

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

## **Compliance under SMP Obligations**

**Response to Consultation and Decision**  
(Response to public consultation 08/14)

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# 1. Introduction

The electronic communications regulatory framework<sup>1</sup> 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 5<sup>th</sup> 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).

Having considered the views of all respondents to the Public Consultation, this Response to Consultation sets out the Authority's conclusions regarding compliance with accounting separation and cost accounting obligations by operators. It also incorporates the Decision Notice and consolidates the decisions currently in force with the new results into one document.

**The Response to Consultation and Decision Notice shall be read in conjunction with all market 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) Regulations<sup>2</sup>, 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) Regulations<sup>3</sup>, 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.

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

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

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<sup>1</sup> 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".

<sup>2</sup> Communications (Access) Regulations 2006.

<sup>3</sup> 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 7<sup>th</sup> 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 Authority received a detailed submission from one operator, Gibtelecom, by the close of the consultation period. The Authority thanks Gibtelecom for their submission. Having considered their views, the Authority sets out in this document its conclusions regarding Accounting Separation, Cost Accounting, Cost Orientation and Retail Price Notification obligations imposed on Notified Operators in Gibraltar. At the time of writing this response, only Gibtelecom is subject to these obligations and therefore they specifically apply to Gibtelecom's ASR 2014 figures onwards. The same obligations will apply to any other Notified Operator who may be subject to the same SMP obligations in the future.

The Response is structured as follows:

**Section 1** outlines the purpose of this document.

**Section 2** lists the Notified Operators and the relevant markets where Accounting Separation & Cost Accounting obligations have been imposed by the Authority.

**Section 3** contains the key principles to be applied by Notified Operators for the purpose of implementing Accounting Separation obligations.

**Section 4** contains the key principles to be applied by Notified Operators for the purpose of implementing Cost Accounting obligations.

**ANNEX A** provides the Authority's 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 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 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 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 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 an 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 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 LRIC based accounting. The Authority is however aware of the limited resources available by the operators and therefore proposes a simplified process of assessing compliance with cost orientation.

The proposed tests 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.

The Price Notification Framework (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 consumer or provider).

For further information, please refer to section 6 of this document.

### 3. Responses to the public consultation

In this section the Authority summarises the responses to the consultation on accounting separation, cost accounting systems, cost orientation and retail price notification and also presents its final position.

#### 3.1. 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 Current cost accounting (CCA) 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 Authority is proposing some amendments to the format of the P&L to give better visibility of any material cost changes that may impact on charges.

The Authority proposes that the current P&L statement be amended so that the lines "operating costs specific to market/service" and "exceptional operating costs specific to market/service" are expanded to show all individual cost items greater than 10% of the total of all Historic Cost Accounting (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.

The impact of valuing assets under CCA can also have a material effect on the P&L through the supplementary CCA depreciation charge that arises from any change in the assets value compared to the HCA values and depreciation used in the statutory accounts. Any change in the CCA valued asset in the year will be reflected in the P&L under the Financial Capital Maintenance (FCM) concept. The FCM concept requires that shareholders funds are preserved during the year and therefore any rise or fall in asset values will see a corresponding gain or loss to the P&L to reflect this change. When prices and asset values change, this can produce material impacts on the P&L and therefore the Authority proposes that the effect of these CCA changes are disclosed separately in the P&L

The amended Profit and Loss statement contains standardised lines of revenues and these amended costs as stated in section 1 of Annex B.

**Question 1: Do you agree that the Profit and Loss statement shall be amended for a relevant market based on the template in section 1 of Annex B? Please give reasons for your answer.**

#### Views of Respondents

Gibtelecom does not expect to have any difficulties with "opening up" the Operating Costs; Exceptional Operating Costs; and CCA adjustments lines. The Company would have to introduce new cost accounting procedures to comply with the >10% total HCA figure reporting requirements to ensure these are reported correctly.

The Company, nonetheless, questions the value of having such additional data in the profit and loss statement. The Company believes this already forms part of the total

cost figure that is currently being disclosed (including a breakdown of the total operating and exceptional costs, as well as splitting up the CCA adjustments). In the Company's mind this would not go beyond what is already being provided to establish the relationship between costs and charges.

### **The Authority's position**

As set out in the Authority's Public Consultation of 5<sup>th</sup> June 2014 (Public Consultation No. 08/14), markets designated with a cost orientation SMP obligation are required to demonstrate a clear relationship between costs and charges. The proposed breakdown of costs 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 proposed 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. This understanding is relevant to the CCA adjustments and depreciation as well as the HCA cost categories, as the CCA adjustments can have a material impact on the Profit and Loss and therefore charges as described in the AS Consultation June 2014.

Although the total cost figures will include this proposed breakdown, it is the extra transparency on costs provided by the proposed breakdown that will enable the Authority to better understand the relationship between costs and charges as described above. This will in turn allow the Authority to better assess Gibtelecom's compliance with its regulatory obligations.

