



Commission for  
**Communications Regulation**

Submissions to Consultation 09/75

## **Accounting Separation and Cost Accounting Review of Eircom Limited**

### **Submissions received from respondents**

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## **1 Eircom Limited**

**eircom Ltd.**

**Response to ComReg  
Consultation and Draft Decision  
09/75**

**of**

**5<sup>th</sup> October 2009**

**Accounting Separation  
And  
Cost Accounting Review**

## DOCUMENT CONTROL

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## Executive Summary

This document constitutes eircom's response to the ComReg Consultation Document 09/75 of 5<sup>th</sup> October 2009 "Accounting Separation and Cost Accounting Review".

- eircom currently operates Accounting Separation and Cost Accounting remedies which were developed to fulfill obligations imposed under the 1998 Regulatory Framework. These were acknowledged by the EU Commission to be "best practice" at the time but *eircom*, understands that these require *adjustment* to reflect the current Regulatory Framework – in particular the movement to market based regulation.
- However the ComReg proposals represent a dramatic expansion of the current disclosure requirements which in our view is disproportionate and unjustified in light of both prevailing market conditions and eircom's legal obligations. [X]
- We believe that this position has arisen through four principal factors -
  - an inappropriate merging of eircom's Accounting Separation and Cost Accounting obligations which leads to excessive requirement for full financial statements in respect of products: Non-discrimination and Cost Accounting obligations do not require this level of disclosure;
  - An attempt to structure the Separated Accounts process in order to meet all investigatory needs which effectively creates ex ante obligations in anticipation of ex post investigations;
  - A failure to acknowledge the distinction between financial reporting models and pricing models leading to inappropriate attempts to incorporate aspects of the relevant pricing models into the accounting framework; and
  - Failure to have full regard of the need to ensure that all remedies are limited to those required to address specific and identified problem(s), are proportionate to the severity of the problem, and are the least costly available.
- eircom believes that ComReg has fundamentally misunderstood the actual impact that implementation of their proposed requirements will have on eircom. As this response demonstrates, compliance with the proposed requirements will not simply be a matter of extracting available information from existing systems, but will require a fundamental revision of the systems and associated supporting data. In particular a number of the proposals have the effect of dramatically expanding both the cost of implementing and operating the regulatory accounting systems, including -
  - Disclosing Separated Accounts for all of eircom's products
  - Imposing an arbitrary sampling threshold at a study level without regard to materiality
  - A documentation requirement that potentially goes beyond the requirements of any jurisdiction that we are aware of
  - Requiring a level of audit assurance that goes beyond the requirements of any jurisdiction that we are aware of

- In performing its Regulatory Impact Assessment (RIA), ComReg has presented its proposals as an “all or nothing” proposition. eircom fundamentally rejects this false dichotomy and, in this respect, presents for each of these areas an alternative proposal which we believe still meets ComReg’s core objectives. This represents a more proportionate approach and would result in a significantly lower cost of implementation. eircom believes that any additional benefit that might arise from ComReg’s proposals would not justify the additional cost.
- In order to assess the merits of its proposals we note that ComReg has compared them to a benchmark group of other entities. However this group is fundamentally flawed as it extremely limited in size, contains entities from other industries, and includes a comparison to a draft Consultation in respect of New Zealand, for whom the final Direction differs materially. As a result we do not accept ComReg’s contention that this comparison represents sufficient evidence that ComReg’s proposals are necessary or in line with best practice.
- In compiling its alternative proposals, eircom has taken into account the current requirements of a much broader set of telecommunications operators. As a result we are satisfied that, both individually and collectively, eircom’s proposals are both in line with best practice and sufficient to meet its regulatory obligations, at significantly lower cost.

## Background

This document constitutes eircom Limited's response to the ComReg Consultation Document entitled "*Accounting Separation and Cost Accounting Review, Draft Accounting Direction to Eircom Limited*" dated 5<sup>th</sup> October 2009 - ComReg Document No. 09/75 (the "Consultation Document"). eircom Limited ("eircom") welcomes the opportunity to engage with ComReg in this Consultation which addresses the key issue of its financial reporting regulatory requirements.

eircom's submission is structured as follows:

- (i) An overview which provides a summary of eircom's general concerns which have an overarching impact on the issues raised in the Consultation Document; and
- (ii) The responses to the specific Consultation questions posed in the Consultation Document.

## Overview

### ***(i) Separate and Distinct Obligations***

Firstly, eircom would like to highlight a fundamental flaw in the approach adopted by ComReg in developing the proposals set out in the Consultation Document. In Appendix 1 to this response, eircom sets out how this approach is inconsistent with the current Regulatory Framework.

In accordance with the relevant legislation, the obligations of (i) Accounting Separation (Regulation 12 of the Access Regulations<sup>1</sup>, and Regulation 14 of the Universal Service Regulations<sup>2</sup>); and (ii) Cost Accounting (Regulation 14 of the Access Regulations and Regulation 14(5) of the Universal Service Regulations) are separate and distinct regulatory instruments with particular characteristics and regulatory purposes which are designed to address specific competition problems.

Accounting Separation involves the preparation of a set of accounts that allocate the affected undertaking's costs in a manner which enables verification of compliance with a non-discrimination obligation.

While Cost Accounting systems are models that allocate costs to products based on particular cost allocation methodologies, a Cost Accounting obligation is specifically applied where an SMP operator is required to demonstrate compliance with a price control obligation. While ComReg and market players need to understand the underlying methodology used for allocating costs in the Cost Accounting system, the specific costs or cost components that are allocated are not required to be published.

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<sup>1</sup> European Communities (Electronic Communications Networks and Services) (Access) Regulations 2003, S.I. No. 305/2003, and amended by the European Communities (Electronic Communications Networks and Services) (Access) (Amendment) Regulations 2007 S.I. No. 373/2007 (the "Access Regulations").

<sup>2</sup> European Communities (Electronic Communications Networks and Services) (Universal Service and Users' Rights) Regulations 2003 S.I. 308/2003 and amended by the European Communities (Electronic Communications Networks and Services) (Universal Service and Users' Rights) (Amendment) Regulations 2007 S.I. 374/2007 (the "Universal Service Regulations").



In response to the Consultation on eircom's Accounting Separation and/or Cost Accounting obligations<sup>3</sup> carried out in 2005, eircom raised a concern that ComReg had inappropriately combined the two obligations. In this Consultation Document it is evident that ComReg maintains this flawed approach and has failed to give due regard to the critical point raised. In adopting this approach, which is fundamental when assessing the appropriateness of the proposed obligations, ComReg has imposed each, without consideration of the sufficiency of one or the other and, in so doing, is seeking to impose obligations that go well beyond what is envisaged in the Access Regulations and/or Universal Service Regulations. Such proposals are unnecessary, disproportionate and not justified in light of ComReg's regulatory duties and objectives as provided for under Section 12 of the Communications Regulation Act, 2002 and the Framework Regulations<sup>4</sup>.

In this context ComReg appears to impose Separated Accounting obligations upon eircom in areas for which it is subject to Cost Accounting obligations. For example, the Consultation contains requirements for the production of Accounting Separation data, such as disaggregated Profit & Loss accounts and Balance Sheets, at a service level. For example Paragraph 5.16 of the Consultation states

*“However it is important that Eircom comply with its obligations, in particular the Transparency obligations. In this regard and so as to facilitate ComReg in monitoring such compliance, it is proposed that Separated Accounts to the level of service are published and audited by Eircom annually”*

eircom considers this obligation to be wholly inappropriate, as relevant individual wholesale services are only subject to a Cost Accounting obligation. We believe that transparency can be more efficiently demonstrated through a disclosure of the average costs and revenues for individual material services within markets. This information is sufficient to meet ComReg's objective of demonstrating non-discrimination and cost orientation. We consider the combination of this disclosure, together with sufficient documentation of the system and its underlying methodologies, meets eircom's Transparency obligation.

## ***(ii) Alignment with Current Regulatory Framework***

The current accounting requirements imposed on eircom were devised more than ten years ago. Since then, the industry has seen the adoption of the current Regulatory Framework for electronic communications networks and services which was adopted by the Council and European Parliament in 2002 and its transposition into Irish law in 2003 (the “Framework”). eircom agrees with ComReg that the scope and nature of the two separate obligations that are the subject of this Consultation – Accounting Separation and Cost Accounting – have to change in order to align with the Framework. eircom also agrees that a system must be put in place to facilitate eircom in demonstrating its compliance with its current regulatory obligations and enable ComReg to monitor such compliance in the most effective and efficient way

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<sup>3</sup> “Consultation on the Proposed Financial Reporting Obligations for Fixed Dominant Operators having Accounting Separation and/or Cost Accounting Obligations” dated 10 March 2005, ComReg Document No. 05/18.

<sup>4</sup> European Communities (Electronic Communications Networks and Services) (Framework) Regulations 2003 S.I. 307 and amended by the European Communities (Electronic Communications Networks and Services) (Universal Service and Users' Rights) (Framework) Regulations 2007 S.I. 271 (the “Framework Regulations”).

possible. eircom believes that it is worth re-stating the key characteristics of the Framework.

Under the Framework, obligations should only be imposed where there is evidence of market failures and competition is ineffective. Competition law principles are used during “market reviews” (also known as “market analyses”) to identify the markets where intervention may be justified, both in terms of market definition and the identification of the operators who should be subject to regulation. Only those operators found to have “Significant Market Power” (“SMP”), a concept equivalent to that of dominance under the competition rules, are regulated.

The obligations – also known as remedies – which may be imposed must address the specific competition problems identified during the market review and be proportionate.

Article 8 of the Access Directive which has been transposed by Regulation 9(6) of the Access Regulations requires that the particular remedy or remedies selected should be:

- (i) based on the nature of the problem identified;
- (ii) proportionate, such that the least burdensome effective remedy should be selected; and
- (iii) justified in light of the Regulator’s objectives. ComReg’s objectives are set out in Section 12 the Communications Regulation Act, 2002 as amended which include *inter alia* the obligations to promote competition, contribute to the development of the internal market and to promote the interests of users within the Community.

In accordance with the Access Regulations and Universal Service Regulations, ComReg can specify the format and accounting methodology to be used when imposing an obligation of Accounting Separation and/or Cost Accounting. However, Recital 6 of the Commission Recommendation on Accounting Separation and Cost Accounting systems under the Regulatory Framework for electronic communications<sup>5</sup> (the “Commission Recommendation on Accounting Separation”) mandates that any methodology must be specified in a way that:

- (i) encourages efficient investment,
- (ii) identifies potential anti-competitive behaviour (i.e. margin squeezes); and
- (iii) should be in accordance with ComReg’s objectives.

In addition, ComReg must take due regard of the commercial and economic environment to minimise risk and uncertainty in the relevant markets. ComReg must take the utmost account of this Recommendation on Accounting Separation.

The Consultation Document should consider eircom’s current obligations in light of the objectives of the Framework and should be:

- Modified to align with the market definitions as identified in the market review process for which eircom has been designated as having SMP and where Cost Accounting and/or Accounting Separation has been specified as a remedy;
- Proportionate to the competition problem identified and take into

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<sup>5</sup> Commission Recommendation of 19 September 2005 on Accounting Separation and Cost Accounting systems under the regulatory framework for electronic communications C(2005) 3480.

consideration the costs of implementation and associated benefits;

- Targeted to address an identified regulatory need and not requiring reporting on areas simply because of some as yet unidentified regulatory need;
- The least burdensome method of addressing the identified competition problem;
- Sufficient to provide the level of detail necessary to monitor compliance, and no more;
- Realistic in terms of timescales required for reporting;
- Flexible enough to adapt to changing market conditions, evolving technologies and to new methods of price control i.e. a wholesale price cap;
- Harmonised with the financial reporting obligations placed on other operators in the Irish market and those applied in other EU administrations.

eircom submits that proposals contained in the Consultation Document do not meet these fundamental criteria nor the objectives of the Framework. The extent and nature of the data requirements outlined in the Consultation Document are disproportionate and are not necessary to monitor the remedies imposed as part of the relevant market reviews. If the proposals are applied in their existing form they will result in disproportionate regulation of eircom.

### ***(iii) Disproportionate and Excessive Reporting Requirements***

We recognise ComReg's responsibility to monitor eircom's compliance with its obligations, and to this end investigate any area of the Cost Accounting system that it wishes. However, the Consultation appears to extend this investigatory power directly to the scope of the Separated Accounts. For instance Paragraph 2.29 of the Consultation is as follows;

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

eircom does not accept that this is a valid objective for the Separated Accounts as it is infeasible to expect the Separated Accounts to meet ComReg's investigation function.

eircom remains willing to discuss with ComReg various means to improve the process of supplying data to support ComReg's enquiries/investigations. However, we consider it wholly inappropriate to attempt to embed these potential lines of enquiry into legal obligations upon eircom.

eircom believes that ComReg's proposals will result in an unwarranted increase in the cost of compliance in terms of the (i) level of support required to produce the separated accounts; and (ii) cost of audit. Indeed there is a fundamental misunderstanding which underpins ComReg's proposals that takes for granted the level of resources required to provide the requested information. This is evidenced by the continued use of the following statement within the Regulatory Impact Assessment,

*“Information should be available from Eircom's accounting system so don't envisage any significant cost for Eircom”*

A review of ComReg's draft proposals indicates that the cost of compliance will increase significantly and would involve, at a minimum, the following:-

- Amendments to the core costing system;
- Development of a new reporting engine to produce the required statements;
- The compilation of new documentation driven by the new requirements;
- The establishment of new sources of data to feed the new information requirements arising from new disclosures;
- A significant expansion of the current core Regulatory Finance team to cope with the appreciably expanded task of co-ordination, compilation, review and approval of the new statements.

Indeed, complying with the proposals contained in the Consultation Document may well involve a more fundamental change to eircom's processes and procedures such as:-

- Expanding time recording requirements to entire new classes of staff;
- Revising the financial coding systems of eircom, with new Appropriation Codes, and responsibility centres etc. and/or
- Accelerating the corporate reporting timetable in order to facilitate the acceleration of the Regulatory reporting timetable.

#### ***(iv) Analysis based on Benchmark Groups***

eircom notes that, in assessing the appropriate level of disclosures, ComReg has reviewed and benchmarked the practices of a number of telecommunications operators and utility companies in other industries, including the postal sector. eircom has a number of concerns with the appropriateness of this benchmark group, of which the most significant are;

- The use of such a small telecommunication benchmark group introduces the real danger of bias, through the failure to identify outliers in the benchmark group. This is most evident in the reliance upon Telecom New Zealand obligations, which eircom consider to be an outlier in many areas, and which would have been identified as such if a wider group had been chosen. Indeed some of the requirements proposed here for eircom were never actually implemented in the final Direction to Telecom New Zealand.
- The proposals go beyond what is currently required of BT and the UK model is generally considered to be one of the most aggressive in the EU
- eircom fundamentally disagrees with the use of reporting obligations in other industries as a benchmark for the appropriate obligations for eircom. We contend that the differing operating conditions and level of complexity of cost attributions make the comparison to telecommunications essentially meaningless.

In assessing ComReg's proposals, eircom has reviewed the obligations of a larger benchmark group, consisting of 15 operators in the telecommunications sector. We attach at Appendix 2 further details as to the make-up of this benchmark group. The results of this analysis differ significantly from the ComReg group, and we will highlight these disparities within the individual answers below.

**(v) Unwarranted Regulation**

ComReg states at paragraph 2.26 of the Consultation Document that the imposition of an obligation of Accounting Separation may cover markets where the operator does not have SMP to ensure coherence of data. In this regard, ComReg is not entitled to regulate unregulated markets. It should be noted that ComReg is only entitled to make a request for information that relates to unregulated markets in exceptional circumstances, and only then when such a request is justified on the basis that the specific information requested is appropriate and proportionate to the problem identified. A number of proposals contained in the Draft Direction in Chapter 12 of the Consultation Document however seek to widen the scope of the Cost Accounting systems unnecessarily in this respect.

The wording currently contained in Section 6 of the Draft Direction (Reporting and Transparency) would require eircom to provide Accounting Separation information on specified: (a) Markets; (b) Services; and (c) Products (See Section 2 of the Draft Direction: Definition and Interpretation). Markets are defined as relevant markets. However, Services and Products have a significantly broader definition, and could include any service or product provided by eircom. For example Section 6.2 of the Draft Direction states that the format and level of detail of the Additional Financial Information (AFI) shall be determined by ComReg following discussions with eircom. However, ComReg reserves the final right to determine and amend these schedules from time to time where agreement cannot be reached (see paragraph 6.3 of the Draft Direction). eircom would be obliged to submit this information to ComReg within four months. Where Products and Services have been defined so broadly, the scope of a request for information potentially could be very wide and excessively burdensome, and eircom strongly objects on this point. Having stated that, any information request must be proportionate and justified. ComReg must be clear in the scope of any obligation imposed, what information it requires, for what purposes and how it aids in the achievement of its objectives.

For the avoidance of doubt, eircom notes that any SMP obligation which has been imposed on eircom to date only relates to “eircom Limited” and that the Final Direction should not attempt to extend these obligations to include eircom’s subsidiaries. eircom further notes that Section 3.1 of the Draft Direction states that the Direction applies to “*eircom Limited and its subsidiaries, its successors and assigns and any undertaking which it owns and controls and any undertaking which owns or controls eircom Limited, and its successors and assigns*”. eircom believes that this language is inappropriate and without legal basis and should therefore be amended.

## **EIRCOM RESPONSES TO COMREG QUESTIONS**

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

As noted in the introduction above, eircom recognises the need to harmonise the current eircom reporting obligations with the Regulatory Framework that underpins them. As a result we agree that this review is necessary. However, as we also pointed out above, this review fails to take sufficient regard of the separate nature of these two obligations or of established benchmarks and is informed by a number of misunderstandings relating to eircom's accounting systems and the current audit of the Separated Accounts. We therefore have a number of fundamental concerns over the underlying principles which appear to govern the setting of the Cost Accounting and Accounting Separation obligations in respect of the Separated Accounts, which we will set out in the remainder of our response.

Also, ComReg has imposed on eircom SMP obligations based on regulatory reporting systems developed prior to the implementation of the Framework. eircom expects that this Consultation will take into consideration the significant increase in competition in the Irish market since the inception of the previous reporting regime.

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

eircom agrees in principle with providing detailed information regarding varying levels of disaggregation of revenues. In particular, the disclosure of internal and external revenues at an appropriate level can help demonstrate eircom's compliance with its non-discrimination obligations.

However, ComReg's proposals for the disclosure of separate lines for directly allocated revenues and apportioned revenues are excessive. Based on our benchmark analysis, no operator was subject to an equivalent reporting requirement. This may be because the issue of apportioned revenues is not significant for telecom operators unlike other utilities. For example, a postal service provider receives a significant proportion of its revenues from the sale of stamps and would have to attribute this revenue line across the various services they might relate to. Given that the postal service provider would have no direct information as to how the customers are using the stamps the apportionment of these revenues has to be based on an analysis of samples. However, in the telecommunications sector revenues are generally allocable directly to products as customers are billed on the basis of the products they consume. Therefore the telecom operator's billing system has to maintain detailed records of the volume of all services consumed including the number and duration of calls made, the number of connections completed or the volume and type of services rented.

Even with the growth of bundling, the telecommunications operators still generally record the customer's service usage data including all call volume data. Indeed bundles are effectively a form of discount that is attributed across the services in the bundle on the basis of the service volumes and related revenues recorded in the billing system. In this regard eircom believes that the issue of direct and apportioned revenues is not significant enough to warrant disclosure in the Separated Accounts

although eircom does agree that ComReg requires transparency around the apportionment of discounts to regulated products and within bundles that contain regulated products.

Therefore, the disclosure of the impact of bundled discounts on markets within the unpublished AFI is acceptable as this respects the confidentiality of such commercially sensitive information. However, we believe that the disclosure for unregulated services and products is excessive and unnecessary and should be removed from the final Direction. A more proportionate remedy, which would ensure transparency, would be the provision of documentation on the approach to revenue identification and discount attribution in the Secondary Accounting Document. It is worth noting here also that where material to the Separated Accounts the application of this methodology would also need to be considered by the auditors. This should provide sufficient comfort to ComReg in respect of the accuracy of the revenue and discount allocation basis.

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

We disagree with the extent of volume information that ComReg suggest should be included on the face of Separated Accounts.

eircom agrees that appropriate volume information can play an important role in aiding the transparency of the accounts as it informs the cost transfers to services and products and facilitates unit cost and revenue calculations. However, there are a number of practical issues involved with ComReg's proposal to identify and disclose weighted average volumes at the market level. Many markets can contain services that have different measurement bases but a weighted-average calculation can only be performed when similar units of measurement are applicable for all services within a specific market. For example, it would not be possible to calculate a weighted average volume for a market that includes connections (measured in number of connections) and traffic services (measured in minutes or calls). Therefore, the disclosure of volumes should not be calibrated at a market level but instead should only be disclosed where service volumes are relevant and meaningful. One example of this is Market 4, of the European Commission's Recommendation<sup>6</sup>, which includes services such as LLU, Line Share and Co-Location. While eircom might be able to disclose a volume for each of these services there would be little value in disclosing these volumes as a total at the market level. eircom's proposed pro-formas [X] to ComReg outlined what we consider to be an appropriate level of disclosure of volumes, which is in line with international practice, including the UK. (The files referenced here are re-submitted to ComReg in association with this current Consultation Response).

Regarding the issue of whether volumes are directly attainable or derived from sample analysis, as discussed in our answer to question 7 below, the vast majority of volume information on eircom's products and services can be obtained directly from its support systems. Therefore, eircom does not consider this issue to be material enough to justify a separate disclosure at the product or service level.

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<sup>6</sup> Commission Recommendation on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation - C(2007) 5406.

