Accounting Separation and Publication of Financial Information by Undertakings having Significant Market Power in the Electronic Communications Sector

Report on Consultation and Decision

20 July 2009

Malta Communications Authority
Valletta Waterfront, Pinto Wharf, Floriana FRN1913, MALTA
Telephone: +356 21 336 840 *Fax:* +356 21 336 846
Web: http://www.mca.org.mt

Table of Contents

1. Introduction

In March 2009, the Malta Communications Authority (hereafter 'MCA') published a Consultation and Proposed Decision on Accounting Separation and publication of financial information by undertakings having significant market power (hereafter 'SMP') in the Electronic Communications Sector (hereafter 'ECS'). This document is the report on the consultative document and decision dealing with Accounting Separation in the ECS.

In October 2002 the MCA had published a Report on Consultation and Decision entitled "Accounting Separation and Publication of Financial Information" (hereafter 'the 2002 Decision') which dealt with the requirements imposed on operators designated with Dominant Market Position (hereafter 'DMP') status and having accounting separation obligations. The aim of the consultation and proposed decision issued in March 2009 was to update the 2002 decision and where appropriate propose amendments based on the experience gained by the MCA from subsequent interactions with SMP operators in this field. Certain parts of this decision reproduce some contents of the original 2002 decision which contents still apply in the present context. This report on consultation and decision contains a summary of the issues discussed in the consultation document; a summary of the feedback received from the respondents; the MCA's position in relation to these comments; and subsequently, the MCA's decision.

2. Responses to Consultation

Responses were received from the following parties:

- Vodafone Malta Ltd
- Go Plc (on behalf of Go Plc and Mobisle Communications Ltd)

The MCA hereby wishes to take this opportunity to thank the respondents for their feedback.

3. Accounting Separation

The ERG Opinion on Cost Accounting and Accounting Separation defines Accounting Separation as "a comprehensive set of accounting policies, procedures and techniques that can be applied to the preparation of financial information that demonstrates compliance with non-discrimination obligations and the absence of anticompetitive cross-subsidies. The outputs from such a system must be capable of independent verification (auditable) and fairly present the financial position and relationship (transfer charge arrangements) between product and service markets. Using accounting separation, a National Regulatory Authority (hereafter 'NRA') imposes on the notified operator a set of rules on how accounting information should be collected and reported."

The EU recommendation of 19 September 2005 states that good presentation of regulatory accounts ensures that the essential messages of the financial statements are communicated clearly and effectively and in as simple and straightforward manner as possible.

The main purposes of imposing accounting separation obligations on SMP operators is to make the reported transactions more transparent, to ensure that non-discrimination obligations through internal transfer charges is adhered to, and/or to assist and provide information which can be used in order to determine the actual cost of services provided.

The MCA would like to clarify that any reference to Separated Accounts and/or Regulatory Accounts throughout this document shall be taken to mean the Audited set of Separated Accounts.

3.1 Level of Accounting Separation

3.1.1 Summary of the Consultation Issue - Decisions 1 - 4

In the consultation and proposed decision the MCA has proposed that the level of accounting separation in the main business areas is to maintain the current level of separation as follows:

- Core Network,
- Access Network,
- Retail,
- Other Activities.

In order to have better transparency over adequate margins as well as potential harmful cross-subsidisation practices, the MCA has also proposed a separation of Go Plc's retail activities to segregate standard tariffs from bundles, which in turn would distinguish residential bundles from their business counterparts. Hence in the consultation document the MCA proposed that Go Plc follows the Detailed Retail Schedules format present in Appendix III of the document. In the same consultation document the Authority also provided the level of separation which should be followed by Vodafone Malta Ltd and Go Mobile. The Authority also made reference to the carrying out of market analyses for the wholesale broadband access market and the wholesale broadcasting transmission services market, where as a result of the market analysis, all remedies were withdrawn from both these markets.

3.1.2 Summary of Responses

Making reference to the detailed retail split proposed by the MCA in the consultation and proposed decision, one respondent noted that to its knowledge, nothing has happened which warrants the more stringent approach being proposed by the MCA with respect to these detailed retail schedules. The same respondent noted that its obligation to prepare detailed retail schedules no longer applies making reference to the MCA's decisions entitled "Retail Public Telephone Call Services provided at a Fixed Location Identification and Analysis of Markets, Determination of Market Power and the Setting of Remedies" where the MCA withdrew retail regulations that were established under the MCA decisions entitled "National telephone services provided at a fixed location" published in 2006 and "International telephone services provided at a fixed location" published in 2007.

This respondent also argued that its accounting separation obligations at a retail level were removed through the aforementioned decision which was published in April 2009. The accounting separation consultation and proposed decision was published in March 2009. Hence, the respondent argued that as a result of the decision published in April 2009, it is no longer required to submit accounting separation at a retail level.

The same respondent made reference to the fact that in the consultation document the MCA mentioned that the detailed retail schedule provided as a template in Appendix III of that consultation document is not meant to be exhaustive. Such respondent mentioned that it did not understand how it can exercise its right to be consulted on a template that can in any case be changed at any time by the Authority.

The same respondent noted that through the April 2009 decision entitled "Retail Public Telephone Call Services provided at a Fixed Location Identification and Analysis of Markets, Determination of Market Power and the Setting of Remedies", the MCA has directed that it is discontinuing the former distinction made between the residential and non-residential calls markets, making reference to the fact that call services provided to residential and non residential customers are practically identical. This respondent noted that it will not necessarily make such a distinction as a result of market forces totally outside its control which necessitates that it realigns its approach to the market if it is to remain relevant.

It was also noted that the Authority should develop one common set of reports for operators. It noted that a group which has two companies offering fixed and mobile services, should have the choice to develop a common set of reports for both operators.