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

#### 3.2 Mean Capital Employed Statement

When the 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, with the value of capital adjusted where necessary to reflect the current valuation of assets and efficiency of operations. This means that the investment made by the operator should take into account and allow him 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 Authority is proposing some amendments to the format of the Mean Capital Employed (MCE) Statement to give better 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 costs will also be impacted by changes to the CCA valuation through holding gains or losses and other adjustments arising from price and asset valuation changes which are reported in the P&L in the year they occur under the FCM convention that has been adopted.



The Authority proposes that the current Mean Capital Employed statement be amended so that the line “tangible fixed assets” is expanded to show all individual asset valuation items greater than 10% of the total of all CCA valuations for that market. For wholesale markets this would typically include items such as access copper, access fibre, duct, transmission, switch and land and buildings valuations. For retail markets this would typically include land and buildings, computing, and software.

The Mean Capital Employed statement contains standardised items amended for specific fixed asset items, as stated in section 2 of Annex B.

**Question 2: Do you agree that the amended Mean Capital Employed statement shall be stated for a relevant market based on the template in section 2 of Annex B? Please give reasons for your answer.**

### **Views of Respondents**

Gibtelecom assumes that the proposed requirement to show all individual asset valuations greater than 10% of the total of all CCA valuations for that market means showing all tangible fixed asset valuations where these are greater than 10% of the Total Fixed Assets figure. Additionally, the Company takes it that the requirement to report additional lines would be based on doing so for asset classes, and not individual assets.

Although the company does not foresee any obstacle in being able to report the additional data, it questions the value of providing such information.

### **The Authority’s position**

The tangible fixed assets are traditionally the most material item in the mean capital employed statement with the remaining categories of intangible fixed assets or investments unlikely to be material. The requirement to show all individual asset valuation items greater than 10% should therefore not be materially different if the 10% is applied to tangible fixed assets or total fixed assets. As the proposal is to provide extra transparency to enable the Authority to better understand the relationship between costs and charges, the 10% should apply to total fixed assets as proposed in Public Consultation 08/14.

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

### **Statement**

#### 3.3 Reconciliation statements with statutory accounts

Financial statements should be reliable and consistent.

The 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 Cost Accounting System 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 captions of the ASR to the statutory financial statements.

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. Currently the Gibtelecom ASR reconciliation statement only reconciles the return in the "Adjustments" section of the Reconciliation Statement; it does not separately disclose the revenue and costs that make up this return. The revenue and cost items that make up the return in the "Adjustments" section of the reconciliation statement could be material. The Authority therefore proposes that the Reconciliation Statement be completed with separate entries for revenue and costs in the "Adjustment" section as illustrated in the amended Reconciliation Statement in Section 3 of Annex B.

A material item in the ASR which is not currently disclosed in the "Adjustment" section of the Reconciliation Statement 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 Authority proposes that this issue be addressed by the addition of a new line in the Reconciliation Statement that eliminates the revenue and costs from these transfer charges which are not in the statutory accounts. This new line is shown in the amended Reconciliation Statement in Section 3 of Annex B.

The Gibtelecom reconciliation statement also includes an "Other Adjustments" line. This again is shown for the return only and does not contain a description of the items that are included in these "Other adjustments". The Authority therefore proposes that the "Other Adjustments" line should contain separate revenue and cost entries as well as a return entry and that a description is included for this entry. This is in the amended Reconciliation Statement in Section 3 of Annex B.

The Authority therefore proposes an amended Reconciliation statement template to show the values in the ASR for revenue and costs separately, include an additional "Elimination of Transfer Charges" line to remove the transfer charges between regulated markets, and explain any items contained in the "Other Adjustment" line.

The amended Reconciliation statement template is provided in section 3 of Annex B.

**Question 3: Do you agree that the operator shall provide an amended Reconciliation statement of the key financial captions 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? Please give reasons for your answer.**

## **Views of Respondents**

Gibtelecom is not clear on what the Authority is seeking with the amended Reconciliation statement. The Reconciliation Statement currently provided by the Company displays the turnover, costs, and returns of the relevant SMP markets. The Company explains that these are then adjusted to incorporate those “below the line” figures which do not have corresponding turnover, cost, and subsequently, return amounts (including, Corporation Tax, Dividends and Interest figures). They argue that the Gibtelecom Reconciliation statement does not ‘only reconcile the return in the ‘Adjustments’ section of the Reconciliation statement’.

As to the new “Elimination of transfer charges”, Gibtelecom does not agree with the inclusion of this new line. The Company argues that the level of transfer charges is already included in the Transfer Charges Matrix (Matrix 2) of the regulated accounts and feels it would be an unnecessary duplication of work.

## **The Authority’s position**

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. Gibtelecom 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.

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 Transfer Charges matrix (Matrix 2) should therefore be included in this reconciliation statement to show how the revenue and costs can be separately reconciled back to the statutory accounts.

**The Notified Operator shall provide an amended Reconciliation statement of the key financial captions 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.**

## **Statement**

### 3.4 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 operator.

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.

The latest ASR from Gibtelecom provides a statement of unit costs but this is at a summarised level for each market. It does not give a clear understanding of the costs reported in the P&L for each market and how these costs relate to the underlying services charged to retail.

