proposes that a catalogue be maintained of all the wholesale and retail products/services sold within each designated SMP market. 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

- all retail products;
- all retail activities;
- all retail support activities; and

- an accurate description of all retail products , retail activities and retail support activities used in the provision of services to end-user

ComReg is also aware that eircom already produce and publish detailed product description on their web site. The Reference Interconnect Offer and the Access Reference Offer provides comprehensive wholesale product documentation. 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 could be refined and a direct link made between it and the regulatory financial statements. ComReg does not consider this to be an overly burdensome obligation as the information already exists and it will ensure that information is synchronised between different sets of existing documentation and the Regulatory Financial Statements.

10.3 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) Long Run Incremental Cost Methodology; and
(g) Irish GAAP/IFRS.

ComReg proposes that insofar as there is any inconsistency between any or all of the Primary Accounting Documents, produced in eircom's 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.

10.4 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. 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.

10.5 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.

10.6 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 define 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 via the audit opinion 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.

10.7 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 submit 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, however ComReg is currently consulting on the issue of confidentiality in a separate consultation.

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

Q. 8. 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.

11 Auditor, Audit Reports and Audit Opinion

11.1 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 Cost Accounting obligations, for which specific proposals are made in Chapters 12 to 14.

11.2 Appointment of and changes to the Auditor

11.2.1 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.

11.2.2 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 the 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.

11.2.3 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.

11.3 Duty of Care and Cooperation

11.3.1 Duty of Care

In eircom's Regulatory Financial Statements for 2004 eircom's auditor states "This report, including the opinion, has been prepared for, and only for, the company and no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing".

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[11]. 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.

[11] 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.

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.

Q. 9. Do you believe that ComReg should have any influence in the decision of a dominant operator to appoint a Regulatory Auditor? If so, how could this be exercised?

Q. 10. 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 from the regulatory auditors and how could this be achieved? Please provide practical and legal justification for your point of view.

11.4 Audit Reports and Opinion

11.4.1 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 Operator 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 D 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 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 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 an opinion 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 complies 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. 11. 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

12 Wholesale Cost Accounting

12.1 Introduction

This Chapter outlines the proposed obligations for Fixed Dominant operators with a Wholesale Cost Accounting or Cost Orientation obligation arising from a market review. The proposals in this chapter are supplemented by those in Chapters 8 to 12 and 13.5, 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 Wholesale Cost Accounting obligations on the following markets[12] :

- Call Origination on the public telephone network provided at a fixed location;
- Call Termination on individual public telephone network provided at a fixed location;
- Transit services in the fixed public telephone network;
- Wholesale Unbundled Access (including shared access) to the metallic loops and sub loops for the purpose of providing broadband and voice services;
- Wholesale Broadband Access;
- Wholesale terminating segments of leased lines; and
- Wholesale trunk segments of leased lines.

12.2 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 to this document on an annual basis.

ComReg proposes that where cost orientation based on top down LRIC is mandated, financial statements should be prepared on a Current Cost/LRIC basis with the Current Cost financial statements reconcilable to the historical cost financial

[12] The markets are those list are those which ComReg has or intends to impose a Wholesale Cost Accounting obligation at the time of publication of this document. Please note that the market analysis/review process is still ongoing.

statements. In the case of the fixed narrowband market, ComReg proposes that top down LRIC/CCA is not required to value local loops as currently these are costed on a bottom up basis. However other services such as LLU co-location should be presented on a CCA/LRIC basis. The preparation of such statements may require extra work on by the dominant operator but the likelihood is that the improved transparency and accuracy will offset this extra cost.

Note that where retail minus is used to set wholesale prices it may not be necessary to prepare full cost accounts at the wholesale level, depending on the circumstances.

Annex B sets out the templates for the wholesale 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. Question 16 below asks if this presentation format is most appropriate.

12.2.1 Network Components and Elements.

It is essential that ComReg understands the way in which costs are attributed to non SMP areas and that the attribution of these costs is on the same basis as for SMP areas. 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. 12. Do you agree with ComReg's proposals for Wholesale Cost Accounting?

13 Accounting Separation

13.1 Introduction

The ERG Opinion[13] on Cost Accounting and Accounting Separation defines Accounting Separation system 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.

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 Fixed Operators with an Accounting Separation obligation arising from a market review. The proposals in this chapter are supplemented by those in Chapters 8 to 11 will also need to be followed by SMP operators having these obligations.

13.2 Level of Granularity Required

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 discourage 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 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.