Finally, both respondents commented on the MCA adopting an asymmetric treatment amongst operators with specific reference to another network operator.

3.1.3 MCA's Responses and Decision

With reference to the detailed retail schedules, as noted in the same consultation document, given the proliferation of retail bundles within a Fixed Network Operator's Business, the Authority had proposed a more detailed breakdown of some of the above business segments. Such a detailed breakdown would allow a more adequate monitoring of possible cross-subsidisation practices by SMP operators and hence control for the potential effect of bundled prices by vertically and horizontally integrated operators, currently having an SMP status in one or more regulated markets. Such an enhanced level of separation would also permit a more effective monitoring of non-discrimination obligations.

Reference must also be made to the EU recommendation of 19 September 2005[1], where accounting separation reporting obligations may require the preparation and disclosure of information for markets where an operator does not have SMP. Article 5 of this recommendation states that:

"Operators may operate in markets in which they have been designated as having significant market power, as well as in competitive markets where they are not so

[1] Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications (2005/698/EC).

designated. In order to carry out its regulatory tasks, a national regulatory authority may need information about markets where operators do not have SMP. When an obligation for accounting separation is imposed on a notified operator with SMP in one or more markets, the imposition of accounting separation may cover markets where the operator does not have SMP, e.g. to ensure the coherence of data." [2]

Hence the MCA would like to point that its proposed format on segregated retail data is still in line with the said recommendation given that an operator has been designated with an SMP in related and wholesale market.

This notwithstanding, the MCA took account of the feedback received and following an evaluation of the additional effort involved in the preparation of this additional information requested, the Authority concluded that this breakdown will not be requested from an SMP operator not having accounting separation obligations at a retail level. However, in line with the requirements of article 5 of the Commission recommendation, the MCA reserves the right to request such information in the format featured in Appendix III of this decision on a needs be basis.

With regards to the template presented in Appendix III, the proliferation of bundles of new services would make it impossible to set a detailed and exhaustive split as this would need to be constantly updated going forward. For this reason the MCA attempted to provide a *proforma* of the required information to act as a guideline and hence its use of the term 'non-exhaustive' in the consultation document.

One of the respondents also made reference to the business and residential split. The MCA wishes to point out that currently this respondent who is a SMP operator, is still making a price distinction between business and residential customers in some of its wholesale and retail offerings. In this regard the MCA directs that the residential/business split is carried out in line with the format presented in appendix III below.

The MCA would also like to note that the European Framework is based on the regulation of the market, and hence the company set-up is irrelevant to the form of regulation and reporting mandated by an NRA. In this regard although every effort has been made to make the reporting structure as homogenous as possible, inherent differences in the reporting requirements remain and hence the MCA directs that an operator which is designated with SMP and has accounting separation obligations should follow the structure of separation presented in the tables below, which make reference to wholesale SMP and Retail SMP. In this decision the Authority is distinguishing between a fixed and a mobile network

[2] Ibid., Article 5.

operator. Where any one of these types of operators is imposed with an accounting separation obligation following the finding of an SMP status, the MCA directs the following level of separation:

FIXED NETWORK OPERATOR with WHOLESALE SMP				
CORE NETWROK	LOCAL ACCESS NETWORK	RETAIL		INT'L GATEWAY (if applicable)
		VOICE	OTHER	

MOBILE NETWORK OPERATOR with WHOLESALE SMP				
CORE NETWROK	LOCAL ACCESS NETWORK	RETAIL		INT'L GATEWAY (if applicable)
		VOICE	OTHER	

FIXED NETWORK OPERATOR with RETAIL SMP
REFER TO DETAILED RETAIL SCHEDULES IN APPENDIX III

The tables above serve to highlight the overall level of separation required from a fixed network operator and a mobile network operator. Appendix III in this decision highlights the actual level of detail required in the separated accounts which is to be used as the required format of the separated accounts.

As noted above, in line with article 5 of the Commission recommendation of 19th September 2005, the MCA also reserves the right to request additional financial information on costs and revenues apart from the annual separated accounts where required.

With reference to the MCA adopting an asymmetric treatment between operators, the MCA would like to clarify that the scope of this decision is solely to provide a basis for the format and technical parameters of the separated accounts. Whether an operator has SMP and accounting separation obligations falls beyond the scope of this decision as this enters the remits of the market analysis process. For the avoidance of doubt, the MCA has replaced specific references in this decision to individual undertakings so as to reflect this principle.

The MCA reserves the right to request accounting information as may be required in order to establish compliance with other obligations, such as wholesale non-discrimination, margin squeeze tests, and universal service costs.

4. Format of the Accounting Separation Financial Statements

The 2002 Decision featured a number of guiding concepts and principles for the preparation of the Separated Accounts including principles on transfer charging and regulatory accounting principles. The MCA is of the view that these principles are still relevant in their totality and hence should be maintained. These principles and guidelines are being reproduced in the Appendices shown hereunder:

- Appendix IV: Regulatory Accounting Concepts
- Appendix V: Regulatory Accounting Principles
- Appendix VII: The Transfer Charging Principles

Appendix VI, also addresses any issues that may arise as a result of improvements being made to the attribution methodology. Reference is also made to any required changes in cost drivers which may in turn trigger changes which would need to be made to comparative figures.

4.1 Publication of Other Financial Information

The 2002 Decision featured also a number of required ancillary submissions from SMP operators having an accounting separation obligation. These required ancillary submissions are summarised hereunder.