To give greater clarity the Authority proposes that the unit costs for the services that make up each market are shown separately, along with their internal and external revenues, volumes and costs. These services should be disclosed separately in a new Wholesale Service Statement as set out in Section 4 of Annex B. If this results in the disclosure of more wholesale services than currently reported in the Statement of transfer charges (as set out in Decision 01/11) then the Statement of transfer charges should be amended to incorporate the services shown in the new Wholesale Service Statement.

The Authority therefore proposes that the operator completes a new Service Statement instead of the current Statement of Unit costs and 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 4 of Annex A in Decision 01/11.

**Question 4: Do you agree that Operators shall replace the current Statement of Unit Costs by providing 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?  
Please give reasons for your answer.**

### **Views of Respondents**

Gibtelecom believes there is a typographical error within the sample Wholesale Service Statement where the second table states figures to be included for the 'current year' and should read 'prior year'. Furthermore under the columns 'Average revenue per unit', Gibtelecom is seeking confirmation that these should display 'R/u' instead of 'X/u'.

The Company would also like to understand what the Authority means by 'Ceiling FAC per unit'. In the note to the table, it explains the figure is derived from the Service Cost statement but there is no reference to this figure in that statement.

Gibtelecom asked if the Authority could also provide some clarity of the purpose and benefits of reporting on this basis (Ceiling FAC per unit), as well as on 'Average revenue per unit/FAC'.

### **The Authority's position**

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.

The way the Authority proposes to measure compliance with the cost-orientation obligation is by monitoring the unit price for each wholesale product against the FAC per unit of this product as described in section 3.7 of the consultation. This describes the way wholesale charges should be set at a rate that is not above the unit FAC hence the description of this unit FAC as a 'Ceiling'. The 'Ceiling FAC per unit' is derived from the second set of tables in the Service Cost Statement 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 replace the current Statement of Unit Costs by providing 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.**

### 3.5 Network Statement of Costs

The principle underlying Fully Allocated Costing (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. These costs should be attributed to products 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 using the methodology documents<sup>4</sup>.

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 as follows:

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<sup>4</sup> Accounting and attribution methodology documents as described in this public consultation.

#### Direct and Shared Costs, consisting of:

- **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 wholesale customer or end users such as billing, maintenance and customer services. For the purpose of this document and the retail costs orientation compliance test, these are considered shared costs (Shared Costs).

#### Common Costs, consisting of:

- **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. For the purpose of this document and the retail costs orientation compliance test, these are considered common costs (Common Costs).

This consultation has suggested improvements to the ASR to address the documentation of the cost attributions by the proposed introduction of a Statement of Services (see Section 3.4) to show the costs for each service. Extra detail is also proposed in the P&L and MCE Statements cost and asset lines (see Sections 3.1 and 3.2) which will give further transparency regarding the costs associated with “Related functions” and “Other functions” by disclosing costs such as billing, maintenance, and customer services etc.

As described above, the other main cost attribution relates to the “network components”. The costs of “network components” are important as they make up the costs for the 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 proposes 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 the HCA and CCA costs separately due to the changes that can occur in the year from the CCA valuation as explained in the P&L Statement amendments (see Section 3.1). These costs also include an allowance for the capital employed by calculating an applicable rate of return based on the Mean Capital Employed. The applicable rate of return is the Weighted Average Cost of Capital 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 in Section 3.6, enabling the FAC for each service to be calculated as shown in the Statement of Services schedule.

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

**Question 5: Do you agree that the network Statement of Costs in Section 5 of Annex B shall be produced to provide documentation and transparency of the network components? Please give reasons for your answer.**

### **Views of Respondents**

As with the Company’s responses to the above new reporting requirements, Gibtelecom believes it would be able to provide this information whenever this can be extracted efficiently.

### **The Authority’s position**

The Authority acknowledges that Gibtelecom agrees that the network Statement of Costs in Section 5 of Annex B shall be produced to provide documentation and transparency of the network components.

**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.**

### **Statement**

#### 3.6 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 proposes 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 will then be 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 proposes that the Service Costs Statement be prepared by the operator using the template in Section 6 of Annex B.

**Question 6: Do you agree that the Service Costs statement in Section 6 of Annex B shall be produced to document and give transparency to the allocation of network component costs to services? Please give reasons for your answer.**

### **Views of Respondents**

As with Question 4, Gibtelecom believe they have identified an error in Section 6 of Annex B of the consultation paper where it shows the data to be provided for the 'current year' instead of 'prior year' as the Company assumes.

Gibtelecom believes this information can be disclosed with further work, as long as it can be extracted effectively.

### **The Authority's position**

The second table in the 'Service Cost Statement – costing of services using routing factors' in Section 6 of Annex B should show 'prior year'.

The Authority notes that Gibtelecom agrees that the Service Costs statement in Section 6 of Annex B shall be produced to document and give transparency to the allocation of network component costs to services.

**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.**

### **Statement**

#### 3.7 Cost Orientation

In meeting the 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).

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 Activity Based Costing, 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 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 proposes a simplified process of assessing compliance with cost orientation.

