



Office of the Director of
**Telecommunications
Regulation**

Accounting Separation and Publication of Financial Information for Telecommunications Operators

Decision Notice D10/99

Document No. ODTR 99/52

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Oifig an Stiúirthóra Rialála Teileachumarsáide
Office of the Director of Telecommunications Regulation
Abbey Court, Irish Life Centre, Lower Abbey Street, Dublin 1.
Telephone +353-1-804 9600 *Fax* +353-1-804 9680
Web: www.odtr.ie

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1. Introduction

In March 1999, the Office of the Director of Telecommunications Regulation (“ODTR”) launched a consultation process in relation to accounting separation and publication of financial information for telecommunications operators. The process involved the publication of a consultation document (“ODTR 99/10”¹) in March 1999.

In May 1999, the Director of Telecommunications Regulation (the “Director”) published a document (ODTR 99/35) which included a decision notice (D5/99) and consultation report and also raised certain issues for further consultation².

The initial consultation document sought views of interested parties on the following areas:-

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

The treatment of subsidiaries in the context of accounting separation was raised under the issues for further consultation, as the Director believed that this matter required further consideration. She wished to have the benefit of views from interested parties before finalising her decision on the following matters:-

- Definitions of the Main Business Areas
- Extent of Disaggregated Activities
- Statement of Average Cost of Network Components
- Additional Principles for a Transfer Charging system involving subsidiaries

In this paper, the ODTR sets out the report on those issues which required further consideration, together with the decisions the Director has made for the effective implementation of accounting separation in Ireland in relation to those issues.

This document sets out the Director’s current position on accounting separation and publication of financial information for telecommunications operators, without prejudice to the legal position or the rights and duties of the Director to regulate the market generally.

¹ Accounting Separation and Publication of Financial Information for Telecommunications Operators, Consultation Paper (Document No. ODTR 99/10)

² Accounting Separation and Publication of Financial Information for Telecommunications Operators, Decision Notice 5/99 and Consultation Paper and Issues for Further Consideration (Document No. ODTR 99/35)

2. Background

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

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

Accounting separation can assist in ensuring that charges are cost based, transparent and non-discriminatory, which in turn promotes a competitive environment in a number of ways, including the following: -

- a) the publication of accounts that are transparent allows other operators to understand how the SMP operator's revenues relate to costs,
- b) the availability of information gives other operators the confidence that the interconnection arrangements are equitable, in that it should demonstrate that there is no over or under recovery of the SMP operator's network costs, and
- c) the publication of detailed cost statements showing the average cost build of products and services provided by an SMP operator will increase and raise the confidence of competitors that there are no anti-competitive cross subsidisations.

Obligations on telecommunications operators in relation to accounting separation are set out in a number of different places. Of particular relevance is Condition 15 of the General Telecommunications Licence and Regulation 9 of the European Communities (Interconnection in Telecommunications) Regulations, 1998.

A number of relevant reference documents are listed in the earlier consultation and report.

At present Telecom Éireann ("TE") is the only operator that has been designated as having SMP in the fixed, interconnect and leased line markets³. It is therefore the only organisation currently subject to the obligations set out in this Decision Notice. For ease of reference TÉ is referred to directly throughout this document.

³ Significant Market Power in the Irish Telecommunications Sector, Decision Notice D4/98 (Document No. ODTR 98/47)

3. Consultative Process & Responses

In ODTR 99/35, a number of issues were raised for further consultation with interested parties. This section briefly summarises those issues and the responses received and sets out the decisions of the Director on each issue.

Three organisations responded to the consultation and the Director wishes to thank those respondents and the others that contributed to the process. The comments received have informed the decisions contained in this document.

Responses were received from the following parties:-

- ESAT Digifone Ltd
- OCEAN Communications Ltd
- Telecom Éireann (“TE”)

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

3.1. Definitions of the Main Business Areas

In general respondents agreed with the definitions of the four main business areas, as set out in the original consultation paper, ODTR 99/10.