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

13.3 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 can also relate to the gathering of retail information for example so as to help avoid margin squeezes. This topic is covered in further detail in chapter 14.

13.4 Transfer Charges

A well-defined, transparent and verifiable transfer charging system is necessary for notified operators to demonstrate 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 (and subsequently into the charge) 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 SMP operator's own retail arm) or external (supplied to an OAO) or the nature of the service supplied.

In the current regime the transfer charge broadly represent the cost of a wholesale service plus a reasonable rate of return and will vary depending on whether historic or current costs are used. Also currently, following a review of a price submission by ComReg adjustments have in the past been required. No restatement to the accounts has been made to reflect such changes. Additionally, the current system does circumstances where the effective transfer charge may not reflect the reported costs (for example where the relevant wholesale product is priced using retail minus).

Therefore, ComReg's preliminary view is that the current system could be improved by ensuring:

- all transfer charges should, in principle, reflect their actual price in the market, whether subject to regulatory control or not. products such as wholesale line rental (which is priced using retail minus) are charged at their actual price;

- where there is no external price, the transfer should be the unit cost including a reasonable return; and

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

13.5 Non Discrimination and 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. ComReg proposes that in any area where Accounting Separation is not imposed as a remedy, but where Retail or Wholesale Cost Accounting is applied, these proposals would apply.

13.5.1 Non Discrimination for Retail and Wholesale 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 areas and that the attribution of these costs is on the same basis as for SMP areas. 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.

13.5.2 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.

13.6 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 to this document

Q. 13. Do you agree with the obligations for Accounting Separation? Please elaborate your response and provide details of any alternatives you consider appropriate?

14 Retail Cost Accounting

14.1 Introduction

The purpose of these obligations is to identify the specific requirements relating to the areas of a dominant operator which has been imposed with a Cost Accounting Systems obligation in the Retail Area e.g. Retail Minus or Retail Price Control. This Chapter outlines the proposed obligations for such operators with a Retail Cost Accounting or Cost Orientation obligation arising from a market review. The proposals in this chapter are supplemented by those in Chapters 8 to 12 and 13.5, which will also need to be followed by a dominant operator having these obligations.

As set out in Annex C, ComReg has consulted on the possibility of imposing Retail Cost Accounting obligations on the following markets.

- Access to public telephone network at a fixed location for residential customers;
- Access to public telephone network at a fixed location for non residential customers;
- Publicly available local and/or national telephone services provided at a fixed location for residential customers;
- Publicly available international telephone services provided at a fixed location for residential customers;
- Publicly available local and/or national telephone services provided at a fixed location for non residential customers;
- Publicly available international telephone services provided at a fixed location for non residential customers; and
- The minimum set of leased lines.

14.2 Retail Cost Accounting obligations

This section outlines proposed retail cost accounting obligations, which include the following:

- Preparation of financial statements relating to retail services and groups of services for which SMP obligations apply;

- Preparation of financial statements relating to services and groups of services where price control based on a retail minus obligation is been /or may be imposed; and

- Preparation of information related to margin squeezes or non discrimination may be required.

14.3 Preparation of financial statements relating to retail services and groups of services for which SMP obligations apply.

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 to this document.

14.3.1 General Preparation and Delivery of Regulatory Financial Statements

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.

14.3.2 Specific Preparation of Financial Statements for the Designated Retail Markets.

ComReg proposes that the dominant operator will prepare and publish the following Financial Statements (as set out in Annex B) on an annual basis.

14.4 Preparation of financial statements relating to retail services and groups of services where a cost orientation obligation of Retail Minus is proposed

ComReg is currently considering imposing retail minus obligations on inter alia the end to end leased lines within the wholesale terminating and trunk segments of the leased lines markets in the wholesale broadband access markets and for the wholesale line rental product. The main aim of a Retail Minus cost obligation, in this case, is to foster the development of competition by preventing the vertical leverage of a SMP operators market power in the wholesale market into the retail market by way of a margin squeeze. To that end ComReg believes that wholesale price control by way of retail minus mechanism is appropriate. Retail minus mechanism guarantees a margin between the wholesale and retail prices and therefore should prevent margin squeezes.

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 be restricted solely to this mechanism, is to obtain data from the dominant network operator on a Fully Allocated Cost Basis. This means that the obligations imposed in practice need to be identical to the obligations which are imposed on an operator in the retail market where it has retail SMP and has been imposed a retail cost accounting obligation, i.e. if the a retail minus mechanism is imposed as a remedy on a wholesale market then, in order for this to be effective, ComReg will require an obligation of Accounting Separation on the retail market.