1. A statement of accounting policies used in the preparation of the accounts;

2. A matrix summarising the total transfer charges between the different Accounts;

3. A statement describing the basis on which unattributable costs have been allocated between different accounts;

4. Information about the cost allocation methodologies employed in order to prepare separate accounts. This should be at a level of detail that makes clear the relationship between costs and interconnection charges;

5. A statement showing the average cost of network components.

Including amongst others:

- Average per minute cost of each conveyance network component;
- Average per minute cost of each non-conveyance network component. For example, Directory enquiries, Operator assistance, etc;
- Other costs split into appropriate categories (split into an average per minute cost where applicable);
- Routing factors for traffic;
- Time of Day Gradients;
- Final charges;
- International Out-Payments.

Accompanying explanatory information should also be provided with, such as, but not limited to:

- A statement of the Regulatory Accounting Principles followed when preparing the Accounts;
- Complete definitions of the main business areas and their disaggregated activities;
- A description of the transfer charging system that is operated for accounting separation;
- Details of significant changes which impact on the financial statements and on comparative figures.

The regulatory accounts should also include and disclose all relevant supporting information, which would assist users to understand the basis of preparation and presentation of the accounts.

The MCA also emphasises that as stated in Appendix VII the internal transfer charges should be equivalent to the charge that would be levied if the product or service were sold externally rather than internally.

4.2 Further Information

4.2.1 Summary of the consultation issue - Decision 5

In the consultation document, the Authority highlighted that for a more enhanced analysis it requires separate disclosure of the depreciation costs and the depreciation rate applicable per network element.

It was also noted that reconciliations with the Statutory Accounts are a very important source of data that sheds light into the different treatment applied on certain items of costs, revenues and balances between the two sets of accounts. Reconciliations are carried out on:

- Revenue (where applicable);
- Profit and Loss; and
- Balance Sheet.

The MCA also highlighted the point that the reconciliations with the Statutory Accounts are considered to be an integral part to the Separated Accounts and proposed that for each set of regulatory financial statements, the SMP operators having accounting separation obligations should include a detailed breakdown of the items considered as out of scope / in scope for the regulatory accounts.

4.2.2 Summary of Responses

One of the respondents noted that a network element can be made up of different asset categories that would have different depreciation rates. In such case it was argued on which depreciation rate one should publish.

The same respondent noted that the disclosure of out of scope/in scope items should be of the same level of the line items found in the financial statements and should not go into detail of the nominal account involved.

Another respondent noted that requests for detailed disclosure of items considered as out of scope and/or in scope within the reconciliation between the Statutory Accounts and the Separated Accounts should only be triggered by the Authority for clarification purposes. The same respondent also noted that such detailed information may contain confidential and sensitive business information and should not be published.

4.2.3 MCA's Response and Decision

After having considered the responses received, the MCA has decided not to impose the disclosure of such individual depreciation rates in the Separated Accounts however, SMP operators are required to submit this information for clarification purposes if the need arises during the review of the separated accounts by the authority. The MCA reserves the right to request such individual depreciation rates in the eventuality of any cost modelling exercise that it might be undertaking in the near future.

The MCA is fully aware of the need to ensure that all confidential information is treated as such. In fact the regulatory accounts are not published by the Authority. Moreover, the MCA does not require information going into the detail of the nominal account involved but a description of each item and its relative amount will suffice. The MCA notes also that the latest sets of separated accounts submitted by the SMP operators having accounting separation obligations presently fulfil this requirement and the reconciliation should be drafted in the same format of the final set of separated accounts submitted. This notwithstanding, the Authority reserves the right to request a further detailed breakdown of the in scope/ out of scope items from the SMP operators having accounting separation obligations for clarification purposes whilst reviewing the separated accounts.

4.3 Audit of the Separated Accounts

4.3.1 Summary of the consultation issue - Decision 6

In the consultation document the MCA, in line with its 2002 Decision, reserved the right to invite the auditors to discuss procedures to be applied by them in performing the audit or to discuss the auditors' findings following performance of the audit. The MCA also reserved the right to request the operators to instruct the auditors to perform additional or alternative work to substantiate the statements and assertions contained in the Regulatory Accounts and to further report on this additional work.

Also, in the consultation document, in view of the auditors providing positive assurance, the MCA had proposed to renounce the right to appoint auditors directly should the operators or their auditors fail to provide the degree of assurance required by the MCA, or should the MCA be of the opinion that the nature, timing or extent of the audit carried out would still be inappropriate following the MCA's intervention detailed above.

4.3.2 Summary of Responses

One of the respondents did not comment on this decision whilst the other noted that it does not object to the proposed decision.

4.3.3 MCA's Responses and Decision

As laid out in the 2002 Decision, and proposed in the consultation document, the auditors will be appointed under a letter of engagement from the operator. The auditors will address their report to the operator's corporate entity and this opinion will be attached to, but will not form part of, the Regulatory Accounts submitted to the MCA by the operators. The requirements related to the audit found in section 3.2 of the consultation document and summarized above are to be treated as an integral part of the audit.

4.4 Auditor's Opinion

4.4.1 Summary of the consultation issue - Decision 7

The consultation document noted that the MCA must be provided with the necessary assurance that the information which is being submitted is relevant, reliable and of high quality.

The MCA also proposed that the most appropriate manner by which this assurance can be provided is that the operators having SMP, and on whom an accounting separation obligation has been imposed, should secure an audit opinion by the Regulatory Auditor.

In the consultation document, the MCA proposed that the auditor's opinion should be in the form of a "Fairly presents in accordance with" (FPIA) audit opinion. Such audit opinion will be in conformity with International Standards on Auditing (ISA) 800. This opinion will provide the highest level of assurance. Appendix VIII to this decision sets out the assurance requirements of an auditor's report giving an unqualified FPIA audit opinion.

An FPIA audit opinion provides comfort that the overall impression given by the regulatory accounts 'fairly presents' the underlying performance and financial position, including its presentation. The level of audit opinion is the general standard for industry and is equivalent to the standard required for statutory accounts.

The auditors' report should also clearly set out the respective responsibilities of the auditor and the operator together with the basis on which the audit has been carried out and the opinion arrived at.

