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

Consultation and Proposed Decision

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1 Introduction

1.1 Background

In October 2002 the Malta Communications Authority (hereafter 'MCA') 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. These requirements mainly focused on the provision and format of regulatory financial information. The 2002 Decision subsequently also became applicable to other undertakings also found to have DMP, as well as to those undertakings which were designated as having Significant Market Power (hereafter 'SMP') in specific markets following a market analysis.

The aim of this proposed decision is 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. The proposed decision will mainly reproduce the whole content of the 2002 decision together with additional updates, and consult by means of a direct question where changes are being proposed.

This proposed decision seeks to keep in line with the European Commission's Recommendation on accounting separation published in September 2005, which advocates the application of consistent principles as well as the need to improve transparency of the accounting systems, the methodologies used, the data elaborated, the auditing and the overall reporting process to the benefit of all involved parties.

In Section 4 of this document the MCA is also providing a summary of consultation responses and a further proposed decision on the Consultation Paper initiated by means of the document issued in July 2005, entitled 'Current Cost Methodologies for the Electronic Communications Sector Consultation Paper – July 2005'.

2 Accounting Separation

2.1 Introduction

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 (NRA) imposes on the notified operator a set of rules on how accounting information should be collected and reported."

Accounting separation provides a systematic division of costs, revenues and capital employed between disaggregated regulatory entities and services. It should also ensure that each single account includes only costs, revenues and capital employed that are relevant to the regulatory entities and services.

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, 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.

Furthermore, in referring to specific companies in this proposed Decision the MCA has considered the applicability of accounting separation as a remedy consequent to the finding of SMP in specific markets.

2.2 Level of Accounting Separation

The 2002 Decision laid down the level of accounting separation in the main business areas as follows:

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

Although the MCA is proposing to maintain the current overall level of separation (see Appendix 1 for a definition of each of the above business segments), given the proliferation of retail bundles within the Fixed Network Operator's Business, the Authority is also proposing a more detailed breakdown of some of the above business segments.

The MCA believes that 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 will also permit a more adequate monitoring of non-discrimination obligations.

It is also important to note that, in line with the EU Recommendation of 19 September 2005, accounting separation reporting obligations may require the preparation and disclosure of information for markets where an operator does not have SMP.

The MCA is therefore proposing the following accounting separation set-up.

I. For Go plc

The MCA is proposing to request the following breakdown from GO plc in accordance with the accounting separation remedy imposed following finding of SMP in relevant markets currently imposed.

For ease of reference, the MCA, under Appendix III, is proposing a template which GO plc is expected to follow when compiling the information on the Retail Segments. This template is being attached for illustrative purposes only and is not meant to be exhaustive.

The MCA also reserves the right to request additional financial information on costs and revenues apart from the annual separated accounts where required, in particular for the purpose of ensuring that price control obligations are being met, and in order to further investigations that may be conducted in accordance with the applicable legislation.

In addition to the above general accounting separation set-up, Appendix II contains a more detailed breakdown and definitions of the disaggregated activities or business segments, namely the "Retail" and "Other" activities. These definitions will be kept under review and will be adjusted where required following an adequate consultative process. Furthermore, Appendix III contains the proposed format of the Separated Accounts required from Go plc under the title of a 'Fixed Network Operator'.

As highlighted above, in order to have better transparency over adequate margins as well as potential harmful cross-subsidisation practices, the MCA is also proposing a separation of retail activities to segregate standard tariffs from bundles, which in turn will distinguish residential bundles from their business counterparts. A format of this schedule is found in Appendix III.

Proposed Decision 1

The MCA directs GO plc to conform to the proposed accounting separation template contained in Appendix III under Fixed Network Operator. These formats may not be departed from without prior approval by the MCA.

II. For Vodafone Malta Ltd (Vodafone)

The MCA is proposing to maintain the current set-up for Vodafone's separated accounts in accordance with the accounting separation remedy imposed following the finding of SMP in relevant markets. Appendix III contains the proposed format of the Separated Accounts required from Vodafone plc under the title of a 'Mobile Network Operator'. As shown hereunder it will require separated accounts from Vodafone as follows:

Level of Separation

Core Network	Access Network	Retail Activities		Int'l Gateway
		Voice Telephony	Other ECS	

The MCA also reserves the right to request additional financial information on costs and revenues apart from the annual separated accounts where required, in particular for the purpose of ensuring that price control obligations are being met, and in order to further investigations that may be conducted in accordance with the applicable legislation.

Proposed Decision 2

The MCA directs Vodafone to conform with the proposed accounting separation template contained in Appendix III under Mobile Network Operator. These formats may not be departed from without prior approval by the MCA.