14.5 Preparation of information related to margin squeezes or Non discrimination.

When an obligation for accounting separation is imposed on an operator with SMP on 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, proportionate.

One example where Accounting Separation might be justified in a non SMP retail would be where there is a risk of an SMP operator at the wholesale level leveraging its power into a downstream retail market, for example by way of margin squeeze. ComReg believes that it would be justified in insisting upon the provision of information at the retail level in these circumstances. This information would most likely be Profit and Loss and MCE information which could take a variety of forms. Examples of such forms would depend whether or not it was to be used on a stand alone basis or incorporated into a DCF type calculation to determine margin squeezes on the basis of cash flows or if it was to act as an input into a bottom up calculation for retail minus. Annex B proposes financial statements for this situation.

Q. 14. 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.

15 Proposed Financial Statements and Schedules and Additional Financial Information

15.1 Introduction

Annexes A to D to this consultation, when backed by transparency of documentation and audit, contain much of the routine data required by ComReg to satisfy itself that a dominant operator is complying with its (eventual) obligations for e.g. accounting separation, cost orientation and price controls.

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 identifies the EU defined market relevant to the fixed telecom's network. The 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. In addition to the schedule for each of the relevant markets, there are two additional schedules for 'Wholesale Other' and 'Capacity Based Interconnection Products'. The 'Wholesale other' schedule identifies services which do not fit appropriately within any of the defined markets.

The Market Analysis Consultation Paper on the Interconnection markets dealt with the issue of Capacity Based Interconnection products. These are the supporting products which are necessary to avail of interconnection and PPC products. Regulation 6 of the Access Regulations, allows ComReg to impose, to the extent that it is necessary to ensure end to end connectivity, obligations referred to in Regulations 10 to 14 inclusive on undertakings that control access to end-users, including in justified cases, the obligation to interconnect their networks where this is not already the case. ComReg considers that the Accounting Separation and Cost Accounting Separation are necessary to monitor a price control obligation. The appropriate worksheet identifies the products/service within this market.

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

This list is likely to need to be modified each year as a result of discussions between ComReg and eircom and input from OAOs where appropriate. Modifications would usually take place annually by way of consents.

15.3 Overview of Annex B

Annex B 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. ComReg welcomes comments on Annex B 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

Annex B 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. The formats of these statements are similar to those currently been prepared by eircom. Annex A sets out the financial statements required at the Service, Segment and Market level. 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.

Annex C 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.

15.3.2 Statement of Costs Schedules

These schedules of statement of Costs for the Core and Access 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. Whereas ComReg proposes to make some minor changes to the current core schedule, the Access schedules will be significantly improved, as will those for leased lines and PPCs. ComReg will discuss this further as appropriate.

Annex C also sets out the audit opinion required for these schedules.

15.3.3 Memorandum Financial Statements

In some cases, certain elements or services are combined to produce another service which is sold. This applies e.g. to an unbundled local loop which is used as an element in Wholesale Line Rental, or where an end user link in combined with an In Span Interconnect to generate a private circuit. In such cases the costs of the combined service or component have already been included in a previous Financial Statement and as such are part of the dominant operator's total business. Therefore they cannot be included again and a memorandum Financial Statement is required to produce the information required by ComReg or other users of the services and financial Statements. Bundled products will also be reported in these memorandum financial statements.

15.3.4 Additional Financial Information

Annex B also sets out the Additional Financial Information required along with a justification. The precise format and content of these schedules will be discussed further at a later date with the relevant dominant operators. As discussed earlier in this consultation, ComReg proposes to align the preparation of the Annual Regulatory Financial Statements with the price submission process and as a result ComReg will require this additional information to satisfy itself as to the appropriateness of the charges. This proposed information will be produced for ComReg's purposes and will be subject to the audit opinion set out in Annex B.

15.4 Overview of Annex C

Annex C sets out the obligations proposed in each of the markets and the current status at time of publication.

Q. 15. Do you have any comments on the attached Annexes A to C to this consultation?

Q. 16. ComReg is particularly interested in your views on the form and content of the proposed financial statements/schedules set out in Annex B. Do you consider there to be other formats or forms in which the information could be presented? Please elaborate on your response

16 Implementation and Transitional Arrangements

16.1 Introduction

The proposals contained in this document are complex and probably cannot therefore be implemented immediately. ComReg proposes to discuss with the SMP 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.

16.2 Current Status

There are two main foundations to the current regime:

a) The various Directions issued by ComReg and side letters which are in place which combine to affect and effect the provision of the current Financial Statements and price submissions.
b) The Regulatory Financial Statements, produced by eircom, which the proposals listed in earlier chapters and the annexes will extend and improve, taking account of the new regulatory framework.