The MCA also noted that the auditors will keep the MCA informed regarding the progress of the audit and, where necessary, have regular meetings with the MCA. Where any issues which require clarification arise, the MCA expects that the operator and / or the regulatory auditor will obtain such clarification regarding the accounting treatment from the MCA.

4.4.2 Summary of Responses

One respondent noted that the relationship of the auditor should be with the operator who appoints him and not with the MCA. Moreover, the same respondent noted that it is not in agreement with the auditors informing the MCA regarding the progress of the audit and, where necessary, having regular meetings with the MCA.

The other respondent did not comment on the proposed decision.

4.4.3 MCA's Response and Decision

In view of the representations made, the MCA feels that by having auditors presenting an audit opinion giving positive assurance, the requirement of having the auditors informing the MCA regarding the progress of the audit, and where necessary having regular meetings with the MCA, is not relevant anymore as this was originally present due to the auditors giving negative assurance in their audit opinion. With reference to the fact that the auditors are now required to provide positive assurance, the MCA is hereby not insisting on the faculty of having regular meetings directly with the auditors.

The MCA hereby directs that all audit reports attached with separated accounts are to provide an FPIA audit opinion in line with the format provided in Appendix VIII.

4.5 Statement of Compliance and Publication of Financial Information

4.5.1 Summary of the consultation issue - Decision 8

In the consultation document the MCA noted that the Electronic Communications Networks and Services (General) Regulations (Chapter 399.28 of the Laws of Malta) (hereinafter 'ECNSR') establishes the manner in which compliance with cost accounting systems should be verified.

Regulation 22(6) states that "The Authority shall cause to be published annually a statement concerning compliance with any cost accounting system imposed under this regulation."

Regulation 37(5) also states that "An undertaking that is subject to retail tariff regulation or other relevant retail control, shall operate and maintain a cost accounting system including related regulatory accounts, that are-

(a) Based on generally accepted accounting practices,

(b) Suitable for ensuring compliance with this regulation, and

(c) Capable of verification by the Authority."

Regulation 37(8) continues by stating that "an undertaking to which sub-regulation (5) applies shall publish in its annual accounts a statement concerning compliance by it with a cost accounting system referred to in sub-regulation (5)".

Reference to the statement of compliance is also made in the Commission recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications[3]. Annex 2 of the Commission recommendation states that:

"The annual statement of compliance should at least include:

- The conclusions of the auditor
- All identified irregularities
- Recommendations made by the auditor (with a description of the corresponding effects)
- The full description of the verification methodology followed, and
- Some aggregate financial accounting data (such as CCA adjustments, main assumptions made on attribution methodologies, level of costs allocated and the level of granularity of the model).

Publication of the statement of compliance and of the audit results should be presented in a form easily accessible by interested parties, such as a paper or electronic version, or published on the operator's or national regulatory authority's website."

In order to fulfil the requirements found in the ECNSR and in the Commission Recommendation, in the consultation document the MCA proposed that the statement of compliance will be in the form of the audit report together with a brief

[3] ibid.

summary of the description of the accounting methodology used to compile the separated accounts. The Authority also proposed that this should be published on the operator's website.

4.5.2 Summary of Responses

One respondent noted that such a requirement will not add value to the information required by the MCA in order to determine discrimination and/or cross-subsidisation to the detriment of competition. It was also noted that such reports may contain commercially sensitive information. Another respondent noted that it was unclear whether such decision entails the publication of the full set of separated accounts.

4.5.3 MCA's Response and Decision

The MCA hereby notes that such requirement arises from the Commission recommendation of 19 September 2005 and local legislation as noted above. The MCA has considered the reservations raised by the said operator with respect to the publication of the statement of compliance, and fails to understand how such a statement would divulge commercially sensitive information when this would only comprise of the Auditor's Report highlighting his opinion on the separated accounts together with a descriptive summary of the accounting methodology used. Appendix IX shows a sample of a statement of compliance.

The MCA directs that SMP operators having accounting separation obligations are to publish a statement of compliance on their website annually on the same day the accounts are submitted to the MCA.

4.6 Timeframe for Publication of the Separate Accounting Information

4.6.1 Summary of the consultation issue - Decision 9

In the consultation document the MCA proposed to align the timeframe for submission of the annual regulatory accounts for ECS operators having SMP status with separated accounts obligations to five (5) months from the year end to which they relate.

4.6.2 Summary of Responses

One respondent noted that the proposed deadline of five (5) months after year end is unrealistic. Another respondent also noted that such proposed timeframe should be reconsidered and possibly extended. This respondent also noted that a more realistic timeframe would prevent any unnecessary late submissions.

4.6.3 MCA's Response and Decision

The MCA has considered the representations made in this respect and has decided that a submission timeframe of six (6) months after the year end to which they relate should be attainable by the operators having SMP status with regulatory accounts obligations.

As noted in the consultation document, the value of the information contained in the separated accounts is intrinsically dependent on the timeliness of their submission. In order for accounting separation to be effective, the information published should be timely and any unnecessary delays in the publication of the regulatory accounts would detract from the purpose of producing such accounting information. In this regard the MCA hereby makes reference to Article 4(10) of the Malta Communications Authority Act (Chapter 418 of the Laws of Malta) which states that:

"Without prejudice to the enforcement powers that it has at law, the Authority may require any person to provide it with any information, including financial information, that the Authority considers necessary for the purpose of ensuring compliance with the provisions of, or decisions or directives made in accordance with this Act or any other law which the Authority is entitled to enforce."

In addition, Article 4(13) of the same Act states that:

"Any person who fails or refuses to comply with a requirement under sub-article (10) shall commit an infringement of this Act and shall be liable to the imposition of an administrative fine by the authority not exceeding the sum of eleven thousand and six hundred and forty five euro (€11,645) and, or two hundred and thirty euro (€230) for each day during which failure to comply persists."