The proposed 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 proposes that the operator's wholesale charges should be set at a rate that is not above that shown in the Wholesale Service Statement proposed in Section 3.4. ((calculated as the CCA 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 CCA 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 CCA FAC level would not be considered cost oriented.

### **Retail charges compliance assessment**

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

- 1) The sum of relevant wholesale charges<sup>5</sup> and all retail Direct and Shared<sup>6</sup> Costs and;
- 2) the above plus retail Common<sup>7</sup> Costs.

Any prices that are materially outside of this range should be justified by the operator's notification under the retail Price Notification Framework 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.

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<sup>5</sup> As contained in the Statement of Transfer Charges.

<sup>6</sup> As defined in Section 3.5 of this document.

<sup>7</sup> As defined in Section 3.5 of this document.

The information required for the standard retail cost orientation compliance assessment is contained in a proposed 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 proposes 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.

**Question 7: Do you agree that the cost orientation test for the cost accounting obligation can be appropriately met by the use of the Service Statement in Section 4 of Annex B for wholesale services and the production by the operator of the retail Cost Orientation Statement in Section 7 of Annex B for retail services? Please give reasons for your answer.**

### **Views of Respondents**

Gibtelecom agrees that compliance with wholesale charges cost orientation obligations could be assessed through the use of a wholesale service statement as set out in Section 4 of the Annex of the Consultation paper. They argue this is in part already disclosed in the Statement of Unit Costs included in the current set of regulated accounts.

In relation to retail charge compliance assessments, Gibtelecom mentions that there is no scope within the compliance statement (Section 7 of Annex B of the consultation document), or Section 3.7 itself to include the standard (industry-practice) retail price mark-up calculations. Therefore, they are asking for some guidance on where, in the retail cost orientation compliance calculations, retail price mark-ups would be included.

Additionally, the Company is unclear and is having trouble marrying the following statements: 'Any prices that are materially outside of this range should be justified by the operator's notification under the retail Price Notification Framework' and the following under Section 6: 'Operators will not be required to submit PNF information for current prices for which they are not requesting changes'.

Gibtelecom are seeking more details on the intended effects or purpose of each statement.

### **The Authority's position**

Any retail price mark-ups included in the retail price will be assessed as part of the retail charges compliance assessment as set out in Section 3.7 of Public Consultation 08/2014. If the retail price mark-up results in the retail charges being materially outside of the range specified in Section 3.7 then a reason for that should be included in the PNF submission to the Authority.

Having reviewed the comments from Gibtelecom the Authority has decided to allow for a retail price mark-up up of 5% as a standard Rate of Return (RoR) within this retail price compliance assessment. The Authority will review each PNF on a case by case basis and reserves the right to alter this standard mark up if justified. A revised retail compliance assessment pro-forma is attached.

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 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.**

## 4. Documentation

The following sections propose amendments to the production of the documentation to support the Regulatory Financial Statements which are based on the Authorities review of the current documentation as set out in Decision 01/11 and a review of the operator's production of this documentation.

### 4.1 Accounting documents

In decision 01/11 the Authority set out the requirements for the accounting documents to be made up of the following:

- **Regulatory accounting Principles** – the principles applied or used by the operator in the preparation of the Regulatory Financial Statements;
- **Methods of revaluation** – this includes details of the methodologies (absolute valuation, indexation, historic) adopted to revalue key asset classes;
- **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**

Having reviewed the accounting documents from Gibtelecom, the Authority has identified a number of areas for improvement to fully meet the requirements as detailed above. These are set out below.

The valuation 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. The Authority notes that Gibtelecom has redacted the depreciation rate in its accounting documents. In decision 01/11 the Authority agreed that documentation provided did not need to contain absolute numbers or percentages if the information was commercially sensitive or confidential that may potentially put an operator at a competitive disadvantage.

The Authority believes that asset lives and depreciation rates are commonly reported in statutory financial statements and that their publication would not put Gibtelecom at a commercial disadvantage. Given the importance of asset valuations and their depreciation, the Authority proposes that the operator publishes the asset lives of all major asset classes so the significance of these assets on costs can be assessed.

The accounting document requirements specified in Decision 01/11 required details of the methodologies (absolute valuation, indexation, historic) adopted to revalue key asset classes. The Authority notes that the Gibtelecom accounting document discusses the different valuation methods available and which ones have been adopted in principle but does not state which classes of asset are valued by which methods.

The Authority therefore proposes that operators provide the asset classes and their valuation method adopted. Where an indexation method is used, the type of index and its source should also be provided.

**Question 8: Do you agree that the accounting documents shall be amended to include the elements outlined in this section? Please give reasons for your answer.**

### **Views of Respondents**

Gibtelecom agrees with the asset lives and depreciation rates elements forming part of the regulated accounts documentation as long as they do not consider them commercially sensitive. However, as concerns the CCA valuation methods, the Company feels it is already providing this in its Attribution Methodology document including the type of index used and its source. This is based on MM17 current cost accounting values derived from the Office for National Statistics in the UK. Furthermore, Gibtelecom also explained its valuation methods in its response to the Authority's public consultation 06/10 of 30 September 2010. Therefore, the Company does not understand why they should include information that is already being disclosed.

