

Review of Cost Accounting Methodology

Accounting Separation, Cost Accounting Systems, Cost Orientation and Retail Price Notification

Response to Consultation and Decision C05/16

2nd November 2016

Gibraltar Regulatory Authority

Communications Division

2nd Floor, Eurotowers 4, 1 Europort Road

Gibraltar

Telephone +350 20074636 Fax +350 20072166

Email: communications@gra.gi

Web: <http://www.gra.gi>

CONTENTS

1. Introduction.....	1
2. Accounting separation, cost accounting, cost orientation and retail price notification SMP obligations	3
3. Current Cost Accounting Vs Historical Cost Accounting.....	5
4. Responses to the Consultation and final Decision	7
5. Key principles and compliance requirements for the Accounting Separation obligation	9
5.1 Structure and content of the Accounting Separation Report.....	9
5.2 Regulatory Financial Statements.....	10
5.2.1 Profit and Loss Statement.....	10
5.2.2 Mean Capital Employed Statement.....	10
5.2.3 Reconciliation Statement with the Statutory Accounts	11
5.2.4 Wholesale Service Statement	12
5.2.5 Network Statement of Costs.....	13
5.2.6 Service Cost Statement.....	14
5.2.7 Retail Cost Orientation Statement.....	15
5.2.8 Statement of responsibility and compliance with Community and national rules.....	15
5.2.9 Auditor’s opinion.....	15
5.2.10 Statement of Transfer Charges.....	17
5.3 Accounting documents.....	19
5.4 Attribution Methodology document.....	19
5.5 Charge compliance assessment	20
5.6 Audit process	22
5.7 Confidentiality and publication of the ASR	22
5.8 Non-compliance of the ASR	25

5.9 Consistency of treatment.....	26
5.10 Maintenance of accounting records	27
5.11 Availability of accounting records.....	27
6. Key principles and compliance requirements for the Cost Accounting obligation.....	29
6.1 Key principles for the determination of annual capital charges.....	30
6.1.1 Method of calculation of annual capital charges.....	30
6.1.2 Approach to calculate the Cost of Capital	31
6.2 Key principles for the implementation of Fully Allocated Costs (FAC) .	32
6.2.1 Cost Attribution process	32
6.2.2 Principles for Cost Causality	33
6.2.3 The Cost Cascade	34
6.2.4 Attribution methodologies.....	35
6.3 Cost Accounting information to be made available to the Authority ...	37
7. Retail Price Notification Framework.....	39
7.1 Purpose and objectives of the retail Price Notification Framework	39
7.2 Processes for changes to existing prices including special offers temporary discounts and promotions	39
7.3 Processes for notification of prices of new services	41
7.4 Process for bundling and tying of services	41
Annex A – Decisions.....	43
Annex B - ASR templates	49
1. Profit and Loss Statement.....	49
2. Mean Capital Employed Statement	50
3. Reconciliation Statement with Statutory Accounts.....	51
4. Wholesale Service Statement.....	52
5. Network Statement of Costs	53

6.	Service Cost Statement	54
7.	Retail Cost Orientation Statement	55
8.	Statement of Transfer Charges	56

1. Introduction

The electronic communications regulatory framework¹ requires the Gibraltar Regulatory Authority (the Authority) to define relevant markets appropriate to national circumstances and to analyse these markets to ensure that regulation remains appropriate in the light of changing market conditions, otherwise known as market reviews.

On 5th June 2014, the Authority issued a public consultation on accounting separation and cost accounting systems with reference to compliance under SMP obligations (Public Consultation No. 08/14). This consultation proposed incremental changes to Decision No. 01/11 (Reissued) with an aim to consolidate the decisions currently standing together with the new results into one document. Consequently, the Authority issued a Response to Consultation and Decision Document 13/14.

On 4th June 2015, the Authority revised and updated Decision Notice 13/14 and issued Decision Notice C01/15, which incorporated all previous GRA documentation on accounting policy including Decisions 07/08, 01/11 and 13/14.

On 1st September 2016, the Authority issued Public Consultation C04/16 in order to gain a better understanding of the industry's views on whether the use of Current Cost Accounting (CCA) for operators designated as having significant market power (SMP) was still beneficial and proportionate.

Having considered the views of all respondents to the Public Consultation, this Response to Consultation and Decision sets out the Authority's conclusions regarding the use of CCA with reference to compliance with accounting separation, cost accounting systems, cost orientation and retail price notification obligations by SMP operators.

This document shall be read in conjunction with all markets reviews within which the following SMP obligations have been imposed:

**Accounting Separation (including non-discrimination);
Cost Accounting;
Cost Orientation;
Retail Price Notification (including transparency).**

Under the provisions of the Communications (Access) Regulations², operators designated as having SMP in Gibraltar (operators) may be required to provide all accounting records, including data on revenues received from third parties, in order to facilitate the Authority's task of verifying that the SMP operator concerned has complied with obligations imposed upon it.

Furthermore, under the provisions of the Communications (Universal Service and Users' Rights) Regulations³, operators designated as having SMP in Gibraltar may be required, amongst other things, to operate and maintain a cost accounting system that complies with the specific requirements and guidelines issued by the Authority.

¹ Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services (the Framework Directive) and later Directive 2009/140/EC "Better Regulation Directive" outlines amendments to Article 16(4) of Directive 2002/21/EC on a "Common Regulatory Framework".

² Communications (Access) Regulations 2006.

³ Communications (Universal Service and Users' Rights) Regulations 2006.

The Authority has taken note of the following legislative documents in compiling this document:

1. Communications Act 2006.
2. Communications (Access) Regulations 2006.
3. Communications (Universal Service and Users' Rights) Regulations 2006.

The Authority has also referred to the documentation, guidance and recommendations produced by the Body of European Regulators for Electronic Communications (BEREC) and the following documents:

1. Commission Recommendation of 19th September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications, (2005/698/EC), published 11th October 2005.
2. ERG Common Position: Guidelines for implementing Commission Recommendation C (2005) 3480 on accounting separation & cost accounting Systems under the regulatory framework for electronic communications, ERG (05) 29.
3. Commission Recommendation of 7th May 2009 on the regulatory treatment of fixed and mobile termination rates in the EU, (2009/396/EC).
4. ERG Report – Regulatory accounting in practice 2009, ERG (09) 41.

The consultation is structured as follows:

Section 1 outlines the purpose of this document.

Section 2 summarises the SMP obligations.

Section 3 compares current cost accounting with historical cost accounting methodologies.

Section 4 summarises the responses to the consultation and explains the Authority's final decision.

Section 5 outlines the key principles and compliance requirements for the accounting separation obligation.

Section 6 outlines the key principles and compliance requirements for the cost accounting obligation.

Section 7 outlines the key principles and compliance requirements for the retail price notification framework.

ANNEX A summarises the decisions.

ANNEX B provides templates for Accounting Separation Reports.

2. Accounting separation, cost accounting, cost orientation and retail price notification SMP obligations

Summary of SMP obligations:

Accounting separation

An accounting separation system is a comprehensive set of accounting policies, procedures and techniques that can be applied to the preparation of financial information that demonstrates compliance with non-discrimination obligations and the absence of anticompetitive cross-subsidies. The outputs from such a system must be capable of independent verification (auditable) and fairly present the financial position and relationship (transfer charge arrangements) between product and service markets. Using accounting separation, the Authority imposes on the Notified Operator a set of rules on how accounting information should be collected and reported.

Accounting separation provides a higher level of detail of information than that derived from statutory financial statements to reflect as closely as possible the performance of parts of the Notified Operator's business as if they had operated as separate businesses, and in the case of vertically integrated undertakings, to prevent discrimination in favour of their own activities and to prevent unfair subsidies.

In the case of transfer charges, these typically reflect the vertically integrated nature of the Notified Operator and will enumerate the wholesale/retail relationships between the economic markets and services within the undertaking's scope of activity. There should be a clear rationale for the transfer charges used and these should be clearly identified in sufficient detail to provide compliance with the transparency and non-discrimination obligations. The charge should be equivalent to the charge that would be levied if the product or service were sold externally rather than internally.

Cost accounting

A cost accounting obligation ensures that Notified Operators maintain cost accounting systems which produce in particular appropriate information to demonstrate compliance with cost-orientation for the prices in the relevant market.

A cost accounting system is a set of rules which supports the attribution of costs, revenues and capital employed to individual activities and services. More precisely it describes a set of systems, processes and procedures that enable a Notified Operator to establish a record keeping regime necessary to meet its regulatory obligations which keeps track of and reports on revenues, costs, assets and capital employed.

When implementing a cost accounting system, the rules used for the allocation of costs should be displayed at a level of detail that makes clear the relationship between costs and charges of network components and services and the basis on which directly and indirectly attributable costs have been allocated between different accounts needs to be provided.

The purpose of imposing an obligation to implement a cost accounting system is to ensure that fair, objective and transparent criteria are followed by the Notified Operator in allocating their costs and services and provide the Authority with detailed and reliable information on their costs, in particular to ensure appropriate compliance with cost-orientation for the prices in the relevant market.

For Accounting Separation and Cost Accounting purposes, all other products/ services (not included within the relevant markets defined above) should be included in a separate market/category "Others" in order to reconcile the Separated Accounts with the Statutory Financial Statements.

Cost orientation

Cost orientation is an important principle in the regulation of telecoms operators with significant market power (SMP). Regulators use it to ensure that the charges set by operators with market power are based on cost.

The Authority needs to be able to monitor compliance with the cost orientation obligations imposed for the relevant markets. Ideally the assessment of cost orientation would be through a form of Long Run Incremental Cost (LRIC) based accounting. The Authority is however aware of the limited resources available by the operators and therefore requires a simplified process of assessing compliance with cost orientation.

The tests for cost orientation outlined in annex B will be applied by the Authority to validate compliance. If a wholesale charge, or a retail price, fall outside the set parameters, the operator shall provide evidence to the Authority to support such charges and prices.

Retail Price Notification

For markets where an operator has been found to have SMP in a retail market, the Authority has determined that the most appropriate and proportionate obligation to safeguard the interests of consumers, whilst reducing the burden on the operator, is compliance with a Price Notification Framework (PNF).

The PNF replaces the Authority's earlier regulation of retail prices in SMP markets via a price cap.

The PNF is intended to be a lighter touch regulation than the price cap, which will balance the burden on operators with the need to protect consumer interests in markets where there is no effective competition.

The PNF process and rules are intended to cover all changes to current prices (whether permanent or temporary) and introduction of new prices. Operators will not be required to submit PNF information for current prices for which they are not requesting changes, but the Authority can request PNF information on an ad-hoc basis to investigate current prices, whether on its own initiative or as a result of a complaint by a third party (whether a consumer or provider).

3. Current Cost Accounting Vs Historical Cost Accounting

The scope of the public consultation was limited to examining whether it is still beneficial and proportionate to require that an SMP provider which is subject to an obligation of accounting separation and/or an obligation of price controls and cost accounting, should provide those accounts and costs using the principle of Current Cost Accounting (CCA).

CCA has been used as the preferred cost accounting standard by National Regulatory Authorities (NRAs) across the EU and in other countries for many years. Its benefits are that the costs calculated using CCA represent an approximation of what it would cost the SMP provider to implement the network or service in question now, using the latest technology, rather than in the past using potentially obsolete technology.

The CCA approach therefore helps send efficient make or buy signals to market entrants (i.e. whether the new competitor could provide the network or service more efficiently itself or whether it should purchase the regulated access service). The benefits of CCA were significant in the past when fixed networks were old and sometimes fully depreciated.