The MCA hereby urges the operators having accounting separation obligations to adhere to the six (6) month submission timeframe. The MCA hereby notes that the legal procedures which will lead to the imposition of the above mentioned fines will commence on the first working day following the deadline date, unless otherwise agreed by the MCA in writing.

5. Regulatory Accounting Concepts, Principles and Transfer Charging Principles

5.1 Basis of Accounting

The general principle that regulatory accounts should be prepared on a fully allocated historic cost basis featured in the 2002 Decision remains relevant, however operators may incorporate modifications to such a concept in order to reflect a fairer picture on the costs of assets. Operators are to consult with the MCA on an *ad hoc* basis prior to affecting such modifications

As noted in the consultation and proposed decision, the MCA is of the opinion that assets should only be presented at revalued amounts in the Regulatory Accounts if these were revalued in the Statutory Accounts. All revaluations of assets must be carried out by professional valuers, independent of the operator, and the value at which the assets are carried in the Regulatory Accounts should be equal to the value at which the same assets are carried in the Statutory Financial Statements. The principles of revaluations should be those established by the relevant International Financial Reporting Standards.

Any compensating revisions to, for example, operating costs would need to be matched to the revised asset valuation.

5.2 Current Cost Accounting Methodologies

5.2.1 Summary of the consultation issue - Decision 10

In the consultation document, the MCA had proposed not to mandate Current Cost Accounting Methodology on operators with SMP solely for accounting separation purposes for the time being. The background of the decision is found in the consultation document and it is not being fully reproduced here.

5.2.2 Summary of Responses

Both respondents agreed with the Authority's proposed decision not to mandate current cost accounting.

5.2.3 MCA's Response and Decision

The MCA is not for the time being, mandating a Current Cost Accounting Methodology on operators with SMP for accounting separation purposes. This notwithstanding, the MCA shall continue to ensure that legacy costs and inefficiencies are not passed on to other operators making use of any wholesale instrument offered by the SMP operator.

In particular the MCA shall ensure that it will set termination rates based on the costs incurred by an efficient operator, in the way elaborated in the Commission Recommendation of 07.05.2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU.

6. Effective Date

6.1.1 Summary of the consultation issue - Decision 11

In the consultation document the MCA had proposed that the proposed decisions become applicable for accounting periods ending on or after 1st January 2009.

6.1.2 Summary of Responses

Only one respondent did not agree with the proposed effective date and noted that the decision should become effective as from 1st January 2010.

6.1.3 MCA's Response and Decision

The MCA has considered the arguments put forward by this operator and has now determined that this decision is applicable for accounting periods ending on or after 31 December 2009.

Ing. Philip Micallef

Chairman
Malta Communications Authority

Appendix I - Definitions of Main Business Areas

The definitions of the main business areas remain unchanged from the ones defined in the October 2002 Decision Notice and are listed below:

1. Core Network

The Core Network business provides a range of interconnection services internally and externally in order to allow the customer of one operator to communicate with customers of the same or another operator, or to access services provided by another operator. These services include the switching and conveyance of electronic communications services.

In addition, the Core Network business may provide other services to operators e.g. such as engineering services related to the development and maintenance of private networks.

The accounts for the Core Network business will include the costs, revenues and capital employed associated with the provision of these services. The revenues of the Core Network business will derive principally from the sale of interconnection services to the Retail business and to other operators.

2. Access Network

The Access Network provides connections to the Core Network. The accounts for the Access Network business will include the costs and capital employed associated with providing and maintaining these connections.

In addition, the Access Network business may provide other services to operators e.g. such as Unbundled Local Loops, Wholesale Line Rental, or Radio Access Services (such as National Roaming, Mobile Virtual Network Operators/Enablers, amongst others).

For accounting separation, the Access Network business will include all the customer-dedicated components of the network including, for example, the line cards and ports located at concentrators and/or exchanges.

The Core Network business will include all other network components.

Customer line rental will be a service provided by the Retail business. The revenue from line rental provided to end-users will therefore be recorded in the Retail accounts. The cost of providing customer lines will be recorded against the Local Access Network business and there will be a transfer charge of costs to the Retail business in order to match revenues with their associated costs. The costs transferred to Retail should be net of any possible local access revenue.

3. Retail

The Retail business includes all those activities involving the selling of electronic communications services to end-users, including line rental, leased lines, calls, payphones and the provision of directory information.

The accounts for the Retail business will include the costs, revenues and capital employed associated with the provision of these services to end-users.

The costs allocated to Retail will include transfer charges related to the use of network resources or services provided by Access Network and the Core Network businesses, and the marketing and billing costs associated with the provision of end user services.

4. Other Activities

Operators typically provide a wide range of other services which are not electronic communications services including the rental, repair and maintenance of customer equipment. In addition, they may have interests in other activities (e.g. TV broadcasting, training services). For the purposes of accounting separation, the costs, revenues and capital employed associated with these activities will be separately identified.

Appendix II - Definitions of Disaggregated Activities – Retail and Other

1. FIXED

1.1 Retail – Access

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

1.2 Retail - Local On-net Calls

Local dialled calls originating from ordinary, ISDN and private payphone telephone exchange lines.

1.3 Retail - International Calls

International calls originating from ordinary, ISDN and private payphone telephone exchange lines. This also includes receipts from overseas telecommunications operators and cashless calling.

1.4 Retail - Directory Enquiry

Local and international calls placed with the operator to obtain information about Maltese and overseas telephone numbers, whether made from business or residential telephone exchange lines or from public payphones and includes calls made to the Directory Enquiry database.

1.5 Retail - Public Payphones

Local and international dialled calls and calls to mobile, originating from public payphones, using cash or phone cards.