III. For Mobisle Communications Ltd (Go Mobile)

The MCA is proposing to maintain the current set-up for Go Mobile's separated accounts in accordance with the accounting separation remedy imposed following finding of SMP in relevant markets. Appendix III contains the proposed format of the Separated Accounts required from Go Mobile under the title of 'Mobile Network Operator'. As shown hereunder it will require separated accounts from Go Mobile as follows:

Level of Separation

Core Network	Access Network	Retail Activities	
		Voice Telephony	Other ECS

The MCA also reserves the right to request additional financial information on costs and revenues apart from the annual separated accounts where required, in particular for the purpose of ensuring that price control obligations are being met, and in order to further investigations that may be conducted in accordance with the applicable legislation.

Proposed Decision 3

The MCA directs Go Mobile to conform to the proposed accounting separation template contained in Appendix III under Mobile Network Operator. These formats may not be departed from without prior approval by the MCA.

IV. Other Undertakings

Under the 2002 Decision, Melita plc was subject to the accounting separation obligation in respect of markets which were subsequently superseded by market analyses undertaken by the MCA.

In November 2008 following the carrying out of market analyses for the wholesale broadband access market and the wholesale broadcasting transmission services market, all remedies were withdrawn from both these markets.

Proposed Decision 4

Should other undertakings be found to have SMP in a relevant market and have the remedy of accounting separation imposed, the MCA reserves the right to direct those undertakings to comply with any or part of the provisions of this proposed decision.

3 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. For ease of reference to the respondents 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

Since the publication of the above-mentioned Decision, the undertakings subject to accounting separation have each developed a Cost Model from which the Separated Accounts started to be compiled on a yearly basis. Being a new requirement and considering the expertise involved, it is only natural that improvements to the Model - by means of refinements to the attribution methodology - are affected. All this necessitates changes to cost drivers that in turn may trigger changes that need to be made to comparative figures. The MCA, through Appendix VI, addresses any issues that may arise as a result of improvements being made to the attribution methodology.

3.1 Publication of Other Financial Information

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

For ease of reference, the 2002 Decision stated that 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 2002 Decision stated also that 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.

3.1.1 Further Information

During its annual reviews of Separated Accounts submitted by the operators, the MCA has considered the information contained in the Network Statement of Costs as of particular relevance in understanding better the underlying network operations of the operators. Consequently, the MCA is of the view that for a more enhanced analysis, it requires separate disclosure of the depreciation costs and the depreciation rate applicable per network element.

3.1.2 Reconciliations

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.

Whilst all operators submit these Reconciliations with their respective Separated Accounts, the level of detail and format differs considerably between the operators.

The MCA directs that a detailed disclosure is made of those items considered out of scope and / or in scope within the reconciliation between the Statutory Accounts and the Separated Accounts. A description of each item and its relative amount is required. This will avoid further information requests by the Authority to the operators when it comes to carry out financial analysis on the Separated Accounts.

Proposed Decision 5

The MCA is of the opinion that the ancillary financial information requirements set out in the 2002 Decision, as reproduced in Section 3.1 above and as amended in Section 3.1.1, should be treated as an integral part of the Separated Accounts and hence it is confirming them in their totality. Furthermore, the MCA considers the Reconciliations with the Statutory Accounts as an integral part to the Separated Accounts and hence directs 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.

3.2 Audit of the Separated Accounts

The 2002 Decision required the operators having regulatory accounting obligations to appoint auditors to carry out the audit of the Separated Accounts and notify the MCA of the appointment. However, the MCA still 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.

The MCA had also reserved the right to appoint auditors directly to carry out such further reviews, examinations and audits as it deemed necessary 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. With respect to this particular point, the MCA is proposing to relinquish this right in view of the changes it is proposing to introduce in Section 3.3 below.

With the exception of the previous point, the MCA is hereby retaining the provisions on the Audit of the Separated Accounts. As also laid out in the 2002 Decision, 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.

Proposed Decision 6

The MCA is of the opinion that those requirements related to the audit of the regulatory accounts set out in the 2002 Decision and reproduced in Section 3.2 above should be treated as an integral part of the accounting separation obligation.

3.3 Auditor's Opinion

The MCA should be provided with the necessary assurance that the information with which it is being provided is relevant, reliable and of high quality. The MCA proposes that the most appropriate manner by which this assurance can be provided is that the operators having SMP, and on which accounting separation obligation has been imposed, should secure an audit opinion by the Regulatory Auditor.

The 2002 Decision had established that the auditors will plan and carry out such work as will enable them to report whether or not any matter has come to their attention, from the work carried out by them, which causes them to believe that the Accounts do not in all material respects comply with the respective reporting requirements.