However, as technologies change and most providers update their networks and services on a much more frequent basis than was the case in the past, the benefits of the CCA approach have reduced over time.

CCA costing can be implemented by absolute re-valuation of each asset or by the use of indices for groups or categories of assets subject to similar price trends. In Gibraltar, the GRA had agreed with Gibtelecom, as the SMP provider, that it could use indexing as this substantially reduces the compliance burden compared to having to obtain current asset quantities and prices for every individual asset. Even when using indexation, however, implementation of CCA costing is a complex undertaking, and particularly so in smaller jurisdictions where indices specific to the operator's assets, reflecting local pricing and labour conditions, may not be readily available.

Experience over the years where CCA costing has been mandated in Gibraltar has shown that it can be very difficult to find appropriate indices for Gibtelecom's assets and that using indices from other countries can cause significant distortions. This should be considered in combination with the fact that networks technologies are developing and evolving rapidly (so asset lives are shorter and many assets are therefore relatively new) resulting in a much smaller difference between historical and current asset values. The GRA therefore considered it would be appropriate and proportionate to modify Decision Notice C01/15 to remove the obligation to use CCA costing methodology and instead to apply the historical cost accounting (HCA) methodology.

In addition to the rationale set out above, the GRA noted that the NRA in Ireland⁴ had also revoked the obligation to use the CCA costing methodology.

The GRA therefore proposed that the costing methodology to be used in the compliance with accounting separation and cost accounting obligations in Gibraltar should no longer be CCA, but HCA.

⁴ ComReg Information Notice 13/59.

The GRA believes that the move to HCA costing will have significant benefits in improving the relevance, transparency and usability of the regulatory accounts in the following ways:

- Asset values and hence associated depreciation costs will reflect those actually incurred by Gibtelecom without the inclusion of CCA adjustments which, for the reasons discussed above, may be considered arbitrary. This will increase confidence in the integrity of the Accounting Separation Report (ASR).
- There will be a significant saving in resources required to produce and validate the ASR (by Gibtelecom, the GRA and their advisors and auditors).

4. Responses to the Consultation and final Decision

This section outlines the responses to the Consultation together with the Authority's position.

Question 1: Do you agree that the move from CCA to HCA will result in the advantages outlined above?

Views of Respondents

Gibtelecom agreed that the move from CCA to HCA will be advantageous. The Company noted the Authority's recognition of the challenges of producing regulatory accounts using CCA methodologies, in particular for an operator the size of Gibtelecom. As previously advised by the Company, obtaining, interpreting and validating the required CCA indices has been burdensome, costly, time-consuming, and undoubtedly lengthens the review process.

The Authority's position

The Authority accepts Gibtelecom's comments and agrees that the move from CCA to HCA is the best way forward as this will improve the relevance, transparency and usability of the regulatory accounts.

The GRA further believes that the drawbacks of moving to a historical approach are minor:

- There is likely to be only a small impact on the cost base used to determine core network services such as fixed and mobile interconnection, as most of the assets used are recently purchased.
- For the cable and duct network, which forms a major component of the access PSTN and broadband services, the HCA values may differ substantially from a CCA valuation. However, as the retail fixed access market is currently loss-making, the GRA believes that the move to HCA will not result in reductions in retail pricing, and hence will not have a detrimental impact on the development of competition in the retail access markets. The GRA will observe these markets carefully and may introduce new remedies should it identify signs of pricing behaviour that could cause harm to competition.

Question 2: Do you agree that the drawbacks in moving to HCA are minor, and will not inhibit the development of competition?

Views of Respondents

Gibtelecom welcomed the Authority's proposals to revert to HCA principles for regulatory accounting purposes and agreed that this would not have an impact on the development of competition.

The Authority's position

The Authority welcomes Gibtelecom's comments that the move to HCA will not affect the development of competition and the drawbacks will be very minor.

Question 3: Any other comments?

Views of Respondents

Gibtelecom noted that the Authority is proposing to re-issue a full set of templates should the obligation to produce regulatory accounts using CCA principles be removed. The Company suggested that the opportunity be taken to reissue the templates providing greater clarity on the reporting level and details required. This would be further to the discussions held between Gibtelecom and the Authority as part of the review process of the Company's ASRs for the financial years ending 31 December 2013 and 2014.

The Authority's position

The Authority notes Gibtelecom's comments and has included a revised set of templates in this Response to Consultation and Decision document. As part of the review process, the Authority and Gibtelecom have already commenced discussions regarding clarification on the reporting level and the details required and will continue doing so until up to the submission of the next forthcoming ASR.

The GRA requires that SMP operators use a historical cost accounting methodology in compliance with accounting separation and cost accounting obligations in Gibraltar.

5. Key principles and compliance requirements for the Accounting Separation obligation

5.1 Structure and content of the Accounting Separation Report

The following sections illustrate the Authority's previous decisions with respect to each particular item and have not been the subject of this consultation. Therefore, for the sake of completeness, these have been included in this Response to Consultation and Decision.

The Notified Operator shall prepare and submit to the Authority **annually within nine months of the end of the company's financial year** an Accounting Separation Report for the relevant markets/services comprising of the three following sets of documents:

1/ REGULATORY FINANCIAL STATEMENTS	Profit and Loss statements
	Mean Capital Employed statements
	Reconciliation statements with statutory accounts
	Wholesale Service statements
	Network Statement of Costs
	Service Cost statements
	Retail Cost Orientation statements
	Statement of responsibility and compliance with Community and national rules
	Auditor's opinion
	Statement of transfer charges
Other notes	
2/ ACCOUNTING DOCUMENTS	Accounting principles
	Description of the costing model
	Detailed description of Weighted Average Capital Cost (WACC) calculation
	Other notes
3/ ATTRIBUTION METHODOLOGY DOCUMENT	Description of cost attributions in the costing model

The Notified Operator shall prepare and submit to the Authority annually within nine months of the end of the company's financial year an Accounting Separation Report which includes the documents in the table in Section 5.1 above.

5.2 Regulatory Financial Statements

5.2.1 Profit and Loss Statement

A Profit and Loss (P&L) statement contains revenues, costs and capital for the products or services of a relevant market for the year reported. Costs shall be calculated on a HCA basis.

Markets designated with a cost orientation SMP obligation requires that the allocation of costs be displayed at a level of detail that makes clear the relationship between costs and charges. To help monitor this obligation the Notified Operator shall prepare the P&L statement so that the lines "operating costs specific to market/service" and "exceptional operating costs specific to market/service" show all individual cost items greater than 10% of the total of all HCA costs for that market. For wholesale markets this would typically include items such as depreciation, general management, network support and maintenance and accommodation. For retail markets, this would typically include marketing and sales, finance and billing, customer services, general management and bad debts.

As set out in Decision Notice 13/14 of 17th September 2014, markets designated with a cost orientation SMP obligation are required to demonstrate a clear relationship between costs and charges. The breakdown of costs in this required P&L statement will help inform the Authority and other stakeholders of the material cost categories that make-up the products and services in each market. By analysing the breakdown of costs along with any changes year on year, the Authority will be better informed on the relationship between costs and charges and the effect on charges from material cost changes.

The P&L statement contains standardised lines of revenues and costs as stated in section 1 of Annex B.

The Notified Operator shall use the template in section 1 of Annex B when providing Profit and Loss statements in its accounting separation report.

5.2.2 Mean Capital Employed Statement

When the Notified Operator calculates costs incurred in providing a product or a service, it is appropriate to allow a reasonable return on the capital employed including appropriate labour and building costs. This means that the investment made by the operator should take into account and allow it a reasonable rate of return on capital employed, taking into account the risks involved.

There must be consistency between the measure of capital employed on which the cost of capital is based and the capital employed reported in the ASR.

All markets designated with a cost orientation obligation require that the allocation of costs should be displayed at a level of detail that makes clear the relationship between costs and charges. To help monitor this obligation, the Notified Operator shall prepare the Mean Capital Employed (MCE) Statement to show the visibility of any

material cost changes that may impact on charges. The valuation of the capital investments by the operator will have an important impact on the costs that may impact charges through depreciation.

The Notified Operator shall prepare the MCE statement so that the line “tangible fixed assets” shows all individual asset items of value greater than 10% of the total of all HCA valuations for that market. For wholesale markets this would typically include items such as access copper, access fibre, duct, transmission switch and land and building valuations. For retail markets this would typically include land and buildings, computing, and software.

Should the other fixed asset categories become material then the Authority will need to review this requirement to see if it is relevant to include a similar level of transparency to these categories as well.

The MCE statement contains standardised items for specific fixed asset items, as stated in section 2 of Annex B.

The Notified Operator shall produce a Mean Capital Employed statement for each relevant market based on the template in section 2 of Annex B.

5.2.3 Reconciliation Statement with the statutory accounts

Financial statements should be reliable and consistent.

The Notified Operator shall therefore ensure that sufficient controls and reconciliation procedures are in place to support the link between the ASR and the accounting records of the operator and hereby:

- a. enable the auditor and the Authority to conclude that, in their opinion, the CAS complies with the accounting documents provided within the ASR;
- b. enable the ASR to be audited and;
- c. enable a reconciliation of the operator’s statutory financial statements.

In order to ensure consistency among the financial statements, the Authority requires reconciliation of the key financial line items of the ASR to the statutory financial statements. In requiring the Notified Operator to provide this Reconciliation Statement the Authority is seeking assurance that the revenues and costs in the regulatory statements can be separately reconciled to the statutory accounts and to demonstrate that sufficient controls are in place in the preparation of both revenues and costs in the regulatory accounts. This reconciliation statement should therefore show the reconciliation to the statutory accounts of items in the revenue and costs column as well as the return column of the reconciliation statement in the regulatory accounts.

To ensure consistency the financial statements should show how the revenue and costs in the ASR are separately reconciled to the statutory financial statements and that any adjustments to this reconciliation are clearly explained. The Notified Operator shall ensure that the Reconciliation Statement is completed with separate entries for revenue and costs in the “Adjustment” section as illustrated in the Reconciliation Statement in Section 3 of Annex B.

A material item in the ASR is the transfer charging of wholesale services to retail. These transfer charges will result in a material entry for revenue resulting from the income to wholesale for the sale of services to retail and a material entry for costs resulting from an equal and opposite material cost for the purchase of these services by retail. As a result, the Notified Operator shall ensure that this issue be addressed by the addition of a line in the Reconciliation Statement that eliminates the revenue and costs from these transfer charges which are not in the statutory accounts. This line is shown in the Reconciliation Statement in Section 3 of Annex B.

The inclusion of the new "Elimination of transfer charges" line is important in this reconciliation to the statutory accounts, as it traditionally is the largest difference between the revenues and costs in the regulatory accounts compared to the statutory accounts. The transfer charges included in the Notified Operators transfer charges matrix should therefore be included in this reconciliation statement to show how the revenue and costs can be separately reconciled back to the statutory accounts.

In addition, the "Other Adjustments" line in the Reconciliation Statement should contain separate revenue and cost entries as well as a return entry and a description for this entry. This is shown in the Reconciliation Statement in Section 3 of Annex B.

The Notified Operator shall provide a Reconciliation Statement of the key financial line items of the ASR with the statutory accounts based on the template in Section 3 Annex B, including the elements outlined in this section to separately reconcile revenue and costs to the statutory accounts.

5.2.4 Wholesale Service Statement

Accounting separation aims to monitor a systematic division of costs between retail and wholesale as well as allowing non-discrimination to be enforced and cross-subsidies to be identified.