1.6 Retail - Leased Lines

Business of rental, maintenance, connection and change of local and international leased lines beyond customers' premises.

1.7 Retail - Calls to Mobile

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

1.8 Retail –VOIP

Calls generated from the 1021 service.

1.9 Retail – Bundles

Disaggregation should be made between the various bundles offered with the 'outside the bundle' services generated from the same clients disclosed separately.

1.10 Retail - Local Calls to Other Fixed Operators

Calls generated to Other Local Fixed Operators.

1.11 Retail - Remaining Activities

All other electronic communications services that are within the Retail Business.

2. Other Business

2.1 Other - Apparatus Supply

The Business relating to the rental and sale of customer premises equipment.

2.2 Other - Remaining Activities

All other telecommunications activities that are within the Other Business.

3. MOBILE

3.1 Retail – Voice Calls

Local and international dialled calls from subscribers connected to the network for the transport of real-time speech.

3.2 Retail – SMS

Transport over the network of SMS serving for the impartation of Short Message Services.

3.3 Retail – Data

Transport over the network of other data signals serving for the impartation of any matter otherwise than retail voice calls or retail SMS.

3.4 Retail – Roaming

The provision of the capability to subscribe to voice calls and SMS/Data services by virtue of roaming agreements concluded with other mobile network operators.

3.4 Retail - Remaining Activities

All other electronic communications services that are within the Retail Business.

Appendix III – Templates for Separated Accounts

1. Fixed Network Operator with Wholesale SMP

Profit and Loss Account

Current Year

Currency €000	200X Core Network	200X LAN	200X Retail Total	200X Retail Business	200X Retail Residential	200X Retail Other	200X Other Business	Total 200X
Turnover								
From Other Operators	X	X						X
Transfer Charges to Retail Business	X	X						X
Transfer Charges to Other Business	X							X
Rental			X	X	X	X		X
Call Charges			X	X	X	X		X
Other Revenue			X	X	X	X	X	X
Total Turnover	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**
Expenses								
Operating Costs Specific to Core Network	(X)							(X)
Operating Costs Specific to LAN		(X)						(X)
Operating Costs Specific to Retail			(X)	(X)	(X)	(X)		(X)
Operating Costs Specific to Other							(X)	(X)
Payphone Transfer Charge			(X)	(X)	(X)	(X)		(X)
Transfer Charges from LAN			(X)	(X)	(X)	(X)		(X)
Transfer Charges from Core Network			(X)	(X)	(X)	(X)	(X)	(X)
Total Operating Costs	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**
Return	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**
Return on Mean Capital Employed								
Return	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**
Mean Capital Employed	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**
% Return on mean capital employed	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**

Profit and Loss Account

Previous Year

Currency €000	**200X Core Network**	**200X LAN**	**200X Retail Total**	**200X Retail Business**	**200X Retail Residential**	**200X Retail Residential**	**200X Other Business**	**Total 200X**
Turnover								
From Other Operators	X	X						X
Transfer Charges to Retail Business	X	X						X
Transfer Charges to Other Business	X							X
Rental			X	X	X	X		X
Call Charges			X	X	X	X		X
Other Revenue			X	X	X	X	X	X
Total Turnover	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**
Expenses								
Operating Costs Specific to Core Network	(X)							(X)
Operating Costs Specific to LAN		(X)						(X)
Operating Costs Specific to Retail			(X)	(X)	(X)	(X)		(X)
Operating Costs Specific to Other							(X)	(X)
Payphone Transfer Charge			(X)	(X)	(X)	(X)		(X)
Transfer Charges from LAN			(X)	(X)	(X)	(X)		(X)
Transfer Charges from Core Network			(X)	(X)	(X)	(X)	(X)	(X)
Total Operating Costs	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**
Return	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**
Return on Mean Capital Employed								
Return	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**
Mean Capital Employed	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**
% Return on Mean Capital Employed	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**

Statement of Mean Capital Employed

Current Year

Currency €000 Capital Employed	200X Core Network	200X LAN	200X Retail Total	200X Retail Business	200X Retail Residential	200X Retail Other	200X Other Business	Total 200X
Fixed Assets								
Property Plant and Equipment	X	X	X	X	X	X	X	X
Intangible Assets	X	X	X	X	X	X	X	X
Total Non-Current Assets	X	X	X	X	X	X	X	X
Current Assets								
Inventories	X	X	X	X	X	X	X	X
Receivables	X	X	X	X	X	X	X	X
Receivables External	X	X						X
Receivables Internal	X	X						X
Cash at bank and in hand	X	X	X	X	X	X	X	X
Total Current Assets	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**
Paybales	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Mean Capital Employed	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**

Statement of Mean Capital Employed

Previous Year

Currency €000 **Capital Employed**	**200X** **Core Network**	**200X** **LAN**	**200X** **Retail** **Total**	**200X** **Retail** **Business**	**200X** **Retail** **Residential**	**200X** **Retail** **Other**	**200X** **Other** **Business**	**Total 200X**
Fixed Assets								
Property Plant and Equipment	X	X	X	X	X	X	X	X
Intangible Assets	X	X	X	X	X	X	X	X
Total Non-Current Assets	X	X	X	X	X	X	X	X
Current Assets								
Inventories	X	X	X	X	X	X	X	X
Receivables	X	X	X	X	X	X	X	X
Receivables External	X	X						X
Receivables Internal	X	X						X
Cash at bank and in hand	X	X	X	X	X	X	X	X
Total Current Assets	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**
Paybales	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Mean Capital Employed	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**