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

eircom disagrees with the proposal that the AFI should include a reconciliation statement between volumes included in the Quarterly Reports and in the Separated Accounts.

eircom acknowledges the need to ensure the general consistency between the two sets of information and agrees with assisting ComReg in understanding any significant differences that might arise. However, the solution proposed by ComReg for a formal reconciliation statement is disproportionate to the issue at hand and in some cases wholly impractical. There are legitimate reasons why small differences might arise between the quarterly report data which tends to track real time volumes and the information used in a set of accounts which has to allow for accruals and provisions for revenue recognition purposes. In such circumstances, completing a full reconciliation that attempts to explain each of these immaterial variances could take considerable effort without producing any significant additional benefit to the understanding of the accounts. In other areas the Separated Accounts may be based on “snapshots” of network volumes such that reconciliation to volumes measured on a full 12-month basis would not be practical. Instead, eircom would propose to include in the AFI a comparative of key volume drivers with explanations of any material differences.

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

eircom agrees that sample data should be based on either generally accepted statistical techniques or other methods, and concurs that the key principles listed in paragraph 3.66 of the Consultation Document are appropriate and therefore should inform the preparation of sample data.

However, ComReg has gone beyond these statistical principles and established a fixed level of statistical accuracy applied at an individual sample level. eircom considers this to be wholly disproportionate and impractical due to the extremely large sample sizes which would be required in some instances. Not a single territory surveyed by eircom was found to apply a fixed, mandated level of statistical accuracy for statistical samples.

To further illustrate the point of the impracticality of ComReg’s proposals, eircom has conducted some pilot investigations into certain key samples within the model. The results of this exercise demonstrate that the application of this threshold results in a requirement for samples representing essentially 100% of the population. Thus, in effect, this requirement represents a prohibition on the use of sampling, rather than a sampling guideline. We consider this to be an entirely disproportionate measure which is totally unprecedented in the area of regulatory reporting.

In addition eircom believes that the proposed sampling mandate fails to take account of the real objective of the reporting system, which is to deliver accurate reported results. A sample may have very minimal impact on the reported results but under



these proposals would have to meet the same stringent statistical accuracy requirements. The current obligation treats each sample in isolation, as if it was an independent output, rather than a step in the process of achieving the reported results. As a result, eircom would propose an alternate benchmark where, rather than prescribing one single statistical hurdle that all samples used in the accounts should achieve, the impact of a sample at statement level in the Regulatory Accounts should drive the level of sample accuracy or other appropriate basis required. In practice, this will mean that a sample with minimal impact on the accounts will be allowed a greater margin of error, whereas a sample with higher impact will require more accuracy.

We note that eircom's Regulatory Accounts are audited, and the audit opinion is provided bearing in mind the use of sampling and the accuracy of those samples. ComReg would therefore have assurance of the significance of the samples on the accounts, which should limit the necessity for strict statistical accuracy requirements. We also note that ComReg is proposing in this Consultation to set up of a tripartite arrangement where eircom's auditors could owe a duty of care to ComReg. Such an arrangement would allow ComReg to highlight in advance to eircom's auditors areas of particular concern to them, so as to ensure that the auditors can address these concerns in the course of their audit.

Therefore, it would be more reasonable and aligned to the common practice that ComReg allow eircom to determine the approach and the appropriate level of statistical accuracy on a case-by-case basis to achieve an appropriate level of accuracy in the Regulatory Accounts.

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

eircom agrees with the principles outlined in paragraph 3.66 of ComReg's Draft Decision with regard to the use of statistical sampling but notes that the application of these principles needs to be informed by a judgement of proportionality in establishing sample accuracy levels. We reiterate that the application of these principles is not compromised by the proposal outlined by eircom above.

We have given further detail on these principles in our answer to question 5 above.

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

eircom recognises ComReg's need for greater transparency of costs and agrees in principle to providing a split of costs by functional cost category and Network Element at a level that is reasonable and workable. We note that currently the disclosure of Network Element costs is limited to private submission to ComReg as part of the AFI. eircom considers the disclosure of such information to be an important measure in providing transparency over the cost of wholesale services to the industry. Therefore we propose to include these disclosures in the published financial statements.

As a result eircom proposes that the following information is published in the Separated Accounts:

- 'Network Statement of Costs of Services' where it is made explicit the derivation of the average costs of wholesale services, through the attribution of the costs of Network Elements, based on the single average cost of each element and element/service usage factors.
- 'Network Costs Market Summary' stating the attribution of costs of Network Elements to the various markets.
- 'Statement of costs' demonstrating the total costs for each Network Element and average costs based on usage volumes.
- 'Market Group Statements' which provide a functional breakdown of costs by the constituent markets (Wholesale Unbundled Access, Wholesale Fixed Narrowband Access, etc).

[X]

In addition, we have proposed that, as part of the AFI, more detailed drill-down reports on specified Network Elements could be provided to ComReg stating the functional cost categories relevant for each Network Element.

eircom believes that disclosing functional cost categories in this way would address the key transparency concerns raised by ComReg:

- ComReg is able to identify which are the most material Network Elements in a particular market or service
- ComReg has the visibility of the functional composition for each of the Network Elements

In addition, eircom is of the opinion that the hierarchy of functional costs and the categorisation of Network Elements have to be flexible enough to accommodate future changes in technology, markets or regulation. Hence the final Direction should not attempt to establish a definitive list, as these will need to be the subject of ongoing review and amended as appropriate from time to time.

With regard to the requirement to show functional cost categories for each service and product, eircom observes that, in a Top-Down model, Network Elements are defined so that they are the penultimate destination of costs before their final attribution to services based on usage factors. It is at the Network Element level that transfers to regulated and unregulated business areas are performed and where compliance with issues of non-discrimination can be demonstrated. Indeed for most regulated services the only costs they receive would be as a result of Network Element allocations. For example the costs received by LLU would comprise of allocations of copper loop related Network Elements. Therefore, showing a functional cost categorisation for the LLU service would be of little added value as, for example, the attribution of finance costs to this service would only be a result of the attribution of allocations of the finance cost against those Network Elements that allocate to LLU.

As such, eircom sees the requirement to show functional cost categories for each service and product as being overly burdensome without any material benefit with regards to further improving transparency.

However, as noted above, eircom proposes to include in the AFI a statement of functional cost categories by market, which would provide the visibility of the most material cost categories in each of the markets.

eircom also notes that its proposals are in line with International practice, as evidenced by our benchmark group, as functional costs are generally not required at all, and ComReg's main benchmark case, BT, only discloses functional costs at the market level.

eircom is willing to provide as part of the AFI some level of functional costs information at the service and product levels where it is appropriate and targeted at specific areas of concern. For example, if there is a regulatory issue relative to Retail Calls, eircom could disclose cost information by functional cost categories for the specific Retail costs allocations. The exact content and format of these disclosures would need clarification and agreement between eircom and ComReg in advance of any specific commitment.

However, eircom disagrees with the proposed requirement to disclose within the AFI (for all markets and services and for the agreed product list) whether the costs can be categorised as direct, indirect and common.

While eircom does not discard the concept of direct, indirect and common in the context of cost modelling and fully acknowledges the Commission Recommendations on cost allocation it does not see the practical merits of reporting this for all markets and services and for the agreed product list. As ComReg has noted "what may be a direct cost at one level may be an indirect or common cost at a subsequent level." Consequently it is not possible to readily establish within a reporting hierarchy whether a cost is direct, indirect or common as this can and does change over the course of the allocation cycle.

To illustrate this, consider a network activity such as "Maintain radio transmission network". This would be a direct cost when allocated to the transmission asset category, but it would then become an indirect cost when the transmission asset category is allocated to various Network Elements based on the specific cost driver. It is apparent that classifying this cost into one cost category (direct / indirect) that can be applied at all stages of the allocation cycle is not feasible. Therefore, in order to compile the AFI reports as requested, a separate assessment would have to be made of every cost allocation to every market, service and product to determine, on the basis of how the costs have been allocated in the context of that market, service or product, whether the costs should be categorised as direct, indirect or common. It is also likely that the same cost may have different categories depending on whether it is being considered at the market, service or product level, for example, a cost could be a direct cost at the market level but an indirect cost for the services within that market.

It should also be noted that the Commission Recommendation should be interpreted not as a recommendation for disclosure of the direct and indirect costs, but as a guideline for differentiating the treatment of direct costs and indirect costs at various stages in the model via the use of appropriate cost drivers. As such the treatment of costs as direct, indirect and common is a Cost Accounting requirement informing the basis for allocating costs in the model (eircom's cost model already operates in this manner) rather than a reporting requirement that demands disclosure on the face of the Separated Accounts.

eircom proposes in relation to the requirement to disclose "non funds movement" cost items that this should be more specific and be narrowed down to depreciation and amortisation only.

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

Answer submitted above in question 7.

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

eircom's views on the preliminary proposals with regard to the hierarchy of costs have been submitted above in question 7.

eircom disagrees with ComReg's proposal to list and explain all manual adjustments in the Separated Accounts. It should be noted that the Separated Accounts already contain a reconciliation between the Statutory Accounts and the Separated Accounts disclosing the impact adjustments such as the effect of the different asset lives used in both sets of accounts. eircom believes that such disclosures enhance the transparency of the accounts and are appropriate

However ComReg appears to have a much broader interpretation of manual adjustments in this instance, founded perhaps on the erroneous idea that the production of Regulatory Accounts is a fully automated and system integrated process requiring very limited manual intervention. Consequently, the term 'manual adjustments' appears to refer to all changes incorporated directly into the top down Cost Accounting model in the months prior to finalising the accounts. In the Consultation Document ComReg states (in paragraph 4.75):

*“ComReg also considers that it would require annually a list of any manual journals/adjustments made by Eircom to reallocate/reapportion specific costs (together with its justifications) after year end and when preparing the Separated Accounts.”*

This would mean that all adjustments to the financial information used in compiling the Separated Accounts including CCA adjustments or other adjustments within the work flow of the Regulatory Accounts/Audit Review are considered as 'manual adjustments'.

eircom believes that this is a disproportionate and impractical measure considering the number of 'manual journals/adjustments' that are required for eircom, or any other operator, to produce Regulatory Accounts in this form. The fact is that the Top Down models used to prepare Separated Accounts have to translate the output data from the statutory financial systems such as the general ledger and asset register so that this data can be allocated to the regulated entities reported on in the Separated Accounts. Many of the studies and cost allocation methods required to support these allocations have to reflect the full year data and cannot be finalised until after the financial year end.

It should be remembered that the purpose of these types of manual adjustments is simply to ensure that the final cost allocations in the accounts fully reflect the cost attribution principles and methodologies disclosed to ComReg and that the allocations are consistent with the relevant cost and volume information forming the basis of the allocation.

Consequently the majority of such adjustments within the Regulatory Accounts typically occur as a result of both internal review and audit procedures being carried out on the various studies and other cost allocation bases. Generally the manual adjustments are required to ensure that final allocations in the model are consistent with the underlying studies that have been reviewed and approved by the audit. As such they are an integral part of the statement preparation process and are implicitly scrutinised as part of the independent audit. Indeed all journals processed as part of the regulatory accounting process are within the scope of the audit and would be subject to testing on a sample basis, taking into account their potential impact on the regulatory financial statements. In fact, there is a specific requirement in auditing standards that manual journals are considered in this way.

Given that the regulatory accounts production process inevitably requires “manual” intervention to ensure that the final allocation of costs is in accordance with the methodology disclosed in the Accounting Documents, ComReg enquiries should focus on the basis of these final allocations. Diverting effort into reviewing how manual journals/adjustments were applied between the various iterations of the model would appear to be more consistent with a review of the accounts’ preparation process rather than a review of the final accounts themselves. It may be that ComReg is seeking to perform what is effectively a re-audit of aspects of the accounts preparation process in this way because of their apparent view that the existing audit is inadequate to their needs. However, this is not an accurate reflection of the scope of the audit and seeking to review all manual journals/adjustments in this way is not an efficient use of ComReg’s or eircom’s resources. ComReg have other avenues to gain assurance over the appropriateness of the final cost allocations, such as ensuring that the available level of documentation is adequate to meet their needs and that the scope of the audit is sufficient to allow them to understand and have confidence in the basis of cost allocation.

In addition, it should be noted that, in the context of international common practice, this is an atypical requirement. When surveying a sample of 15 jurisdictions (including BT and Telecom New Zealand) where Accounting Separation is practised, not a single jurisdiction made reference to requiring a list of all manual adjustments to cost allocations to be provided.

At the same time, it departs from EU recommendation, which makes no reference to the need to disclose such specific adjustments. Therefore we disagree strongly with this proposed requirement and conclude that it is disproportionate, impractical and unprecedented.

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

eircom is of the opinion that the general content of most of ComReg’s proposals on disclosures in “Schedule of Network Components” and “Usage by Service Schedule and Network Activity Statement” for each Network Element is reasonable and consistent with eircom’s current Separated Accounts on the requirements to provide a detailed view of the costs by Network Element and how these elements are consumed by individual products.

Currently, eircom discloses:

- HCA Statement of Costs of Access Network Services, including Routing Factors and average cost per minute for retail and wholesale access services;
- HCA Statement of Costs of Core Network Services, including Routing Factors and average cost per minute for retail and wholesale access services;
- Statement of Costs including CCA adjustments (FAC and LRIC) for the Core Network Business, including operating costs, supplementary depreciation, holding gain/loss, capital employed, cost of capital, capital cost, volumes and unit costs;
- Statement of Costs of Core Network Services (CCA and LRIC), including Routing Factors and average cost per minute for RIO and retail services.

As noted already in this response eircom is sensitive to the proposed requirement to increase the transparency in the accounts in relation to its cost attributions in light of its obligations in respect of non-discrimination and cost orientation.

In response to question 7 above, eircom has outlined a set of proposals of pro-forma statements which eircom believes addresses these key concerns.

However, eircom believes that some of ComReg's suggested information requirements within the proposed schedules are excessive and wholly unnecessary for the stated purpose of the Separated Accounts, namely to enable monitoring of different parts of an SMP operator's business, to ensure non discrimination, and to prevent unfair cross-subsidisation. We believe that not all of the elements as set out in section 4.79 are required to demonstrate compliance with eircom's obligations.

In particular we find the following information requests excessive and unnecessary:

- Element Count (total number of such elements controlled by the service group)
- Location in Network (e.g. remote cabinet)
- Average Designed Maximum Capacity
- Average Capacity Utilisation (percentage).
- Region (i.e. geographic region).

We also note that these requirements are identical to the reporting requirements in the Draft Notification (Appendix F: Network Components List) published by the Commerce Commission of New Zealand in October 2008. As such, the requirements outlined by ComReg include reference to characteristics that have no meaning in the Irish context, such as "service group". In addition, eircom considers this to be a particularly unfortunate choice of template given the fact that the final "Telecom Accounting Separation Information Disclosure Requirements", published by the Commerce Commission of New Zealand in March 2009, dropped these requirements, keeping only a simplified Schedule of Network Components and Network Activity Statement.

eircom believes that ComReg should also drop these categories from their final Direction, as it is not practical to integrate them into a top down model. For example, while geographic regional data would be pertinent to some regulatory costing requirements such as costing USO or pricing some services, it is not possible to formally integrate such regional data into the cost model. USO and LLU costing models often need to consider cost sensitivities at an MDF level and it would not be feasible to process information in a top down costing model for each of the

approximately 1,000 MDF's in eircom's network. Also, when pricing some data services the regional dimension will have to adapt to changes in technology and levels of competition, so the definition of the appropriate regions will be subject to flux. In such circumstances, the established practice is to use the information in the top down costing model to determine the overall level of cost that applies at the national level, but to carry out the required geographic/regional analysis in a parallel costing or pricing model.

In relation to the timing proposed by ComReg, eircom agrees to submit to ComReg the pro forma schedules/statements within 4 months of the effective date of the Direction, but notes that changes will be required over time to take account of technological, market, business and regulatory developments.

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

eircom disagrees that eircom should be a required to produce and include Separated Accounts for non regulated markets, service and/or products in the AFI.

The imposition of an obligation to provide Separated Accounts for unregulated products or services is only appropriate in limited cases, and to ensure that eircom, as a vertically integrated operator, is not acting in a discriminatory manner. However, any such request must be justified on the basis that the specific information requested is appropriate and proportionate in relation to the nature of the problem identified.

In relation to the need for transparency as to how shared costs (including Network Element costs) are allocated between regulated and unregulated services, this can be established from the Secondary Documentation. Also, the assessment of cost allocation methodologies,, including those related to the attribution of shared costs between SMP and non-SMP markets, is a key element of the audit of the financial statements. As such, ComReg should be able to take comfort over these allocations from this audit.

Furthermore, if ComReg has a specific concern about a particular shared cost category or Network Element's allocations, despite this visibility and assurance, this can be adequately addressed through a specific AFI request. The proposal to routinely provide Separated Accounts for non regulated markets is wholly disproportionate and unjustified.

Alternatively, when necessary and upon request, eircom can provide the required information relating to unregulated markets in the form of an ad-hoc report. It is eircom's intention that the reporting structures within the accounting model are designed to facilitate such a request in a timely and efficient manner. However, as stated above, rather than routinely providing information relating to unregulated markets, any such request must be specific and justified by ComReg on the basis that the information requested is appropriate and proportionate in relation to the nature of the problem identified in a regulated market.

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

eircom agrees with the underlying transfer pricing principles outlined by ComReg and with the requirement to calculate and disclose transfer charges in the Separated Accounts.

However the level of difficulty encountered in the implementation of such a transfer pricing structure can vary with the complexity of the service structure and wholesale pricing agreements. Therefore the discussion over the timeframe for implementation should take into consideration the methodological complexity of this requirement.

The implementation of transfer price arrangements will require significant incremental efforts. These include

- a) collecting an extensive amount of data necessary for calculations, in particular volumes for all the relevant markets, services and products,
- b) setting up a “Standard Service” mechanism to enable the transfer charges calculation, and
- c) setting up the internal transfer pricing mechanisms such that provision and consumption of relevant services between market groups are charged as though they were separate businesses.

An example of the issues which would be encountered can be given in respect of the transfer charges applicable to Retail Call Conveyance. Currently, the Separated Accounts show the Retail Calls business as being charged for Core Network costs on a 'cost plus a return on capital' basis. These charges are dependent on the usage of Core Network Elements, which is measured by standard Routing Factors compiled from engineering and statistical data. A market based structure of charges will involve the derivation of a set of standard services equivalent to the RIO services (Origination, Termination, Transit), services which the Retail Calls businesses will buy from. This process will be complicated by the fact that the current charging structure for RIO services is not consistent with the requirements for such a market based conveyance charging process. We would point out that a similar transition in the UK involved the restructuring of external charges into “standard services” which were consistent with this requirement.

Additionally, eircom notes two other areas of further concern. The requirement for detailing the terms of supply indicates a rather onerous disclosure. The only relevant terms of supply in the context of Accounting Separation are pricing terms (e.g. RIO prices, retail minus), which would be documented in the Accounting Documents. Any other terms of supply would only be applicable in relation to the external provision of services, or in the context of operational or functional separation. Therefore their documentation would be unnecessary for Accounting Separation reporting. Also, regarding the requirement to disclose transfer charges for every situation when a market provides services to another market, it should be clarified that there would be no transfer charges between markets within the same market group. In this instance, costs, assets and liabilities would be treated as though internal to that market (e.g. if the LLU market provides Network Components to WLR or WBA, then the cost of these Network Components should not be charged through the transfer charging mechanism, but it should be allocated directly to WLR or WBA).



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

eircom does not believe that the Core and Access networks should be retained as separate network statements in future Separated Accounts. The distinction between the Access and Core networks derives from the previous regulatory regime when the focus of regulation was on voice traffic conveyance and product based regulation. This resulted in the PSTN network being the main concern for regulators and, as PSTN costs are deemed to be sensitive either to the volume of core traffic (calls and minutes) or the number of access lines, the line card was felt to determine the boundary between access (line sensitive) and core (traffic sensitive) networks.

However, subsequent technology, product and regulatory developments imply this distinction is less relevant at both the network and service levels. In particular, the line card boundary is only relevant for PSTN switching and this is declining in its relative importance as a network resource. Also, at present all DSL related network costs sit in the Access Network statement but these include an increasing share of inter-exchange transmission backhaul that is on the switch side of the line card.

Rather than separate Access and Core statements, eircom propose a single network statement. This will still maintain the line card boundary for line sensitive and traffic sensitive PSTN switching costs for the purposes of market attribution, but otherwise aggregates the Access and Core network statements.

The revised network statement should also include Network Elements that are defined on the basis of the primary type of technology that is being deployed. This is in contrast to many of the Network Elements in the present Access and Core statements, which were often defined on the basis of products supported, e.g., leased lines, DQ, international. As a result a Network Element such as leased lines could be made up of different technologies including transmission networks and data management platforms as well as different network activities such as Provision and Repair. Redefining the Network Elements so that they are categorised on the basis of shared technology or whether they share cost drivers could serve to increase the transparency of cost allocations and facilitate future pricing reviews. Indeed many of the misunderstandings that have arisen between ComReg and eircom in the course of previous pricing reviews were due to the fact that the Network Element structure had not evolved sufficiently to meet changing regulatory needs.

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

In relation to the Separated Accounts, eircom has a number of disagreements in respect of the detailed form and content, which we have presented in our responses to the individual disclosure questions.

In respect of the AFI, eircom welcomes the overall dual reporting framework, with certain disclosures being limited to this private reporting to ComReg. However, eircom believes that it is critical to acknowledge that the purpose of the majority of information proposed for AFI is to facilitate ComReg reviews of various pricing submissions. In this context we believe that the precise form and content of the AFI for a particular period should be based upon ComReg's proposed work programme

for the period. As such, eircom believes that there should be no permanent elements to the AFI and that the form and content of the AFI should be the subject of periodic review and agreement. It is also important to note that the exact requirements of the AFI for a particular period must be agreed in advanced between eircom and ComReg, to facilitate the preparation of these statements.