For that purpose, the Authority needs to identify the unit costs of the wholesale services that may be used internally for providing retail services and sold externally to other operators.

A cost orientation obligation may also be imposed on the Notified Operator within some of the relevant markets.

The Notified Operator shall therefore produce appropriate information to demonstrate compliance with those principles, via a Wholesale Service Statement for a relevant wholesale market that provides:

- The total costs allocated to the wholesale service;
- The unit and volume of the stated service for the relevant accounting period (for example total number of minutes, total number of calls, total number of lines, etc.); and
- The unit cost of the stated service.

To ensure that the relevant information is provided to check compliance with non-discrimination and/or cost orientation obligations, it is necessary to understand the costs that make up the wholesale services and how these are then charged to retail.

To provide this information the unit costs for the services that make up each market should be shown separately, along with their internal and external revenues, volumes and costs. These services should be disclosed separately in a Wholesale Service Statement as set out in Section 4 of Annex B. If this results in the disclosure of more wholesale services than is reported in the Statement of transfer charges (see Section 3.2.10 of this document) then the Statement of transfer charges should incorporate the services shown in the new Wholesale Service Statement.

The Notified Operator shall therefore complete a Wholesale Service Statement demonstrating that this contains the standardised items, as stated in Section 4 of Annex B. The internal revenue and volumes shown in this Statement should be the same as those provided in the Statement of transfer charges for the wholesale services purchased by the retail services as was set out in Section 3.2.10 of this document.

This Wholesale Service Statement includes the requirement to show the unit costs and unit revenue as well as the 'Average revenue per unit/FAC'. The purpose and benefits for reporting the unit costs (Ceiling FAC per unit) and unit revenue is to show the relationship between unit costs and revenue for the regulated wholesale products. This will give the Authority information to assess compliance with the cost orientation obligation for the wholesale products. The 'Average revenue per unit/FAC' provides a useful indicator of how closely the charges are related to costs by dividing the unit revenue by the unit cost.

This Wholesale Service Statement also includes the 'Ceiling FAC per unit' which is used by the Authority to measure compliance with the cost-orientation obligation by monitoring the unit price for each wholesale product against the FAC per unit of this product as described in section 3.5 of this document. The 'Ceiling FAC per unit' is derived from the second set of tables in the Service Cost Statement (see Section 3.2.6 of this document) that shows the 'Total FAC' at the bottom of these tables.

The Authority attaches a revised Wholesale Service Statement to address the additional points raised by the Company in its response to this question.

The Notified Operator shall provide a Service Statement for each relevant wholesale market as set out in Section 4 of Annex B, including the elements outlined in this section in order to check compliance with non-discrimination and/or cost orientation obligations.

5.2.5 Network Statement of Costs

The principle underlying FAC is that the total cost incurred in producing a single product or in delivering a specific service should be attributed to that product or to that service. As described in more detail in Section 4.2.1 of this document, these costs should be attributed to products based on the principles of:

- Causality;
- Objectivity;
- Consistency; and
- Transparency.

In allocating these costs they may be attributed to "Services", or to cost pools called "network components", "Related functions" or "Other functions". These are defined in more detail in Section 4.2.3 of this document.

The costs of "network components" are important as they make up the costs for the reported wholesale services. Visibility of these wholesale service costs, and the way they change over time, is required by the Authority to fully discharge its obligations for cost accounting and cost orientation.

To give this visibility in the ASR, the Authority requires that the ASR includes a Network Statement of Costs to show the cost breakdown of these network components. Such network components might typically be access loops copper, access loops fibre, line cards, switches, IP network equipment etc.

The costs required in the Network Statement of Costs include an allowance for the capital employed by calculating an applicable rate of return based on the MCE. The applicable rate of return is the WACC as set by the Authority. The inclusion of this allowance for capital allows for the calculation of the FAC for the "network components" which can then be allocated to the wholesale products and services. The allocation of this FAC is done using the routing factors described below in Section 3.2.6 of this document, enabling the FAC for each service to be calculated as shown in the Statement of Services schedule.

The Authority requires that the network Statement of Costs be prepared by the operator using the template in Section 5 Annex B.

The Notified Operator shall produce a Network Statement of Costs as shown in Section 5 of Annex B to provide documentation and transparency of the network components.

5.2.6 Service Cost Statement

The "network component" costs identified in the Network Statement of Costs described in the previous section must be allocated to the wholesale products and services. Key relevant information for this stage is the routing factors matrix, which provides the usage of network element for each type of product/network service.

The routing factors matrix is published in the attribution methodologies documentation and can be used to allocate the cost of the network components to the wholesale products and services. This routing factors matrix will need to be expanded to cover any new components the operator produces in the network Statement of Costs.

The Authority requires that, to give visibility to the way the network component costs are used by the wholesale services, a Service Cost Statement is prepared which will utilise the routing factors matrix to allocate the network component average cost per unit from the network Statement of Costs to individual services. This is illustrated in the "Service Cost Statement – usage of services by network components" schedules shown in Section 6 of Annex B. The schedules show how each network component is used by the wholesale services. This usage is shown by the applying routing factors taken from the routing factors matrix as published in the attribution methodologies documentation.

These routing factors are then applied to the cost of relevant network components to produce the FAC for each wholesale service as illustrated in the "Service Cost Statement – costing of services using routing factors" schedules in Section 6 of Annex B. These

schedules show the way the wholesale services use network components and gives a cost breakdown for the network components making up the services. The resultant FAC unit cost by service from this schedule should equal the FAC shown in the Service Statement as the "Ceiling" in Section 4 of Annex B.

The Authority requires that the Service Costs Statement be prepared by the operator using the template in Section 6 of Annex B.

The Notified Operator shall produce a Service Costs statement as shown in Section 6 of Annex B to document and give transparency to the allocation of network component costs to services.

5.2.7 Retail Cost Orientation Statement

For retail services that are subject to cost orientation obligations the Authority needs to be able to monitor compliance with the cost orientation for the relevant Retail markets. The Authority will evaluate this compliance as described in Section 3.5 of this document by requiring the Notified Operator to produce the Retail Cost Orientation Statement set out in Section 7 of Annex B. This cost orientation statement should contain the wholesale charges and the retail Direct, Shared and Common costs relevant to each retail service and calculate the price range as described in Section 3.5 of this document.

The Notified Operator shall produce a Retail Cost Orientation Statement as set out in Section 7 of Annex B for retail services.

5.2.8 Statement of responsibility and compliance with Community and national rules

The ASR must be prepared in accordance with the requirements of the relevant governing EU and Gibraltar communications legislation. The Notified Operator shall provide a statement of responsibility regarding the compliance of the ASR with these requirements.

The Notified Operator shall prepare its accounting separation report in accordance with the requirements of the relevant governing EU and Gibraltar communications legislation.

5.2.9 Auditor's opinion

The auditor's opinion has great value in enhancing the quality, objectivity and credibility of the information provided. User confidence and understanding of the ASR is significantly enhanced by the presence of an independent audit.

The auditors shall plan and carry out such work as will enable them to report whether or not any matter that has come to their attention in cases where the regulatory financial statements do not in all material respects:

a) Present fairly and properly the revenues, costs and mean capital employed by each of the businesses and activities disclosed in the ASR in accordance with the accounting and attribution methodology documents that are to be attached to the Regulatory Financial Statements;

b) Comply with any relevant regulation, notice or decision issued by the Authority with respect to Accounting Separation & Cost Accounting.

Where any such irregularities have come to the auditor's attention, they shall be clearly described in their opinion together with, where reasonably possible, the potential monetary impact on the P&L or MCE statements, or a statement that the potential monetary impact is not reasonably possible to establish.

The auditor's opinion shall at least include:

- The conclusions of the auditor;
- All identified irregularities (with the potential monetary impact, where reasonably possible);
- Recommendations made by the auditor (with a description of the corresponding effects); and
- A full description of the verification methodology followed, including a clear set of the respective responsibilities of the auditor, of the Notified Operator and of the basis on which the audit has been carried out and the opinion arrived at.

The auditors shall plan and carry out such work as will enable them to report whether or not any matter that has come to their attention in cases where the regulatory financial statements do not in all material respects:

a) Present fairly and properly the revenues, costs and mean capital employed by each of the businesses and activities disclosed in the ASR in accordance with the accounting and attribution methodology documents that are to be attached to the Regulatory Financial Statements;

b) Comply with any relevant regulation, notice or decision issued by the Authority with respect to Accounting Separation & Cost Accounting.

Where any such irregularities have come to the auditor's attention, they shall be clearly described in their opinion together with, where reasonably possible, the potential monetary impact on the Profit & Loss or Mean Capital Employed statements, or a statement that the potential monetary impact is not reasonably possible to establish.

The auditor's opinion shall at least include:

- **The conclusions of the auditor;**
- **All identified irregularities (with the potential monetary impact, where reasonably possible);**
- **Recommendations made by the auditor (with a description of the corresponding effects); and**
- **A full description of the verification methodology followed, including a clear set of the respective responsibilities of the auditor, of the Notified Operator**

and of the basis on which the audit has been carried out and the opinion arrived at.

5.2.10 Statement of Transfer Charges

Transfer charges relate to transactions that flow between disaggregated entities, markets and services of a vertically integrated Notified Operator.

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

Basic elements or conditions of this transfer charging system are:

- There should be a clear rationale for the transfer charges used and each charge should be justifiable. Charges should be non-discriminatory and there should be transparency of transfer charges in the separated accounts.
- Transfer charges should be determined as the product of usage and unit charges. The charge should be equivalent to the charge that would be levied if the product or service were sold externally rather than internally.
- For accounting separation purposes it should be assumed that the Notified Operator's retail business pays the same charge for the same input service (bought on its own wholesale market) as it would if bought externally by an alternative operator.
- Where a service is also sold externally, the transfer charge should be equal to the price stated in the Reference Interconnection Offer (RIO) and Reference Unbundling Offer (RUO) or any other Reference offer.
- There should be consistency of treatment of transfer charges from year to year. Any change should be consistent, transparent and satisfactory to the Authority.

The fundamental principle for the operator in setting transfer charges between the separated accounts is non-discrimination. This principle requires that the charges set internally (e.g. while selling services within the operator's business) reflect the charges applied to other operators. This principle allows the regulator to accurately evaluate the financial performance of each separated business unit.

Wholesale services utilised in the retail segment would generate internal costs that also equal internal revenues from transfer services presented in the wholesale segment.

There are two principles for setting the transfer price as outlined below:

- Transfer charge based on external prices

The basic assumption for calculating charges of the transfer services is that they should be equal to the market price. Therefore, where the Notified Operator renders a relevant service both internally and on the external wholesale market, the price for this service would be equivalent to the wholesale price for external customers stated in the

RIO, RUO or any other Reference offer. Consequently, the internal revenue of the wholesale segment would equal the wholesale price multiplied by the quantity rendered to the retail segment.

- Transfer charge based on unit cost of service

Where the Notified Operator does not render transfer services both internally and on the external wholesale market, the transfer charge for the service would equal the unit cost of service calculated according to the notified accounting basis and accounting methodology. Therefore, internal revenues from transfer services would equal the transfer charge multiplied by the volume of transactions in a year.

A transparent and verifiable transfer charging system is necessary for Notified Operators to demonstrate non-discrimination and calculate internal costs and revenues for both cost orientation and non-discrimination purposes.