Gibtelecom also assumes that, although outside question 8 in the consultation paper, this section is to be treated in the same way as for the "Asset lives and depreciation rates" and "CCA valuation methods" sections.

The Company has a query as regards network components. They are unsure whether the Authority meant having the network components described in the "Attributions Methodology" document, and not the "Accounting Methodology" in the consultation document.

Gibtelecom nonetheless accept the Authority's proposal to amend the relevant regulated accounts document to describe the network components and which comprise the provision of services, which would be subject to confidentiality considerations, if any.

### **The Authority's position**

The Authority welcomes the inclusion of assets lives and depreciation rates in the accounting documents to assist in the assessment of the compliance by Gibtelecom of its regulatory obligations. The inclusion of CCA valuation methods by class of asset is also important to assess regulatory compliance. The published Attribution Methodology document does not show these valuation methods by asset class or the type of index used and its source.

The Network component descriptions should be included in the Attributions Methodology document as set out in section 4.2 of Public Consultation 08/14.

**The Notified Operator shall provide the amended accounting documents to include the elements outlined in this section.**

## 4.2 Attribution Methodology document

The network components are a key part of the costing and attribution methodology and it is now proposed that these are shown in the network Statement of costs described in Section 3.5. A description of these network components including their definition and the services that utilise each component would enhance the understanding of the ASR. As described in Section 3.5 the understanding of the network components are important to the Authority in discharging its obligations for cost accounting and cost orientation.

The Authority proposes that the accounting methodology document be amended to include 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. Preparation of the ASR

The following sections propose amendments to the preparation and production of the information contained in the ASR based on the Authority's review of the current obligations.

### 5.1 Valuation of assets

A key element of the current cost methodology is the valuation of assets. When no direct replacement for the asset is available it is necessary to make detailed estimates of the current value of all fixed assets on a replacement cost or on a modern equivalent asset (MEA) basis.

With the technological changes taking place in telecommunications it is necessary to continuously review the CCA valuation method to ensure it is the most appropriate for each type of asset. The CCA valuation methods were discussed in the previous accounting separation Decision (No 01/11) and were:

- Historical Cost
- Indexation
- Absolute Valuation
- Modern Equivalent Asset (MEA)

To ensure that the most appropriate methods are used and updated, the Authority proposes that the valuation methods used for each class of asset is reviewed by the Authority together with evidence of the most recent price of these assets from supplier's invoices against a previous price (at least one year from the most recent price). This will help the Authority to decide if the valuation method used is the most appropriate. Where there has been significant technological change and the asset in use cannot be purchased then this should be indicated by the operator as it may require the use of an MEA valuation. This information is proposed to be provided to the Authority only and not published and will supplement the information on asset valuation methods that has been proposed for the accounting documents (see Section 4.1)

The Authority therefore proposes that the operator submit an annual list to the Authority of the valuation methods and prices used for each class of asset. The annual list should be produced at the same time as the ASR.

**Question 9: Do you agree that the production of an asset list showing purchase prices including the elements outlined in this section would improve the valuation of assets? Please give reasons for your answer.**

### Views of Respondents

Gibtelecom does not agree that the production of an asset list showing purchase prices, including the elements outlined in this section, would improve the valuation of assets.

The Company have previously explained their assets are valued using the indexation method from the Office for National Statistics in the UK. The reason for applying this method is due to the Company not being in favour of having discrete replacement cost methodologies for different types of assets as doing so, they argue, is

impractical and costly with the limited resources available. In particular, should they have to obtain asset valuations through the use of supplier quotes and invoices as this would raise some difficulties as accepted by the Authority in its Response to Consultation and Decision 01/11 of 30th November 2011.

The Company feels the Authority's proposal to submit an annual list showing the prices used for each class of asset, is not clear. They state that prices are determined on an individual asset basis, not by groups or classes.

As a result, the Company proposes to continue employing the indexation valuation methodology, providing clear information on this within the Attributions Methodology document.

### **The Authority's position**

The Authority is not currently proposing to change the valuation basis of Gibtelecom's assets, but to obtain information to assess the current valuation methodology applied to determine if this is the most appropriate methodology for the future. The Authority recognises that prices are determined on an individual asset basis and therefore is proposing representative samples of these prices for each main asset class to minimise the burden on Gibtelecom.

To further minimise the cost to Gibtelecom of providing this information, the Authority proposes to modify this request so that the information is not provided on an annual basis. Instead the Authority proposes that this information is provided based on the latest financial year that regulatory accounts are being prepared only. Subject to an analysis of this information by the Authority, future updates to this list may only need to be provided when there is a change to an asset valuation basis or a new material asset is purchased or valued.

**The Notified Operator shall produce an asset list showing purchase prices including the elements outlined in this section which will improve the valuation of assets.**

### **Statement**

#### 5.2 Consistency of treatment

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. The current requirement set out in Decision 01/11 states "There shall be consistency of treatment from year to year for the Notified Operators accounting separation Report".

The current requirement means that 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 proposes 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.