ComReg proposes that all the directions issued by ComReg by public consultation or letter under the old framework will be carried forward in the new regulatory regime, unless superseded by issues in this consultation.

16.3 Implementation Issues.

16.3.1 Preparation of Regulatory Financial Statements

ComReg proposed that the Regulatory Financial Statements will be prepared on a Current Cost (CCA)/Long Run Incremental Cost/ LRIC basis and reconciled to the Historical Cost Accounts. ComReg believes that the full suite of information should be available from 2006/07, and that these accounts will also be used to inform prices for the RIO related services. ComReg considers that some progress (specifically with regard to the restatement of prior year figure) can be made in the preparation of the 2005/06 Regulatory Financial Statements to reflect the new regulatory framework. ComReg proposes to discuss the transitional arrangement for 2005/06 with the relevant dominant operators.

As discussed in Chapter 12, In the case of the fixed narrowband market, ComReg proposes that top down LRIC/CCA is not required to value local loops as currently these are costed on a bottom up basis. However other services such as LLU co-location should be presented on a CCA/LRIC basis. The preparation of such statements may require extra work on by the dominant operator but the likelihood is that the improved transparency and accuracy will offset this extra cost.

ComReg does not consider that major system changes should be required by dominant operators to comply with the new obligations and most of the information and documentation should be available for the new Regulatory Financial Statement and schedules, i.e. it should mostly be a case of extracting information from the existing systems.

16.3.2 Alignment of the Regulatory Financial Statements and the price submission process.

As discussed earlier in this paper, ComReg proposes to align the preparation of the Regulatory Financial Statements with the Price submission process and is of the view that this can be achieved by 2006/07.

16.3.3 Accounting Documentation

ComReg proposes that this documentation should be incorporated into the Primary and Secondary Accounting Documentation within 4 months of ComReg issuing a final direction on the financial reporting obligations and thereafter within 4 months of the financial year end.

ComReg also proposes that the technicalities and details of the existing Directions should be incorporated into the Primary and Secondary Accounting Documentation for Financial year 2005/6. Once the regime is implemented ComReg will review these Directions with a view to removing the vast majority of these existing Directions. ComReg is willing to discuss with any operator any Directions which it considers could be removed before this date and would welcome responses with respect to this.

16.3.4 Restatement of the Financial Statements

Currently, when following a review of a price submission by ComReg a number of adjustments may be required to that submission, however, once this price determination is made, no restatement is made to the Regulatory Financial Statements to reflect these adjustments. This means that the final actual profit, sales and cost figures, and the return on capital employed is not disclosed. ComReg proposes that this situation is rectified and that whilst Determinations are being made (if a price cap was introduced such restatements probably would not be necessary) such a restatement will take place, so that final sales, costs, profit and ROCE figures are transparent.

ComReg proposes that the Regulatory Financial Statement be re stated and audited to reflect such adjustments where necessary. ComReg proposes that this obligation will take effect from 2006/07.

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Q. 17. 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?

17 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 fixed telecom markets. ComReg in this paper consults as to how these remedies can be effectively implemented.

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. 18. 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 objective, proportionate and justified and offer views on what factors ComReg should consider in completing it Regulatory Impact Assessment?

Q. 19. 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

18 Submitting Comments

All comments are welcome; however it would make the task of analysing responses easier if comments were referenced to the relevant question numbers from this document.

The consultation period will run from 10h March 2005 to 6th May 2005 during which the Commission welcomes written comments on any of the issues raised in this Consultation paper.

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

In order to promote further openness and transparency ComReg will publish the names of all respondents and make available for inspection responses to the consultation at its Offices.

Please note ComReg will publish all submissions with the Response to Consultation, subject to confidentiality. 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. Respondents are requested to clearly identify confidential material and if possible to include it in a separate annex to the response. Such information will be treated as strictly confidential.

Appendix A – Consultation Questions

List of Questions

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

18.1 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.

18.2 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;

'Alternative Regulatory Auditor' means any Auditor not for the time being appointed as the Dominant Operator's Regulatory Auditor;

'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;

‘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 –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 Activities[14] 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 Activities[15] (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:

[14] 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.

[15] 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 E –Overview of the Attached Annexes

- Annex A sets out the list of products/services within the EU designated markets.
- Annex B sets out the financial statements which ComReg requires as part of the Accounting Separation/Cost Accounting obligation.
- Annex C sets out the list of markets and the obligations which apply.