Transfer charges/prices shall be calculated by the Notified Operator as follows:

- **There should be a clear rationale for the transfer charges used and each charge should be justifiable. Charges should be non-discriminatory and there should be transparency of transfer charges in the separated accounts;**
- **Transfer charges shall be determined as the product of usage and unit charges;**
- **Where a service is sold externally, the transfer charge shall be equal to the price stated in the Reference Interconnection Offer (RIO) and Reference Unbundling Offer (RUO) or any other Reference offer;**
- **Where a service is rendered only internally, the transfer charge for the service is equal to the unit cost of service according to the notified accounting basis and accounting methodology; and**
- **There shall be consistency of treatment of transfer charges from year to year. Any change shall be consistent, transparent and satisfactory to the Authority.**

The Notified Operator shall produce a Statement of Transfer Charges which shall include the following:

- **Retail activities where Notified Operators are designated as having SMP;**
- **Measure unit and volume of the stated activities for the relevant accounting period (for example total number of minutes, total number of calls etc.);**
- **The network unit charges;**
- **The product of the unit charges and the volumes, in order to identify total network charge for the activity; and**
- **Accounting policies.**

The statement of transfer charges shall follow the same format as section 8 in Annex B.

5.3 Accounting documents

The Regulatory Financial Statements are prepared in accordance with the accounting documents, which set out the framework under which the statements are to be prepared in accordance with this public consultation.

These accounting documents are made up of the following:

- **Regulatory Accounting Principles** – the principles applied or used by the Notified Operator in the preparation of the Regulatory Financial Statements;
- **Description of the costing model** – which implies the type of model used (Activity-Based Costing (ABC) for instance), a description of the cost categories and the cost cascade, the depreciation method and asset life implemented, etc.
- **Detailed description of (Weighted Average Capital Cost) WACC calculation; and**
- **Other notes**

The values of fixed assets and their depreciation costs can have an important impact on the Service costs that may affect charges and the Authority's ability to assess any cost accounting and cost orientation obligations as described in Section 4.1.1 of this document. Given the importance of asset values and their depreciation, the Authority requires that the Notified Operator publishes the asset lives of all major asset classes so the significance of these assets on costs can be assessed.

The Authority also requires that Notified Operators provide the asset classes and their values.

The Authority requires the Notified Operator to prepare accounting documents that are made up of the following:

- **Regulatory Accounting Principles** – the principles applied or used by the Notified Operator in the preparation of the Regulatory Financial Statements;
- **Description of the costing model** – which implies the type of model used (ABC for instance), a description of the cost categories and the cost cascade, the depreciation method and asset life implemented, etc.
- **Detailed description of (Weighted Average Capital Cost) WACC calculation; and**
- **Other notes**

5.4 Attribution Methodology document

The Attribution Methodology document describes in more detail the methods of attributing costs, revenues, assets and liabilities.

- Revenue Attribution

Usually revenues can be directly allocated to the products and services to which they relate based on accounting records and billing system information. Where direct allocation based on accounting records or billing system data is not possible (e.g. bundled discounts), revenues should be attributed on the basis of causation.

- Cost Attribution

Following the principle of cost causation, each item of cost and revenue should be allocated to the products and services provided by an operator. Most revenues can be allocated directly to their related products or services. However, this is not the case for costs due to the relatively high proportion of costs that are shared between different products and services.

More specifically the document shall include details on driver description and purpose, sources and destinations (i.e. routing factors matrix, wholesale-retail service mapping matrix), the procedure for the driver preparation and the data sources.

The network components are a key part of the costing and attribution methodology shown in the Network Statement of Costs described in Section 3.2.5. A description of these network components including their definition and the services that utilise each component is required to enhance the understanding of the ASR.

The Authority requires the Notified Operator to produce the Attribution Methodology document which shall include the elements of revenue attribution and cost attribution and shall also include details on driver description and purpose, sources and destinations (i.e. routing factors matrix, wholesale-retail service mapping matrix), the procedure for the driver preparation and the data sources. The Notified Operator shall include in the Attribution Methodology document a table describing each of the network components shown in the Network Statement of Costs and indicating the network components that comprise the provision of services.

5.5 Charge compliance assessment

The Authority needs to be able to monitor compliance with the cost orientation obligations imposed for the relevant markets. Ideally the assessment of cost orientation would be through a form of LRIC based accounting. The Authority is however aware of the limited resources available by the operators and therefore requires a simplified process of assessing compliance with cost orientation.

The charge compliance tests will be applied by the Authority to validate compliance. If a wholesale charge, or a retail price, fall outside the set parameters, the operator shall provide evidence to the Authority to support such charges and prices. The Authority will evaluate such submissions to determine whether exceptional circumstances exist that permit the charges or prices to sit outside the standard framework compliance parameters.

Due to the different natures of the wholesale and retail markets, compliance analyses have been split to deal with the wholesale and retail markets as discussed below.

Wholesale charges compliance assessment

The Authority requires that the Notified Operator's wholesale charges should be set at a rate that is not above that shown in the Wholesale Service Statement in Section 3.4. ((calculated as the HCA FAC (which includes an allowance for a reasonable return on its capital using the WACC)), adjusted as necessary by the Authority to reflect requirements and best practice as issued by the European Commission, BEREC or other such relevant organisations or bodies. Adjustments made would be reductions of the HCA FAC-based charge, to reflect other costing methodologies considered best practice (including LRIC and pure LRIC where appropriate) and efficiency improvements the Authority considers reasonable having reviewed the operator's costs. A rate above the HCA FAC level would not be considered cost oriented.

Retail charges compliance assessment

For retail services the Authority requires that the prices would be considered compliant with cost orientation if they lie between:

- 1) The sum of relevant wholesale charges⁵ all retail Direct and Shared⁶ Costs and a retail price mark up of 5% and;
- 2) the above plus retail Common⁷ Costs.

Any prices that are materially outside of this range should be justified by the operator's notification under the retail Price Notification Framework (PNF) as discussed in section 6 of this document. The Authority will evaluate such submissions to determine whether exceptional circumstances exist that permit the charges or prices to sit outside the standard framework compliance parameters.

Once this assessment has been made there will not be a need to submit further PNF information unless there has been a change in the price (e.g. if the reason for the PNF notification was solely due to an agreed retail mark up, and the Authority is satisfied this charge is cost orientated, there will not be a need to make further submissions each year).

The information required for the standard retail cost orientation compliance assessment is contained in the Retail Cost Orientation Statement set out in Section 7 of Annex B. This cost orientation statement should contain the wholesale charges and the retail Direct, Shared and Common costs relevant to each retail service and calculate the price range as described above.

The Authority therefore requires the Notified Operator to use the Service Cost Statement to assess the cost orientation for wholesale services and the retail Cost Orientation Statement to assess the cost orientation of retail services.

The Notified Operator shall carry out a cost orientation test for the cost accounting obligation to be appropriately met by the use of the Service

⁵ As contained in the Statement of Transfer Charges.

⁶ As defined in Section 3.5 of this document.

⁷ As defined in Section 3.5 of this document.

Statement in Section 4 of Annex B for wholesale services and shall produce a Retail Cost Orientation Statement as set out in Section 7 of Annex B for retail services.

5.6 Audit process

From the Authority's perspective it is important that the audit process is performed to high standards and the resulting auditor's opinion attached to the ASR is also at a level appropriate to the information presented. The Notified Operator shall therefore appoint suitably qualified auditors to carry out the audit and notify the Authority of the appointment at least three months before the deadline for submission of the annual ASR on 30th September each year i.e. before 30th June of the same year.

The auditors shall have access to all information (including confidential information) needed to fulfil their audit work. **The auditors are required to ensure the confidentiality of such information in accordance with Community and Gibraltar law on business confidentiality and in particular as regards third parties and competitors.**

The Authority may invite the auditors to discuss procedures to be applied by them in performing the audit or to discuss the auditor's findings following performance of the audit.

The Authority may also request the Notified Operator to instruct its auditors to perform additional or alternative work to substantiate the statements and assertions contained in the ASR and to further report on this additional work. In accordance with international practice, the Authority may appoint auditors to carry out such further reviews, examinations and audits as it deems necessary should the operator or its auditors fail to provide the information required.

The Notified Operator shall appoint suitably qualified auditors and shall notify the Authority of the appointment at least three months before the deadline for submission of the annual ASR on 30th September each year.

5.7 Confidentiality and publication of the ASR

Where information is confidential in nature, the Authority is required to ensure the confidentiality of such information in accordance with Community and Gibraltar law.

Notified operators are assured that sensitive information provided to the Authority in the ASR will remain confidential and not made public. Sensitive information is regarded as that information that may potentially put an operator at a competitive disadvantage.

The Authority will allow the Notified Operator the opportunity to demonstrate that information is sensitive. The Authority will consider this in advance of any decision regarding publication.

However, a number of provisions of the regulatory framework aim at increasing public access to accounting data and methodologies. In particular:

- Under Section 27(2) of the Communications Act, the Authority is granted the power to publish such information that would contribute to an open and competitive market;

- Regulation 10(2) of the Communications (Access) Regulations allows the Authority, in accordance with the provisions of Regulation 98 of the same Regulations, to impose obligations for transparency in relation to interconnection and/or access, requiring operators to make public specific accounting information. In this respect, the Authority may specify the manner in which the information is made public (type of publication, cost, etc);
- In accordance with Regulation 12(6) of the Communications (Access) Regulations, accounting records that would contribute to an open and competitive market may be published by the Authority; and
- According to Regulation 14(7) of the Communications (Access) Regulations where the implementation of a cost accounting system is mandated in order to support price controls, a description of this system is made publicly available, showing at least the main categories under which costs are grouped and the rules used for the allocation of costs.

The Authority requires therefore that publicly available documents include the following:

- The Regulatory Financial Statements for the relevant markets and services, including the auditor's opinion regarding the ASR; and
- The accompanying documentation, explaining the accounting assumptions invoked within the Regulatory Financial Statements (namely the Accounting documents and the Attribution methodology document).

⁸ This section has been transposed from Article 8 of the EU Access Directive 2002/19/EC.

The table below shows the publication requirements for all information requested from the Notified Operator.

		To be made publicly available
REGULATORY FINANCIAL STATEMENTS	Profit and Loss statements	YES
	Mean Capital Employed statements	YES
	Reconciliation statements with statutory accounts	YES
	Service Statement	YES
	Network Statement of Costs	YES
	Service Cost Statement	YES
	Retail Cost Orientation Statement	YES
	Statement of responsibility and compliance with Community and national rules	YES
	Auditor's opinion	YES
	Statement of transfer charges	YES
	Other notes	YES
	List of material changes in any ASR reported number by more than 5% prior to publication and audit of the ASR	NO
ACCOUNTING DOCUMENTS	Accounting principles	YES*
	List of major asset values	YES**

	Description of the costing model	YES*
	Detailed description of (Weighted Average Capital Cost) WACC calculation	YES
	Other notes	YES*
ATTRIBUTION METHODOLOGY DOCUMENT	Description of cost attributions in the costing model	YES*
	Network component description table	YES*

***provided they do not contain absolute numbers or percentages**

****asset lives as a number should be shown separately by asset class**

The Authority requires the Notified Operator to make the above mentioned documents publicly available on the website of the Notified Operator annually **within two months** after the submission of its ASR to the Authority and provide the Authority with the corresponding hyperlink.

Due to the importance of the ASR in meeting the operator's regulatory requirements and in enabling the Authority to discharge its regulatory duties, the Authority requires that the ASR should be signed off by a board member of the operator. Signing of the ASR at such a senior level will help ensure that all necessary steps have been taken by the operator to ensure compliance with the regulatory obligations and give the assurance that it has been considered at a suitable level in the organisation.