However, as noted in ODTR 99/35, respondents raised the issue of how subsidiaries should be treated for accounting separation purposes. ODTR 99/35 requested comments on the definition of the main business areas having particular regard to subsidiaries.

All respondents agreed that the separated accounts should include the main subsidiary activities of TÉ within the “Other Activities” main business area. One respondent believes that there should be clear reconciliation between the total revenues costs and net assets of the accounting separation statements, and the published financial accounts for the Group.

TÉ pointed out that the accounting separation statements being produced for this year are only for the company and consider that it is now too late in the process to produce group separated accounts by the end of September, which is the deadline for production of separated regulatory accounts in accordance with ODTR 99/35. However, they do anticipate being able to produce Group accounts next year. TÉ further state that any revenue, costs, assets and liabilities relating to subsidiary activities but which have arisen in the parent company’s accounts will be recognised in the “Other Activities” category in this year’s statements.

The Director considers in order to increase the transparency of the accounting separation statements that the subsidiary activities of T   should be included as part of the "Other Activities" main business area.

The Director notes T  's concern in relation to the current year's accounts. However she also notes that the majority of the information required to publish separate accounts for subsidiaries should already be available because: -

- It is necessary for the preparation of existing group consolidated accounts;
- It is a key input into the reconciliation of the accounting separation statements to the group consolidated accounts;
- Individual subsidiary accounts are required to be laid before the annual general meeting for compliance with Section 148 of the Companies Acts, 1963.

The Director believes therefore that T   should include the additional subsidiary information required by this decision notice in the separated accounts to be published at the end of September 1999. The Director will consider on a case by case basis any exceptions to this deadline. The revised definition of the "Other Activities" main business area is detailed in Appendix I.

Decision 3.1

The relevant subsidiary activities of T   (see Decision 3.2) shall be included as part of the "Other Activities" category. This information shall be included in the 1998/99 set of accounting separation statements.

3.2. Extent of Disaggregated Activities

ODTR 99/35 sought the views of interested parties on the extent of disaggregation of subsidiary activities, if any, within the 'Other Activities' main business area.

Two respondents agreed that both Eircell and Indigo should be shown separately in the separated accounts and one respondent considered that all subsidiary activities should be disaggregated. Such separated accounts were considered to add to clarity, transparency and public confidence that there are proper accounting relationships between the T   business units. A view was also expressed that such publication may not in itself be sufficient to guard against potential abuses of market power, and the ODTR's power of investigation will therefore also be important.

One respondent does not agree that Eircell and Indigo and any other subsidiary should be shown separately in the separated accounts because subsidiaries such as Eircell are separately incorporated companies and produce their own statutory accounts. In addition they either operate in separate markets, which are highly competitive, do not have dominant market positions, or do not operate in the telecommunications industry or in Ireland.

The Director considers that accounting separation should apply to TÉ and its relevant downstream retail activities, including those activities operated through subsidiaries. The Director believes that this will contribute to an open and competitive market as it will increase operators' confidence that proper accounting relationships exist between TÉ and its various business units, and that they are not the beneficiary of cross-subsidies from other areas within the TÉ Group.

The "Other Activities" category should therefore be further disaggregated to show separately the subsidiary activities of TÉ. Subsidiary activities for accounting separation purposes should comply with the definitions as outlined in the Companies Acts, 1963 to 1990, the European Community (Companies: Group Accounts) Regulations, 1992 and relevant Accounting Standards. For accounting separation purposes the following subsidiaries need not be disclosed separately:-

- Non-trading subsidiaries;
- Subsidiaries not offering licensable telecom services within Ireland.

The Director reserves the right to review the level of disaggregated activities as set out in this paper in light inter alia of relevant market growth or changes in product offerings by TÉ.

Decision 3.2

The "Other Activities" category should be further disaggregated to show separately the subsidiary activities of TÉ as outlined above.