The MCA is proposing to require the opinion to be in the form of a "Fairly presents in accordance with" (FPIA) audit opinion. The use of such audit opinion is identified in International Standards on Auditing (ISA) 800, 'The Independent Auditors Report on Special Purpose Audit Engagements'[1]. Article 10 of this standard states that *"The opinion should state whether the financial statements are prepared, in all material respects, in accordance with the identified basis of accounting. The terms used to express the auditor's opinion are to "give a true and fair view" or "present fairly" which are equivalent terms."* ISA 800 also makes reference to examples of financial reporting frameworks that are designed to address

[1] Handbook of International Auditing, Assurance, and Ethics Pronouncements 2007. ISA800

the needs of specific users and makes specific references to financial statements prepared for regulatory purposes.

The MCA feels that an FPIA audit opinion provides the highest level of assurance. Appendix VIII to this consultation 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 financial statements '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 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.

Proposed Decision 7

The MCA directs that for each set of regulatory financial statements, the SMP operator having accounting separation obligations should secure an audit opinion from the regulatory auditor in the form of a 'Fairly presents in accordance with' (FPIA) audit opinion. Due to this positive assurance, the MCA is relinquishing its right to request further reviews, examinations and audits at the expense of the operators as the assurance to be obtained from the regulatory audit will provide the MCA the highest level of assurance.

3.4 Statement of Compliance and Publication of Financial Information

The Electronic Communications Networks and Services (General) Regulations (Chapter 399.28 of the Laws of Malta) ('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[2]. Annex 2 of this 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

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

paper or electronic version, or published on the operator's or national regulatory authority's website."

The Authority believes that the requirements found in the ECNSR and in the Commission Recommendation referred to above are being addressed through the audit report which forms part of the audited Regulatory Accounts currently being submitted by operators having SMP obligations and on which accounting separation obligation has been imposed.

In line with the requirements found in the Commission Recommendation as outlined above, the Authority is of the view that a statement of compliance should also be published on the operators' website. This statement of compliance should include the audit report together with a brief summary of the description of the accounting methodology used to compile the separated accounts so as to satisfy the items mentioned in the Commission's Recommendation.

Proposed Decision 8

The MCA directs that operators having SMP obligations and on which accounting separation obligation has been imposed shall publish on their website the audit report attached to the separated accounts (which highlights the conclusions made by the regulatory auditor) together with a brief summary of the description of the accounting methodology used to compile the separated accounts so as to satisfy the items mentioned in the Commission's Recommendation.

As previously noted in its 2002 Decision, the MCA may request detailed financial information at any time from all the operators as may be reasonably required.

3.5 Timeframe for Publication of the Separate Accounting Information

In the 2002 Decision the MCA stipulated the timeframes for submission of the first set of separated accounts together with the timeframes of the submission of the subsequent annual separated accounts. The timeframes of submission of the annual Regulatory Accounts are listed below:

- **Vodafone Malta Ltd (Vodafone)**: Separated Accounts are to be provided to the MCA annually and within five (5) months from the year-end to which they relate.
- **Go Plc (then Maltacom Plc**): Separated Accounts are to be provided to the MCA annually and within five (5) months from the year-end to which they relate.

- **Mobisle Communications Ltd (Go Mobile):** Separated Accounts are to be provided to the MCA annually and within five (5) months from the year-end to which they relate.

The timeframes of the submission of the Separated Accounts are crucial for information to be of value to the users of the accounts. 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. The MCA feels that the above stipulated timeframes should be aligned and proposes that the above obligations are set to five (5) months for each set of the regulatory financial statements.

Article 4(10) of the Malta Communications Authority Act (Chapter 418 of the Laws of Malta) 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 has been monitoring the compliance with established timeframes for submission of the Separated Accounts and hereby notes that in certain instances SMP operators have failed to submit the regulatory accounts by the set deadline. In this respect, the MCA believes that operators should have gained sufficient expertise in the compilation of the Separated Accounts and hence expects the accounts to be submitted by the set deadlines. Whilst the MCA urges the operators having accounting separation obligations to adhere to these timeframes, it reserves the right to take the necessary remedial measures at law to ensure compliance with this decision. 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.

Proposed Decision 9

The MCA proposes to align the submission timeframes to five (5) months from the year end to which the accounts relate, and also directs that legal procedures leading to the imposition of fines highlighted in 3.5 above will commence immediately following the specified submission date for every set of Separated Accounts not submitted by the established date of the SMP operator.

4 Regulatory Accounting Concepts, Principles and Transfer Charging Principles

4.1 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 concept in order to reflect a fairer picture on the costs of assets.

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.

4.2 Current Cost Accounting Methodologies

4.2.1 Background

In July 2005, the MCA published a Consultation Paper entitled 'Current Cost Accounting Methodologies for the Electronic Communications Sector'. In this Consultation Paper, the MCA sought comments from interested parties in relation to the adoption of current cost accounting systems for the fixed and mobile electronic communications services and on the various issues arising from the transition from a historic cost base to a current cost base.