The Notified Operator shall publish the above list of publicly available documents shown in the table in Section 5.7 and make these public on the website of the operator annually within two months after the submission of the ASR to the Authority. The ASR should be signed off by a board member to give the necessary assurances that the ASR has been considered at a suitable level.

Where information is confidential in nature, the Authority is required to ensure the confidentiality of such information in accordance with Community and Gibraltar law.

These documents shall be made public on the website of the Notified Operator annually within two months after the submission of the ASR to the Authority.

5.8 Non-compliance of the ASR

Where the Authority has reasonable grounds to believe that any or all of the Regulatory Financial Statements of the ASR and/or accompanying documentation are deficient, the Notified Operator shall in period defined by the Authority:

- Amend the accompanying documentation in order to remedy the deficiencies identified by the Authority;
- Amend the Regulatory Financial Statements;
- Deliver to the Authority the amended Regulatory Financial Statements and corresponding audit opinion; and
- Publish the amended Regulatory Financial Statements, including the corresponding audit opinion and amended accompanying documentation.

Where the Authority has reasonable grounds to believe that any or all of the Regulatory Financial Statements of the ASR and/or accompanying documentation are deficient, the Notified Operator shall in period defined by the Authority:

- **Amend the accompanying documentation in order to remedy the deficiencies identified by the Authority;**
- **Amend the Regulatory Financial Statements;**
- **Deliver to the Authority the amended Regulatory Financial Statements and corresponding audit opinion; and**
- **Publish the amended Regulatory Financial Statements, including the corresponding audit opinion and amended accompanying documentation.**

The Authority will provide a reasonable timeframe which is considered to be proportionate to the information which needs to be amended.

5.9 Consistency of treatment

There shall be consistency of treatment from year to year for the ASR. Where there are material changes to the regulatory accounting principles including attribution methods, transfer charges or general accounting policies that have a material effect on the information reported in the ASR, then the previous year's ASR shall be amended accordingly.

Consistency of treatment is essential to understanding the information in the ASR and being able to compare it from year to year with confidence that the same accounting treatment and cost allocation methodologies have been applied. Where there are material changes to the regulatory accounting principles including attribution methods, transfer charges or general accounting policies that have a material effect on the information reported in the ASR, then the previous year's ASR shall be restated to reflect these changes on a comparable basis with the current year. This restatement should be in the ASR submitted to the Authority and published together with the relevant audit opinion covering the current and restated year accordingly.

The Authority recognises that there can be considerable discretion applied in determining what a material change is as it will depend on the size of the market and information reported. To assist the operator and the Authority in determining if a change during the year is material enough to require a restatement of the prior year the Authority requires that if any number reported to the Authority changes by more than 5%, due to a change

in the operator attribution methods, transfer charges or general accounting policies, then this change should be notified to the Authority prior to the production and audit of the ASR to allow the Authority to determine if a restatement is required.

The Authority therefore requires that where there are changes in the information required to produce the ASR that would have a material effect on the information reported in the ASR, the previous year's ASR shall be restated to reflect these changes on a comparable basis with the current year. This restatement should be in the ASR submitted to the Authority and published together with the relevant audit opinion covering the current and restated year accordingly.

The Authority also requires that if in the production of the ASR any number that would be reported changes by more than 5%, due to a change in the operator attribution methods, transfer charges or general accounting policies, then this change should be notified to the Authority prior to the publication and audit of the ASR.

The Notified Operator shall ensure that any material changes result in the prior year figures being restated and presented with the relevant audit opinion and that all changes of more than 5% are notified to the Authority prior to publication and audit of the ASR to assess if there are material changes.

5.10 Maintenance of accounting records

The Authority requires that Notified Operators shall preserve records sufficient to provide an adequate explanation of each ASR for a period of **five years** from the reporting date. This will enable investigations to take place and trend information to be prepared if necessary.

Notified Operators shall preserve records sufficient to provide an adequate explanation of each regulatory ASR for a period of five years from the reporting date.

5.11 Availability of accounting records

Information to support regulatory decisions is necessary both on a periodic basis and to support investigations and queries that may arise. The accounting systems must be capable of performing both functions. The ASR has to be provided annually and shall be used to monitor the Notified Operator's compliance with SMP obligations.

The Authority's view is that on-request reporting would be required for investigating specific cases into potential breaches of obligations. The amount of detail that can reasonably be requested will vary. It is likely that periodic information (e.g. annual accounts) can be planned to produce more comprehensive information than reports based on a specific request. In framing an on demand request the Authority will consider its practicality and also have regard to the seriousness of whatever issue is at hand.

In addition, the Authority may also require Notified Operators to submit other more detailed information which would not be published within a reasonable and proportional timeframe.

The Authority requires this information so as to effectively monitor and enforce compliance with the Notified Operator's SMP obligations. The information will generally be presented to the Authority on a confidential basis.

Notified Operators shall provide any accounting records based on requests for information or queries made by the Authority within a reasonable and proportional timeframe.

6. Key principles and compliance requirements for the Cost Accounting obligation

There are two main cost accounting methodology options which can be envisaged, Fully Allocated Cost (FAC) and Long Run Incremental Cost (LRIC). In addition, FAC can be undertaken on a Historic Cost Accounting (HCA) or on a Current Cost Accounting (CCA) basis.

Under the HCA methodology, the gross book value of assets is given by their historical purchase price. Further adjustments of the asset values are not needed.

The objective of CCA is to provide more useful and relevant information than would be provided by the HCA methodology which, for example, does not reflect inflationary effects. The CCA methodology is therefore used for financial reporting purposes within an environment of changing prices. In addition, CCA takes into consideration current market conditions in terms of prices and technologies. Therefore, assets valued on a CCA basis reflect the value to the business resulting in a cost base and related profits similar to that under fully competitive market conditions.

Experience over the years where CCA costing has been mandated in Gibraltar has shown that it can be very difficult to find appropriate indices for Gibtelecom's assets and that using indices from other countries can cause significant distortions. Considering this in combination with the fact that networks technologies are developing and evolving rapidly (so asset lives are shorter and many assets are therefore relatively new) resulting in a much smaller difference between historical and current asset values, the GRA (following a consultation) considers it would be appropriate and proportionate to remove the obligation to use the CCA costing methodology and instead to apply the historical cost accounting HCA methodology.

The FAC approach attributes all relevant costs, revenues, assets and liabilities incurred by an undertaking to all of its outputs applying the causality principle. It allocates costs that are directly and not directly attributed to services or products using techniques such as ABC, samples and surveys.

The LRIC approach allocates costs that are directly or indirectly attributed to services or products, often using cost volume relationships. Forward-looking costs are defined as the costs of an efficient operator building its network today using modern technology bought at current prices (i.e. CCA).

The Authority requires for the purpose of enforcing SMP obligations that the ASR covering all relevant markets and services shall be based on HCA as a cost base and FAC as the accounting methodology.

The Authority requires for the purpose of enforcing SMP obligations that the ASR covering all relevant markets and services shall be based on HCA as a cost base and FAC as the accounting methodology.

The Authority may reassess whether the requirements are appropriate and reserves the right to change and supplement them if necessary.

6.1 Key principles for the determination of annual capital charges

6.1.1 Method of calculation of annual capital charges

There are two methods which can be used to calculate annual capital charges which essentially differ in the way they treat and calculate depreciation. These are the Accounting Cost Approach and Annuities Approach.

Accounting Cost Approach

Accounting depreciation explains that the use of long-life assets can be considered as the decrease in the service potential of the assets. This is determined by accounting and/or tax allowance rules under which operators prepare their financial statements.

In this approach, the annual capital charge is the sum of accounting depreciation and the cost of capital (which is set at WACC⁹ multiplied by the Net Book Value of the asset).

Annuities approach

This method allows the asset value to change in equal portions over its life span. However, most of the payments early in the life of the asset go toward recovering the cost of capital. At the end of the asset life, most of the charges go toward depreciation. It is similar to mortgage arrangements, in which most of the payments early in the life of the mortgage are for interest payments, while in later years most of the payments are used to pay back the principal. The total capital charge will be based on the purchase cost of the particular asset and will be annualised based on the formula:

$$\text{Annual capital charge} = \text{purchase cost} \times \text{WACC} / (1 - (1/(1+\text{WACC})^t))$$

Where t = the asset life, and
WACC = Weighted average cost of capital.

The annuity will be a flat profile, initially consisting mainly of capital charges and later on mainly driven by depreciation charges.

If the price of an asset is expected to change over time, it is better to use a tilted annuity approach. According to this approach an annuity charge is calculated, that changes over time at the same rate at which the price of the asset is expected to change. This means that the annual capital charge will decline if prices are expected to fall over time.

$$\text{Annual capital charge} = \text{purchase cost} \times (\text{WACC} - p) / (1 - [(1+p)/(1+\text{WACC})^t])$$

Where p = rate of price change or "tilt".

The depreciation charge in the annuities approach depends primarily on the asset's economic life and the replacement rate.

The Authority considers that the cost accounting system of the Notified Operator shall use an accounting based approach to capital charges, as operators' own statutory

⁹ See 6.1.2 Approach to calculate the Cost of Capital.

accounting records are based on this. Accounting depreciation is therefore considered the most appropriate, simple, cost effective and transparent approach.

The cost accounting system of the Notified Operator shall use an accounting based approach to calculate annual capital charges. Accounting depreciation is considered the most appropriate, simple, cost effective and transparent approach.

6.1.2 Approach to calculate the Cost of Capital

The cost of capital represents the opportunity cost of funds invested in the business and ensures that other profit mark-ups are not required.

The methodology used in Accounting Separation Systems for calculating the cost of capital shall be the WACC. The WACC methodology is a widely accepted method for calculating the cost of capital. It is understood by both the finance community and the communications industry, and is consistent with the methodology used by many regulators. The concept underlying the WACC methodology is that the return expected from the assets managed by a firm must be the total of the returns expected by debt holders and equity holders, weighted by their respective contribution to the financing of these assets.

The WACC shall be calculated on pre-tax basis using the following formula:

$$WACC_{pre-tax} = K_e \times \frac{E}{E+D} \times \frac{1}{1-t} + K_d \times \frac{D}{E+D}$$

Where K_e = Cost of equity
 E = Equity
 D = Debt
 K_d = Cost of debt
 t = Tax rate

The cost of equity shall be calculated using the Capital Asset Price Model (CAPM), which relates the value of equity to the implied risk investors must bear according to the following formula:

$$K_e = R_f + \beta(R_m - R_f)$$

Where R_f = Risk free rate
 β = Equity Beta represents the risk of asset relative to the market risk
 R_m = Market risk premium

The Notified Operators shall prepare and present with the annual ASR a detailed description of the methodology, sources, and calculation used in the determination of the annual WACC.

The Authority requires that the Notified Operators cost of capital calculation is the pre-tax WACC formula using the CAPM for the calculation of the equity price.