Due to the importance of ensuring comparable information, the Authority proposes to amend this consistency of treatment requirement to make the following changes.

The Authority proposes 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 proposes 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.

**Question 10: Do you agree that material changes should result in the prior year 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? Please give reasons for your answer.**

### **Views of Respondents**

Gibtelecom agrees with the principle of restating 'prior year' figures as long as the Authority is willing to be flexible in the submission deadlines. Otherwise, the Company would not be in favour of having to notify the Authority of such material effects these changes may have on the regulated accounts ahead of their publication and audit.

The Company feels that having to notify the Authority of any material changes impacting the separated accounts ahead of its submission would mean having to have them ready earlier in the year. They explain this would not be practicable or reasonable given the fact that the first 'usable' versions of the statutory accounts from which the ASR is derived are not normally available until the fourth or fifth month of the year. Therefore, they will only be able to notify the Authority of any material changes and leave enough time to complete the audit of the regulated accounts, if the Authority is willing to extend the nine-month deadline, at least in years where material changes do take place.

Furthermore, Gibtelecom expressed concern in the circumstances where a material change needs to be implemented as a direct cause of regulatory requirements and where the Company can be penalised and pushed to completely rewrite the previous year's separated accounts.

## **The Authority's position**

Consistency of regulatory accounting between the two years reported is an essential requirement in most regulatory reporting regimes. This is as a result of the importance of having current and prior year comparability to assess regulatory compliance.

The Authority is aware that prior year restatement and their audit can have a material impact on the production of the regulatory accounts and will assess a request for any extension in the reporting deadlines on a case by case basis. The Authority does not accept that the current nine-month deadline for the production of the regulatory accounts should be extended by the proposed requirement of Gibtelecom notifying the Authority of any material changes. The notification of material changes should not hold up the production of the regulatory accounts process. If the total of the notified material changes represents a material change to the published regulatory account in aggregate (which requires a prior year restatement), then the Authority will discuss with Gibtelecom the appropriate timescales for publication.

Where there are regulatory enforcements or decisions made by the Authority that require a restatement of the prior year results to ensure comparability, then the Authority will discuss the appropriate timescales with Gibtelecom as mentioned above. The prior year will only need to be restated for those items affected by the decisions of the Authority and should not result in the previous year's separated accounts having to be completely re-written.

**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.**

### 5.3 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.

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

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).

The table below shows the publication requirements for all information requested from the SMP operator.

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

	Description of the costing model	<b>YES*</b>
	Detailed description of (Weighted Average Capital Cost) WACC calculation	<b>YES</b>
	Other notes	<b>YES*</b>
	List of asset valuation methods with current and prior year purchase prices indicating if MEA applies	<b>NO</b>
<b>ATTRIBUTION METHODOLOGY DOCUMENT</b>	Description of cost attributions in the costing model	<b>YES*</b>
	network component description table	<b>YES*</b>

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

*\*\*asset lives as a number should be shown separately by asset class along with the valuation method and indices used by each asset class.*

The Authority requires the operator to make the above mentioned documents publicly available on the website of the 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 proposes 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.

**Question 11: Do you agree that the above amended list of publicly available documents shall be made public and published on the website of the operator annually within two months after the submission of the ASR to the Authority? Do you also agree that 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? Please give reasons for your answer.**

### **Views of Respondents**

Gibtelecom appreciates the Authority's continuing assertions to keep sensitive information confidential and not made public. The Company also welcomes the Authority allowing operators the opportunity to show that information is sensitive.

Other than those documents/statements/lists that Gibtelecom is not in agreement with producing (material changes prior to the publication of the ASR; list of asset valuation methods with current and prior year purchase prices indicating if MEA applies) explained above, the Company already publishes its suite of regulated accounting documents on its web page and within the same timeframes. Gibtelecom therefore foresees no major problems with continuing this process, as well as now having to seek sign-off by a Gibtelecom board member. The Company is nevertheless of the opinion that having the separated accounts independently audited and verified would have been enough.

### **The Authority's position**

The Authority notes that Gibtelecom accepts the publication of the ASR and expects no problems in continuing this process as well as having the inclusion of a signature by a Gibtelecom Board Member.

**The Notified Operator shall publish the above amended list of publicly available documents and make 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.**

## 6. 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.

This section describes the Authority's proposal for the Price Notification Framework (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.

### 6.1 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 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.

**Question 12: Do respondents agree with the purpose and scope of the PNF? If not, please provide reasons for your view and justification for why the scope and purpose should differ from that set out above. Where possible, please provide examples to illustrate your position.**

### Views of Respondents

Gibtelecom agrees with the Authority that any obligation or regulation on retail prices should bear into consideration the effects these might have on small operators. As such, the Company is broadly in agreement with the proposal to assess retail price obligations via "lighter touch" regulation. This would take the form of notifying the Authority and providing certain additional details whenever there is a change to a regulated retail service (access to the public telephone network at a fixed location; publicly available local telephone services at a fixed location; and publicly available international services provided at a fixed service). This includes the introduction of new prices on these regulated fixed services, as well as when bundling or tying such services.