2. Fixed Network Operator with Retail SMP

Profit and Loss Account

	Retail Fixed Business				Retail Fixed Residential					Other Reidential					Other Business					
	Bundle 1	Bundle 2	Standard	Total Retail Business	Bundle 1	Bundle 2	Bundle 3	Standard	Total Retail Residential	Leased Lines	1021	Supplimental Services	Directory Enquiries	Payphone	Leased Lines	1021	Supplimental Services	Directory Enquiries	Payphone	TOTAL RETAIL
Revenue																				
Rental			X	X				X	X	X					X					X
Call Charges																				
Fixed Bundle Revenue / Standard																				X
Calls To Fixed	X	X	X	X	X	X	X	X	X											
Calls to Mobile	X	X	X	X	X	X	X	X	X											
International Calls	X	X	X	X	X	X	X	X	X											
Calls to Internet	X	X	X	X	X	X	X	X	X											
Directory Enquires	X	X	X	X	X	X	X	X	X											
Variable Bundle Revenue																				X
Calls to Fixed	X	X		X	X	X	X		X											
Calls to Mobile	X	X		X	X	X	X		X											
International Calls	X	X		X	X	X	X		X											
Calls to Internet	X	X		X	X	X	X		X											
Directory Enquires													X					X		
Other Revenue											X	X		X		X	X		X	X
Total Revenue	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Operating Costs																				
Transfer Charges from LAN	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)					(X)					(X)
Transfer Charges from Core	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)		(X)	(X)	(X)	(X)		(X)
Operating Costs Specific to Retail	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)		(X)	(X)	(X)	(X)	(X)	(X)
Payphone Transfer Charge	X	X	X	X	X	X	X	X	X					(X)					(X)	
Total Operating Costs	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Return	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Return on Revenue	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X

3. Mobile Network Operator with Wholesale SMP

Profit and Loss Account

Current Year

	200X	200X	200X		200x	
	Core Network	**LAN**	**Retail**		**International**	**Total 200X**
Currency €000			**Voice**	**Other**	**Gateway**	
Turnover						
From Other Operators	X				X	X
Transfer Charges to Retail Business	X	X			X	X
Transfer Charges to Core Network		X				X
Transfer Charges to International Gateway	X	X				X
Transfer Charges to Other Business					X	X
Other Turonver				X		X
Revenue from Customer Services			X			X
Total Turnover	**X**	**X**	**X**	**X**	**X**	**X**
Expenses						
Operating Costs	(X)	(X)	(X)	(X)	(X)	(X)
Transfer Charges from Core Network			(X)		(X)	(X)
Transfer Charges from LAN			(X)		(X)	(X)
Transfer Charges from International Gateway			(X)	(X)		(X)
Total Operating Costs	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**
Return	**X**	**X**	**X**	**X**	**X**	**X**
Return on Mean Capital Employed						
Return	**X**	**X**	**X**	**X**	**X**	**X**
Mean Capital Employed	**X**	**X**	**X**	**X**	**X**	**X**
% Return on Mean Capital Employed	**X**	**X**	**X**	**X**	**X**	**X**

Profit and Loss Account

Previous Year

Currency €000	200X Core Network	200X LAN	200X Retail Voice	Other	200x International Gateway	Total 200X
Turnover						
From Other Operators	X				X	X
Transfer Charges to Retail Business	X	X			X	X
Transfer Charges to Core Network		X				X
Transfer Charges to International Gateway	X	X				X
Transfer Charges to Other Business					X	X
Other Turonver				X		X
Revenue from Customer Services			X			X
Total Turnover	**X**	**X**	**X**	**X**	**X**	**X**
Expenses						
Operating Costs	(X)	(X)	(X)	(X)	(X)	(X)
Transfer Charges from Core Network			(X)		(X)	(X)
Transfer Charges from LAN	(X)		(X)		(X)	(X)
Transfer Charges from International Gateway			(X)	(X)	-	(X)
Total Operating Costs	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**
Return	**X**	**X**	**X**	**X**	**X**	**X**
Retun on Mean Capital Employed						
Return	**X**	**X**	**X**	**X**	**X**	**X**
Mean Capital Employed	**X**	**X**	**X**	**X**	**X**	**X**
% Return on Mean Capital Employed	**X**	**X**	**X**	**X**	**X**	**X**

Statement of Mean Capital Employed

Current Year

Currency €000	**200X**	**200X**	**200X**		**200x**	
	Core Network	**LAN**	**Retail**		**International**	**Total 200X**
Capital Employed			**Vocie**	**Other**	**Gateway**	
Fixed Assets						
Tangible Fixed Assets	X	X	X	X	X	X
Current Assets						
Stocks			X	X		X
Debtors	X		X	X	X	X
Cash at bank and in hand	X	X	X	X	X	X
Total Current Assets	**X**	**X**	**X**	**X**	**X**	**X**
Creditors	(X)	(X)	(X)	(X)	(X)	(X)
Mean Capital Employed	**X**	**X**	**X**	**X**	**X**	**X**

Statement of Mean Capital Employed

Previous Year

Currency €000	200X	200X	200X		200x	
	Core Network	LAN	Retail		International	Total 200X
Capital Employed			Voice	Other	Gateway	
Fixed Assets						
Tangible Fixed Assets	X	X	X	X	X	X
Current Assets						
Stocks			X	X		X
Debtors	X	X	X	X	X	X
Cash at bank and in hand	X	X	X	X	X	X
Total Current Assets	**X**	**X**	**X**	**X**	**X**	**X**
Creditors	(X)	(X)	(X)	(X)	(X)	(X)
Mean Capital Employed	**X**	**X**	**X**	**X**	**X**	**X**

Appendix IV - Regulatory Accounting Concepts

The following Regulatory Accounting Concepts shall be applied when preparing the Accounts. Where there is a conflict between the concepts, they are to be applied in the order in which they appear below.