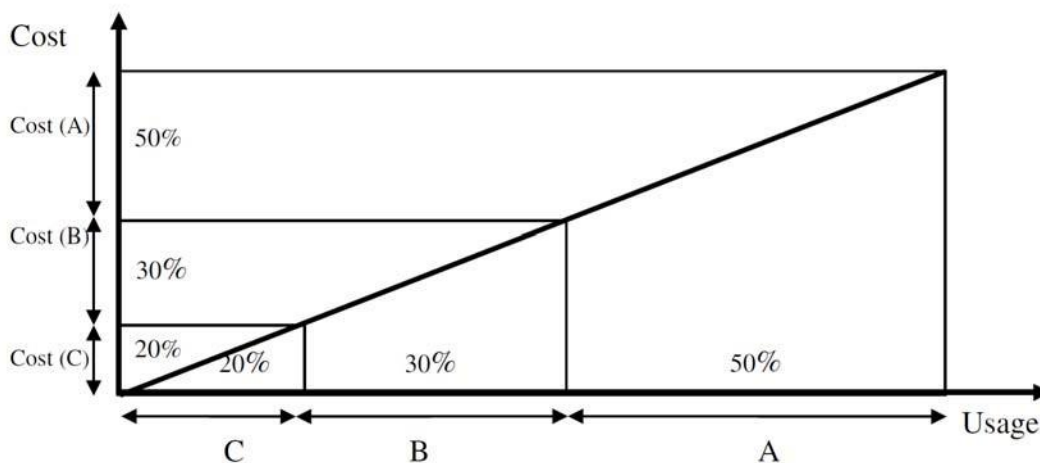
6.2 Key principles for the implementation of Fully Allocated Costs (FAC)

The principle underlying FAC is that the total cost incurred in producing a single product or in delivering a specific service should be attributed to that product or to that service.

The fully allocated cost of a specific product or service includes both:

- The direct costs of the labour, capital and material resources used exclusively in the delivery of the service; and
- A portion of the joint costs of labour, capital and material resources used in the production of a group of services.

According to this method all costs that are incurred in the provision of services are allocated across those services in the precise ratio of their utilisation as presented in the following figure:



FAC are usually used to allocate historic costs. In this case, FAC results in a historic presentation of the costs incurred by each of the products or services offered by the undertaking. It is normally based on the existing network architecture and technology, and the existing operational structure of the undertaking.

FAC can also be used to allocate current costs that are calculated on the basis of assets that are valued according to their replacement cost rather than the historical purchase cost as described in the following sections.

6.2.1 Cost Attribution process

Identifying different types of costs and attributing these to individual services or other objects such as network components can be complex and detailed. Attributions shall be based on the principles of:

- Causality;

- Objectivity;
- Consistency; and
- Transparency.

Indeed, to establish one or more of the measures of cost for a given product or service it is necessary to:

- Establish the costs, revenues, assets and liabilities associated with all of the activities underlying the provision of the product or service;
- Establish rules which, amongst others, address how costs associated with shared activities are distributed between products and services ultimately supplied (since the majority of activities will be carried out in the course of supplying more than one service or services to more than one market); and
- Document the costs and rules for e.g. via methodology documents¹⁰.

6.2.2 Principles for Cost Causality

The principle of causality implies that costs are allocated, directly or indirectly, to the services that "cause" the costs (and revenues) to arise. This requires the implementation of appropriate and detailed cost allocation methodologies.

Following the principle of cost causation, each item of cost and revenue should be allocated to the products and services provided by an operator. In the case of revenue most, if not all, revenues can be allocated directly to their related products or services. However, this is not the case for costs due to the relatively high proportion of the costs that are shared between different products and services. Each cost item may be considered to fall into one of the following categories:

a. Directly attributable costs

Directly attributable costs are those costs that can be directly and unambiguously related to a service or product.

b. Indirectly attributable costs

Indirectly attributable costs are those costs that can be related to a service or product on a non-arbitrary basis based on the relationship of the costs to directly attributable costs. Such costs shall be allocated to the relevant service or product using an appropriate cost driver (e.g. usage of shared facilities).

For example, depreciation relating to power equipment may initially be allocated to the power equipment to which it relates. It may then be allocated to the network equipment that is supported by that power equipment (possibly on the basis of usage).

In order to derive the apportionment bases, sampling techniques may be used as long as these are based on appropriate statistical techniques, which result in an immaterial margin of error.

¹⁰ Accounting and Attribution methodology documents as described in this Decision Notice.

c. Unattributable costs

Unattributable costs are those costs for which no direct or indirect method of apportionment can be identified. It is therefore not possible to allocate these costs to products and services on a non-arbitrary basis. These costs are likely to be of the character of 'corporate overheads'.

A significant level of communications operators' costs are joint and common in nature, however the rigorous application of cost causation methods can be expected to reduce substantially the proportion of these costs that are truly unattributable.

6.2.3 The Cost Cascade

Costs may be attributed to "Services", or to cost pools called "Network components", "Related functions" or "Other functions". These are defined as follows:

- **Services:** These are the costs that can be directly identified with a particular service. For these purposes, the term "service" refers both to end user services (e.g. the provision of exchange lines) and wholesale services (e.g. interconnection services).
- **Network components:** This pool contains the costs relating to the various components of transmission, switching and other network plant and systems. The costs will be in respect of network components that cannot be attributed directly to a particular service as they are utilised in the provision of a number of services.
- **Related functions:** This pool contains the costs of retail and wholesale functions necessary for the provision of services to the customer or end users such as billing, maintenance and customer services.
- **Other functions:** This pool contains the costs of functions that are not related to the provision of particular services but are an important part of the operations of the operator. Examples of such costs include planning, personnel and general finance.

There are a series of steps which allocate cost pools in a tiered approach to allocate costs to services. These allocation steps are performed using appropriate drivers. Each step is summarised below:

Step 1: The allocation of 'other' functions across related functions, network components and services.

Step 2: The allocation of the related function costs to services and network components.

Step 3: The allocation of network components to services.

Step 4: The grouping of services into markets (as defined for the purposes of accounting separation).

The fundamental objective is to arrive at an appropriate basis of attribution to comply with the principle of causation. However, when the Authority is considering or determining a cost recovery mechanism or value, there are factors to be taken into account in addition to the cost causality principle (normally established in the cost

accounting system), such as distribution of benefits, effective competition, cost minimisation, reciprocity and practicality.

The Authority requires Notified Operators to:

- Review and justify each item of cost, capital employed and revenue;
- Establish and quantify the factor or “driver” that caused each item to arise;
- Use the driver to allocate each item to individual businesses/activities/network components or services; and
- Pool costs that cannot be related on a causation basis to activities (i.e. unattributable costs) and allocate them on a predetermined basis.

Notified Operators shall:

- **Review and justify each item of cost, capital employed and revenue;**
- **Establish and quantify the factor or “driver” that caused each item to arise;**
- **Use the driver to allocate each item to individual businesses/activities/network components or services; and**
- **Pool costs that cannot be related on a causation basis to activities (i.e. unattributable costs) and allocate them on a predetermined basis.**

6.2.4 Attribution methodologies

The attribution methodologies should be comprehensively documented and transparent to the satisfaction of the Authority.

a. Attribution methodology for directly attributable costs

Each item of revenue and cost must be attributed to the products and services provided by operators. In the case of revenues, it should be relatively straightforward to allocate a substantial proportion directly. In the case of network costs, Notified Operators may need to use survey and sampling techniques such as pattern of usage of network element for each type of product/network service.

Key relevant information at this stage are the routing factors matrix, which provides the usage of network element for each type of product/network service, as well as the wholesale-retail service mapping matrix, which provides the usage of wholesale services for each type of retail service.

The attribution methodologies should be comprehensively documented and transparent to the satisfaction of the Authority.

The key relevant information for the understanding of the attribution of directly attributable costs are:

- **The routing factors matrix, which provides the usage of network element for each type of product/network service; and**

• **The wholesale-retail service mapping matrix, which provides the usage of wholesale services for each type of retail service.**

b. Attribution methodology for indirectly attributable costs

Attribution methodologies need to be developed and applied where costs are not directly allocated to the reporting object (e.g. component, market or regulated service). In these cases, management accounting techniques such as ABC can be used.

ABC is a management accounting approach that allows causal relations to be established between costs and services or products. ABC views the services and products as a series of activities, each of which consumes resources and therefore generates costs. This methodology, based on cost drivers, traces and allocates costs through the activities performed and establishes clear cause-and-effect relationships between activities, their associated costs and the resulting output.

ABC makes it possible to calculate each cost that is absorbed by various activities that take place in an organisation, i.e. provision of communications network, order processing, etc. and allocate this cost respectively to the company's products and services (e.g. telephone calls, data transmission) based on various cost drivers. This method of allocation enables the allocation of both resources directly involved in producing services and overhead costs to the products and/or the services.

The resources represent everything that is consumed in the organisation for the purpose of producing services. Resources include employees, equipment, information systems, financial assets etc.

Activities represent the processes performed to produce outputs (end products for e.g. telecommunication services). These activities may be regarded as unique processes, functions or tasks. The core and support activities can be distinguished. The core activities are the activities directly linked with particular products or services. The support activities are linked to the volume of products or several products or are linked to the core activities.

The cost drivers are measurable factors that represent the amount of resources consumed by activities and the amount of activities consumed by end products. Cost drivers may take the form of the number of iterations, amount of effort, etc.

For example, periodic analysis of the tasks undertaken by staff in customer call centres may be used to determine the amount of time spent by those staff on different tasks. This information may then be used to allocate - either directly or indirectly - the costs associated with the staff to the services provided by the operator.

The ABC method is based on the cost causation principle which requires resources to be allocated or apportioned to products (referred to as cost objects) in a way that reflects the way that cost objects cause or drive the costs incurred. In some situations, there may be a direct causal relationship between a cost and a product (direct allocation) and in other cases the causal relationship may be built up over a series of intermediate stages (indirect allocation).

The Authority considers that the Notified Operator should use the ABC method for cost allocation. In the case where the notified operator considers some other method as more appropriate, this has to be justified and properly documented.

The Notified Operator shall use the ABC method for cost allocation, in particular for directly attributable costs.

c. Attribution methodology for unattributable costs

Once direct and indirectly attributable costs have been allocated to particular services on the basis of causality, the remaining costs might be allocated using an arbitrary basis. These may include apportionments based on revenues, other costs or input- output share where costs are not assigned to activities to the extent to which they "cause" the cost. In a well-defined costing system these remaining costs should be kept to a minimum i.e. not exceeding 10% of the total costs.

A usual way of recovering unattributable costs such as common costs is to apply the Equal Proportional Mark-Up (EPMU) method. In this method the common costs are allocated to the separated services or products in proportion to the costs already allocated to these services or products.

This kind of method of allocation does not reflect the real service contribution in common costs however, it is easy to implement and does not create any distortion in the proportion of the costs of different network elements. This method is quite easy to apply and is used very often.

The Authority considers that the Notified Operator should use the EPMU method for the cost allocation of unattributable costs such as common costs. In the case where a notified operator considers some other method as more appropriate, this has to be justified and properly documented.

The Notified Operator shall use the Equal Proportional Mark-Up method for the cost allocation of unattributable costs such as common costs.

6.3 Cost Accounting information to be made available to the Authority

When building the cost accounting system, Notified Operators should aim to make it as transparent as possible.

The Authority believes that it should have full access to the Notified Operator's cost accounting system at the Notified Operator's premises. Furthermore, the Notified Operator shall provide any kind of data related to the cost accounting system if requested to do so by the Authority, including but not limited to:

- Equipment prices;
- Utilisation Rates;
- Other network design parameters (for e.g. busy hour Erlangs);
- Cost of capital;
- Traffic Volumes;
- Annualisation methodologies;
- The inclusion/exclusion of fully depreciated assets;

- Asset useful life; and
- Price trends.

The Authority shall have full access to the Notified Operator's cost accounting system at the Notified Operator's premises and the Notified Operator shall provide any kind of data related to the cost accounting system if requested to do so by the Authority.

7. Retail Price Notification Framework

For markets where an operator has been found to have SMP in a retail market, the Authority has determined that the most appropriate and proportionate obligation to safeguard the interests of consumers whilst reducing the burden on the operator, is compliance with a Price Notification Framework (PNF).