3.3. Statement of Average Cost of Network Components

Two respondents agreed that the activities of the disaggregated subsidiary should form part of the statement of Average Network Component Costs.

One of these respondents stated that if the activities of subsidiaries are included within the accounting separation exercise, the disaggregated subsidiary activities should form part of the statement of Average Network Component Costs. Another respondent believes that all cost transfers should be appropriately sub-analysed within an accounting separation system, and be subject to audit, and the aggregate effect exposed in the transfer charge summaries. The same respondent notes that the complexity of the business relationships between the subsidiaries and the core network activities may make such network components difficult to construct and understand.

One respondent does not believe that a separate Network Statement of Costs should be prepared for any of the subsidiaries and that these statements should only be produced for services where T  has SMP, and where the market would not be considered to be fully competitive (The respondent believes both Eircell and Indigo operate in highly competitive markets). They feel any use of the T  network by subsidiary companies would be reflected in the recharge that the Network Business makes for the use of its network.

The Director believes that a detailed statement of the costs of all network services used is required to ensure transparency and promote competition particularly at the current stage of market development. This statement should be sufficiently detailed to show that Telecom  ireann's own downstream arm is not treated more or less favourably than other operators. However, while the level of traffic Telecom  ireann generates is one component of the information to be provided, the Director considers that this information is commercially confidential and need not be published at this time. The Director reserves the right to publish this information in the future if she considers it appropriate.

The Director believes that the complexity of the interrelationship between the activities of T  and its subsidiaries would make the construction of subsidiary network statement of costs difficult and not easily understandable and this would not therefore be of significant value. For example, the cost transfers between T  and the subsidiaries may relate to a range of both interconnect and retail services, in which case a unit charge of this service would be meaningless.

Decision 3.3

T  is required to publish a statement of network component costs, as part of accounting separation information and this should contain the following information:

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

Pro forma schedules are set out in Appendix III (Statement of Costs of Network Services – Transfer to Retail and Other Activities). A further confidential schedule on volume information must be provided to the ODTR only. This should be provided at the same time as the publication of separated accounts. The pro forma schedule for the Network Statement of Costs remains in the form outlined in ODTR 99/35.

3.4. Principles for a Transfer Charging System

ODTR 99/35 sought the views of interested parties on the proposed approach to dealing with the issue of the confidentiality of the disaggregated information on internal operational costs and activities of the TÉ group. The Director's stated view was that to maintain the commercial confidentiality of this information, detailed statements of the internal operational costs and relationships between TÉ and its subsidiaries should only be provided to the ODTR.

One respondent disagrees with this approach, as they have no confidence as to whether or not a proper accounting relationship exists between TÉ and Eircell and do not believe that the proposed approach will provide for sufficient transparency or public accountability.

Another respondent believes that the publication of the transfer charge statement shown in Appendix VII of ODTR 99/35 is sufficient (this is reproduced in Appendix V of this document) and it is appropriate that some of these details remain commercially confidential. They are of the opinion that what is important is that the subsidiary businesses are treated at arms' length on a non-discriminatory basis.

Another agrees with the approach outlined in ODTR 99/35 and concurs that the detailed statements of the internal operational costs and relationships between TÉ and its subsidiaries should only be supplied to ODTR.

The Director has set out in ODTR 99/35 the principles that should apply to transfer charging including the fact that it is applicable to all products and services purchased internally in TÉ. The Director is of the view that to ensure no preferential treatment is given to businesses within the TÉ group, charges for internal use for any product/service should be equivalent to the charge that would be levied if the product or service were sold externally rather than internally.

Having regard, *inter alia*, to the views put forward, the Director remains of the view that the detailed statement of internal transfers should be provided to the ODTR in the first instance and, in the interests of commercial confidentiality, should not be published at this time. This strikes an appropriate balance between ensuring that no inappropriate transfers or cross subsidies take place on the one hand and commercial confidentiality on the other.