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

eircom fundamentally disagrees with the format proposed by ComReg in the relevant Appendices of the Draft Direction for the reasons set out in the responses to the individual disclosure questions. For that reason, we have submitted in response to question 7 above, an alternative set of pro-forma statements which we believe meet ComReg's key transparency expectations and, at the same time, are proportionate and reasonable. These pro-forma statements are re-submitted to ComReg in association with this current Consultation Response.

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

eircom concurs with the need to demonstrate that the Separated Accounts have been appropriately derived from the underlying statutory financial statements. We therefore agree with the proposal for reconciliation between the Separated Accounts and the statutory financial statements. eircom notes that it currently publishes a similar reconciliation as notes to the HCA financial statements, specifically notes 11 and 12. We have included a revised proposal in relation to this reconciliation in our attached proposed pro-forma.

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

eircom concurs with the proposal to remove the rate of return adjustment, as we believe that this element is outdated, and now serves to reduce the level of transparency over eircom's financial performance.

In relation to the “as at” requirement for mean capital employed, eircom fundamentally disagrees with this proposal, which is at odds with best practice adopted in all of the jurisdictions in our benchmark group. We therefore propose that the basis of preparation for capital balances should continue to be mean capital employed. This is consistent with the ERG guidelines, which state that:

“For price-setting purposes, NRAs and operators will be concerned with average capital employed during any period rather than with capital employed

at a single point in time such as the end of the financial year. This is because a 'snap-shot' at any one point in time may not be representative of the average level of capital employed by operators. Specifically, working capital balances at a single point in time may not be representative of average working capital requirements over an extended period. The separate accounts of operators should therefore show average capital employed, rather than year-end balances, calculated using a geometric average between the beginning and the end of the fiscal year." (paragraph 5.3).

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

eircom agrees with ComReg's requirement to provide a narrative in respect of the financial performance of individual markets. However, we consider that the proposed format of commentary and narrative explanations is excessively onerous and unprecedented. It requires eircom to prepare commentary covering expected future trends and events and how these might impact the business. It also appears to suggest that eircom should prepare commentary at service level. We note that, based on analysis of the published information available in a sample of a further five jurisdictions (Belgium, Guernsey, Romania, France, Italy), it may be observed that commentaries to the statements are not commonly requested. In parallel, BT presents a short high level review at Market Group level for Access and Other Wholesale market groups, followed by a market level review which includes: market definition, key regulatory changes and key market changes. There is no compelling argument or evidence to suggest that the provision of commentaries in excess of those provided by BT, would be of value to ComReg in understanding eircom's regulatory financial statements.

eircom believes a proposal consistent with international practice would be to narrow this requirement to a set of explanatory notes for market groups "Access Wholesale" and "Core Wholesale" and a more limited commentary for "Retail", with a similar form and content to that currently disclosed in BT's accounts, and at the same level of detail. Additional commentaries may be provided for each regulated market, including short definition, key changes in the regulatory requirements and key market changes, again based on BT's example. However, eircom is of the view that, although the commentary can be published with the audited Separated Accounts, there should be no obligation to have an external Audit Opinion provided in respect of that commentary. This approach would be consistent with statutory reporting obligations and the UK regulatory reporting environment whereby the auditor is required by audit standards to read this additional information and report by exception if they believe it is materially inconsistent with the audited financial statements.

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

eircom is unclear about the relevance and benefits of repeating this information in both the Accounting Documents and Separated Accounts, particularly as it is clearly

stated in the introduction to the Separated Accounts that they must be read in conjunction with the Accounting Documents. This requirement should be either completely removed or at least replaced with a very high level description of the basis of preparation in the Separated Accounts, similar to BT's accounts and to eircom's current accounts.

Issues such as "income recognition policy, depreciation policy, capitalisation policy", proposed by ComReg to be included in the basis of preparation of Separated Accounts, are more appropriately included in the Primary Accounting Documents, following the common practice including BT (see section "4. The Accounting Policies" in the Primary Accounting Document published by BT). BT's Separated Accounts include a chapter called "Basis of preparation", which describes the key differences between the Statutory Accounts and the Regulatory Accounts, the key features and objectives of the regulatory costing system and the content of the Accounting Documents. However, the comprehensive basis of preparation is included in the Primary and Secondary Accounting Documents. In summary, the BT approach seems to be a more appropriate template.

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

eircom disagrees with this proposal. Given the relatively low values typically associated with disposals, the requirement to disclose profit/loss on disposals seems disproportionate. Moreover this is not a proposal that is practiced in any international benchmark location.

In the event that eircom conducted an exceptional and material disposal of fixed assets, eircom would propose to disclose to ComReg, the effect of such transactions within the AFI.

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

The cost of preparing top-down CCA statements for the services indicated above would be significant given the extensive data gathering that would be required. Therefore, given the high cost of complying, eircom considers it critical that ComReg only consider this requirement if it genuinely represents the least burdensome remedy to address a specific regulatory need. In the absence of knowing what added benefit would be gained by the production of these accounts, eircom must disagree with the proposal.

In relation to the Capital Maintenance concept to be used, eircom agrees with the ComReg's proposed approach for the Financial Capital Maintenance (FCM). This approach is currently in use by eircom and has been supported by accounting industry and is embedded in CCA reporting standards such as SSAP16 and the

"Accounting for the effects of changing prices: a Handbook" published by the Accounting Standards Committee in the UK.

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

Fundamentally eircom believes it is critical to acknowledge that Separated Accounts are financial statements, and as such should follow accounting principles. In this context we believe that any proposal to breach these accounting principles in order to more closely align the statements with any individual pricing model currently being used is wholly inappropriate.

For this reason, eircom disagrees with the proposed approach that life to date holding gains and losses ("HGL") should be amortised over the life of the asset. This proposed approach is a deviation from the FCM concept suggested by ComReg in its Draft Accounting Direction (paragraph 5.139) and moves the Regulatory Accounts away from their intended purpose, in order to satisfy requirements more appropriate to price setting models. It is also unprecedented, as this approach is not adopted in any of our benchmark operators which face CCA obligations. Furthermore CCA guidance issued by the European Regulators Group (ERG) supports the use of FCM without any modification and does not include such amortisation of HGL.

ComReg seems to believe that the proposed methodology will 'smooth' the P&L impact of holding gains or losses coming from pricing movements. However, this is only valid in those cases where asset price movements are uncertain and volatile in both directions. In those assets where the value continuously decreases the proposed treatment ("Option 2") will produce a higher P&L charge towards the end of the life of the asset compared to a pure FCM approach ("Option 1"). In a similar fashion, an asset that consistently increases in price every year will eventually cause large positive P&L charges. In these cases the effect of ComReg's proposal will be to systematically misstate the economic value of the assets and the annual capital costs flowing from the asset.

Additionally, ComReg appears to imply in paragraph 5.93 that a charge resulting from the movement GBV to GRC will be taken to the P&L in the first year of CCA accounting. To clarify, the CCA methodology includes both opening and closing balance valuations. HGL P&L movements will exclusively result from price movements in the reporting year. Significant movements in previous years will not result in P&L charges under first year CCA reporting. The movement from historic to current asset cost will only impact the actual asset values in terms of GRC and NRC and thus the capital cost.

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

eircom refers ComReg to its proposed statements and schedules where it proposes that HCA and CCA cost items will be presented in the same set of Accounts. [X] Therefore eircom disagrees with the need to produce any further reconciliation between HCA and CCA accounts.

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

In this response eircom has set out our objections to the proposed level of granularity of the Separated Accounts and AFI. However, in the event that ComReg continues to require distinct Separated Accounts for HCA and CCA, eircom does not see the immediate regulatory need for the same level of granularity to be required in CCA as necessary for HCA.

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

eircom is of the opinion that a reconciliation of costing data provided for pricing purposes with the top down CCA accounts is impractical and may be unachievable. However, where cost information from the Separated Accounting is directly incorporated into pricing models eircom is content to demonstrate consistency on an ad-hoc basis.

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

ComReg appears to have based its proposal on Ofcom's requirement that BT should submit the Separated Accounts within 4 months from the year end. However, ComReg doesn't appear to recognise that BT has faced serious difficulties in complying with this requirement. BT's Current Cost Financial Statements for the year ended 31<sup>st</sup> March 2008 were first published on 16<sup>th</sup> September 2008 (5.5 months after year end), and for the year ended 31<sup>st</sup> March 2009 on 13<sup>th</sup> August 2009 (4.5 months after year end).

Following the existing methodology, eircom currently submits the Separated Accounts within 6 months from the year end, and its significant current resources are fully utilised in achieving this obligation. In comparison to BT, which can afford to keep a substantial team dedicated to the production of the accounts within a shorter timeframe, eircom does not have, nor can it afford, a similar level of resources.

Therefore it is clearly unrealistic to be able to comply with the 5 months deadline in the first year and 4 months in the second year proposed by ComReg, especially as it is in parallel with the implementation of the new Accounting Direction. Even under the existing obligations, eircom faces challenges meeting the 6 months deadline for Regulatory Accounts submission. Therefore it is excessive to demand significant changes within an even shorter timeframe.

In the long term eircom needs to aspire to a shorter timeframe. However in the short term the deadlines need to be more reflective of the increase in requirements. Over

time eircom should then be able to work at shortening the timetable. eircom would propose that a more reasonable timeframe could be 7 months for the first production of the accounts based on the new requirements, decreasing to 6 months for the subsequent year and finally to 5 months for the combined HCA/CCA statements.

A survey of practice in other jurisdictions showed that six months is the most common timeline granted to operators for submission of Separated Accounts post year-end. Even so, operators often struggle to produce the accounts within this timeframe.

Given the level of detail in the accounts that eircom is required to produce, eircom is likely to need more time than other jurisdictions.

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

Assuming the Accounting Direction will become effective in the first months of 2010, it is possible that the Primary Accounting Documents may be submitted before the start of the financial year 2010/11 (i.e. by 1<sup>st</sup> July 2010). However the submission of the more detailed Secondary Accounting Documents within this deadline is not practical. The same requirement is already impossible for year 2009/10, as the deadline has expired.

The Secondary Accounting Document includes details of the allocations and the accounting treatment of various Network Components and Activities, which would not be fully known until the end of the financial year (after new technologies have been deployed, the new services launched, new allocation methods defined and the availability of data assessed). It is therefore impractical to provide documentation regarding such methodologies before the end of the accounting period for which accounts are prepared.

It would be more practical to supply ComReg with the proposed methodologies for various significant cost items at the time when the details of the cost components are known, but at least six months before the Separated Accounts submission, for the first two years after the Accounting Direction effective date. This would be effective for both eircom and ComReg, allowing the latter to perform a comprehensive review of the methodologies over a larger time span. Analysis of our benchmark group revealed that in the first year of implementation of a Decision, it is common that most regulators require a draft methodology to be submitted for review or approval before the submission of accounts. However, there is no precedent for documentation to be submitted more than one year before Separated Accounts submission (e.g. Spain – five months before accounts submission). However, the extent of the Accounting Documents in most jurisdictions is far less than is proposed by ComReg.

In conclusion, we concur with the principle of ComReg receipt of the Accounting Documents prior to the publication of the Separated Accounts, particularly in the first year. However the timeframe proposed by ComReg is too onerous given the proposed scope and detail of the documentation. Further, ComReg’s proposed

timescales are impractical given that submission of documentation would precede the actual events that the accounts are intended to report.

It should also be noted that any Accounting Documents provided to ComReg prior to accounts finalisation will be by definition be draft in nature, as they cannot be finalised until the accounts are final and audit is completed. This fact should be recognised in the final Direction.

**28. Do you agree or disagree with ComReg’s preliminary proposals with regard to Auditor Independence, Duty of Care, Auditors Letter of Engagement? Please detail your response in full.**

This question addresses three different topics and we set out below our response to each of these separate matters.

**Auditor Independence**

We agree with ComReg’s view that it is necessary for an auditor to have appropriate resources and capability and to maintain their independence of the preparer of the financial statements they are being asked to audit. Indeed we understand that under the auditing profession’s ethical and technical guidance these are matters that any registered auditor would need to satisfy themselves in respect of, prior to accepting an audit engagement.

On this basis, were ComReg to be a party to the audit relationship (see “duty of care” below), we believe it is reasonable for them to seek assurances regarding the appointed auditors independence and competence.

With regard to the skills and experience necessary to undertake the audit ComReg suggests in paragraph 7.16 of the Consultation Document that a “cost” auditor be appointed to perform the “audit of the cost allocation system”. Given the scope of an audit of regulatory financial statements conducted in accordance with International Standards on Auditing (see response to question 29 below) we do not believe that there is any justification for requiring a separate “audit” of the cost allocation system.

**Duty of Care**

The Draft Direction does not introduce any definitive requirements in respect of duty of care with regard to who the regulatory auditor will contract with, who they will address their reports to and to whom they will acknowledge a duty of care.

However, the Consultation Document states that “a duty of care should be owed by the auditor to ComReg, through the letter of engagement and audit opinion being provided to ComReg” (7.46) and makes reference to the ongoing project by the Institute of Chartered Accountant in Ireland (ICAI) to introduce definitive guidance for the accountancy profession with regard to reporting to regulators of regulated entities.

We note the international precedent for such an arrangement in the UK and elsewhere, and we see some merit in the introduction of a tripartite relationship between eircom, ComReg and the auditor. Clearly any such arrangement would need to be codified through an engagement contract acceptable to all parties and in the absence of definitive guidance from the ICAI we note the existing guidance from the UK (“Reporting to Regulators of Regulated Entities” (Audit 05/03) issued by the



Audit and Assurance Faculty of the Institute of Chartered Accountants in England and Wales in October 2003.)

### **Auditor’s Letter of Engagement**

The Consultation Document proposes that the auditor’s engagement letter should “set out the audit tasks that need to be performed” and contains a description (7.67) of the scope of work of the auditor and that this should include a requirement to:

- verify compliance with the requirements of the accounting Direction
- review the Accounting Documents on an annual basis
- audit the Separated Accounts and the Additional Financial information
- conduct an audit of eircom’s cost allocation system in accordance with the principles and guidance set out by bodies representative of the Irish accountancy profession
- review processes and procedures employed by Eircom
- review statistical sampling processes employed to identify volumes and/or revenues.

We note that this list of requirements differs from the list provided in paragraph 7.23 of the Consultation Document and it is not clear to us whether ComReg sees each of these requirements as a separate exercise or as elements of the work expected to be completed by the auditor in order to form their opinion on the regulatory financial statements. For the purposes of this response we have assumed that ComReg views these as elements of work required to support an audit opinion on the regulatory financial statements. We have dealt with this point in further detail in our response to Question 29 below.

In our view it is reasonable for ComReg to seek a reasonable level of assurance over the regulatory financial statements and such assurance would be provided by an audit conducted in accordance with International Standards on Auditing (UK & Ireland) (“ISA UK&I”). We understand that an audit conducted in accordance with ISA (UK&I) would be required to consider the costing systems, control environment and the appropriateness and robustness of data supporting the financial statements to the extent the auditor believes is necessary to support their opinion.

If our interpretation of these requirements is wrong and ComReg is actually proposing that reviews of processes and procedures or statistical sampling processes are undertaken in addition to those determined by the auditors as being necessary to the audit of the regulatory financial statements then we would strongly object to any such a proposal which we believe would be wholly inconsistent with international practice and would be inconsistent with the requirements of Regulation 24(1) (a) of the Framework Regulation which require that separated accounts be “*audited in accordance with generally accepted auditing practices for the activities associated with the provision of that network or service,.....*”, a requirement which is met fully by the conduct of an audit in accordance with ISA (UK&I).

We note that ComReg has made clear in its Draft Direction that it is not its intention to impose an excessive cost burden on eircom as a result of this project.

**29. Do you agree or disagree with the preliminary proposal that a “Fairly Presents in Accordance with audit opinion” is appropriate for both the Separated Accounts and Additional Financial Information? Do you agree or disagree with the preliminary proposal that there is a need for ComReg to obtain an opinion with regard to Eircom’s compliance with its Cost Accounting obligations, in addition to its compliance with the requirements of the accounting Direction? Please detail your response in full.**

This question deals with a number of separate issues:

- The appropriate forms of opinion in respect of the published Separated Accounts
- The subject matter for the auditors opinions (e.g. Separated Accounts, individual markets, products and services)
- The need for assurance over AFI to be provided only to ComReg
- The need for assurance over compliance with other aspects of the Accounting Direction.

### **Nature of Audit Opinions**

ComReg proposes that audit opinions be required in the form “fairly presents in accordance with..” and asserts that this level of opinion is required in order to provide ComReg with “the necessary assurance that the information provided in Eircom’s Separated Accounts is relevant, reliable and of a high quality.”. However, elsewhere in the Consultation Document ComReg has recognised the fact that in other jurisdictions the nature of assurance required by regulators is tailored to reflect the specific nature of the information and actual assurance required. For example, where detailed costing methodology information is available to the regulator such that they can make their own assessment of the costing methodologies employed, we believe that “properly prepared in accordance with...” provides reasonable assurance that the detailed costing methodologies have been followed in all material respects.

ComReg’s proposal to seek opinions in the form “fairly presents in accordance with...” seems to be based, at least in part, on a misunderstanding of the scope of the audit currently conducted for eircom. If a tri-partite audit arrangement is to be entered into in future under which our auditors formally acknowledge a duty of care to ComReg then it is vital that the audit requirements determined for that new regime are based on a proper understanding of the nature of the audit work currently undertaken and the implications of proposed changes on cost and timeliness of reporting.

Paragraph 7.5 of the Consultation Document states:

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

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

We believe this represents a serious misunderstanding of the report of the independent auditors on the Separated Accounts. The separation of the statutory and regulatory audits, such that the underlying general ledgers used in the preparation of the statutory financial statements are used as a given starting point in planning and executing the audit of the regulatory financial statements, is common practice. The audit of the regulatory financial statements focuses on attribution of the revenues and costs to the regulatory businesses. This is also clearly set out in the audit report on the regulatory financial statements of BT Group plc which states that the auditors:

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

ComReg notes that it appears from the statement made by the auditors of eircom that its audit “is not consistent with the guidelines of the ERG.” and that “PwC has not performed any tests over and above that which is required for the Statutory Financial Accounts e.g. audit of cost allocation system at the market, service and product levels”.

We believe the current audit is entirely consistent with the guidelines of the ERG.

eircom believes that an overall audit opinion in the form “fairly presents in accordance with...” in respect of the published Separated Accounts taken as a whole is a reasonable request.

### **Granularity of Audit Opinions**

Whilst it is not set out explicitly in the Draft Direction the Consultation Document implies that ComReg is seeking to impose audit requirements not only on the Separated Accounts as a whole but also to seek separate opinions in respect of individual markets and even individual services.

If an audit requirement is applied to individual markets or services within the Separated Accounts then the auditors assessment of materiality will reduce accordingly. As a direct result of this the level of work and complexity of judgement assessments required of the auditor will increase.

As ComReg have noted, a requirement for the auditor to provide audit opinions in the form “fairly presents in accordance with...” in respect of all regulated markets in the UK resulted in numerous technical qualifications to the audit opinions issued by Pricewaterhouse LLP. We understand that given the highly integrated nature of telecommunications costing models where common network and overhead costs are attributed to many network elements and services the auditor is required to make an assessment of the reasonableness of the costing methodologies as they relate to each separate opinion.

Consequently, if a particular item of cost is attributed to 20 markets or services and an audit opinion is required for each the auditor would be required to determine whether this costing methodology was both objective and cost causal with regard to each of these 20 markets.

This level of detailed judgement can rapidly become impractical and lead to the auditor being required to qualify their opinion.

In addition to this the lower levels of materiality associated with auditing small markets or individual services requires the auditor to perform detailed substantive testing over a wide population of relatively small cost attributions. We believe a requirement to provide audit opinions on all regulated markets and services could

result not only in numerous qualifications to the auditors opinions but also to a significant and disproportionate increase in audit costs.

In our view this would be inconsistent with ComReg's statement that "it is not its intention to impose an excessive burden on Eircom, in the form of high audit costs." Whilst eircom are willing to bear the costs of having its Separated Accounts audited at an appropriate level, the obligations must be proportionate to ensure the overall costs are controlled.

eircom believes that an audit regime similar to that currently in place in the UK, while recognising the difference in scale between eircom and BT, could be a more reasonable and proportionate approach providing ComReg with sufficient comfort through a combination of:

- the existence of more detailed documentation of costing methodologies;
- the ability to request audits of individual market data within the Separated Accounts, on a "fairly presents" or "properly prepared" basis as appropriate, where this is required to meet a particular regulatory need; and
- a mechanism for agreeing and procuring additional specific procedures ("agreed upon procedures") of individual aspects of the regulatory costing process, where considered necessary, through the tri-partite audit relationship;
- a tripartite audit relationship through which ComReg could place reliance on the audit of the overall published Separated Accounts.

A tripartite audit relationship could provide ComReg with the ability to consider the appropriateness of costing methodologies and as a result audits of selected individual markets in "properly prepared in accordance with..." form could provide ComReg with sufficient assurance over markets where there is a particular need for assurance.

### **Audit of AFI**

ComReg has stated in the Consultation Document that they envisage eircom procuring an audit in respect of both the published Separated Accounts and the AFI. We note however that this is not carried over into the Draft Direction which specifies audit requirements in respect of the Separated Accounts and compliance with the Direction only.

As we explain above, we believe there are significant practical difficulties and potentially disproportionate costs associated with a requirement to procure audit opinions in the form "fairly presents in accordance with..." in respect of very granular AFI requirements not least because the form and content of this AFI is not yet defined.