This section describes the Authority's proposal for the PNF. It sets out the information the operator would be required to submit to the Authority and the timeframes and process applicable to the different categories of pricing events covered by the framework.

7.1 Purpose and objectives of the retail Price Notification Framework

The PNF replaces the Authority's earlier regulation of retail prices in SMP markets via a price cap.

The PNF is intended to be a lighter touch regulation than the price cap, which will balance the burden on an operator with the need to protect consumer interests in markets where there is no effective competition.

The PNF process and rules are intended to cover all changes to current prices (whether permanent or temporary) and introduction of new prices. Operators will not be required to submit PNF information for current prices for which they are not requesting changes, but the Authority can request PNF information on an ad-hoc basis to investigate current prices, whether on its own initiative or as a result of a complaint by a third party (whether consumer or provider).

The operator should accompany each PNF notification with a signed statement on behalf of the company that, to the best of its knowledge, the proposed price is cost oriented and not anticompetitive.

The Notified Operator shall comply with the PNF obligations imposed by the Authority.

7.2 Processes for changes to existing prices including special offers temporary discounts and promotions

The terms in this section shall apply to both price increases and decreases.

1. The operator shall not change the price without the prior written notification to the Authority in accordance with this obligation.
2. The operator shall submit to the Authority a notification of a tariff or price change, as appropriate, at least 45 days before the proposed effective date of the change.
3. Such notification shall include:
 - (a) The name and a description of the product or service for which the price change is being requested;
 - (b) Proposed effective date for the price change;
 - (c) Current tariffs/prices;

(d) Proposed tariffs/prices;

(e) Any proposed changes to the applicable terms and conditions that will result from the price change;

(f) Commercial rationale for making the proposed change;

(g) Explanation of how the new price is cost oriented;

I. Pricing of wholesale inputs to the service;

II. Volume of wholesale service inputs;

III. Costs of wholesale inputs for the service;

IV. Direct and Shared Costs of the service including capital costs and operating expenditures (e.g. network components and billing costs);

V. Common Costs allocated to the service;

VI. Impact on the Profit and Loss and Mean Capital Employed for the product and the relevant market

(h) Data relevant to the proposed change, including the following for the past year and projected for three years:

I. Historic and projected volume of demand;

II. Number of existing users that would be affected by the proposed tariff change

III. Size of overall market/market share of the operator

IV. Relevant revenues for the service;

4. The Authority reserves the right to request additional information from the operator relating to the proposed price change.

5. The Authority may block or propose amendments to any price change notified under the PNF. If so, the Authority must issue such notice to block or modify the price change no later than 15 days of receipt of a complete notification (all information is provided in accordance with this section of the PNF). In exceptional circumstances, the Authority may advise the operator in writing within 10 days of receipt of a complete notification, that it will not be able to complete its analysis within the standard 15-days period. In such circumstances the Authority must not exceed a total of 30 days to complete its analysis.

6. Failure by the Authority to block or modify a price change under this process does not constitute an approval of the price. The Authority reserves its right to investigate any price for SMP products and services at any time.

The Notified Operator shall comply with the process and information requirements set out in Section 7.2 above for modification to existing prices by an operator.

7.3 Processes for notification of prices of new services

1. The operator shall submit to the Authority a notification of the new service price, at least 45 days before the proposed effective date of the change.
2. The process for notification of prices for new services would be the same as for notification of changes to existing prices, with the exception that the information to be provided would consist of business case information and projections of costs and revenues. The same categories of information should be provided and the operator should refer to the section of notification of changes to existing prices for guidance on the information requirements.
3. The Authority may block or propose amendments to any price change notified under the PNF. If so, the Authority must issue such notice to block or modify the price change no later than 15 days of receipt of a complete notification (all information is provided in accordance with this section of the PNF). In exceptional circumstances, the Authority may advise the operator in writing within 10 days of receipt of a complete notification, that it will not be able to complete its analysis within the standard 15-days period. In such circumstances the Authority must not exceed a total of 30 days to complete its analysis.

The notified Operator shall comply with the process and information requirements set out above in Section 7.3 for the introduction of new prices by an operator.

7.4 Process for bundling and tying of services

1. The operator may bundle, tie or offer new packages of SMP services as long as each price regulated service included in such a bundle, tied purchase or package is also available on a standalone basis on reasonable terms and conditions. A bundle, tied purchase or package that includes at least one SMP service shall be subject to price regulation. The operator shall provide the Authority with the costing information of each service included in the bundle, tied purchase or package and demonstrate to the Authority that the price of the bundle is not anti-competitive and would not have the effect of lessening competition in a relevant market.
2. The operator shall submit to the Authority a notification of new service price, at least 45 days before the proposed effective date of the change.
3. The information requirements for bundles, tied purchases or packages are those set out under the heading of Changes to existing prices in the PNF. Applicable timeframes are also the same as for changes in pricing to existing services.
4. The Authority may block or propose amendments to any price for a bundled, tied or package services notified under the PNF. If so, the Authority must issue such notice to block or modify the price change no later than 15 days of receipt of a complete notification (all information is provided in accordance with this section of the PNF). In exceptional circumstances, the Authority may advise the operator in writing within 10 days of receipt of a complete notification, that it will not be able to complete its analysis within the standard 15 days period. In such circumstances the Authority must not exceed a total of 30 days to complete its analysis.

The Notified Operator shall comply with the process and information requirements set out above in Section 7.4 for the bundling and tying of services by an operator.

Annex A – Decisions

- 1. The GRA requires that SMP operators use a historical cost accounting methodology in compliance with accounting separation and cost accounting obligations in Gibraltar.**
- 2. The Notified Operator shall prepare and submit to the Authority annually within nine months of the end of the company's financial year an Accounting Separation Report which includes the documents in the table in Section 5.1 above.**
- 3. The Notified Operator shall use the template in section 1 of Annex B when providing Profit and Loss statements in its accounting separation report.**
- 4. The Notified Operator shall produce a Mean Capital Employed statement for each relevant market based on the template in section 2 of Annex B.**
- 5. The Notified Operator shall provide a Reconciliation Statement of the key financial line items of the ASR with the statutory accounts based on the template in Section 3 Annex B, including the elements outlined in this section to separately reconcile revenue and costs to the statutory accounts.**
- 6. The Notified Operator shall provide a Service Statement for each relevant wholesale market as set out in Section 4 of Annex B, including the elements outlined in this section in order to check compliance with non-discrimination and/or cost orientation obligations.**
- 7. The Notified Operator shall produce a Network Statement of Costs as shown in Section 5 of Annex B to provide documentation and transparency of the network components.**
- 8. The Notified Operator shall produce a Service Costs statement as shown in Section 6 of Annex B to document and give transparency to the allocation of network component costs to services.**
- 9. The Notified Operator shall produce a Retail Cost Orientation Statement as set out in Section 7 of Annex B for retail services.**
- 10. The Notified Operator shall prepare its accounting separation report in accordance with the requirements of the relevant governing EU and Gibraltar communications legislation.**
- 11. The auditors shall plan and carry out such work as will enable them to report whether or not any matter that has come to their attention in cases where the regulatory financial statements do not in all material respects:**
 - a) Present fairly and properly the revenues, costs and mean capital employed by each of the businesses and activities disclosed in the ASR in accordance with the accounting and attribution methodology documents that are to be attached to the Regulatory Financial Statements;**
 - b) Comply with any relevant regulation, notice or decision issued by the Authority with respect to Accounting Separation & Cost Accounting.**

Where any such irregularities have come to the auditor's attention, they shall be clearly described in their opinion together with, where reasonably possible, the potential monetary impact on the Profit & Loss or Mean Capital Employed statements, or a statement that the potential monetary impact is not reasonably possible to establish.

The auditor's opinion shall at least include:

- The conclusions of the auditor;**
- All identified irregularities (with the potential monetary impact, where reasonably possible);**
- Recommendations made by the auditor (with a description of the corresponding effects); and**
- A full description of the verification methodology followed, including a clear set of the respective responsibilities of the auditor, of the Notified Operator and of the basis on which the audit has been carried out and the opinion arrived at.**

12. A transparent and verifiable transfer charging system is necessary for Notified Operators to demonstrate non-discrimination and calculate internal costs and revenues for both cost orientation and non-discrimination purposes.

Transfer charges/prices shall be calculated by the Notified Operator as follows:

- There should be a clear rationale for the transfer charges used and each charge should be justifiable. Charges should be non-discriminatory and there should be transparency of transfer charges in the separated accounts;**
- Transfer charges shall be determined as the product of usage and unit charges;**
- Where a service is sold externally, the transfer charge shall be equal to the price stated in the Reference Interconnection Offer (RIO) and Reference Unbundling Offer (RUO) or any other Reference offer;**
- Where a service is rendered only internally, the transfer charge for the service is equal to the unit cost of service according to the notified accounting basis and accounting methodology; and**
- There shall be consistency of treatment of transfer charges from year to year. Any change shall be consistent, transparent and satisfactory to the Authority.**

13. The Notified Operator shall produce a Statement of Transfer Charges which shall include the following:

- Retail activities where Notified Operators are designated as having SMP;**

- **Measure unit and volume of the stated activities for the relevant accounting period (for example total number of minutes, total number of calls etc.);**
- **The network unit charges;**
- **The product of the unit charges and the volumes, in order to identify total network charge for the activity; and**
- **Accounting policies.**

The statement of transfer charges shall follow the same format as section 8 in Annex B.

14. The Authority requires the Notified Operator to prepare accounting documents that are made up of the following:

- **Regulatory Accounting Principles – the principles applied or used by the Notified Operator in the preparation of the Regulatory Financial Statements;**
- **Description of the costing model – which implies the type of model used (ABC for instance), a description of the cost categories and the cost cascade, the depreciation method and asset life implemented, etc.;**
- **Detailed description of (Weighted Average Capital Cost) WACC calculation; and**
- **Other notes**

15. The Authority requires the Notified Operator to produce the Attribution Methodology document which shall include the elements of revenue attribution and cost attribution and shall also include details on driver description and purpose, sources and destinations (i.e. routing factors matrix, wholesale-retail service mapping matrix), the procedure for the driver preparation and the data sources. The Notified Operator shall include in the Attribution Methodology document a table describing each of the network components shown in the Network Statement of Costs and indicating the network components that comprise the provision of services.

16. The Notified Operator shall carry out a cost orientation test for the cost accounting obligation to be appropriately met by the use of the Service Statement in Section 4 of Annex B for wholesale services and shall produce a retail Cost Orientation Statement as set out in Section 7 of Annex B for retail services.

17. The Notified Operator shall appoint suitably qualified auditors and shall notify the Authority of the appointment at least three months before the deadline for submission of the annual ASR on 30th September each year.

18. The Notified Operator shall publish the above list of publicly available documents shown in the table in Section 5.6 and make these public on the website of the operator annually within two months after the submission of the ASR to the Authority. The ASR should be signed off by a board member to

give the necessary assurances that the ASR has been considered at a suitable level.

Where information is confidential in nature, the Authority is required to ensure the confidentiality of such information in accordance with Community and Gibraltar law.

These documents shall be made public on the website of the Notified Operator annually within two months after the submission of the ASR to the Authority.

19. Where the Authority has reasonable grounds to believe that any or all of the Regulatory Financial Statements of the ASR and/or accompanying documentation are deficient, the Notified Operator shall in period defined by the Authority:

- Amend the accompanying documentation in order to remedy the deficiencies identified by the Authority;
- Amend the Regulatory Financial Statements;
- Deliver to the Authority the amended Regulatory Financial Statements and corresponding audit opinion; and
- Publish the amended Regulatory Financial Statements, including the corresponding audit opinion and amended accompanying documentation.