Cost Causality: Revenue (including transfer charges), costs (including transfer charges), assets and liabilities shall be attributed to cost components, services and businesses or disaggregated businesses in accordance with the activities which cause the revenues to be earned or costs to be incurred or the assets to be acquired or liabilities to be incurred. This is also stated in the commission recommendation of 19th September 2005 where it is recommended that the allocation of costs, capital employed and revenues be undertaken in accordance with the principle of cost causation.

Objectivity: The attribution shall be objective and not intended to benefit the SMP operator or any other Operator, product, service, component, business or disaggregated business.

Consistency of treatment: There shall be consistency of treatment from year to year. Where there are material changes to the Regulatory Accounting Principles, the Attribution Methods, or the Accounting Policies that have a material effect on the information reported in the Financial Statements of the Businesses, the parts of the previous year's Financial Statements affected by the changes shall be restated.

Transparency: The Attribution Methods used should be transparent. Costs and revenues, which are allocated to Businesses or activities, shall be separately distinguished from those that are apportioned.

Appendix V - Regulatory Accounting Principles

The preparation of the Accounts should follow a set of guiding principles. Examples of such principles are as follows:

a) The separated accounts shall be prepared in accordance with the Regulatory Accounting concepts, which set out the general rules by which the Accounts are prepared. See Appendix IV.

b) The separated accounts shall be based on a transparent cost apportionment methodology based on a Fully Allocated Costing (FAC) Historic system.

c) The separated accounts shall include transfer charges between the main business areas and the disaggregated activities for services the organisation provides to itself. They shall also disclose the equivalent transactions with competing operators.

d) The separated accounts shall be based on the Statutory Financial Statements which are prepared in accordance with IFRS.

e) Details of significant changes that impact on the financial statements and prior year restatements shall be given.

f) Separated accounts shall be published annually and contain comparative information following the initial period. Where there are material changes to Regulatory Accounting Concepts, cost allocation methodologies, attribution methods, or to accounting policies that have a material effect on the information reported in the separated accounts of a main business area or a disaggregated activity, the parts of the previous year's separated accounts affected by the changes shall be restated.

g) The separated accounts shall make explicit any differences between costs allocated to different activities by the operator, and the costs that the MCA allows for the purpose of determining charges.

h) The separated accounts shall be subject to an audit in accordance with International Standards on Auditing.

Appendix VI – Improvements to the Attribution Methodology

The MCA welcomes any sort of improvements to the Attribution Methodology that operators may undergo in their respective Separated Accounts which translates into more reliable and relevant information. Any changes to the cost causality principles adopted should be communicated to the Authority.

Improvements and changes affected should be reflected in the comparative figures as amplified under Appendix IV for the sake of consistency and as amplified also under paragraph f of Appendix V. This should be accompanied by a note to the accounts explaining the change affected, the quantum involved and the manner in which the change translates into more reliable and relevant information.

The MCA would like to draw the attention of the operators to International Accounting Standard 8 (IAS 8) on the limitations that may arise on retrospective application of the improvements affected.

IAS 8 states that *'…a change in accounting policy shall be applied retrospectively except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the change.'* Should the operator in question prove to the MCA that it is impracticable to re-instate the comparative in accordance with IAS 8, the MCA may restrictively authorise the operator to only disclose a note stating the nature of the change, and the manner in which the change is affected making reference to any disclosure also published in the respective statutory accounts.

Such instances should always be brought to the attention of the MCA for its prior final approval.

Appendix VII: Transfer Charging Principles

The transfer charging system shall follow the Regulatory Accounting Concepts and conform to the following principles: -

1. Transfer charges (revenues and costs) shall be attributed to cost components, services and main business areas or disaggregated businesses in accordance with the **activities**, which cause the revenues to be earned, or costs to be incurred;

2. The attribution shall be **objective** and not intended to benefit any business or disaggregated business;

3. There shall be **consistency** of treatment of transfer charges from year to year;

4. The transfer charging methods used should be **transparent.** There should be a clear rationale for the transfer charges used and each charge should be supportable;

5. The transfer charges for internal usage should be determined as the **product of usage and unit charges**;

6. The charge for internal usage should be **equivalent to the charge that would be levied if the product or service were sold externally rather than internally**. For accounting separation purposes, it should be assumed that the retail business pays the same wholesale charge for the same service as set out in the relevant wholesale offer;

7. The separated accounts shall disclose **the transfer charges** between businesses and disaggregated businesses.

Appendix VIII: Unqualified FPIA Audit Report

The MCA directs that in accordance with the FPIA standard imposed upon the Regulatory Accounts (as set out in Section 4.4 of this decision), the SMP operator having accounting separation obligations shall ensure that the regulatory auditor shall state whether in his opinion:

1) The Regulatory Accounts have been prepared, audited and delivered in accordance with MCA's specifications and various decision notices issued on the subject;

2) Each set of Regulatory Accounts fairly presents in accordance with the accounting methodologies […].

Example of an Unqualified Fairly Presents in Accordance with (FPIA) Audit Opinion

<u>Example 1</u>

In our opinion, the regulatory accounts for the year ended 31 December 20XX:-

Fairly present in accordance with the accounting methodologies attached to the Regulatory Accounts, the results, mean capital employed and costs incurred by each of the businesses and activities disclosed in the regulatory accounts;

Comply with the relevant decision notices;

Contain the information specified by the Relevant Decision Notices.

<u>Example 2</u>

In our opinion:

The regulatory accounts for the year ended 31 December 20XX, which have been prepared in accordance with the accounting methodologies attached to the regulatory accounts, fairly present in accordance with the accounting methodologies the results, mean capital employed and costs incurred by the Company and comply with the requirements and decision notices issued by the MCA.

Appendix IX: Example of Statement of Compliance

[Copy of the opinion by the regulatory auditor on the separated accounts]

[Summary of the cost accounting methodologies used]