In our view it is inappropriate for ComReg to define a form of audit assurance in respect of undefined data with no regard to the nature and purpose of the data.

We set out above our views on appropriate audit requirements which include the ability for ComReg and eircom to agree from time to time on the scope of additional detailed testing to be performed on aspects of the costing model through a separate engagement between eircom, ComReg and the auditors.

## Other Audit Requirements

In addition to the proposed audit of the Separated Accounts the Consultation Document and Draft Direction also propose a number of additional audit requirements on eircom including:

- ensure that the processes and procedures used by Eircom be subject to a review by a competent independent reviewer on an annual basis
- engage a competent independent body to conduct an audit of its cost allocation system.
- engage a competent independent body to verify compliance with this Direction,
- ensure that any statistical sampling conducted to identify volumes and/or revenues be subject to an external and independent review on an annual basis.
- ensuring that the Accounting Document is subject to review by a competent independent body annually;

It is not clear from the Consultation Document whether ComReg's intention was to impose additional audit requirements over and above the audit of the Separated Accounts or whether this language was intended to merely clarify some of the matters that an auditor would be expected to consider in conducting an audit of the Separated Accounts.

If these are intended as separate additional audit requirements which would require separate opinions from an auditor then they would represent an exponential increase in the audit burden and would, in our opinion, be wholly out of line with international best practice.

With regard to the requirements in respect of processes, procedures and the cost allocation system, we note that auditing standards require an auditor to obtain an understanding of the entity's information system relevant to financial reporting. The auditor is also required to obtain a sufficient understanding of control activities to assess the risks of material misstatement and to design audit procedures in response to this risk assessment. Therefore, an audit performed under ISAs would require an assessment of the underlying information systems and processes relevant to the Separated Accounts including the cost allocation systems.

An additional requirement to provide a separate audit opinion on the cost allocation systems would be a very significant and expensive exercise akin to the introduction of reporting on internal controls under Sarbanes Oxley legislation.

The proposed wording of the requirement for an audit of compliance with the Accounting Direction is also likely to result in significant additional audit costs for eircom. An audit of the Separated Accounts would have to consider whether those accounts had been drawn up in compliance with the Accounting Direction.

However, the Draft Direction requires the auditor to consider compliance with all aspects of the Accounting Direction not just with regard to the Separated Accounts.

For example this requirement would overlap with the requirement to opine on compliance with the appropriate use of statistical sampling. The Draft Direction imposes a statistical accuracy requirement of +/-1% at the 95% Confidence Level wherever statistical sampling is used. This is an extraordinarily high and impractical

threshold and one that would not be required to meet the requirements of an audit of the Separated Accounts.

For example if statistical sampling were used to attribute a cost category that was not significant in total or to any individual market this +/-1% accuracy at the level of the sample could translate to an impact of a small fraction of a percent when the cost item is considered in the context of the overall costs of even a small market. Clearly, an auditor, applying their professional judgement, would not require the sample to meet this level of accuracy. Therefore the situation would arise where the auditor would apply their professional judgement in considering the impact of sampling on the financial statements and then have to report separately on the compliance of all samples with this accuracy threshold.

There are many other aspects of the Draft Direction, unrelated to the preparation of the Separated Accounts, which would also need to be considered by an independent auditor at significant cost if this requirement is retained in its current format.

Finally with regard to the proposed review of the Accounting Documentation we note that the auditor is required under auditing standards to consider the company's accounting policies such that an audit of the Separated Accounts resulting in a "fairly presents in accordance with..." form of opinion would require the auditor to assess whether the material detailed costing methodologies were appropriate to implement the principles of cost attribution such as objectivity and cost causality. In this context, without further detailed justification and explanation of scope we can see no need for, or benefit of, a separate review of the Accounting Documentation as this is essentially already a part of the audit process.

**30. Do you agree or disagree that the audit report should set out details of the systems testing conducted, auditor assessment of estimates and judgements and the application by Eircom of accounting policies? Please detail your response in full.**

We note that the Draft Direction (section 9.1(c)) does not include the full proposals as set out in the Consultation Document stating that "The report should set out details of the tasks performed". The Consultation Document includes the following further detailed proposals saying "*the audit report should set out in greater detail the specific tasks undertaken by the auditor to satisfy itself that eircom is complying with its obligations (e.g. the Accounting Direction) including details of the systems testing undertaken to verify the appropriateness of its cost allocation/apportionment process, assessment of estimates and judgements made, application of accounting policies etc*"

We disagree with these proposals as we believe they are inconsistent with the requirements of ISA (UK&I).

If in accordance with European guidance, ComReg is seeking the opinion of an independent auditor, then that opinion should be reached in accordance with ISA (UK&I). In this case the opinion would be required to refer to the standards used in the conduct of the audit and a summary of the work conducted. It would not specify the detailed procedures adopted and the specific tests conducted.

Further with regard to the proposal that the auditor set out its assessment of estimates and judgement we note that an audit opinion is provided on financial statements as a whole and not on each individual estimate or judgement used in the preparation of those financial statements.

Having said this it appears that ComReg's proposals in this area may be based on a misinterpretation of the scope of the audit of eircom's existing separated accounts. The Consultation Document includes the following statements:

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

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

And

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

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

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

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

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

As has been noted previously in correspondence to ComReg, and as set out above, we believe these statements misrepresent the nature and scope of the audit of eircom's separated accounts. The separation of the statutory and regulatory audit engagements and the use of the general ledgers used to prepare the statutory accounts as a starting point for the regulatory accounts preparation and audit processes is in line with international best practice and, in our experience, the audit of the regulatory financial statements includes extensive testing of each of the areas noted in the ERG guidance above.

We also note that the inclusion of the paragraph noted above is wholly consistent with the audit opinion issued in respect of the BT Regulatory financial statements.

**31. Do you agree or disagree that the accounting Direction should include an obligation on the Board of Directors to include a statement in the Separated Accounts acknowledging their responsibilities for the preparation of the Separated Accounts and verifying Eircom compliance with the requirements of the accounting Direction? Please detail your response in full.**

The current Separated Accounts include a statement of director's responsibilities, which includes the acknowledgement. On this basis eircom agrees with the continuation of this obligation.

**32. What is your view of the preliminary proposed timelines for compliance? Please detail your response in full.**

eircom holds a number of fundamental concerns over the proposed compliance timeline, given the likely date of a final Direction and the nature and extent of ComReg's current proposals.

Firstly, eircom is not in a position to produce a detailed programme for compliance in advance of the publication of a final Direction. The current deadline, as set out in the Draft Direction, for receipt of this document is 28<sup>th</sup> February 2010. We believe it is highly unlikely that a final Direction will have been published by this date, and eircom will clearly require sufficient time to prepare the programme for compliance. In this context eircom suggests that the deadline for this programme for compliance be amended to be within four months of the publication of the final Direction.

Secondly, as a matter of practicality, it is necessary to point out that the current Consultation is taking place during the eircom 2009/10 financial year and is unlikely to be finalised until the fourth quarter of this financial year. Setting aside any legal questions as to the potential retrospective application of regulatory obligations, the production of accurate regulatory information is predicated upon the contemporaneous capture of representative data for the period concerned. As a result, eircom must point out that, given the current time line for publication of the Directive, we believe that in practice no substantial progress towards compliance in relation to any area involving the attribution/disaggregation of financial balances is possible in respect of this financial year.

However eircom is content to provide ComReg with a proposal in respect of interim enhancement of documentation in 2009/10 as a step towards full compliance in respect of the 2010/11 financial year.

As a result of the points noted above the maintenance of the existing timeline for full compliance, essentially requires eircom to make the transition to the new reporting framework in one financial year. The practicality of this deadline is clearly dependent upon the nature and extent of the obligations proposed by ComReg. We have already set forth in the other elements of our response the objections that eircom holds over a number of the requirements. We would add here, that in addition to being dis-proportionate, the obligations as currently set out in the Draft Direction cannot be appropriately completed within one financial year. Therefore, taking into account the remainder of the Draft Direction as currently structured, eircom disagrees with the proposed timeline, and suggest that a deadline of 2011/12 would represent the minimum appropriate deadline for full compliance.



eircom has set forth in the other elements of our response an alternate set of obligations that we consider to be both proportionate and in line with ComReg's reporting objectives. In the event that these revised obligations are adopted, eircom would be happy to withdraw its objection to the 2010/11 deadline for full compliance.

**33. Do you agree or disagree with the content of the proposed accounting Direction (including Annex's attached) and whether it is proportionate and justified? Please detail your response in full from a commercial, practical and legal perspective.**

The Draft Direction sets out the ComReg's proposals as detailed in the Consultation paper above. As has been made clear from our detailed responses to these individual ComReg views, eircom holds a number of fundamental objections to the proposed reporting obligations. Therefore, taken as a whole, eircom does not agree that the Draft Direction is either proportionate or justified.

For reference, eircom summarises here its key objections:

- Disclosure of Separated Accounts at a product level
- Disclosure of Separated Accounts for Non-SMP markets, services and/or products
- Application of a fixed level of statistical accuracy at an individual sample level.
- Disclosure of manual adjustments in the terms defined by ComReg
- Reconciliation of costing data provided for pricing purposes
- Split of costs for each service and product between Direct, Indirect and Common
- Potentially unprecedented requirement for documentation
- Proposed time line for publication of the Separated Accounts and AFI

We attach for reference under the condition of strict confidentiality, an amended version of the Draft Direction which we believe represents a proportionate and justified set of reporting obligations.

**34. Respondents are requested to provide views on whether there are other factors (if any) that ComReg should consider in completing its Regulatory Impact Assessment? Please detail your response in full.**

eircom holds a significant number of objections to the RIA as currently conducted by ComReg, beginning with the entire underlying premise that it has been conducted under. As correctly stated the purpose of the RIA is to identify the regulatory options available to ComReg, assess the impact upon the differing stakeholders of those options, and subsequently make a determination as to the appropriate option to select. In performing this assessment ComReg has identified two potential options;

- Option 1: Do nothing
- Option 2: Implement Draft Direction as currently stated

This is a patently incomplete set of alternative options. Obviously ComReg has the option of implementing alternate measures to those currently stated in the Draft

Direction. This possibility has been ignored by ComReg, and in our view results in a fundamentally flawed approach. Indeed the entire basis of eircom's response is based upon acceptance of the need to change (i.e not option 1), but points out the various points in which the Draft Direction as currently stated does not represent the most appropriate choice (i.e not option 2). Thus our core argument has been completely ignored by ComReg in their RIA.

The remainder of the RIA has been conducted on the basis of assessing option 2 in light of six core principles;

- Appropriateness/necessity
- Effectiveness
- Proportionality
- Transparency
- Accountability
- Consistency

eircom concurs with these general principles for the conduct of the assessment. The RIA includes an assessment of the obligations as a whole against these principles. eircom believes that in relation to at least three of these principles (Necessity, Proportionality, Consistency) this is inappropriate as in our view it is essential that they are assessed on an individual obligation basis. We consider this to be a critical omission from the RIA. In addition, ComReg's contention that it has met the consistency objective by following best practice cannot be sufficiently demonstrated by its comparison to a limited benchmark group. Indeed the benchmark group only include two Telecom operators, and in fact the benchmark group is biased further as the data for one of these operators was based upon an interim Consultation, rather than the actual final requirements. Given the importance of this assessment this is clearly deficient, and eircom would expect ComReg to contest the validity of evidence of any operator submission based on such a flawed premise.

The next step of the RIA is represented by a table purporting to demonstrate the impact upon stakeholders. Clearly we are best placed to comment on the "impact on eircom" element of this table. In this context we would contend that the analysis currently presented systematically understates the level of impact and associated costs of the measures that it proposes. This is clearly demonstrated by the size of the cost of implementation estimate detailed in response to question 35.

Finally, we note that ComReg has not attempted to perform a quantitative analysis of the impacts upon the stakeholders. Given the very significant costs that the proposed measures will levy upon eircom, and potentially all market operators as we consider this to represent a relevant cost for all wholesale charges, we consider this to be another critical omission. Fundamentally ComReg has provided no evidence that the benefits of the measures as stated outweigh these significant costs.

Indeed this error is compounded by the use of implied quantitative comparisons of cost/benefits without any support whatsoever. For instance in the section on the submission of Regulatory Accounts and AFI is the following impact upon eircom

"This will involve additional work for Eircom in producing its Separated Accounts but it will be more than offset by improvements in regulatory process"

No support has been presented for this contention, or any other similar item in the RIA.

**35. Respondents are requested to provide views on the likely cost of full compliance with the proposed accounting Direction. Please detail your response in full.**

Computing a precise cost of implementation for ComReg's proposals would require a detailed scoping exercise, which eircom cannot complete at this stage. However eircom has conducted a preliminary exercise to determine a range of cost within which we believe the cost of implementation would fall.

Despite ComReg's contention in the RIA that much of the data for the new reporting structure is already available in eircom's systems, the changes to eircom's reporting obligations will, in fact, have a very significant impact upon eircom. As currently drafted, the proposed Accounting Direction would require, at a minimum, the following incremental workstreams;

➤ **Accounting Separation Model**

Significant changes to the underlying Cost Accounting system to encompass the new market structure, an appropriate transfer pricing model and ComReg's proposed sampling requirements. In particular the specific proposals in respect of the dramatic expansion of the granularity of the model to cover all individual services and the imposition of a 95% confidence at +/- 1% accuracy level, would require significant adjustments to be made to the current model.

➤ **Separated Accounts Disclosures**

Generation and review of a significantly increased number of new financial statements, accompanying narratives and additional cost/revenue disaggregations

➤ **AFI**

Production of the additional financial analyses proposed for the AFI, including product level reporting and cost/volume reconciliations

➤ **Current Cost Accounting**

Generation of current cost valuations for Access and non-conveyance assets

➤ **Documentation**

Production of extremely granular primary and secondary accounting documents according to the current ComReg specification

➤ **Audit**

Additional first year audit procedures to gain assurance over all of the incremental/amended system, procedures and disclosures identified above

We have examined each of these areas in turn and have calculated the following ranges of implementation cost:

[X]

This estimate only considers the most significant impacts of the ComReg's proposals. For example, the estimate given for the impact to achieve ComReg's sampling requirements has only looked at the material cost allocations, and therefore when the full population is reviewed, it is quite likely that that the true cost of implementation will be significantly higher than this estimate.

As stated throughout our response to these requirements, we consider many of the proposed obligations to be onerous and excessive. The underlying high cost of implementation arises from a number of key cost drivers within the ComReg proposals which have the effect of significantly contributing to this total:

❖ **Number of Products**

The current list of wholesale services and products submitted by ComReg is substantial, despite the fact that the revenue associated with many of these products is minimal. In addition, the proposals assert a similar need for non-wholesale services/product. As a result, the Cost Accounting model would require significant revision to incorporate this level of detail. [X]

❖ **Sampling Threshold**

The ComReg proposal requires the application of a sample level maximum error threshold of 95% confidence and 1% accuracy. This threshold ignores the significance of the sample concerned, or the impact of these samples on the financial statements themselves. This would result in, at a minimum, a dramatic expansion in sample sizes in all areas, and in some cases effectively prohibits the use of sampling. [X]

❖ **Current Cost Accounting**

The current ComReg proposal extends the remit of CCA from the inland conveyance network to all network assets, including access. As we have pointed out in our response, this proposal has been included in the absence of any intention to utilise this data in the area of price control, and it represents a significant task.

❖ **Documentation**

ComReg stated in their Consultation Document that their intention was not to emulate the BT Detailed Attribution Methods (DAM) document, with its associated significant cost. However the wording of the current proposal is, in fact, at least equal to the DAM, and in some areas goes beyond these requirements. As a result, the implementation of this requirement would represent a very significant implementation cost.

❖ **Audit Specification**

ComReg proposes the extension of the current audit requirement from the current business level opinions to encompass assurance at an individual service level. This represents a dramatic expansion of the scope of the audit, and we therefore estimate that this will have a similarly significant effect upon the level of audit fees. We also refer you to our comments in respect of inconsistencies between the Consultation Document and the Draft Direction, which have been dealt with in our responses above. Other additional potential requirements, such as the proposed requirement to opine on the overall systems and compliance with the Direction, would significantly increase the overall cost. We have noted that we disagree with these requirements and again emphasise that the inclusion of these requirements would have a significant impact on the overall audit cost.

In our responses above we have proposed a number of alternatives to these disclosures, which we believe, still meet ComReg's objectives, but have the effect of removing the most onerous tasks. [X] On this basis we believe, in the event that ComReg maintains its existing proposals, it is critical that ComReg justify within its RIA the incremental benefits which justify this significant incremental cost.

It should be noted that in addition to the initial implementation costs noted above, the proposals would also require significant ongoing costs in order to maintain the revised system. Particularly in the case of ComReg's proposals, much of this expenditure will be incremental to what are already significant operating costs.

## **Appendix 1**

As noted in the “Introduction” section of this response, eircom continues to believe that ComReg is proposing disproportionate and impractical costing and reporting requirements, which fail both to take full account of the differences between the Separated Accounting and Cost Accounting obligations. We examine below the implications of this omission.

### **Separate and Distinct Obligations**

There is no overriding “Regulatory Accounting” obligation imposed on eircom under the Regulatory Framework. Instead there are two separate financial reporting obligations – Accounting Separation and Cost Accounting. Clearly if the Council, Parliament and Commission had wished to impose a broader or more extensive Regulatory Accounting obligation they would have done so. The fact that these obligations are set out as separate and distinct obligations in the Access Directive and the Universal Service Directive indicates that the clear intention of the legislature was that they should be considered and implemented as separate obligations.

eircom believes that ComReg’s Consultation is ambiguous on this crucial point. At certain times it appears to acknowledge what eircom believes to be the correct position, that these are separate obligations. For example within the background section it correctly states that the Framework Regulations define two types of financial reporting obligations: Accounting Separation and Cost Accounting.

However in all other sections of the Consultation, ComReg dispenses with this distinction between the separate obligations and treats them instead as if they were different elements or outputs of a broader Regulatory Accounting obligation.

From eircom’s perspective it is critical that this ambiguity be resolved. Otherwise it will be impossible for it and for other market participants to gain a clear understanding on the legal and regulatory basis for the obligations that ComReg intends to impose on it and prevent a clear assessment of the extent to which these obligations are based on the nature of the problem identified, proportionate and justified.

eircom is concerned with the manner in which ComReg has blurred the distinction between these separate remedies, not for reasons of legal form, but because the net effect of treating them as common obligations has been to greatly increase the burden of financial information that it will be required to prepare, audit and publish. eircom does not believe that this enormous increase in the extent and degree of eircom’s reporting obligations is either justified in order for ComReg to satisfy its regulatory duties, or necessary in order to address specific competition problems. On this basis, the extent of the reporting obligations ComReg intends to impose is disproportionate.

### **Key Characteristics of the Separate Obligations**

Accounting Separation involves the preparation of a set of accounts that allocate the affected undertaking’s costs in a manner which enables verification of compliance with a non-discrimination obligation. There is no requirement that these accounts are to be audited or published.

While Cost Accounting systems are models that allocate costs to products based on particular cost allocation methodologies, a Cost Accounting obligation is specifically applied where an SMP operator is required to demonstrate compliance with a price control obligation. While the NRA and market players need to understand the underlying methodology used for allocating costs in the Cost Accounting system, the specific costs or cost components that are allocated are not to be published.

eircom submits that it is perfectly feasible to impose an Accounting Separation obligation without also imposing a Cost Accounting obligation or a price control obligation and vice versa. For example Regulation 14(5) of the Universal Service Regulations provides that an undertaking subject to retail tariff regulation shall operate and maintain a Cost Accounting system, without imposing a corresponding Accounting Separation obligation on such undertakings.

Therefore, eircom rejects ComReg's implication that Accounting Separation is a prerequisite to Cost Accounting obligations. This is clearly contrary to the Access Directive, the Access Regulations or the Universal Service Regulations and represents a fundamental misunderstanding of the nature of these separate and distinct obligations.

eircom submits that ComReg has not had sufficient regard to the regulatory purposes for which these separate obligations should be imposed in the first instance – in order to make transparent an SMP operator's wholesale charges and associated internal transfers between regulated markets in the case of Accounting Separation, and in order to support a cost-oriented price control obligation in the case of the Cost Accounting obligation. As a result, the document extends typical financial performance obligations associated with Accounting Separation, such as Profit and Loss accounts and Balance Sheets, to areas subject to Cost Accounting obligations, such as individual wholesale services.

### **Implications of Treating Accounting Separation and Cost Accounting as Common Obligations**

The manner in which ComReg has treated Accounting Separation and Cost Accounting as common obligations may be a function of its stated intention of aligning the Accounting Separation process and the price review process. As a result, eircom may be required to routinely provide sufficient data to allow ComReg to monitor every price that pertains in a market where eircom may have SMP. A consequence of this is that eircom is being asked, as part of its annual Separated Accounts submission, to produce and have audited a level of detail on a wide range of services on the basis that some of this detail may be needed to monitor a particular, but as yet unidentified, aspect of compliance. However eircom submits that there is no basis for the imposition of such significant ex-ante reporting obligations.

This undue regulatory burden is compounded by ComReg's proposal that detailed financial information may be required for non-SMP markets, ostensibly on the basis of the extent to which electronic communications services are characterised by common costs. In particular, ComReg's requirement that P&L's be produced down to the product level suggests that reviewing P&Ls is the only means of understanding cost and revenue attributions and for monitoring compliance with pricing obligations. eircom believes that this is an impractical and inefficient way of monitoring pricing obligations.