The Authority will provide a reasonable timeframe which is considered to be proportionate to the information which needs to be amended.

20. The Notified Operator shall ensure that any material changes result in the prior year figures being restated and presented with the relevant audit opinion and that all changes of more than 5% are notified to the Authority prior to publication and audit of the ASR to assess if there are material changes.

21. Notified Operators shall preserve records sufficient to provide an adequate explanation of each regulatory ASR for a period of five years from the reporting date.

22. Notified Operators shall provide any accounting records based on requests for information or queries made by the Authority within a reasonable and proportional timeframe.

23. The Authority requires for the purpose of enforcing SMP obligations that the ASR covering all relevant markets and services shall be based on HCA as a cost base and FAC as the accounting methodology.

The Authority may reassess whether the requirements are appropriate and reserves the right to change and supplement them if necessary.

24. The Notified Operator shall produce an asset list showing major asset classes, values and their useful lives.

25. The cost accounting system of the Notified Operator shall use an accounting based approach to calculate annual capital charges. Accounting depreciation is considered the most appropriate, simple, cost effective and transparent approach.

26. The Authority requires that the Notified Operators cost of capital calculation is the pre-tax WACC formula using the CAPM for the calculation of the equity price.

27. Notified Operators shall:

- Review and justify each item of cost, capital employed and revenue;**
- Establish and quantify the factor or “driver” that caused each item to arise;**
- Use the driver to allocate each item to individual businesses/activities/network components or services; and**
- Pool costs that cannot be related on a causation basis to activities (i.e. unattributable costs) and allocate them on a predetermined basis.**

28. The attribution methodologies should be comprehensively documented and transparent to the satisfaction of the Authority.

The key relevant information for the understanding of the attribution of directly attributable costs are:

- The routing factors matrix, which provides the usage of network element for each type of product/network service; and**
- The wholesale-retail service mapping matrix, which provides the usage of wholesale services for each type of retail service.**

29. The Notified Operator shall use the ABC method for cost allocation, in particular for directly attributable costs.

30. The Notified Operator shall use the Equal Proportional Mark-Up method for the cost allocation of unattributable costs such as common costs.

31. The Authority shall have full access to the Notified Operator’s cost accounting system at the Notified Operator’s premises and the Notified Operator shall provide any kind of data related to the cost accounting system if requested to do so by the Authority.

32. The Notified Operator shall comply with the PNF obligations imposed by the Authority.

33. The Notified Operator shall comply with the process and information requirements set out in Section 7.2 above for modification to existing prices by an operator.

34. The notified Operator shall comply with the process and information requirements set out above in Section 7.3 for the introduction of new prices by an operator.

35. The Notified Operator shall comply with the process and information requirements set out above in Section 7.4 for the bundling and tying of services by an operator.

Annex B - ASR templates

1. Profit and Loss Statement

PROFIT AND LOSS STATEMENT	Current year (£)	Prior year (£)
Turnover		
Internal Sales		
External Sales		
Total Turnover	_____	_____
Operating Costs		
Operating costs specific to market/service		
Operating cost A (if >10% of total HCA costs)		
Operating cost B (if >10% of total HCA costs)		
etc.		
Exceptional operating costs specific to market/service		
Exceptional operating cost A (if >10% of total HCA costs)		
Exceptional operating cost B (if >10% of total HCA costs)		
etc.		
Charges from other market/service (Transfer charges)		
Exceptional charges from other market/service (Transfer charges)		
Total HCA Operating Costs	_____	_____
Return	_____	_____

2. Mean Capital Employed Statement

STATEMENT OF MEAN CAPITAL EMPLOYED	Current year (£)	Prior year (£)
Fixed Assets		
Tangible Fixed Assets		
Tangible Fixed Asset A (if >10% of total fixed assets)		
Tangible Fixed Asset B (if >10% of total fixed assets)		
Intangible Fixed Assets		
Investments		
Total Fixed Assets	_____	_____
Current Assets		
Stock		
Debtors		
Other		
Total Current Assets	_____	_____
Creditors	_____	_____
Provisions for Liabilities and Charges	_____	_____
Mean Capital Employed	_____	_____
RETURN ON MEAN CAPITAL EMPLOYED		
Return	_____	_____
Mean Capital Employed	_____	_____
Return On Mean Capital Employed	_____	_____

3. Reconciliation Statement with Statutory Accounts

RECONCILIATION STATEMENT

Profit and Loss	Turnover	Costs	Return
Activities			
Market/Service 1	x	y	z
Market/Service 2	x	y	z
...			
Market/Service N	x	y	z
Others			
Total Activities	<u>X</u>	<u>Y</u>	<u>Z</u>
Adjustments			
Elimination of transfer charges	x	y	
Corporation Tax		y	z
Dividends payable		y	z
Interest		y	z
Other Adjustment (describe adjustments)	x	y	z
Total Adjustments	<u>X</u>	<u>Y</u>	<u>Z</u>
As per statutory accounts	<u>X</u>	<u>Y</u>	<u>Z</u>

4. Wholesale Service Statement

Wholesale Service Statement

Market A

Market summary

Revenue							
	External	Internal	Total	Total Operating Costs	Return	Mean Capital Employed	ROCE
Current Year	X	Y	Z	x	X	X	%
Prior Year	x	y	Z	x	X	X	%

Service Current Year	Revenue			Volume			Total Operating Costs	Unit	Average revenue per unit		"Ceiling" FAC per unit	Average revenue per unit / FAC
	External	Internal	Total	External	Internal	Total			External	Internal		
Service 1	r	r	R	v	v	V	X	u	r/u	r/u	FAC	R/u/FAC
Service 2	r	r	R	v	v	V	X	u	r/u	r/u	FAC	R/u/FAC
....												
Service N	r	r	R	v	v	V	X	u	r/u	r/u	FAC	R/u/FAC
Total	RE	RI										

Service Prior Year	Revenue			Volume			Total Operating Costs	Unit	Average revenue per unit		"Ceiling" FAC per unit	Average revenue per unit / FAC
	External	Internal	Total	External	Internal	Total			External	Internal		
Service 1	r	r	R	v	v	V	X	u	r/u	r/u	FAC	R/u/FAC
Service 2	r	r	R	v	v	V	X	u	r/u	r/u	FAC	R/u/FAC
....												
Service N	r	r	R	v	v	V	X	u	r/u	r/u	FAC	R/u/FAC
Total	RE	RI										

FAC per unit comes from the Service Cost Statement ('Total FAC')

5. Network Statement of Costs

Network Statement of Costs

For the current year

Network Component	HCA Operating Cost	HCA Depreciation	Total HCA Operating Costs	HCA Mean Capital Employed (a)	Applicable rate of return on MCE (b)	Capital Cost (a) x (b)	Total of operating and capital costs	Volume	Average cost per unit
Component 1	x	x	x	x	%	x	x	units	x
Component 2	x	x	x	x	%	x	x	units	x
....									
Component N	x	x	x	x	%	x	x	units	x

Total

For the prior year

Network Component	HCA Operating Cost	HCA Depreciation	Total HCA Operating Costs	HCA Mean Capital Employed (a)	Applicable rate of return on MCE (b)	Capital Cost (a) x (b)	Total of operating and capital costs	Volume	Average cost per unit
Component 1	x	x	x	x	%	x	x	units	x
Component 2	x	x	x	x	%	x	x	units	x
....									
Component N	x	x	x	x	%	x	x	units	x

Total

Applicable rate of return is the WACC

6. Service Cost Statement

Service Cost Statement - usage of services by network components

For the current year

Network Component	Unit	Average cost per unit (£'s)	Market A			Market B			Market N		
			Service A	Service B	Service N	Service A	Service B	Service N	Service A	Service B	Service N
Component 1	u	x	r	r	r	r	r	r	r	r	
Component 2	u	x	r	r	r	r	r	r	r	r	
....											
Component N	u	x	r	r	r	r	r	r	r	r	

For the prior year

Network Component	Unit	Average cost per unit (£'s)	Market A			Market B			Market N		
			Service A	Service B	Service N	Service A	Service B	Service N	Service A	Service B	Service N
Component 1	u	x	r	r	r	r	r	r	r	r	
Component 2	u	x	r	r	r	r	r	r	r	r	
....											
Component N	u	x	r	r	r	r	r	r	r	r	

Service Cost Statement - costing of services using routing factors

For the current year

Network Component	Unit	Average cost per unit (£'s)	Market A			Market B			Market N		
			Service A	Service B	Service N	Service A	Service B	Service N	Service A	Service B	Service N
Component 1	u	x	x	x	x	x	x	x	x	x	
Component 2	u	x	x	x	x	x	x	x	x	x	
....											
Component N	u	x	x	x	x	x	x	x	x	x	
Total FAC			X	X	X	X	X	X	X	X	

For the prior year

Network Component	Unit	Average cost per unit (£'s)	Market A			Market B			Market N		
			Service A	Service B	Service N	Service A	Service B	Service N	Service A	Service B	Service N
Component 1	u	x	x	x	x	x	x	x	x	x	
Component 2	u	x	x	x	x	x	x	x	x	x	
....											
Component N	u	x	x	x	x	x	x	x	x	x	
Total FAC			X	X	X	X	X	X	X	X	

Average cost per unit comes from the Network Statement of Costs

Average cost per unit is allocated to Services using the routing factors in the Routing Factors Matrix

7. Retail Cost Orientation Statement

Retail Cost Orientation Statement

Market A Current year

Retail Service	Revenue	Wholesale Costs (a)	Retail Direct Costs (b)	Retail Shared Costs (c)	Retail mark up (RoR 5%) (d)	"Floor" (a)+(b)+(c)+(d)	Retail Common Costs (e)	"Ceiling" "Floor"+ (e)	Volume	Unit "Floor" Costs	Unit "Ceiling" Costs	Retail Unit Charge
Retail Service 1	x	x	x	x	x	x	x	x	units	x	x	x
Retail Service 2	x	x	x	x	x	x	x	x	units	x	x	x
....												
Retail Service N	x	x	x	x	x	x	x	x	units	x	x	x

Market A Prior year

Retail Service	Revenue	Wholesale Costs (a)	Retail Direct Costs (b)	Retail Shared Costs (c)	Retail mark up (RoR 5%) (d)	"Floor" (a)+(b)+(c)+(d)	Retail Common Costs (e)	"Ceiling" "Floor"+ (e)	Volume	Unit "Floor" Costs	Unit "Ceiling" Costs	Retail Unit Charge
Retail Service 1	x	x	x	x	x	x	x	x	units	x	x	x
Retail Service 2	x	x	x	x	x	x	x	x	units	x	x	x
....												
Retail Service N	x	x	x	x	x	x	x	x	units	x	x	x

8. Statement of Transfer Charges

Retail (or other) Service	Wholesale Service	Billing Rate	Billing Rate Unit	Usage Of Billing Units	TOTAL
	Wholesale service 1	a	xxx	d	$A=a \times d$
Service 1	Wholesale service 2	b	xxx	e	$B=b \times e$

	Wholesale service N	c	xxx	f	$C=c \times f$
Total for service 1					$A+B+...+C$

	Retail service 1	Retail service 2	...	Retail service N	Wholesale service 1	Wholesale service 2	...	Wholesale service N
Retail service 1								
Retail service 2								
...								
Retail service N								
Wholesale service 1								
Wholesale service 2								
...								
Wholesale service N								