### The Authority's position

The Authority acknowledges that Gibtelecom agrees with the purpose and scope of the PNF via 'lighter touch' regulation.

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

6.2 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:
    - Historic and projected volume of demand;
    - Number of existing users that would be affected by the proposed tariff change
    - Size of overall market/market share of the operator
    - 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.

**Question 13: Do respondents agree with the process and information requirements set out above for modification to existing prices by an operator? If not, please provide reasons for your view and justification for why the scope and purpose should differ from that set out above. Where possible, please provide examples to illustrate your position.**

### **Views of Respondents**

Gibtelecom considers that some of the additional information being proposed is superfluous, unnecessary, and at times burdensome. For instance, the requirement to assess the impact on the profit and loss and mean capital employed statement for the relevant regulated market is confusing in their view.

In the case of the profit and loss and mean capital employed statements, they question if this would mean having to generate a new ASR every time a price changes, and comparing this to most current ASR submission. They also question what would happen if the Company makes two price changes in the same year and against what would such impact be assessed. The Company believes that providing parts of the data required under (h) would also be onerous. For example, the requirement to provide information on the number of existing users that would be affected by the proposed change would need in-depth analysis and examination of marketing and business information.

Gibtelecom further commented that the Authority should be able to meet its own timescales. Gibtelecom feels it cannot afford to notify the Authority 45 days before a price change is expected to be introduced, and commit financial and other resources, in particular towards marketing campaigns whilst meeting the 14 day regulatory requirement to make public announcements, if the Authority can block or modify the Company's proposal at the last minute.

### **The Authority's position**

It is the Authority's view that the information requested in respect of price changes is only that which Gibtelecom would have to analyse internally in order to satisfy their own compliance with the regulatory requirements. This should therefore not present an extra burden to the Company in providing this information to the Authority.

In terms of price changes, there would not be a necessity for the Company to generate a completely new ASR every time. The new price change can simply be applied as a sensitivity adjustment to the most recently issued ASR, and the impact on the P&L and MCE statements reassessed. This is intended to be an indicative impact assessment, not a complete restatement of the ASR. However, should more than one price change be made within a year then further impact assessments



should be established, and the extra impact (in addition to the first price change) should be indicated.

Regarding the information requested under section (h), Gibtelecom would need to assess demand and user volumes, market size/share and revenues for its own purposes, in order to understand the commercial and regulatory impact of the proposed price change. Therefore, providing this information to the Authority as supporting data should not be onerous for Gibtelecom.

The Authority will issue a notice to block or modify a price change within 15 days of a complete submission under the PNF requirements. Only in exceptional circumstances, will the GRA take up to 30 days to respond and Gibtelecom will be advised 10 days after the PNF notification.

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

### 6.3 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.

**Question 14: Do respondents agree with the process and information requirements set out above for the introduction of new prices by an operator? If not, please provide reasons for your view and justification for why the scope and purpose should differ from that set out above. Where possible, please provide examples to illustrate your position.**

### **Views of Respondents**

Gibtelecom's comments under this question are the same as for question 13 above. The Company would further like some clarification on what is meant by 'business case information and projection of costs and revenues'. The Company feels this is additional information to that already being asked through the price change notifications.

## **The Authority's position**

The business case information and projection of costs and revenues is not additional to what is asked for price change notifications. The information required is similar to that requested in paragraph (h) of section 6.2, although clearly for new services historical data on costs and revenues will not be available and so only forecast data is required.

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

### 6.4 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.

**Question 15: Do respondents agree with the process and information requirements set out above bundling and tying of services by an operator? If not, please provide reasons for your view and justification for why the scope and purpose should differ from that set out above. Where possible, please provide examples to illustrate your position.**

### **Views of Respondents**

With regards being able to offer bundled regulated services as standalone products, Gibtelecom at this time does not imagine this would be a major problem. For all other aspects under this proposal, Gibtelecom's comments under this question are identical to those provided under question 13 above.

### **The Authority's position**

The Authority notes Gibtelecom's position that they do not expect this to be a major issue and will be able to comply with the requirements set out by the Authority.

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

## **Annex A - Decisions**

- 1. The Notified Operator shall use the template in section 1 of Annex B when providing Profit and Loss statements in its accounting separation report.**
- 2. The Notified Operator shall produce a Mean Capital Employed statement for each relevant market based on the template in section 2 of Annex A.**
- 3. The Notified Operator shall provide an amended Reconciliation statement of the key financial captions 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.**
- 4. The Notified Operator shall replace the current Statement of Unit Costs by providing 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. 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.**
- 6. 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.**
- 7. 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.**
- 8. The Notified Operator shall provide the amended accounting documents to include the elements outlined in this section.**
- 9. The Notified Operator shall produce an asset list showing purchase prices including the elements outlined in this section which will improve the valuation of assets.**
- 10. 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.**
- 11. The Notified Operator shall publish the above amended list of publicly available documents and make 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.**