In addition, eircom is actively engaged with ComReg on a bilateral basis in producing an enhanced level of documentation, which, in itself, is a significant exercise. [3<]

In the Introduction to our response eircom set out the key criteria that it believes are critical to the proportionate application of these obligations. In our view the current ComReg proposals demonstrate a number of key inconsistencies with these criteria, which we set out below;

### **The tests that ComReg should apply when imposing these obligations**

Based on the above, eircom suggests a number of cumulative tests that should guide ComReg when considering the imposition of either an Accounting Separation or Cost Accounting obligation, or both. eircom believes that these tests reflect the objectives of the Framework and are faithful to the specific provisions of the Access and Universal Service Regulations which govern the imposition of these obligations.

### **Separate obligations**

ComReg should always have due regard to the fact that these are separate and distinct regulatory instruments that were promulgated in order to achieve separate regulatory objectives and that therefore there should be an *a priori* assumption that they are to be evaluated, imposed and implemented separately.

### **Consider the obligations in light of the objectives of the Framework**

ComReg should only seek to impose one or both of these obligations insofar as this intervention is justified in light of the objectives imposed on NRAs in Article 8 of the Framework Directive to promote competition, contribute to the development of the internal market and to promote the interests of EU citizens.

### **Necessary and proportionate**

Any obligations imposed must meet the requirements of Article 8 of the Access Directive that the particular remedy, or remedies, selected should be based on the nature of the problem identified and proportionate, such that the least burdensome effective remedy should be selected. eircom does not believe that ComReg has given due consideration to this requirement in light of the enormous increase in the financial reporting obligations that it is proposing to impose on eircom in this Consultation.

### **Do not require the undertaking in question to do one or more things that were not envisaged by the Regulation imposing the particular obligation**

eircom believes that in purporting to impose a number of proposed obligations, ComReg has departed from the actual provisions of the Access and Universal Service Regulations that address the obligations of Accounting Separation and Cost Accounting. In so doing, it has exponentially increased the regulatory burden on eircom, by requiring it to do things that are not envisaged by the particular provisions of the Regulations. This is most apparent in the imposition of audit and publication requirements.

**Have due regard to the regulatory purpose of each obligation**

eircom does not believe that ComReg has given due consideration to the actual objective that the separate obligations are intended to achieve, and that this, in turn, has caused it to intermingle the obligations such that they are, to a large extent, not anchored to their underlying regulatory purpose.

**Restrict the obligations to SMP markets**

Any financial reporting obligations imposed on eircom should be restricted to markets in which it has been designated as having SMP. This principle was recognised by Ofcom in its 2004 statement on the Regulatory Financial Reporting obligations on BT and Kingston and its subsequent amendments.



## **Appendix 2**

In order to assess ComReg's proposals against best practice, eircom have examined the requirements of fifteen operators. This consists of the following EU and non-EU operators;

<b>EU</b>	<b>Non-EU</b>
UK	Guernsey
France	Bahrain
Denmark	Jamaica
Belgium	New Zealand
Italy	United Arab Emirates
Spain	Other*
Greece	
Czech Republic	
Romania	

\* Represents one additional European operator provided on the condition of anonymity

## **2 PricewaterhouseCoopers**

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

12 February 2010

loe02b106

## Submission to ComReg 09/75

### Accounting Separation and Cost Accounting Review Draft Accounting Direction to eircom Limited

Dear Ms Devereux

1. We have considered ComReg's Consultation Document on Accounting Separation and Cost Accounting Review and Draft Accounting Direction to eircom Limited (the Consultation Document).
2. We have confined our observations to the proposed role of the independent auditor and the reporting requirements proposed of the independent auditor. In doing so we have drawn attention to a number of preliminary conclusions that have been included in the Consultation Document which we believe represent a misunderstanding by ComReg of the level of assurance provided to the entity by the current audit report on the Separated Accounts.

### Comments on Chapter 7

3. We comment below on chapter 7 of the Consultation Document with particular reference to "Issues identified by ComReg".
4. At paragraph 7.4 of the Consultation Document ComReg notes that the independent auditors' report on eircom's 2008 Separated Accounts states that the report may not be relied upon by third parties. It is standard reporting practice for auditors to point out that they do not accept responsibility to parties other than those who have contracted with them in relation to the report following the judgement in *Royal Bank of Scotland v Bannerman Johnstone Maclay and Others*. See **ICAI Professional Update Bulletin Issue 2 (Feb. 2006)**. As discussed below, for the independent auditor to accept a duty

Ronan Murphy Olwyn Alexander Brian Bergin Damian Byrne Pat Candon John Casey Mary Cleary Siobhán Collier Andrew Craig Thérèse Cregg  
Richard Day Fiona de Búrca David Devlin John Dillon Ronan Doyle John Dunne FCCA Kevin Egan Martin Freyne Teresa Harrington Alisa Hayden  
Paul Hennessy Ken Johnson Patricia Johnston Paraic Joyce Andrea Kelly Ciaran Kelly Joanne P. Kelly Chand Kohli John Loughlin Vincent MacMahon  
Tom McCarthy Enda McDonagh John McDonnell Ivan McLoughlin Robin Menzies Brian Neilan Damian Neylin Andy O'Callaghan Jonathan O'Connell  
Denis O'Connor Marie O'Connor FCCA Paul O'Connor Irene O'Keeffe Dave O'Malley Garvan O'Neill Michael O'Neill Joe O'Shea Ken Owens  
Anthony Reidy Emma Scott Bob Semple Mike Sullivan Billy Sweetman Paul Tuite Tony Weldon

Located at Dublin, Cork, Galway, Kilkenny, Limerick, Waterford and Wexford

Chartered Accountants

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of care to ComReg it would be necessary for ComReg to become a party to the engagement contract between eircom and the independent auditor.

5. At paragraph 7.5 of the Consultation Document it is stated:

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

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

6. We respectfully point out that this view is a misunderstanding of the report of the independent auditors on the Separated Accounts. It is not true that the independent auditors report on the Separated Accounts gives very limited comfort on the accuracy and reliability of the Separated Accounts. On the contrary, the report explicitly states that the auditors planned and performed their examination "to give reasonable assurance" in respect of the matters reported on.

7. The report provides an unqualified opinion that each of the Businesses and each of the Activities for the year ended 30 June 2008:

- "fairly presents in accordance with the Accounting Documents, dated 30 November 2008, the result and mean capital employed of, and costs incurred by, each of the Businesses and each of the Activities;
- Complies with the Decision Notices;
- Contains information specified by the Decision Notices to be published in the financial statements."

8. We would also draw your attention to the auditors' report on the Separated Accounts of BT which states that the auditors "*have not performed any additional tests of the transactions and balances recorded in the general ledgers and other accounting records beyond those already performed, for the purpose of the audit of the Statutory Financial Statements.*"

9. The misunderstanding of the independent auditors report in paragraph 7.5 leads to an erroneous conclusion in paragraph 7.9 that "It appears from the statement made by the auditors of eircom that its audit is not consistent with the guidelines of the ERG." The audit is consistent with the guidelines of the ERG.

10. This misunderstanding is repeated in paragraph 7.29 which also includes the incorrect statement that "*PwC has not performed any tests over and above that which is required for the Statutory Financial Accounts e.g. audit of cost allocation system at the market, service and product levels*". These misunderstandings are the basis for an erroneous conclusion in paragraph 7.57.

11. The report makes it clear that the independent auditors have conducted their work in accordance with International Standards on Auditing (UK and Ireland) ("ISA (UK and Ireland)") issued by the Auditing Practices Board.

12. We respectfully suggest that paragraph 7.23 is not correct in seeking to specify the content of the engagement letter in so far as it refers to verification procedures as is the comment in paragraphs 7.29 and 7.59 which suggests that an engagement letter would set out the audit tasks that need to be performed. Where ComReg requires assurance from the independent auditors in relation to the Separated Accounts and related matters, then the engagement letter will set out the auditors' responsibilities and the matters to be reported on but it will not specify the procedures to be adopted by the independent auditor. The latter will be for the independent auditor's judgement and will be influenced by many factors which may change from one examination to another and perhaps during the course of an engagement. That is the essence of an assurance engagement i.e. that the independent auditor decides on how to obtain sufficient competent evidential matter on which to found his opinion.
13. Paragraph 7.30 notes that *"in considering the extent to which the audit can give users of the accounts confidence that the information contained in the accounts is accurate, it is important to understand the nature of the audit work undertaken and the resulting opinion."* As set out above, the auditing reporting framework under which the audit is performed should be clearly set out within the audit opinion. An auditor performing an audit under ISAs (UK & Ireland) is required to comply with the detailed standards and guidelines issued by the Auditing Practices Board.
14. Alternatively, if the contracting parties other than the independent auditor wish to specify the procedures to be undertaken by the independent auditor then the engagement becomes an agreed upon procedures engagement and the independent auditor reports the factual findings from conducting the specified procedures but does not provide an opinion.
15. Paragraph 7.6 of the Consultation Document notes that:

*"The audited opinion covering the Separated Accounts relates only to each of the 'businesses' and 'activities' of the firm and does not cover individual markets, services or products"*.
16. Currently there is no requirement for the Separated Accounts to provide information on individual markets, services or products and thus no audit requirements in relation thereto.
17. At paragraph 7.26 ComReg observes that "the FPIA audit opinion provides a high level of assurance..." An assurance engagement conducted in accordance with International Standards on Auditing (UK and Ireland) is designed to provide reasonable assurance but "reasonable assurance is a high level of assurance"<sup>1</sup>. There are however inherent limitations in an audit as is clear from ISA 200 Objective and general principles governing an audit of financial statements, at paragraphs 8 to 12 as follows:

*"An auditor conducting an audit in accordance with ISAs obtains reasonable assurance that the financial statements taken as a whole are free from material*

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<sup>1</sup> Paragraph 5 of ISA 200 (UK and Ireland) "Overall objectives of the independent auditor and the conduct of an audit in accordance with International Standards on Auditing (UK and Ireland)".

*misstatement, whether due to fraud or error. Reasonable assurance is a concept relating to the accumulation of the audit evidence necessary for the auditor to conclude that there are no material misstatements in the financial statements taken as a whole. Reasonable assurance relates to the whole audit process.*

*An auditor cannot obtain absolute assurance because there are inherent limitations in an audit that affect the auditor's ability to detect material misstatements. These limitations result from factors such as the following:*

- The use of testing.*
- The inherent limitations of internal control (for example, the possibility of management override or collusion).*
- The fact that most audit evidence is persuasive rather than conclusive.*
- The impracticality of examining all items within a class of transactions or account balance.*
- The possibility of collusion or misrepresentation for fraudulent purposes.*

*The view given in financial statements is itself based on a combination of fact and judgement and, consequently, cannot be characterised as either 'absolute' or 'correct'. A degree of imprecision is inevitable in the preparation of all but the simplest of financial statements because of inherent uncertainties and the need to use judgement in making accounting estimates and selecting appropriate accounting policies.*

*Also, the work undertaken by the auditor to form an audit opinion is permeated by judgement, in particular regarding:*

- a) The gathering of audit evidence, for example, in deciding the nature, timing and extent of audit procedures; and*
- b) The drawing of conclusions based on the audit evidence gathered, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.*

*Further, other limitations may affect the persuasiveness of audit evidence available to draw conclusions on particular assertions (for example, transactions between related parties). In these cases certain ISAs identify specified audit procedures which will, because of the nature of the particular assertions, provide sufficient appropriate audit evidence in the absence of:*

- a) Unusual circumstances which increase the risk of material misstatement beyond that which would ordinarily be expected; or*
- b) Any indication that a material misstatement has occurred.*

*Accordingly, because of the factors described above, an audit is not a guarantee that the financial statements are free from material misstatement, because absolute assurance is not attainable. Further, an audit opinion does not assure the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity."*

18. As pointed out above, ComReg's preliminary position as set out in paragraph 7.29 is mistaken. The independent auditors assert that it is their intention that their report

should provide eircom with reasonable assurance. The sentence in the independent auditors' report that reads:

*"In conducting our subsequent examination of the financial statements we have not performed any additional tests of the transactions and balances recorded in the general ledgers and other accounting records beyond those already performed for the purpose of our audit of the Statutory Financial Statements"*

has been misunderstood by ComReg. In particular ComReg asserts in paragraph 7.29 that "...PwC has not performed any tests over and above that which is required for the Statutory Financial Accounts e.g. audit of cost allocation system at the market, service and product levels." This is incorrect. The independent auditors have conducted an extensive examination in order to furnish their opinion on the Separated Accounts; however in doing so they have not re-audited the transactions and balances in the Statutory Financial Statements.

19. We respectfully suggest that the "initial view" of ComReg expressed in paragraph 7.57 regarding additional matters to be reported on is founded on a mistaken view on the level of assurance currently provided by the independent auditors to eircom in their report on the Separated Accounts as explained above.

20. In regard to paragraph 7.67 we would comment as follows:

- (i) We are of the view that it should be left to the auditor's judgement to decide on the extent of testing required to give an opinion on whether eircom has prepared its Separated Accounts in compliance with the Accounting Direction. A requirement to "verify" compliance with the Accounting Direction implies a guarantee of full compliance which would require exhaustive testing and may in any event be unattainable. The Concise Oxford Dictionary, 7<sup>th</sup> edition defines verify as "to establish the truth or correctness of by examination or demonstration".
- (ii) The term "review the Accounting Document" is too vague to be of any practical value. This is also the case in respect of the fourth and fifth bullet points in paragraph 7.67.
- (iii) We note that the Draft Accounting Direction does not require the Additional Financial information to be audited in contrast to the third bullet point in 7.67.
- (iv) No principles or guidance have been promulgated by bodies representative of the Irish accountancy profession in regard to cost allocation systems and we are not aware of any plans to do so.

21. At paragraphs 7.67 and 7.71 there is an assumption that the Additional Financial information will be audited. This is at variance with the Draft Accounting Direction.

22. Paragraph 7.15 states that ComReg initially considers "that it is important that a qualified body, independent of eircom be appointed to verify its compliance with its Cost Accounting and Account Separation obligations" and paragraph 7.16 states that "The use of qualified personnel should provide ComReg and other interested parties with greater assurance as to the accuracy and reliability of eircom's Separated Accounts together with compliance with its regulatory responsibilities. In the case of an audit of the cost allocation system, a cost auditor should be appointed to perform such an audit. The cost auditor will need to have a detailed knowledge of the markets,

*service and products of eircom to enable it perform its audit tasks e.g. review of cost allocation and apportionment at the market, service and product levels."*

23. There is no definition of a cost auditor and a cost auditor is not defined under Auditing Standards.
24. Paragraph 7.59 states that *"While ComReg does not object to the regulatory auditor also being the statutory auditor, it is however important that the appointed auditor has the right skills to perform the specific audit tasks set out in the letter of engagement. Whereas the statutory auditor needs to have a good understanding of the company and the telecom industry, performance of the regulatory audit may require different skills, such as a detailed understanding of the regulations, economic, regulatory and cost allocation expertise. Such skills therefore need to be assessed as part of the appointment process."*
25. We concur with ComReg's view that the auditor should have the right skills to perform all the required tasks. Indeed, this is a matter that is dealt with by existing auditing standards which require an auditor to consider whether the firm has the capabilities, competence, time and resources before accepting or continuing with an audit engagement.
26. ISQC1 "Quality Control for Firms that perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements" includes a requirement for audit firms to establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it will only undertake or continue relationships and engagements where it:
- (a) Has considered the integrity of the client and does not have information that would lead it to conclude that the client lacks integrity;
  - (b) Is competent to perform the engagement and has the capabilities, time and resources to do so; and
  - (c) Can comply with ethical requirements.
27. In considering whether the firm has the capabilities, competence, time and resources to undertake an engagement for a new or an existing client, the firm reviews the specific requirements of the engagement and existing partner and staff profiles at all relevant levels. Matters the firm considers include whether:
- Firm personnel have knowledge of relevant industries or subject matters;
  - Firm personnel have experience with relevant regulatory or reporting requirements, or the ability to gain the necessary skills and knowledge effectively;
  - The firm has sufficient personnel with the necessary capabilities and competence;
  - Experts are available, if needed;



- Individuals meeting the criteria and eligibility requirements to perform engagement quality control review are available, where applicable; and
- The firm is able to complete the engagement within the reporting deadline.

ISA 620 (UK & Ireland) "Using the work of an expert" establishes standards and provides guidance on using the work of an expert as audit evidence.

28. Paragraphs 7.41 to 7.43 refer to The Miscellaneous Technical Statement M46 "Reporting to the Financial Regulator under The Central Bank and Financial Services Authority of Ireland Act 2004". This Technical Statement provides guidance to auditors on complying with certain statutory duties of the auditor to the Financial Regulator as set out under the relevant legislation. Consequently, the Statement is not relevant to eircom's Separated Accounts.

#### **Area 4: Questions relating to Audit proposals**

**Q.28. Do you agree or disagree with ComReg's preliminary proposals with regard to Auditor Independence, Duty of Care, Auditor's Letter of Engagement? Please detail your response in full.**

##### Auditor Independence

We have no objection to ComReg seeking information about the capability and independence of the firm proposed to act as auditor of the Separated Accounts. We suggest however that ComReg should make its enquiries of the proposed auditors rather than to eircom.

##### Duty of Care

The authoritative guidance on the auditors duty of care to regulators is set out in the Technical release "**Reporting to Regulators of Regulated Entities**" (Audit 05/03) issued by the Audit and Assurance Faculty of the Institute of Chartered Accountants in England and Wales in October 2003.

Absent any statutory provision, a duty of care by the independent auditor to ComReg will arise only in the event that ComReg agrees to become a party to the engagement contract between eircom and the independent auditor.

##### Auditor's letter of engagement

The terms of the letter of engagement are a matter for the contracting parties. Where an opinion is sought from the independent auditor it is a matter for the auditor to decide on the nature and extent of the work required to provide the evidence to support that opinion. Alternatively if the parties engaging the auditor wish to have specific procedures conducted by the auditor then these can be set out in the engagement letter but the resulting report will be a description of the results of the specified procedures and will not contain an opinion from the auditor.

An engagement to perform specific procedures would be performed under a separate letter of engagement to that required for the audit engagement.

**Q.29. Do you agree or disagree with the preliminary proposal that a “Fairly Presents in Accordance with audit opinion” is appropriate for both the Separated Accounts and Additional Financial Information? Do you agree or disagree with the preliminary proposal that there is a need for ComReg to obtain an opinion with regard to eircom’s compliance with its cost accounting obligations, in addition to its compliance with the requirements of the Accounting Direction? Please detail your response in full.**

We note that the draft Accounting Direction does not contain a requirement for the Additional Financial Information to be audited.

The question of whether a “Fairly presents in accordance with audit opinion” is appropriate for the Separated Accounts will depend on the circumstances and some of the factors that will determine if such an opinion is appropriate are well explained in paragraphs 7.53 and 7.54 of the Consultation Document and with which we are in agreement.

We do not consider the wording of the requirement for the auditors to verify compliance with the Accounting Direction to be appropriate and it should be reconsidered in our view.

We would suggest that the auditors’ opinion should include an opinion that the Separated Accounts have been properly prepared in accordance with the Accounting Direction. This is consistent with the opinion required in respect of statutory financial statements where the auditors include their opinion as to whether the financial statements have been properly prepared in accordance with the requirements of the relevant Companies Acts and any other relevant legislation or framework. In our view the requirement, as included at paragraph 9.1 of the Draft Direction, should be amended in this regard.

The Draft Accounting Direction includes a requirement for the auditors to provide an opinion on eircom’s compliance with the requirements of this Direction. The scope of the Direction goes beyond the Separated Accounts and includes other compliance obligations of eircom. Consequently, the scope of the work required to provide an appropriate opinion on compliance with the Direction, would be significantly more extensive than the work required to provide an appropriate audit opinion on the Separated Accounts, including that the Separated Accounts have been “fairly presented” or “properly prepared” in accordance with the requirements of the Accounting Direction.

Although the question as set out above requires a view on whether ComReg should obtain an opinion with regard to eircom’s compliance with its cost accounting obligations we note that paragraph 9.1 (a) of the Draft Direction Accounting requires the auditors to “conduct an audit of its cost allocation system, in accordance with the principles and guidance set out by bodies representative of the Irish accountancy profession from time to time” and paragraph 9.1. (c) requires eircom to “include the report and opinion of the independent competent body on ..... the audit of the cost allocation system.... within the Separated Accounts”. Although there is an inconsistency between the question and the Draft Accounting Direction we have assumed that the Draft Accounting Direction takes precedent over the question and have therefore responded in the context of the requirement to perform a separate audit and given an audit opinion in respect of the cost allocation system.

The scope of engagement to perform an audit of the cost allocation system or the nature of the assurance opinion required is not defined within the Draft Accounting Direction.

However we note at paragraph 7.23 that ComReg envisage that this would include "review and verify the appropriateness of the cost allocation/apportionment process as set out in the Accounting Document." As set out above, it would not be possible for the auditor to verify the appropriateness of the cost allocation/ apportionment process.

We believe that ComReg should carefully consider whether it is necessary to require a separate audit of eircom's cost allocation system. The scope of the work required to provide an appropriate opinion on a cost allocation system would be significantly more extensive than that required to provide an appropriate opinion on the Separated Accounts.