4.2.2 Summary of Responses

The Consultation period for the above-mentioned Document expired in August 2005. The MCA received comments from Melita Cable plc, Vodafone Malta Ltd, Mobisle Communications Ltd and the then Maltacom plc. The MCA would like to thank these respondents for their submissions.

The Comments can be summarised as follows:

- The additional costs involved in the implementation of a Current Cost Accounting methodology (CCA) would far outweigh the regulatory benefits achieved;
- Fixed Asset values are reasonably current for mobile operators due to recent infrastructure used. Results from the implementation would not be significantly different from those of HCA;
- One respondent argued that the CCA concept is ideal for the NRA in addressing the issue of fixed infrastructural inefficiencies, in view that such network developments were undertaken in a completely monopolistic environment;
- One of the respondents noted that in view of its upgrade of the Core Network, conditions will be such that inflation and technological advances will have minimal effect on computations based either on HCA or CCA;
- One respondent argued that despite using an HCA system, it carries out a revaluation exercise of its network every five years;
- One respondent proposed a simplified system were interconnection tariffs would be based on agreed EU benchmarks rather than adopting CCA.

4.2.3 MCA Further Proposed Decision

The MCA has analysed the responses received and observed market developments occurring since the publication of the Consultation Period and makes the following observations:

- During the past 3 years, the MCA engaged in an extensive Cost Modelling Exercise (hereinafter 'BUCM') with the objective, amongst others, of arriving at an efficient fixed interconnection rate. This was possible through the Bottom-up cost modelling of GO plc's Network.

- Mobile termination rates were established based on an agreed glide-path with the operators involved. The rates are currently based on EU benchmarks.

- Both Wholesale and Retail Local and International Leased lines are now efficiently determined following the extension to the original BUCM Exercise carried out by the MCA.

In view of the above, the MCA is, for the time being, proposing not to mandate Current Cost Accounting Methodology (hereinafter 'CCA') on operators with SMP for accounting separation purposes. Notwithstanding this, the MCA will still endeavour to continue to ensure that legacy costs and inefficiencies are not shifted to other competing operators through incorporation in a Reference Wholesale Offer – an objective which the MCA had originally intended to achieve through the adoption of CCA for accounting separation purposes.

The MCA intends to continue meeting its objective of achieving efficient wholesale rates for access and interconnection in line with the EU Recommendations.

This is being done through the extensive NGN Bottom-Up Model and also through the use of EU Benchmarks. Consequently until such time as CCA is not mandated on the operators for accounting separation, the MCA will continue to exercise its powers at law to request information from time to time from the operators that will assist the MCA in arriving at efficient economic make or buy decisions in the interest of competition.

Proposed Decision 10

The MCA proposes not to mandate Current Cost Accounting Methodology on operators with SMP solely for accounting separation purposes at this stage.

The MCA reserves the right to adopt the cost-base and cost accounting methodologies that are most appropriate for the purposes of price control and cost-orientation, in order to arrive at efficient economic make or buy decisions in the interest of competition.

5 Consultation Framework

The MCA is proposing to allow sufficient time for operators to adopt the required changes which would need to be carried out as a result of the proposed decisions set out in this document.

Proposed Decision 11

The MCA is proposing that the proposed decisions set out in this document become effective for accounting periods ending on or after 1st January 2009.

The MCA invites comments from interested parties regarding this proposed decision.

The consultation period will run until 1200hrs on Friday 10th April 2009. The MCA believes this period is sufficient to give interested parties the opportunity to comment on the proposed decision.

Comments should be sent to:

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Written representations will be made public by the MCA subject to MCA's Internal Guidelines on Confidentiality published on 16th December 2004.

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 - Formats for Separated Accounts

1. Fixed Network Operator

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**

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	Suppliment al 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**

2. Mobile Network Operator

Profit and Loss Account

Current Year

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

Profit and Loss Account

Previous Year

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

Statement of Mean Capital Employed

<u>Current Year</u>

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

Statement of Mean Capital Employed

Previous Year

Currency €000	**200X**	**200X**	**200X**		
	Core Network	**LAN**	**Retail**		**Total 200X**
Capital Employed			**Voice**	**Other**	
Fixed Assets					
Tangible Fixed Assets	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
Total Current Assets	**X**	**X**	**X**	**X**	**X**
Creditors	(X)	(X)	(X)	(X)	(X)
Mean Capital Employed	**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 proposes that when a FPIA standard is imposed upon the Regulatory Accounts (as set out in Section 3.2 of this consultation document), 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

Example 1

In our opinion, the regulatory accounts for the year ended 31 December 2008:-

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.

Example 2

In our opinion:

The regulatory accounts for the year ended 31 December 2008, 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.