Details of internal transfers to be prepared along with the separated accounts as set out in Appendix IV and V. Appendix V on Inter Business Costs Summary remains unchanged from that detailed in ODTR 99/35.

Decision 3.4

The details of internal transfers that T  is required to publish along with the separated accounts are as set out in Appendix IV and V.

3.5. Other Issues

A number of additional comments were received from respondents on the definitions of certain disaggregated activities. The Director considers that certain amendments are appropriate and the amended definitions are detailed in Appendix II. The remaining definitions are as originally detailed in Decision Notice 5/99 (ODTR 99/35). In particular, in order to ensure an appropriate symmetry between the treatment of subsidiaries providing internet services and an operator's business units that provide a similar service, the Director considers it appropriate that an additional retail disaggregated activity for internet services should be added to those listed in the Decision Notice 5/99 (ODTR 99/35).

Decision 3.5

The amended and additional disaggregated activities defined in Appendix II shall be incorporated into the accounting separation statements. The remaining definitions are as originally detailed in Decision Notice 5/99 (ODTR 99/35).

Appendix I – Definitions of Main Business Areas

Other Activities

Operators typically provide a wide range of other services including the rental, repair and maintenance of customer equipment. In addition, they may have interests in non-telecommunications activities. For the purposes of accounting separation, the costs, revenues and capital employed associated with these activities will be separately identified. All subsidiary activities of the operator shall be included in the 'Other Activities' main business area.

Appendix II – Additional Definitions of Disaggregated Activities

RETAIL

Retail – Access

The business relating to the supply of customer line rental and its associated costs.

Retail – Internet Services Supply

The business relating to the supply of internet services.

Retail – Calls to Mobile

Dialled calls originating on ordinary and private payphone lines that terminate on a mobile, not fixed network.

OTHER ACTIVITIES

Other – Apparatus Supply

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

Other – Subsidiary Activities (in accordance with Decision 3.2)

Subsidiary activities for accounting separation purposes should comply with the definitions as outlined in the Companies Acts, 1963 to 1990, the European Community (Companies: Group Accounts) Regulations, 1992 and relevant Accounting Standards. For accounting separation purposes the following subsidiaries need not be disclosed separately:-

- Non-trading subsidiaries;
- Subsidiaries not offering licensable telecom services within Ireland.

Appendix III – Statement of Costs of Network Services

	<i>Traffic Sensitive</i>				<i>Non-Length Dependent</i>	<i>Length Dependent</i>						(Split as above)	International Transmission	Directory Enquiry	International Directory enquiry	Private Circuits\Leased Lines	Interconnect connections and rentals	Other cost categories will be included as required
	Subscriber Unit	Primary Switch	Secondary Switch	Tertiary Switch		RSU to Primary to Primary Link	Primary to Secondary Link	Secondary to Secondary Link	Secondary to Tertiary Link	Tertiary to Tertiary Link								
Average Cost Pence/Minute⁴	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Total Costs⁵																		
Usage Factors (Routing or Percentage)																		
<i>Retail Services</i>																		
Local Calls	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
National Calls	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
International Calls	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
<i>(Other retail services as appropriate)</i>																		
<i>Other Activities Services</i>																		
Apparatus Supply	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
<i>(Other services as appropriate)</i>																		
<i>RIO Services</i>																		
Call Termination																		
Primary	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Tandem	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
<i>(Other RIO services as appropriate)</i>																		
Other subsidiaries as appropriate	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X