In considering this matter we suggest that ComReg have regard to the requirements on auditors in regard to information systems in conducting audits under ISAs (UK and Ireland). ISA (UK and Ireland) 315 "Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement" paragraph 81 imposes the following requirement, as follows:

*"The auditor should obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following areas:*

- *The classes of transactions in the entity's operations that are significant to the financial statements.*
- *The procedures, within both IT and manual systems, by which those transactions are initiated, recorded, processed and reported in the financial statements.*
- *The related accounting records, whether electronic or manual, supporting information, and specific accounts in the financial statements, in respect of initiating, recording, processing and reporting transactions.*
- *How the information system captures events and conditions, other than classes of transactions that are significant to the financial statements.*
- *The financial reporting process used to prepare the entity's financial statements, including significant accounting estimates and disclosures."*

In addition the auditor is required to obtain:

- an understanding of internal control relevant to the audit<sup>2</sup>
- a sufficient understanding of control activities to assess the risks of material misstatement at the assertion level and to design further audit procedures responsive to assessed risks<sup>3</sup>
- an understanding of how the entity has responded to risks arising from IT<sup>4</sup>, and
- an understanding of the major types of activities that the entity uses to monitor internal control over financial reporting, including those control activities relevant to the audit, and how the entity initiates corrective actions to its controls<sup>5</sup>.

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<sup>2</sup> Paragraph 41 of ISA (UK and Ireland) 315

<sup>3</sup> Paragraph 90 of ISA (UK and Ireland) 315

<sup>4</sup> Paragraph 93 of ISA (UK and Ireland) 315

<sup>5</sup> Paragraph 96 of ISA (UK and Ireland) 315

ISA (UK and Ireland) 315 recognises that an entity's information system typically includes the use of standard journal entries that are required on a recurring basis to record transactions, or to record accounting estimates and that an entity's financial reporting process also includes the use of non-standard journal entries to record non-recurring, unusual transactions or adjustments<sup>6</sup>.

Paragraph 86 of the standard requires that *"In obtaining an understanding, the auditor considers risks of material misstatement associated with inappropriate override of controls over journal entries and the controls surrounding non-standard journal entries. For example, automated processes and controls may reduce the risk of inadvertent error but do not overcome the risk that individuals may inappropriately override such automated processes, for example, by changing the amounts being automatically passed to the general ledger or financial reporting system. Furthermore, the auditor maintains an awareness that when IT is used to transfer information automatically, there may be little or no visible evidence of such intervention in the information systems"*.

**Q.30. Do you agree or disagree that the audit report should set out details of the systems testing conducted, auditor assessment of estimates and judgements and the application by eircom of accounting policies? Please detail your response in full.**

We disagree. If ComReg wishes for the opinion of an independent auditor then that opinion will be framed in accordance with accepted standards for reporting. An opinion will refer to the standards used in the conduct of the engagement and while it will contain a summary of the nature of the audit it will not specify the procedures adopted and the detail of the testing conducted. Alternatively if ComReg wishes the independent auditor to conduct specific procedures, a separate report would set out the results of these procedures but this report would not include an opinion. An engagement of this nature is not an assurance engagement. An engagement of this nature is an agreed upon procedures engagement and is conducted in accordance with ISRS 4400<sup>7</sup>.

An audit conducted in accordance with ISAs (UK & Ireland) requires the auditor to design and perform audit procedures to obtain sufficient appropriate audit evidence as to whether the entity's accounting estimates are reasonable in the circumstances and, when required, appropriately disclosed. The Auditor is also required to make a final assessment of the reasonableness of the entity's accounting estimates based on the auditor's understanding of the entity and its environment and whether the estimates are consistent with other audit evidence obtained during the audit.

However, the audit opinion is provided on the financial statements as a whole (or at individual business or other appropriate level) and not on each individual estimate and judgement used in the preparation of the financial statements. ISAs (UK & Ireland) 540 "Audit of Accounting Estimates" establishes standards and provides guidance on the audit of accounting estimates impacting on financial statements.

This is consistent with the responsibilities of the auditors as set out in the Audit Opinion on the 2008 Separated Accounts which states that:

<sup>6</sup> Paragraph 83 and 84 of ISA (UK and Ireland) 315

<sup>7</sup> See International Standard on Related Services 4400 – Engagements to perform agreed upon procedures regarding financial information, paragraph 18.

*"We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. Our work included examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also included an assessment of the significant estimates and judgements made by the company in the preparation of the financial statements.*

*We planned and performed our examination so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that each of the financial statements is fairly presented in accordance with the Accounting Documents and that it complies with the Decision Notices and contains the information specified by the Decision Notices to be published in the financial statements. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements".*

Under auditing standards the auditor is required to obtain an understanding of the entity's selection and application of accounting policies and consider whether they are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry. The understanding encompasses the methods the entity uses to account for significant and unusual transactions; the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus; and changes in the entity's accounting policies. The auditor also identifies financial reporting standards and regulations that are new to the entity and considers when and how the entity will adopt such requirements. Where the entity has changed its selection of, or method of applying a significant accounting policy, the auditor considers the reasons for the change and whether it is appropriate and consistent with the requirements of the applicable financial reporting framework.

The presentation of financial statements in conformity with the applicable financial reporting framework includes adequate disclosure of material matters. These matters relate to the form, arrangement, and content of the financial statements and their appended notes, including, for example, the terminology used, the amount of detail given, the classification of items in the statements, and the basis of amounts set forth. The auditor considers whether the entity has disclosed a particular matter appropriately in light of the circumstances and facts of which the auditor is aware at the time.

## **Area 2: Questions relating to proposals with regard to disclosure in the Separated Accounts and Additional Financial Information**

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

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

*statutory audit and would directly impact upon the Separated Accounts". This requirement is included at paragraph 6.1.2 (o) of the Draft Accounting Direction.*

It would not be normal practice for details of manual journals and adjustments to be included within the audited financial statements. We do not believe that it would be appropriate for any such information to be included within the financial statements.

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

The extent of any commentary and narrative explanations required as part of the Separated Accounts is a matter for ComReg and eircom.

However, in our view Paragraph 6.1.2(a) of the Draft Accounting Direction should be amended and the relevant information should be required to be published with the Separated Accounts rather than forming part of the Separated Accounts.

ISA (UK and Ireland) 720 establishes standards and provides guidance on the auditor's consideration of other information, on which the auditor has no obligation to report, in documents containing audited financial statements. This standard requires that the auditor should read the other information to identify material inconsistencies with the audited financial statements. If as a result of reading the other information, the auditor becomes aware of any apparent misstatements therein, or identifies any material inconsistencies with the audited financial statements, the auditor should seek to resolve them.

We believe therefore that the appropriate role for the independent auditor in relation to the information set out in Paragraph 6.1.2(a) in this paragraph should be to consider whether it is consistent in all material respects with the Separated Accounts.

It would not be appropriate in our view for the independent auditor's report on the Separated Accounts to cover the explanations specified at 6.1.2(a) of the Draft Accounting Direction.

Paragraph 6.1.2(a) includes a requirement to include "significant or large adjustments made to produce the Separated Accounts" as part of the narrative explanations on the Separated Accounts. It would not be normal practice for such information to be included within the performance commentary. In our view, it would be more appropriate to require the information to be provided by way of the Additional Financial Information requirements.

**Area 5: Other**

**Q.32. What is your view of the preliminary proposed timelines for compliance? Please detail your response in full.**

The Draft Accounting Direction states that the Direction will be applicable to accounting periods beginning on or after 1 July 2009 and that full compliance should, however, be achieved no later than 30 June 2011.

The timelines for compliance as set out in paragraph 10.1 could be subject to misinterpretation, in particular the sentence that requires that full compliance should, however, be achieved no later than 30 June 2011.

We would suggest that the date for full compliance should be determined by reference to an appropriate accounting period "ending on or after" or "commencing on or after" to ensure the required compliance date is clear.

Given that the audit opinion will require to include an opinion on whether the Separated Accounts are prepared in accordance with the requirements of the Accounting Direction, the extent to which the Accounting Direction is applicable to accounting periods beginning on or after 1 July 2009 should be clarified.

In paragraph 5.175 ComReg notes that it is of the preliminary view that eircom should submit to ComReg and publish on its website its Separated Accounts within 4 months of its financial year end and we note from the Draft Accounting Direction that the Additional Financial Information is also required to be submitted with the Separated Accounts. This timeline is significantly shorter than the existing timeline which requires that the Audited HCA Separated Accounts are submitted within 5 months of eircom's financial year end and the Audited CCA Separated Accounts within 6 months.

The proposed timeline of 5 months in the first year and 4 months for subsequent years are very short, especially when consideration is given to the complexity of the Separated Accounts and that they will require to be prepared and finalised by management and subsequently audited within this timeframe. There is significant work involved in auditing Separated Accounts and the deadline is likely to be extremely challenging from an audit perspective.

We hope that ComReg finds our comments useful both in respect of clarifying the level of assurance provided to the entity by the current audit report on the current Separated Accounts and in considering the audit requirements in respect of the Separated Accounts going forward. We would be happy to provide any further clarification or explanation required in respect of the matters set out above or to discuss any other relevant matters with ComReg.

If you believe it would be useful to discuss these matters, please contact Mary Cleary.

Yours faithfully

*PricewaterhouseCoopers*

PricewaterhouseCoopers

### **3 Chartered Accountants Ireland**





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

10 February 2010

Dear Ms. Devereux

**Reference: Submission re ComReg 09/75**

**Consultation Document 'Accounting Separation and Cost Accounting Review' - Draft Accounting Direction to Eircom Limited**

Chartered Accountants Ireland is pleased to respond to the above consultation document.

### General comments

Chartered Accountants Ireland has endeavoured to work with ComReg on the drafting of an Information Sheet to provide guidance for auditors and ComReg on the issue of tri partite reporting. This was undertaken at ComReg's request. A draft document (Information Sheet) was sent for your consideration on 10 March 2009 and we have only recently received any feedback. The content of that Information Sheet does not appear to have been considered in the drafting of this Accounting Separation and Cost Accounting Review Consultation Document (the "Consultation Document").

Due to the detailed technical content of this Consultation Document we cannot comment on all the proposals contained therein.

Our response therefore focuses on the audit independence, duty of care and audit engagement principles referred to throughout the document, this is primarily Area 4 of the Consultation Questions. However these issues are referred to throughout the document and we have endeavoured to refer to each of these issues and the relevant parts of the Consultation Document below.

We do not necessarily support or agree with items we have not commented on.

Throughout the Consultation Document terms such as “verify” (7.23), “qualified” (7.15), “accurate” (7.30) and “review” (7.23, 7.67 and 9.2 of the Consultation Document), are used without any definition or explanation. This could result in differing interpretations of these terms which will lead to confusion and misinterpretation and could result in legal issues.

In particular, the term, “verify” is used in respect of certain assurances required from auditors. We do not believe that this is an appropriate term and the requirement for auditors to “verify” matters is not appropriate or in accordance with International Standard on Accounting (UK and Ireland).

## **Detailed commentary on the basis of preparation**

### **Paragraphs 5.36 and 6.1.2**

***The need for the separated accounts to include commentary on the basis of preparation in the Separated Accounts, including notes and longer form narrative and explanation on a wide variety of items.***

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

These requirements are incorporated in the Draft Accounting Direction at Paragraph 6.1.2 which sets out that:

*“Eircom’s audited final Separated Accounts shall contain by way of notes or longer form narrative various information in relation to trends and details of one-off or exceptional events in the year and significant or large adjustments made to produce the Separated Accounts and the extent to which (if any) this explains Eircom’s Separated Accounts”.*

6.1.2 lists many items, the detail of which would not normally be included within the audited financial statements. The information described would normally be included by way of an appropriate report accompanying the financial statements, rather than within the financial statements.

This is well recognised by Company Law which sets out the information to be contained in the Directors’ Report accompanying statutory financial statements.

ISA (UK and Ireland) 720 Section A and Section B<sup>1</sup> (“ISA (UK and Ireland) 720”) clearly sets out the auditors’ responsibilities in respect of Other Information in Documents Containing Audited Financial Statements and The Auditors Statutory Reporting Responsibility in Relation to the Directors’ Reports.

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<sup>1</sup> ISA (UK and Ireland) 720A The auditor’s responsibilities relating to other information in documents containing audited financial statements and ISA (UK and Ireland) 720B The auditor’s statutory reporting responsibility in relation to directors’ reports

ISA (UK and Ireland) 720 requires that the auditor should read the other information to identify material inconsistencies with the audited financial statements. The standard also sets out the requirements for auditors where a material inconsistency is identified.

It is beyond the auditors' scope to do other than comment where there are material inconsistencies between any commentary made by the directors or the management in documents such as the Directors Report or Operating and Financial Review that accompanies audited financial statements. This is clearly recognised practice. If such commentaries contain "forward looking statements" e.g. comments on trends expected in the future (see 6.1.2 of the Draft accounting Direction), the auditors can have nothing to do with such statements.

Under "ISA (UK and Ireland) 720 Section A, the auditor has no specific responsibility to determine that other information is properly stated. If, on reading the other information, the auditor identifies a material inconsistency, the auditor shall determine whether the audited financial statements or the other information needs to be revised.

ISA 720 A paragraph 8 provides that where there is an obligation to report specifically on other information, the auditor's responsibilities are determined by the nature of the engagement and by local legislation and professional standards. Where such responsibilities involve the review of other information, the auditor will need to follow the guidance on review engagements in the appropriate ISAs (UK and Ireland) and this would be subject to a separate engagement. The scope of the work and the report thereon would be determined by the relevant standards and the nature of the report and level of assurance would be entirely different to those for an assurance engagement.

Any such requirement is clearly separate from the auditor's responsibilities in respect of the financial statements and therefore it is not appropriate to require the information as set out in Paragraph 6.1.2 of the Draft Accounting Direction to be included within the audited financial statements.

### **Section 7 - Audit**

Section 7 of the Consultation Document deals with ComReg's draft proposal in respect of the audit of the financial statements and sets out a number of questions in respect of the audit of the Separated Accounts.

We have outlined below a number of areas within this section which we believe require to be clarified in addition to responding to the individual questions raised by ComReg.

There seems to be some confusion in section 7 of the Consultation Document as to whether there is a review or audit being carried out and whether IRSE 4400 or the ISAs (UK and Ireland) should be the standards upon which the work and reporting is based.

ISRE 4400 deals with Agreed Upon Procedures Engagements. Such an engagement would comprise of procedures agreed upon by all parties to the engagements which in this case should include the regulator, the regulated entity and the audit firm. A duty of care would be set out in this contractual framework. Under IRSE 4400 the report is typically addressed directly to those engaging the auditor and agreeing the scope of work. The report form for such an engagement will be a report of factual findings rather than a conclusion or opinion. The addressee of the report will be in a position to draw their own conclusions based on the facts reported to them.

Paragraph 7.5 to Paragraph 7.10 sets out various initial views of ComReg in relation to the current audit and the level of assurance it provides. Given that ComReg are not currently party to the engagement letter, it is unclear as to how ComReg has formed its conclusions or whether or not they appropriate.

However, we note that the auditors' opinion states that the audit was performed in accordance with ISAs (UK and Ireland) and that the audit opinion is a fairly presented opinion. Consequently, ComReg's comments in relation to "very limited comfort on the accuracy and reliability of the separated accounts" as set out in Paragraph 7.5 would appear to be unfounded, given the detailed standards and guidance an auditor is required to comply with under those standards.

**Q 28 Do you agree or disagree with ComReg's preliminary proposals with regard to Auditor Independence, Duty of Care, Auditors Letter of Engagement?**

The report referred to in paragraph 7.4 ([http://www.eircom.ie/bveircom/pdf/2008\\_HCA\\_Financial\\_statements1.pdf](http://www.eircom.ie/bveircom/pdf/2008_HCA_Financial_statements1.pdf)) was prepared under a different framework, as set out in various Decision Notices, not a tri-partite agreement and therefore the reporting firm cannot accept responsibility for anyone else relying on this report.

As set out in Section 7, there is currently no agreement in place with ComReg for the audit firm to establish a duty of care to ComReg. In these circumstances the current wording as set out in the auditors' report and noted in paragraph 7.4 is appropriate and consistent with audit reporting standards in Ireland.

You will also note that this is entirely consistent with the guidance issued by the ICAEW Technical release, as set out in Paragraph 7.40 of the Consultation Document.

**Auditor Independence (7.14 and 7.31)**

The Consultation Document refers to a "cost" auditor but has not defined this term. The in-depth market knowledge required by this person may only be actually available to auditors' working within the industry. This fact would not preclude them from being independent.

Members of Chartered Accountants Ireland are expected to adhere to the highest standards of professional practice at all times. One of the key tenets of this is the need to maintain objectivity and independence (see Appendix 1 for details of the specific requirements).

In addition, member firms, when undertaking audits, reviews of historical financial information and other assurance and related services engagements must comply with ISQC (UK and Ireland) 1 "Quality control for firms that perform audits and reviews of historical financial information and other assurance and related services engagements". This includes a requirement that "*The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements (including experts contracted by the firm and network firm personnel), maintain independence where required by the IFAC Code and national ethical requirements*". The IFAC code and the national ethical requirements in Ireland set out detailed requirement conclude for auditors in an independence ensuring their integrity, objectivity and independence is maintained. Auditors are therefore required to implement safeguards and practices to ensure that independence is maintained and demonstrable.

In paragraph 7.36 ComReg states that “it is reasonable to propose that the expert chosen should be approved by ComReg.”

The Statutory Auditor (who reports on the statutory financial statements to the shareholders as a group) and the Regulatory Auditor will, in most cases be the same entity. Under statute, it is the shareholders as a group who should take the decision to appoint/remove an auditor.

Given the public interest factors present the Regulator should have some recourse if the Regulatory Auditor is not performing their function. This is normally achieved by certain reports required under the statute to be provided to the Regulator (by the client or in certain cases in other industries the auditor) and the Regulator having legal recourse if these are not provided. A direct influence on the decision to appoint a Regulatory Auditor, without establishing criteria by which Regulatory Auditors should be eligible for appointment and setting out legal obligations of the same Regulatory Auditor, could result in apparently arbitrary decisions being made in respect of the Regulatory Auditors appointment/removal. In addition, any arbitrary requirement to appoint an additional auditor is likely to result in additional costs being incurred.

ComReg should note that ISQC 1 also requires firms to establish policies and procedures for the acceptance and continuance of engagements including a requirement to consider whether the auditor is competent to perform the engagement and has the capabilities, time and resources to do so.

Auditing Standards also set out detailed requirements for auditors on the use of experts and reliance on experts as part of the overall engagement.

We note that although ComReg refer to the “Study on the cost accounting systems of providers of universal postal service”, there is no such requirement included in the Accounting Direction to An Post. The relevant Accounting Direction requires that An Post shall engage a competent body in accordance with the principles and guidance set out from time to time by ComReg, following discussion with An Post and bodies representative of the Irish Accountancy Profession.

#### **Duty of Care of the auditor (7.17 and 7.39)**

The Consultation Document refers to our Miscellaneous Technical Statement 46 (M46) “Reporting to the Financial Regulator under The Central Bank and Financial Services authority of Ireland Act 2004”. This reference seems to be completely out of context. This document was prepared by Chartered Accountants Ireland with the involvement of the Financial Regulator to assist our members meet certain specific obligations arising under legislation. This is to meet certain specific statutory regulations, without this statutory obligation (in the absence of a contract) there is no duty of care arising.

This section also refers to legislation in the UK and in New Zealand; again this is irrelevant in the context of ComReg and Ireland unless there is similar legislation in place.

#### **Letter of engagement (7.20, 7.47 and 7.65)**

In paragraph 7.24 ComReg raises the question as to whether it should be a party to the engagement letter. In order for an auditor to accept a duty of care to ComReg it would be necessary for ComReg to be party to an engagement letter. In the absence of an agreed engagement letter, it would not be appropriate for an auditor to accept a duty of care to any third party, including ComReg.

We are in favour of a tri-partite letter of engagement as suggested in our draft information sheet. We also consider that agreeing the scope of the work up front would enable all parties to ensure that the terms of engagement and the format of the report would meet their individual requirements.

However, we feel that the scope of the work to be undertaken as discussed in the Consultation Document is somewhat unrealistic. Verification of procedures and processes, even were this possible, would be a detailed and arduous process that would probably be extremely costly to Eircom.

In paragraph 7.29 ComReg refers to the current work performed by the auditors. It is unclear as to the basis of these comments, given that ComReg is not party to the letter of engagement. However, as set out above the audit opinion states that the audit was performed in accordance with ISAs (UK and Ireland) and consequently would be expected to address many of the areas set out in order for the auditors to be in a position to provide a fairly presents audit opinion.

In addition in paragraph 7.59, ComReg refers to an engagement letter being in place which sets out the audit tasks that need to be performed. We would point out that if the auditors are engaged to give an assurance opinion on the financial statements then although the engagement letter would clearly set out the auditors' responsibilities it would not contain the detailed procedures to be carried out by the auditor, as this is a matter for the auditors' judgement. ISA (UK & Ireland) 210 "Terms of Audit Engagements" is the relevant standard for auditors in respect of engagement letters.

In any event it would be impractical for an auditor to set out details of all of the tasks performed in order to provide an assurance opinion on financial statements.

An engagement that sets out the detailed tasks to be performed would normally be an agreed upon procedures engagement and in these circumstances an auditor would provide a report of factual findings rather than an assurance opinion.

In paragraph 7.30 ComReg states that it is important to understand the nature of the audit work undertaken and the resulting opinion. We believe that this requirement is fulfilled by the existing audit opinion on the financial statements, which clearly sets out the auditing framework under which the audit has been performed. The auditing standards clearly set out the responsibilities of the auditors in respect of any financial statements and provide detailed standards and guidelines to be adhered to by auditors in conducting an audit under ISA (UK and Ireland). Any requirement for an audit opinion to include information over and above the requirements of those standards and governing legislation would be inconsistent with best practice.

***Q 29 Do you agree or disagree with the preliminary proposal that a "Fairly Presents in Accordance with audit opinion" is appropriate for both the Separated Accounts and Additional Financial Information? Do you agree or disagree with the preliminary proposal that there is a need for ComReg to obtain an opinion with regard to Eircom's compliance with its cost accounting obligations, in addition to its compliance with the requirements of the Accounting Direction?***

As outlined in the draft information sheet referred to above we feel that a "Fairly presents in accordance with" audit opinion would be suitable for the Separated Accounts. I attach the proforma report included in the draft information sheet as Appendix 2.