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

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

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

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

## Annex B - ASR templates

### 1. Profit and Loss Statement

<b>PROFIT AND LOSS STATEMENT</b>	<b>Current year</b>	<b>Prior year</b>
	<b>(£)</b>	<b>(£)</b>
<b>Turnover</b>		
Internal Sales		
External Sales		
<b>Total Turnover</b>	_____	_____
<b>Operating Costs</b>		
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)		
<b>Total HCA Operating Costs</b>	_____	_____
<b>CCA Adjustments</b>		
CCA Supplementary Depreciation		
CCA Other Adjustments		
<b>Total CCA Adjustments</b>		
<b>Total CCA Operating Costs</b>		
<b>Return</b>	_____	_____

## 2. Mean Capital Employed Statement

<b>STATEMENT OF MEAN CAPITAL EMPLOYED</b>	<b>Current year (£)</b>	<b>Prior year (£)</b>
<b>Fixed Assets</b>		
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		
<b>Total Fixed Assets</b>	_____	_____
<b>Current Assets</b>		
Stock		
Debtors		
Other		
<b>Total Current Assets</b>	_____	_____
<b>Creditors</b>	_____	_____
<b>Provisions for Liabilities and Charges</b>	_____	_____
<b>Mean Capital Employed</b>	_____	_____
<b>RETURN ON MEAN CAPITAL EMPLOYED</b>	<b>Current year (£)</b>	<b>Prior year (£)</b>
Return		
Mean Capital Employed		
<b>Return On Mean Capital Employed</b>	_____	_____

### 3. Reconciliation Statement with Statutory Accounts

#### RECONCILIATION STATEMENT

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



## 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	x/u	x/u	FAC	R/u/FAC
Service 2	r	r	R	v	v	V	X	u	x/u	x/u	FAC	R/u/FAC
....												
Service N	r	r	R	v	v	V	X	u	x/u	x/u	FAC	R/u/FAC
<b>Total</b>	RE	RI										

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	x/u	x/u	FAC	R/u/FAC
Service 2	r	r	R	v	v	V	X	u	x/u	x/u	FAC	R/u/FAC
....												
Service N	r	r	R	v	v	V	X	u	x/u	x/u	FAC	R/u/FAC
<b>Total</b>	RE	RI										

**FAC per unit comes from the Service Cost Statement**

## 5. Network Statement of Costs

### Network Statement of Costs

For the current year

Network Component	HCA Operating Cost	CCA Depreciation	CCA Adjustments	Total CCA Operating Costs	CCA 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	x	units	x
Component 2	x	x	x	x	x	%	x	x	units	x
....										
Component N	x	x	x	x	x	%	x	x	units	x
<b>Total</b>										

For the prior year

Network Component	HCA Operating Cost	CCA Depreciation	CCA Adjustments	Total CCA Operating Costs	CCA 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	x	units	x
Component 2	x	x	x	x	x	%	x	x	units	x
....										
Component N	x	x	x	x	x	%	x	x	units	x
<b>Total</b>										

**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
			Routing Factors								
Component 1	u	x	r	r	r	r	r	r	r	r	r
Component 2	u	x	r	r	r	r	r	r	r	r	r
....											
Component N	u	x	r	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
			Routing Factors								
Component 1	u	x	r	r	r	r	r	r	r	r	r
Component 2	u	x	r	r	r	r	r	r	r	r	r
....											
Component N	u	x	r	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
			£/unit			£/unit			£/unit		
Component 1	u	x	x	x	x	x	x	x	x	x	x
Component 2	u	x	x	x	x	x	x	x	x	x	x
....											
Component N	u	x	x	x	x	x	x	x	x	x	x
<b>Total FAC</b>			<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>

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
			£/unit			£/unit			£/unit		
Component 1	u	x	x	x	x	x	x	x	x	x	x
Component 2	u	x	x	x	x	x	x	x	x	x	x
....											
Component N	u	x	x	x	x	x	x	x	x	x	x
<b>Total FAC</b>			<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>

**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 Charges (a)	Retail Direct Costs (b)	Retail Shared Costs (c)	"Floor" (a)+(b)+(c)	Retail Common Costs (d)	"Ceiling" (a)+(b)+(c)+(d)	Volume units	Unit "Floor" Costs	Unit "Ceiling" Costs	Retail Unit Charge
Retail Service 1	x	x	x	x	fl	x	ce	u	fl/u	ce/u	p
Retail Service 2	x	x	x	x	fl	x	ce	u	fl/u	ce/u	p
....											
Retail Service N	x	x	x	x	fl	x	ce	u	fl/u	ce/u	p

Market A Prior year

Retail Service	Revenue	Wholesale Charges (a)	Retail Direct Costs (b)	Retail Shared Costs (c)	"Floor" (a)+(b)+(c)	Retail Common Costs (d)	"Ceiling" (a)+(b)+(c)+(d)	Volume units	Unit "Floor" Costs	Unit "Ceiling" Costs	Retail Unit Charge
Retail Service 1	x	x	x	x	fl	x	ce	u	fl/u	ce/u	p
Retail Service 2	x	x	x	x	fl	x	ce	u	fl/u	ce/u	p
....											
Retail Service N	x	x	x	x	fl	x	ce	u	fl/u	ce/u	p