⁴ From Statement of Network Costs Schedule

⁵ Ibid

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

	<i>Traffic Sensitive</i>				<i>Non-Length Dependent</i>	<i>Length Dependent</i>					<i>Length Dependent</i> (Split as above)	International Transmission	Directory Enquiry	International Directory enquiry	Other cost categories will be included as appropriate	<i>Call Conveyance Cost</i>										
	Subscriber Unit	Primary Switch	Secondary Switch	Tertiary Switch		RSU to Primary/Secondary Link	Primary to Primary Link	Primary to Secondary Link	Secondary to Secondary Link	Secondary to Tertiary Link						Tertiary to Tertiary Link	Gradient	Call Conveyance Cost								
Average Cost Per Minute																										
<i>Retail Services</i>⁶																										
Local Calls	X	X	X	X		X	X	X	X	X	X	X	X	X	X		<table border="1"> <tr><td>Peak</td><td>X</td><td>X</td></tr> <tr><td>Off - peak</td><td>X</td><td>X</td></tr> <tr><td>Weekend</td><td>X</td><td>X</td></tr> </table>	Peak	X	X	Off - peak	X	X	Weekend	X	X
Peak	X	X																								
Off - peak	X	X																								
Weekend	X	X																								
National Calls <i>(Other retail services as appropriate)</i>	X	X	X	X		X	X	X	X	X	X	X	X	X	X		<table border="1"> <tr><td>Peak</td><td>X</td><td>X</td></tr> <tr><td>Off - peak</td><td>X</td><td>X</td></tr> <tr><td>Weekend</td><td>X</td><td>X</td></tr> </table>	Peak	X	X	Off - peak	X	X	Weekend	X	X
Peak	X	X																								
Off - peak	X	X																								
Weekend	X	X																								
<i>Other Activities Services</i>																										
Apparatus Supply <i>(Other services as appropriate)</i>	X	X	X	X		X	X	X	X	X	X	X	X	X	X		<table border="1"> <tr><td>Peak</td><td>X</td><td>X</td></tr> <tr><td>Off - peak</td><td>X</td><td>X</td></tr> <tr><td>Weekend</td><td>X</td><td>X</td></tr> </table>	Peak	X	X	Off - peak	X	X	Weekend	X	X
Peak	X	X																								
Off - peak	X	X																								
Weekend	X	X																								
<i>RIO Services</i>																										
Call Termination Primary	X	X	X	X		X	X	X	X	X	X	X	X	X	X		<table border="1"> <tr><td>Peak</td><td>X</td><td>X</td></tr> <tr><td>Off - peak</td><td>X</td><td>X</td></tr> <tr><td>Weekend</td><td>X</td><td>X</td></tr> </table>	Peak	X	X	Off - peak	X	X	Weekend	X	X
Peak	X	X																								
Off - peak	X	X																								
Weekend	X	X																								
Tandem <i>(Other RIO services as appropriate)</i>	X	X	X	X		X	X	X	X	X	X	X	X	X	X		<table border="1"> <tr><td>Peak</td><td>X</td><td>X</td></tr> <tr><td>Off - peak</td><td>X</td><td>X</td></tr> <tr><td>Weekend</td><td>X</td><td>X</td></tr> </table>	Peak	X	X	Off - peak	X	X	Weekend	X	X
Peak	X	X																								
Off - peak	X	X																								
Weekend	X	X																								

⁶ Those costs are obtained from multiplying the average cost per minute by the usage factors, both of which are shown on page 18. These costs reflect the conveyance element of the service only.

Appendix IV – Transfer Charge Statement

Costs/Services	<i>Retail Services</i>										<i>Other Activities Services</i>		
	Local Calls	National Calls	International Calls	Directory Enquiry Services	Public Payphones	Lease Lines	Calls to Mobile	Internet	Supplemental Services Business	Remaining	Apparatus Supply	Remaining Activities	Other Subsidiaries (as appropriate per Decision 3.2)
Network Cost	X	X	X	X	X	X	X	X	X	X	X	X	X
Local Access Costs	X	X	X	X	X	X	X	X	X	X	X	X	X
Other Operating Costs	X	X	X	X	X	X	X	X	X	X	X	X	X
Total Transfer Charges	X	X	X	X	X	X	X	X	X	X	X	X	X

Appendix V – Inter Business Costs Summary

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