Nonetheless, the preparation **with absolute objectivity**, of very granular or detailed data in a top down costing system is simply not feasible. Accordingly, a “fairly presents” type assurance – a high level of assurance – is not always achievable. Lower levels of independent assurance such as an opinion stating “properly prepared” in accordance with a suite of very detailed and comprehensive rules drawn up by ComReg or some other equally comprehensive framework may be the only feasible approach in respect of certain financial information, depending on the granularity or detail of financial information upon which an opinion is required. This is consistent with Ofcom’s findings in respect of the inherent difficulties of attributing relatively small proportions of large shared and common costs to relatively small market or product groups as set out in paragraph 7.54 of the Consultation Document.

Another possibility might be to engage the auditor’s in an “agreed upon procedures” engagement to be carried out in accordance with International Standard on Related Services 4400 “Engagement to perform agreed upon procedures regarding financial information” in respect of certain financial information where a fairly presents or properly prepared audit opinion is not feasible.

7.65 also refers to auditing the additional financial information, as this would normally be outside the scope of an audit engagement. The Draft Accounting Direction does not require the Additional Information to be audited, which appears to be inconsistent with the question raised above.

The Consultation Document also refers to, in 7.65, the auditors conducting an audit of Eircom’s cost allocation system in accordance with the principles and guidance set out by the bodies representative of the Irish accountancy profession. We are not aware of any guidance on the audit of cost allocation systems or any current work plans to provide such guidance and suggest that appropriate details are provided for further discussion.

In relation to the cost accounting obligations the level of granularity envisaged by ComReg may make this a very costly exercise. We note that it is not ComReg’s intention to impose an excessive cost burden on eircom, in the form of high audit costs.

We believe that ComReg’s objective of obtaining the necessary assurance that the information provided in Eircom’s separated accounts is relevant, reliable and of high quality can be achieved without a requirement for the auditors to verify eircom’s compliance with its cost accounting obligations. As set out above, a requirement to “verify” compliance is not in accordance with auditing standards. Therefore, ComReg and/or eircom would need to engage with the auditors in agreeing a suitable scope of work and opinion in respect of any engagement to provide an appropriate level of comfort over eircom’s obligations in relation to cost accounting, if ComReg believes that this is necessary.

***Q 30 Do you agree or disagree that the audit report should set out details of the systems testing conducted, auditor assessment of estimates and judgements and the application by Eircom of accounting policies?***

It is not appropriate for the audit report to set out details of the systems testing conducted, auditor assessment of estimates and judgements and the application by eircom of accounting policies.

Auditing standards clearly set out the duties of auditors in respect of the audit of the financial statements, including the auditor's responsibility in respect of understanding the accounting systems and assessments of estimates and judgements. The auditor's responsibility is to form an opinion on the financial statements as a whole on not on each individual judgement. It is the auditor's responsibility to ensure the scope of the work performed is appropriate to give the appropriate level of assurance opinion required on the financial statements.

This contrasts with an agreed upon procedures engagement where an auditor agrees to perform specific tasks and they provide a report of factual findings based on the work performed. However, in this instance the report is of factual findings and the auditor would not provide an assurance opinion on the financial information.

### ***Systems testing***

Paragraph 7.57 refers to ComReg's preliminary view that there should be a statement confirming eircom's compliance with processes and procedures included in the separated accounts. The terms of this work would need to be carefully considered as the level of testing to reach such a conclusion could be very onerous. This is not the type of report envisaged under ISRE 4400.

### **Audit Report and Opinion (7.25 and 7.50 and 7.68)**

#### **Accounting policies**

Audit and review work is undertaken to give an opinion on the financial statements. The directors are responsible for the selection of the most appropriate accounting policies and are responsible for the application of the selected policies. In the course of their audit work the auditors consider whether the policies selected by the directors are appropriate and have been properly applied. Any unresolved disagreement over the selection and application of accounting policies will be reflected in the audit report. It should not be necessary for the auditors to repeat this exercise and provide an additional report on this issue for the Separated Accounts.

***Q 31 Do you agree or disagree that the accounting Direction should include an obligation on the Board of Directors to include a statement in the Separated Accounts acknowledging their responsibilities for the preparation of the Separated Accounts and verifying Eircom compliance with the requirements of the accounting Direction.***

#### **Corporate Governance (8.1)**

Chartered Accountants Ireland would agree that the Directors of eircom should acknowledge their responsibility for the Separated Accounts and their compliance with the Accounting Direction.

We note that the current Separated Accounts contain such a statement.

***Q 32 What is your view of the preliminary proposed timelines for compliance?***

ComReg has extended the consultation period for this Consultation Document and therefore the timeframe for compliance should be reconsidered by the parties involved before the Accounting Direction is finalised.



We note that the Accounting Direction includes significant change from the previous basis of preparation for the Separated Accounts. The timeframe for implementation should be appropriate to allow for the efficient implementation of the relevant changes.

There is normally a considerable lead time between the introduction of new accounting standards and the date entities are required to implement the relevant changes in their financial statements to allow the necessary changes in management information systems to be implemented.

***Q33 Do you agree or disagree with the content of the proposed accounting Direction (including Annex's attached) and whether it is proportionate and justified? Please detail your response in full from a commercial, practical and legal perspective.***

We have not set out in detail the amendments to the proposed accounting Direction. However, we believe that the Direction requires to be amended to take account of the factors noted above.

***Q34 Respondents are requested to provide views on whether there are other factors (if any) that ComReg should consider in completing its Regulatory Impact Assessment?***

At this point we are not aware of any other factors ComReg should consider however further discussions on the draft Information Sheet referred to above may result in new issues coming to the fore.

We welcome the opportunity to comment on the Consultation document and are happy to discuss any of the issues we raise above.

Yours sincerely



Anne Sykes  
Representation and Technical Policy Department  
Chartered Accountants Ireland

## Appendix: 1

### Extract from CAI Ethical Code

100.4 A professional accountant is required to comply with the following fundamental principles:

**(a) Integrity**

A professional accountant should be straightforward and honest in all professional and business relationships.

**(b) Objectivity**

A professional accountant should not allow bias, conflict of interest or undue influence of others to override professional or business judgements.

**(c) Professional Competence and Due Care**

A professional accountant has a continuing duty to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques. A professional accountant should act diligently and in accordance with applicable technical and professional standards when providing professional services.

**(d) Confidentiality**

A professional accountant should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of the professional accountant or third parties.

**(e) Professional Behaviour**

A professional accountant should comply with relevant laws and regulations and should avoid any action that discredits the profession.

### Section 120 Objectivity

120.1 The principle of objectivity imposes an obligation on all professional accountants not to compromise their professional or business judgement because of bias, conflict of interest or the undue influence of others.

*Objectivity is the state of mind which has regard to all considerations relevant to the task in hand but no other.*

120.2 A professional accountant may be exposed to situations that may impair objectivity. It is impracticable to define and prescribe all such situations. Relationships that bias or unduly influence the professional judgement of the professional accountant should be avoided.

## **Section 290 Independence– Assurance engagements**

### **Other assurance engagements**

290.2 Assurance engagements are designed to enhance intended users' degree of confidence about the outcome of the evaluation or measurement of a subject matter against criteria. The International Framework for Assurance engagements (the Assurance Framework).

290.3 As further explained in the Assurance Framework, in an assurance engagement<sup>2</sup> the professional accountant in public practice expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.

290.4 The outcome of the evaluation or measurement of a subject matter is the information that results from applying the criteria to the subject matter. The term "subject matter information" is used to mean the outcome of the evaluation or measurement of subject matter. For example:

The recognition, measurement, presentation and disclosure represented in the financial statements<sup>3</sup> (subject matter information) result from applying a financial reporting framework for recognition, measurement, presentation and disclosure, such as International Financial Reporting Standards, (criteria) to an entity's financial position, financial performance and cash flows (subject matter).

An assertion about the effectiveness of internal control (subject matter information) results from applying a framework for evaluating the effectiveness of internal control, such as COSO<sup>4</sup> or CoCo<sup>5</sup>, (criteria) to internal control, a process (subject matter).

290.5 Assurance engagements may be assertion-based or direct reporting. In either case they involve three separate parties: a public accountant in public practice, a responsible party and intended users.

290.6 In an assertion-based assurance engagement, the evaluation or measurement of the subject matter is performed by the responsible party, and the subject matter information is in the form of an assertion by the responsible party that is made available to the intended users.

290.7 In a direct reporting assurance engagement the professional accountant in public practice either directly performs the evaluation or measurement of the subject matter, or obtains a representation from the responsible party that has performed the evaluation or measurement that is not available to the intended users. The subject matter information is provided to the intended users in the assurance report.

290.8 Independence requires:

#### Independence of Mind

The state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgement, allowing an individual to act with integrity, and exercise objectivity and professional scepticism.

## Independence<sup>4</sup> in Appearance

The avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional scepticism had been compromised.

290.9 The use of the word "independence"<sup>5</sup> on its own may create misunderstandings. Standing alone, the word may lead observers to suppose that a person exercising professional judgement ought to be free from all economic, financial and other relationships. This is impossible, as every member of society has relationships with others. Therefore, the significance of economic, financial and other relationships should also be evaluated in the light of what a reasonable and informed third party having knowledge of all relevant information would reasonably conclude to be unacceptable.

290.10 Many different circumstances, or combination of circumstances, may be relevant and accordingly it is impossible to define every situation that creates threats to independence and specify the appropriate mitigating action that should be taken. In addition, the nature of assurance engagements<sup>6</sup> may differ and consequently different threats may exist, requiring the application of different safeguards. A conceptual framework that requires firms and members of assurance teams to identify, evaluate and address threats to independence<sup>7</sup>, rather than merely comply with a set of specific rules which may be arbitrary, is, therefore, in the public interest.

<sup>4</sup> ***A U.S. publication used to conduct an evaluation of an organisation's internal control system.***

<sup>5</sup> ***A publication from the Canadian Institute of Chartered Accountants which provides advice and guidance on the criteria for control.***

## APPENDIX 2

### EXAMPLE OF AN UNQUALIFIED AUDIT REPORT FOR REGULATORY ACCOUNTS (to be tailored as appropriate for the particular circumstances of each engagement)

#### Independent Accountants' report to the Commission for Communications Regulation ("the Regulator") and ABC Limited<sup>2</sup>

We have audited the Regulatory Accounts of ABC Limited ("the Company") on pages x to x which comprise the profit and loss account, the statement of total recognised gains and losses, the balance sheet, [the cashflow statement] and the related notes to the Regulatory Accounts.

This report is made, on terms that have been agreed<sup>3</sup>, solely to the Company and the Regulator in order to meet [the requirements of the Regulatory Licence<sup>4</sup>]. Our audit work has been undertaken so that we might state to the Company and the Regulator those matters that we have agreed to state to them in our report, in order (a) to assist the Company to [meet its obligation under the Regulatory Licence to procure such a report] and (b) to facilitate the carrying out by the Regulator of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Regulator, for our audit work, for this report or for the opinions we have formed.

#### Basis of preparation

The Regulatory Accounts have been prepared under the historical cost convention (as modified by the revaluation of certain fixed assets) and in accordance with conditions [ ], [ ] and [ ] of the Company's Regulatory Licence, Regulatory Accounting Guidelines [ ], [ ] and [ ] ("the RAGs") issued by the Regulator and the [accounting policies] set out in the statement of accounting policies.

The Regulatory Accounts are separate from the statutory financial statements of the Company and have not been prepared under the basis of [Generally Accepted Accounting Practice in Ireland ("Irish GAAP")/International Financial Reporting Standards [as adopted by the European Union] ("IFRS")]. Financial information other than that prepared on the basis of [Irish GAAP/IFRS] does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Acts 1963 to 2006.

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<sup>2</sup> Any modification to this form of report should be made in accordance with ISA [(UK and Ireland) 700. The report is addressed to the Regulator as well as to the Company without any disclaimer of responsibility to the Regulator only where the Regulator has signed a tri-partite engagement contract or there is a bi-partite engagement contract supplemented by written notice signed by the Regulator. In other cases the report may be addressed to the Company only. In certain circumstances it may be necessary to include the Regulator as an addressee (to meet the requirements of the Regulatory Licence) but includes a disclaimer under which responsibility is accepted to the Company only and co-addressing to the Regulator is expressed to be only to meet the requirements of the Regulatory Licence.

<sup>3</sup> This requires an engagement letter/contract in a satisfactory form to be in place.

<sup>4</sup> Or other reference. If the appropriate reference is to a Regulatory Licence that licence will require to be defined in the reference where appropriate.

## **Respective responsibilities of the Regulator, the Directors and Auditors**

The nature, form and content of Regulatory Accounts are determined by the Regulator. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the Regulator's purposes. Accordingly we make no such assessment.

The directors' responsibilities for preparing the Regulatory Accounts in accordance with conditions [ ], [ ] and [ ] of the Regulatory Licence are set out in the statement of directors' responsibilities on page x.

Our responsibilities, as independent accountants are established in Ireland by the [Auditing Practices Board] and our profession's ethical guidance. Our responsibility is to audit the Regulatory Accounts in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board, except as stated in the 'Basis of audit opinion' below and having regard to *Guidance Name*. This report, including the opinion, has been prepared for, and only for, the Company [and the Regulator] and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report our opinion as to whether the Regulatory Accounts present fairly, in accordance with conditions [ ], [ ] and [ ] of the Company's Regulatory Licence, the RAGs [ ], [ ] and [ ], and the accounting policies set out on page x, the results and financial position of the company. We also report to you if, in our opinion, the Company has not kept proper accounting records or if we have not received all the information and explanations we require for our audit [or if we have not received proper returns adequate for our audit from operating locations not visited by us].

[We read the other information contained within the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent mis-statements or material inconsistencies with the Regulatory Accounts.]

### **Basis of audit opinion**

[The Regulatory Accounts are prepared by disaggregating balances recorded in the general ledgers and other accounting records of the [NAME OF STATUTORY ENTITY] maintained in accordance with the Companies Acts 1963 to 2006 and used, in accordance with those Acts, for the preparation of [NAME OF STATUTORY ENTITY]'s statutory financial statements.]

[No additional tests will be performed of the transactions and balances which are recorded in the general ledgers of [NAME OF STATUTORY ENTITY] other than those carried out in performing the audit of the statutory financial statements that include the Company].

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board except as noted below. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Regulatory Accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Regulatory Accounts, and of whether the accounting policies are consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Regulatory Accounts are free from material mis-statement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of Regulatory Accounts are determined by the Regulator, we did not evaluate the overall adequacy of the presentation of the information.

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of the Company on which we reported on [date], which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our “Statutory” audit) was made solely to the Company’s members, as a body, in accordance with section 193 of the Companies Act, 1990. Our Statutory audit work was undertaken so that we might state to the Company’s members those matters we are required to state to them in a Statutory auditor’s report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company’s members as a body, for our Statutory audit work, for our Statutory audit report, or for the opinions we have formed in respect of that Statutory audit.

### **Opinion**

In our opinion the Regulatory Accounts fairly present in accordance with conditions [ ], [ ] and [ ] of the Company’s Regulatory Licence, Regulatory Accounting Guidelines [ ], [ ] and [ ], and the accounting policies set out on page x, the state of the Company’s affairs at [date] and of its profit (or loss) [and cashflows] for the year then ended, and have been properly prepared in accordance with those conditions, guidelines and accounting policies.

[Name of auditor]

#### **4 BT Communications Ireland Limited**



**BT Communications Ireland Ltd (“BT”)  
Response to ComReg Consultation on:**

**Accounting Separation and Cost Accounting Review – Draft  
accounting Direction 168 ComReg document 09/75**

**Issue 1 – 11<sup>th</sup> February 2010**

**1. Introduction**

BT welcomes this consultation on Accounting Separation and Cost Accounting obligations on eircom which should help prevent eircom over recovering costs and lead to faster setting of wholesale prices in addition to ensuring that eircom is not employing anti-competitive practices.

We had always suspected that the level of information provided by eircom was not sufficient to enable appropriate forward looking prices to be set and this consultation provides a stark and bleak picture of the past. Lack of information, late provision of information and poor auditing practices, amongst many other issues, provide a depressing picture of eircom meeting its regulatory obligations. It also accounts for the level of wholesale prices in Ireland, the delays in finalizing appropriate prices and the low level of competition on a European scale. eircom has and continues to have a significant share of the fixed line market that has proved almost impossible to change in recent years.

We believe that access seekers may be being considerably overcharged for wholesale services and may be being discriminated against by eircom using anti-competitive practices. Without the availability of public domain information that provides sufficient transparency of costs and revenues by service it is not possible to draw any other conclusion.

In the absence of functional separation as a remedy and the current lack of transparency and difficulty with eircom’s accounting separation and cost accounting (as addressed by this consultation) we have no certainty of obtaining equivalent inputs as eircom downstream arms enjoy in terms of price and service. Investment in such an environment is always highly questionable.

It is of great importance in the next phase of the development of communications in Ireland as NGN and NGA services emerge that access seekers pay appropriate rather than inflated wholesale prices that over recover costs and are not discriminated against.

The current lack of pricing transparency has and continues to damage the development of effective competition in Ireland and consumers suffer. Uncertainty and the passage of time always play into the hands of the incumbent when seeking to limit competition. Examples are well documented by ComReg including the extraordinary time it is taking to set an appropriate price for LLU line share.

eircom launched retail current generation Ethernet services without providing a wholesale equivalent. Following dispute procedures eircom was eventually forced to offer wholesale services. The prices for these services are too high by logical deduction from the input components and we have raised this matter separately with ComReg.

Confidential Text Removed. Ref.1

ComReg will need to prevent any eircom retail launches until such time it is confident as to the appropriateness of the wholesale prices.

We agree that separated accounts will contain inefficient costs on a historical basis but provide an important input by way of checks and balances in the creation of appropriate forward looking efficient cost models and hence wholesale prices.

We note that over the last year, the difficulty encountered by ComReg in reconciling the service and product information with the eircom Separated Accounts, together with a lack of visibility as to how costs have been allocated/ apportioned at the market, service and product levels has heightened ComReg's concerns.

It is extraordinary to note that no detailed breakdown at the market, service or product levels within the Access or Core businesses are provided by eircom. This is extremely worrying for access seekers who must now assume that in all probability eircom may be over recovering its costs and discriminating across a range of services.

The process for accounting separation and cost accounting used by BT in the UK are widely referenced and we believe that they provide a good model for ComReg to adopt. We also note that BT UK is also functionally separated and believe that eircom should be required to be functionally separated when the new regulatory framework is transposed into Irish law.

The overall approach proposed in the draft Accounting Direction is very closely aligned to and derived from the manner in which BT produces separated accounts in the UK. Other than a few matters of detail we fully endorse the approach being taken by ComReg. Our response to consultation is therefore relatively short.

## **2. Response to Questions**

### **Area 1: Questions relating to proposals with regard to principles/processes**

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

**A 1.** We agree that a review should take place at this time. As mentioned in the introduction the lack of transparency, high probability of over cost recovery and

delays in achieving appropriate prices damages competition and is bad for consumers. Various evidential issues have arisen over recent years including the failure of eircom to offer wholesale Ethernet products whilst openly selling retail Ethernet products; the failure of eircom to correctly resolve inappropriate eircom retail access to UAN information (ComReg Doc 09/70); and the discrimination of providing a DSL Sync Checker (ComReg Doc 09/74) that eircom has been prone to discriminate in favor of its own retail business.

The discrimination cases and the key launch of eircom NGN services make it particularly important at this time to ensure eircom regulatory accounting is fit for purpose to enable the verification of appropriate prices for access products including LLU and NGN Ethernet Services.

LLU provides a glide path to Next Generation Broadband (NGB) and Ethernet is a corner stone of access needed for competition to take place in the business market.

Confidential Text Removed. Ref. 2

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

**A 5.** We agree that sampling is a pragmatic and proportionate way forward and that all samples should be ideally better than a +/-1% margin of error at a 95% confidence level. Margins of error will always take place with such work but must be minimized as proposed to provide confidence to access seekers that appropriate wholesale prices are set and that eircom is not over recovering its costs. Much of the input data will be required as inputs to eircom's legislative company accounts so it is not unreasonable that eircom will have much of the information and of sufficient quality.

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

**A 6** We agree with the key principles that should be applied in using sample data. Principles are required to prevent the incumbent manipulating the data provided to suit their own objectives. The principles proposed are sensible and reasonable in our opinion.

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

**A 12** We generally agree with ComReg's proposals regarding Transfer Pricing Principles. It is right that revenues and costs should be attributed to the cause of the cost or revenue. "Cost Causality" is a fundamental enshrining principle. However we are of the view that eircom should publish Internal Reference Offers (IROs) for products and facilities that eircom purchases from itself, so that other operators can

decide whether these products would be more appropriate to avail rather than the wholesale products currently available. Hence eircom should be required to publish the transfer pricing of services it offers itself as a transparency obligation to minimise the risk of discrimination taking place. If these services are equivalent as we are told, then why not publish if there is nothing to hide. As an example we would like to understand the pricing of the access service that eircom offers itself for bitstream to understand whether it is equivalent to the line share price. We certainly don't believe eircom was paying the 8.41 Euro monthly rental price for line share that it was charging the industry.

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

**A 19** We agree with the preliminary proposals that it should include details of eircom's: income recognition policy, depreciation policy and capitalisation policy and its approach to dealing with issues such as cost allocation, prior year adjustments and changes in accounting policy. We fully endorse the ComReg position that it reserves the final right to amend this final list from time to time where agreement cannot be reached.

We believe that this sets out the core details that are necessary to the process.

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

**A 20** We agree with ComReg's preliminary conclusion. Where eircom has recovered the cost of an asset or the contribution to the cost of an asset, from regulated wholesale charges then should that asset be disposed of then such transactions should be recognised in the accounts against the market where the costs have been recovered. As we enter into an NGB environment it is highly likely that many such assets will be disposed of or re-used for different purposes and this needs to be identified. We suggest that asset disposal should include asset re-use for other purposes such as office accommodation for the use of eircom or through rental charges to third parties.

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

**A 22** We agree that life to date holding gains and losses should be amortised over the life of the asset. We agree with the reasoning set out by ComReg and believe that this proposed approach would avoid sudden step changes and reflect in a more realistic way the level of profitability.

**Q 33 Do you agree or disagree with the content of the proposed accounting Direction (including Annex attached) and whether it is proportionate and justified? Please detail your response in full from a commercial, practical and legal perspective.**

**A 33** We agree with the content of the proposed accounting Direction. We would suggest that further clarity in clause 8.5 k); “*accounting treatment of NGN’s*” is necessary. In this context we assume that “NGN” means “NGN, NGA, NGB and other similar terms that may be used to describe next generation networks and access.

**Area 2: Questions relating to proposals with regard to disclosure in the Separated Accounts and Additional Financial Information**

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

*A 2 We agree with the ComReg view that; “The distribution of revenues by market, service and product is considered by ComReg to be of great importance to both Eircom and ComReg and the wider industry. In particular it assists in assessing the ability of Eircom to recover its costs, identify any possible margin squeeze or predatory pricing issues and the rates of return being generated on a market by market, service by service and product by product basis.”*

We have made many complaints against eircom over the years and have often been found in favour of by ComReg. It is therefore of great importance to the development of effective and sustainable competition that eircom is prevented from creating a margin squeeze etc.

The rise of bundled offers and eircom’s recent behavior with respect to bundling and the complaints and actions around that are well documented. We are therefore of the strong opinion that bundled discounts must be disclosed.

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

**A 3** We agree with the proposed approach. It is an approach that has been successfully used in the UK and we believe that it is appropriate.

**Q 4 Do you agree or disagree with the preliminary proposal that the Additional Financial Information shall include a reconciliation statement of Quarterly**

**Reports and Separated Accounts volumes together with detailed explanations? Please detail your response in full.**

**A 4** We agree with the proposed approach. It would otherwise be all too easy for eircom to produce rolling information that did not align without explanation thus clouding the whole process of transparency.

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

**A 7** We agree with the proposal. At present there is no transparency and it is impossible for any view to be formed from public domain information as to the costs. A key element of understanding whether an SMP operator is compliant with cost orientation regulation is to understand costs and where they are applied, Counting costs at too broad a level can potentially lead to a situation where the blending of underlying component costs and allocation decisions may distort the costs attributed to a product.

For example BT remains concerned that eircom's bitstream services created a margin squeeze to LLU Line Share whilst the Line Share price was 8.41euro per month. Given that the physical access components for LLU Line Share and the access element of eircom bitstream are the same eircom have had the same 8.41 euro per month rental cost as BT and the OAOs. Hence for eircom to have offered its wholesale bitstream services for around 9.5 euro per month appears incredible.

It is therefore essential that eircom provide sufficient granularity of eircom costs for eircom access and wholesale costs to be justified.

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

**A 9** We agree with the proposal. The hierarchy of costs seems fair and reasonable and it is also necessary to have full knowledge of adjustments as set out in the manual journals for their impact to be understood.

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

**information that you believe should also be provided? Please detail your response in full.**

**A 10** We agree with the preliminary recommendation that eircom be required to develop and submit to ComReg as part of its AFI a “Schedule of Network Components”, a “Network Activity Statement” and a “Usage by Service Schedule” for all markets, services, and products.

We agree that the content of such schedules/statements should be prepared and submitted by eircom to ComReg for its review within four months of the effective date of this Direction.

We would like to suggest that the list of products that this requirement applies to should be clarified given eircom’s track record of issues with Wholesale Terminating Segments of leased lines and Ethernet technology. I.e. Wholesale leased lines, wholesale terminating segments of leased lines and PPCs should be included in the products to be covered. We would also suggest that CPS and WLR are included as these are key regulated services the industry depends on.

We consider ComReg should reserve its position on the future amendment to the information to be provided.

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

**A 11** We agree with the proposal. The current lack of transparency heightens the risk if not actuality of eircom engaging in discriminatory behavior including margin squeeze and predatory pricing by shuffling costs between regulated and non-regulated services. The recent situation of eircom bundling of regulated and non-regulated products highlights that the pricing of non-regulated products can have an impact on the price to market of regulated products in effect causing a margin squeeze situation in the market.

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

**A 14** We agree with the preliminary proposals regarding the level of disclosure in the published and audited Separated Accounts and the Additional Financial Information.

We agree that eircom be required to prepare and submit to ComReg for approval draft schedules within four months of the effective date of the Direction.

As a general theme throughout this consultation but one that we specifically address here is that we note that ComReg has encountered problems regarding eircom's current obligations. We therefore wonder why these problems have not been addressed through enforcement action. It also begs the question that eircom will simply not comply with this proposed Direction and what action ComReg then propose to take?

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

**A 15** We agree with the proposal.

We note ComReg's view: *"that the level of disaggregation provided in regulated accounts varies from operator to operator e.g. BT Plc provides disaggregated accounts for 25 markets and more than 100 different services, whereas Eircom provides Separated Accounts for the Local Access Network Business, Core Network Business, Retail Business (and disaggregated accounts for 12 groups of retail services) and Other Business (disaggregated into 5 groups of other business services). Based on the above, and taking into account the fact the BT UK and Eircom are clearly of very different scales, it is ComReg's preliminary view that the level of disaggregation in Eircom's Separated Accounts on its own is insufficient to enable it demonstrate its compliance with its legal obligations and ComReg monitor such compliance."*

Whilst eircom and BT are clearly of different scales in terms of revenue and customers we do not agree that that difference in scale should mean that the number of markets and services is any different. We therefore agree with the ComReg conclusion but are concerned should the wrong interpretation be put on "scale" differences and hence obligations.

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

**A 16** We agree with the proposal. We agree that such an approach represents best practice as set out in the consultation. We see no reason why best practice should not be followed and in financial terms one would expect the statutory financial statements to be reconcilable with the regulatory accounts as both represent the trading of the company.



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

**A 17** We agree with the proposal. The approach should aid greater transparency by reflecting the level of efficiency or inefficiency of eircom.

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

**A 18** We agree with the proposal. Regulated accounting represents the provision of detail and to assist transparency we agree that the increased level of disclosure will assist in ensuring that eircom meets its regulatory obligations.

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

**A 21** We agree that CCA Separated Accounts should be provided by eircom for wholesale access, LLU and WBA (in addition to Call Origination, Call Termination and Leased Lines) as part of its Separated Accounts together with CCA profit and loss accounts for each regulated service. We note that currently the WUA LLU market states that eircom does not purchase LLU, however it is evident that eircom is providing to itself access akin to WUA Line Share to support its bitstream product. In the absence of the WPNIA decision ComReg will need to include this CCA Separated accounting for the access facility that eircom provide to itself to support bitstream services, whether in the WBA market or a new market.

We believe that the FCM approach is appropriate.

We believe that it is a grave omission to exclude wholesale access, LLU and WBA from the CCA Separated Accounts as it has clearly caused significant difficulties in price setting.

We note and agree that best practice and the actual practices employed throughout Europe support the proposed approach.

**Q 23 Do you agree or disagree with the preliminary proposal that Eircom be required to provide as part of its Separated Accounts a reconciliation of the**

**HCA and CCA accounts (at the market level)? Please detail your response in full.**

**A 23** We agree with the proposal. We are of the view that the provision of HCA information is required as an input to the derivation of CCA hence it is essential to show the reconciliation. Without such an approach there is always the risk of double counting by eircom and even if that was inadvertent it could lead to anti competitive effects.

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

**A 24** We agree with the proposal. Unless the level of granularity is consistent it would be impossible to undertake any form of reconciliation or formation of a considered view of forward looking pricing.

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

**A 25** We agree with the proposal for the same reasoning as set out in A 24.

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

**A 26** We agree with the proposal. We agree that the current length of time it takes eircom to publish is not acceptable. Delay works to eircom's advantage and this is just another example of delaying tactics. We note eircom's previous position on this that such timescales are wholly unrealistic. However, best practice indicates a contrary view. Therefore we would suggest that the motivation of eircom is simply to delay.

### **Area 3: Questions relating to documentation in an Accounting Document**

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

**A 8** We agree with the proposal. The approach represents best practice and without such an approach it is difficult to see how appropriate analysis could be conducted.

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**End**

## **5 Alternative Telecom Operators (“ALTO”)**

**Response to ComReg Consultation on:  
Accounting Separation and Cost Accounting Review –  
Draft accounting Direction 168 ComReg document**

**ComReg 09/75**

## **ALTO response to the ComReg consultation 09/75:**

ALTO welcomes this consultation on Accounting Separation and Cost Accounting Review – Draft accounting Direction 168.

### **1. Introduction**

ALTO welcomes this consultation on Accounting Separation and Cost Accounting obligations on eircom which should help prevent eircom over recovering costs and lead to faster setting of wholesale prices in addition to ensuring that eircom is not employing anti-competitive practices.

We had always suspected that the level of information provided by eircom was not sufficient to enable appropriate forward looking prices to be set and this consultation provides a stark and bleak picture of the past. Lack of information, late provision of information and poor auditing practices, amongst many other issues, provide a depressing picture of eircom's interest in meeting its regulatory obligations. It also accounts for the level of wholesale prices in Ireland, the delays in finalizing appropriate prices and the low level of competition on a European scale. Eircom has and continues to have a significant share of the fixed line market that has proved almost impossible to change in recent years.

We believe that access seekers may be being considerably overcharged for wholesale services and may be being discriminated against by eircom using anti-competitive practices. Without the availability of public domain information that provides sufficient transparency of costs and revenues by service it is not possible to draw any other conclusion.

In the absence of functional separation as a remedy and the current lack of transparency and difficulty with eircom's accounting separation and cost accounting (as addressed by this consultation) we have no certainty of obtaining equivalent inputs as eircom downstream arms enjoy in terms of price and service. Investment in such an environment is always highly questionable.

It is of great importance in the next phase of the development of communications in Ireland as Next Generation Networks – NGN, and Next Generation Access – NGA, services emerge that access seekers pay appropriate rather than inflated wholesale prices that over recover costs and are not discriminated against.

The current lack of pricing transparency has and continues to damage the development of effective competition in Ireland and consumers suffer. Uncertainty and the passage of time always play into the hands of the incumbent when seeking to limit competition. Examples are well documented by ComReg including the extraordinary time it is taking to set an appropriate price for Local Loop Unbundling – LLU, line share.



eircom launched retail current generation Ethernet services without providing a wholesale equivalent. Following dispute procedures eircom was eventually forced to offer wholesale services. The prices for these services are too high by logical deduction from the input components and we have raised this matter separately with ComReg.

eircom has advised that it intends to launch NGN Ethernet services in May 2010. It is unclear how the prices for these new services could be set by May 2010 in a way that we could have any confidence in them. Even if eircom do not challenge this proposed direction it will take a further period before appropriate and transparent information becomes publicly available.

ComReg will need to prevent any eircom retail launches until such time as it is confident as to the appropriateness of the wholesale prices.

We agree that separated accounts will contain inefficient costs on a historical basis but provide an important input by way of checks and balances in the creation of appropriate forward looking efficient cost models and hence wholesale prices.

We note that over the last year, the difficulty encountered by ComReg in reconciling the service and product information with the eircom Separated Accounts, together with a lack of visibility as to how costs have been allocated/ apportioned at the market, service and product levels has heightened ComReg's concerns.

It is extraordinary to note that no detailed breakdown at the market, service or product levels within the Access or Core businesses are provided by eircom. This is extremely worrying for access seekers who must now assume that in all probability eircom may be over recovering its costs and discriminating across a range of services.

The process for accounting separation and cost accounting used by BT in the UK and other EU member states are widely referenced and we believe that they provide a good model for ComReg to adopt. We also note that BT UK is also functionally separated and believe that eircom should be required to be functionally separated when the new regulatory framework is transposed into Irish law.

The overall approach proposed in the draft Accounting Direction is very closely aligned to and derived from the manner in which BT produces separated accounts in the UK. Other than a few matters of detail we fully endorse the approach being taken by ComReg. Our response to consultation is therefore relatively short.

## Detailed Comments

### Area 1: Questions relating to proposals with regard to principles/processes

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

We agree that a review should take place at this time. As mentioned in the introduction the lack of transparency, high probability of over cost recovery and delays in achieving appropriate prices damages competition and is bad for consumers. Various evidential issues have arisen over recent years including the failure of eircom to offer wholesale Ethernet products whilst openly selling retail Ethernet products; the failure of eircom to correctly resolve inappropriate eircom retail access to UAN information (ComReg Doc 09/70); and the discrimination of providing a DSL Sync Checker (ComReg Doc 09/74) that eircom has been prone to discriminate in favour of its own retail business.

The discrimination cases and the key launch of eircom NGN services makes it particularly important at this time to ensure eircom regulatory accounting is fit for purpose to enable the verification of appropriate prices for access products including LLU and NGN Ethernet Services.

LLU provides a glide path to Next Generation Broadband (NGB) and Ethernet is a corner stone of access needed for competition to take place in the business market.

eircom has advised that it plans to launch NGN services in May 2010. Such a launch should not take place unless appropriate wholesale prices have been set and they could only be set if the outcome of this consultation is reached and implemented. This will not be achieved for a May 2010 launch date. eircom should not be permitted to launch NGN retail services until such time as ComReg is fully satisfied that eircom is not over recovering its costs for wholesale NGN services and is not acting in an anti-competitive manner.

### Area 2: Questions relating to proposals with regard to disclosure in the Separated Accounts and Additional Financial Information

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

**Answer 2:** We agree with the ComReg view that; *“The distribution of revenues by market, service and product is considered by ComReg to be of great importance to both Eircom and ComReg and the wider industry. In particular it*

*assists in assessing the ability of Eircom to recover its costs, identify any possible margin squeeze or predatory pricing issues and the rates of return being generated on a market by market, service by service and product by product basis.”*

We have made many complaints against eircom over the years alleging margin squeeze and predatory pricing issues and have often been found in favour of by ComReg. It is therefore of great importance to the development of effective and sustainable competition that eircom is prevented from acting in such ways.

The rise of bundled offers and eircom’s recent behavior with respect to bundling and the complaints and actions around that are well documented. We are therefore of the strong opinion that bundled discounts must be disclosed.

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

**Answer 3:** We agree with the proposed approach. It is an approach that has been successfully used in the UK and we believe that it is appropriate.

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

**Answer 4:** We agree with the proposed approach. It would otherwise be all too easy for eircom to produce rolling information that did not align without explanation thus clouding the whole process of transparency.

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

**Answer 7:** We agree with the proposal. At present there is no transparency and it is impossible for any view to be formed from public domain information as to the costs. A key element of understanding whether an SMP operator is compliant with cost orientation regulation is to understand costs and where they are applied, Counting costs at too broad a level can potentially lead to a situation where the blending of underlying component costs and allocation decisions may distort the costs attributed to a product. To prevent situations such as margin squeeze, where the calculation at the higher level shows compliance, more granular investigation may show a completely different outcome.

For example BT remains concerned that eircom's bitstream services creates a Margin Squeeze to LLU Line Share based on the Line Share 8.41euro per month charge that eircom is seeking to maintain through its legal challenge of ComReg's Line Share Decision notice (ComReg Doc. 09/66). Given that the physical access components for LLU Line Share and the access element of eircom bitstream are the same eircom must therefore have the same 8.41 euro per month rental cost as BT and the OAOs. Hence for eircom to offer a whole end-to-end solution for around 9.5 euro per month appears incredible.

It is therefore essential that eircom provide sufficient granularity of eircom costs for eircom access and wholesale costs to be justified.

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

**Answer 9:** We agree with the proposal. The hierarchy of costs seems fair and reasonable and it is also necessary to have full knowledge of adjustments as set out in the manual journals for their impact to be understood.

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

**Answer 10:** We agree with the preliminary recommendation that eircom be required to develop and submit to ComReg as part of its AFI a "Schedule of Network Components", a "Network Activity Statement" and a "Usage by Service Schedule" for all markets, services, and products.

We agree that the content of such schedules/statements should be prepared and submitted by eircom to ComReg for its review within four months of the effective date of this Direction.

We would like to suggest that the list of products that this requirement applies to should be clarified given eircom's track record of issues with Wholesale Terminating Segments of leased lines and Ethernet technology. Wholesale leased lines, wholesale terminating segments of leased lines, PPCs should be included in the products to be covered. We would also suggest that CPS and

WLR are included as these are key regulated services the industry depends on.

We consider ComReg should reserve its position on the future amendment to the information to be provided.

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

**Answer 11:** We agree with the proposal. The current lack of transparency heightens the risk if not actuality of eircom engaging in discriminatory behavior including margin squeeze and predatory pricing by shuffling costs between regulated and non-regulated services. The recent situation of eircom bundling of regulated and non-regulated products highlights that the pricing of non-regulated products can have an impact on the price to market of regulated products in effect causing a margin squeeze situation in the market.

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

**Answer 14:** We agree with the preliminary proposals regarding the level of disclosure in the published and audited Separated Accounts and the Additional Financial Information.

We agree that eircom be required to prepare and submit to ComReg for approval draft schedules within four months of the effective date of the Direction.

As a general theme throughout this consultation but one that we specifically address here is that we note that ComReg has encountered problems regarding eircom's current obligations. We therefore wonder why these problems have not been addressed through enforcement action? It also begs the question that eircom will simply not comply with this proposed Direction and what action ComReg then propose to take?

**Q. 15 Do you agree or disagree with the format and content of the draft Separated Accounts Schedules and the draft Additional Financial**

**Information Schedules as set out in Appendices B, C, and D? Please detail your response in full.**

**Answer 15:** We agree with the proposal.

We note ComReg's view: *"that the level of disaggregation provided in regulated accounts varies from operator to operator e.g. BT Plc provides disaggregated accounts for 25 markets and more than 100 different services, whereas Eircom provides Separated Accounts for the Local Access Network Business, Core Network Business, Retail Business (and disaggregated accounts for 12 groups of retail services) and Other Business (disaggregated into 5 groups of other business services). Based on the above, and taking into account the fact the BT UK and Eircom are clearly of very different scales, it is ComReg's preliminary view that the level of disaggregation in Eircom's Separated Accounts on its own is insufficient to enable it demonstrate its compliance with its legal obligations and ComReg monitor such compliance."*

Whilst eircom and BT are clearly of different scales in terms of revenue and customers we do not agree that that difference in scale should mean that the number of markets and services is any different. We therefore agree with the ComReg conclusion but are concerned should the wrong interpretation be put on "scale" differences and hence obligations.

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

**Answer 16:** We agree with the proposal. We agree that such an approach represents best practice as set out in the consultation. We see no reason why best practice should not be followed and in financial terms one would expect the statutory financial statements to be reconcilable with the regulatory accounts as both represent the trading of the company.

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

**Answer 17:** We agree with the proposal. The approach should aid greater transparency by reflecting the level of efficiency or inefficiency of eircom.

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

**Answer 18:** We agree with the proposal. Regulated accounting represents the provision of detail and to assist transparency we agree that the increased level of disclosure will assist in ensuring that eircom meets its regulatory obligations.

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

**Answer 21:** We agree that CCA Separated Accounts should be provided by Eircom for wholesale access, LLU and WBA (in addition to Call Origination, Call Termination and Leased Lines) as part of its Separated Accounts together with CCA profit and loss accounts for each regulated service. We note that currently the WUA LLU market states that eircom does not purchase LLU, however it is evident that eircom is providing to itself an access service akin to WUA Line Share to support its bitstream product. In the absence of the WPNIA decision ComReg will need to include this CCA Separated accounting for this access facility that eircom provide to itself to support bitstream services, whether in the WBA market or a new market.

We believe that the FCM approach is appropriate.

We believe that it is a grave omission to exclude wholesale access, LLU and WBA from the CCA Separated Accounts as it has clearly caused significant difficulties in price setting.

We note and agree that best practice and the actual practices employed throughout Europe support the proposed approach.

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

**Answer 23:** We agree with the proposal. We are of the view that the provision of HCA information is required as an input to the derivation of CCA hence it is essential to show the reconciliation. Without such an approach

there is always the risk of double counting by eircom and even if that was inadvertent it could lead to anti competitive effects.

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

**Answer 24”** We agree with the proposal. Unless the level of granularity is consistent it would be impossible to undertake any form of reconciliation or formation of a considered view of forward-looking pricing.

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

**Answer 25:** We agree with the proposal for the same reasoning as set out in A 24.

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

**Answer 26:** We agree with the proposal. We agree that the current length of time it takes eircom to publish is not acceptable. Delay works to eircom’s advantage and this is just another example of delaying tactics. We note eircom’s previous position on this that such timescales are wholly unrealistic. However, best practice indicates a contrary view. Therefore we would suggest that the motivation of eircom is simply to delay.

**Area 3: Questions relating to documentation in an Accounting Document**

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## **Conclusion**

ALTO considers ComReg's activity and future Directions to eircom and as critical to the investment cycles required to sustain new entrant operators and foster growth in the Communications industry. As mentioned in detail above, roll back of existing regulation is not a requirement at all. The economic and technological change industry faces currently require refining of obligations in a more granular fashion or where deficient, the widening of reporting requirements to foster the sustainable and dynamic change assisted by regulation and clear regulatory policy.

ALTO – Alternative Telecom Operators

12 February 2010