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Organization and procedural aspects regarding the imposed by the CRC obligation for introduction and application of accounting separation as an instrument for control and monitoring of the prices of regulated electronic communications services.

Nikolina Hubavenska
Chief Expert in Market Regulation Department
Communication Regulation Commission



Presentation highlights -

1. Introduction: Procedural aspects of price and tariff regulation
2. Organization regarding the imposed by the CRC obligation for AS as an instrument for control and monitoring of the prices
3. Challenges and steps from the imposition of the AS on the SMP operator to the final CRC's decision on assessment of the "Form and methodology for introduction and application of accounting separation"



Introduction: Procedural aspects of price and tariff regulation

1. EU Recommendation 2005/698/EC on Accounting Separation (AS) and Cost Accounting (CA)

- Applies to SMP operators following Market Analysis.
- Seeks to ensure Fair, Objective and Transparent criteria are followed.
- Purpose is to provide a higher level of detail, showing operations as if they were separate businesses and to prevent discrimination and unfair cross subsidy.



Introduction: Procedural aspects of price and tariff regulation

2. Bulgarian Law on Electronic Communications (LEC) and EU framework accounting separation regime will involve the following considerations

NRA should undertake two steps:

- Market analysis – included services, dominant operators (if any), appropriate regulatory remedies to the SMP

- Review the need for separated accounts



Introduction: Procedural aspects of price and tariff regulation

2. Bulgarian Law on Electronic Communications (LEC) and in EU framework accounting separation regime will involve the following considerations

Experience of CRC:

- CRC imposed AS obligation on SMPs on market analysis of fixed origination and termination and on mobile termination
- AS obligation - text in citation 5 of the preamble and item 4 of Recommendation 2005/698/EC
- Preparation of CRC`s requirements for introduction and implementation of accounting separation
- With final decision CRC assessed so called “Form and methodology for introduction and application of accounting separation” after public consultation and received “No comments” from EC (case BG/2012/1357).



Organization regarding the imposed by the CRC obligation for AS as an instrument for control and monitoring of the prices

1. Separated accounts also known as regulatory accounts split the activities of a vertically integrated SMP operator into separate businesses or services

- They provide financial statements for each business or service as defined by the regulatory authority
- Include both profit and loss accounts and balance sheets
- The total costs, revenues, assets and liabilities of the operator are allocated between businesses/services according to a set of allocation principles agreed between the operator and regulator.



Organization regarding the imposed by the CRC obligation for AS as an instrument for control and monitoring of the prices

2. The information from regulatory reports should be presented by each obligated operator in a way that it proves

- The fulfillment of specific obligations imposed with market analysis such as: transparency, non-discrimination, as well as no anti-competitive cross subsidization;
- The meeting of the requirements for determination of prices for services by SMPs on the relevant markets set out in Article 219(5) of the LEC, like:
 - not to contain any components of pricing, based solely on the significant power of the undertaking at the respective market;
 - not to contain any discounts, violating the competition opportunities for other undertakings, providing the respective electronic communication service;
 - not to generate benefits for individual users of the same of a similar electronic communication service;
 - not to be under the level of the cost of their provision.



Organization regarding the imposed by the CRC obligation for AS as an instrument for control and monitoring of the prices

3. Regulatory accounts differ from statutory accounts

- Statutory accounts do not contain the same level of detail as regulatory accounts
 - Normally show a single profit and loss account and balance sheet for an operator
 - May not split out domestic and overseas subsidiaries
 - May not split out competitive and non-competitive businesses

- In addition, statutory accounts are unlikely to provide an estimate of the economic costs operators incur
 - Based on historic, not forward looking costs
 - No allocation of costs to services.



Organization regarding the imposed by the CRC obligation for AS as an instrument for control and monitoring of the prices

4. “Form and methodology for accounting separation introduction and application”

The document includes following requirements to introducing and implementation of AS by obliged operators:

- the requirements for separation (disaggregation) of accounting information about the costs, revenues, assets and liabilities;
- the methodology for allocation of costs, revenues, assets and liabilities;
- the form and contents of the reports which display the results from the obligation for accounting separation application.



Organization regarding the imposed by the CRC obligation for AS as an instrument for control and monitoring of the prices

5. The requirements for separation (disaggregation) of accounting information about the costs, revenues, assets and liabilities are based on five key concepts:

- **Cost Causality:** Revenue, costs, assets and liabilities shall be attributed to cost components, services and businesses in accordance with the activities which cause the them.
- **Objectivity:** Attribution shall be objective and not intended to benefit the operator or any other operator, product, or service.
- **Consistency of treatment:** Accounts should be prepared on a consistent basis between years.
- **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.
- **Audit:** The separated accounts shall be subject to an audit in accordance with International Standards on Auditing.



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6. Need to separate the obliged SMPs activities related to the provision of fixed and mobile services from the undertakings' overall activity:

- A. Provision of **mobile** telephone services;
- B. Provision of **fixed** telephone services; and
- C. Other activities within the meaning of the Commerce Act.



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7. Need to vertically divide (disaggregate) the obliged SMPs activities (A, B) into wholesale and retail services' business units:

In regard to provision of mobile services (A)

- 1) Wholesale mobile network services provision;
- 2) Retail mobile services provision;
- 3) Other unregulated mobile services which differ from the ones in items 1) and 2).

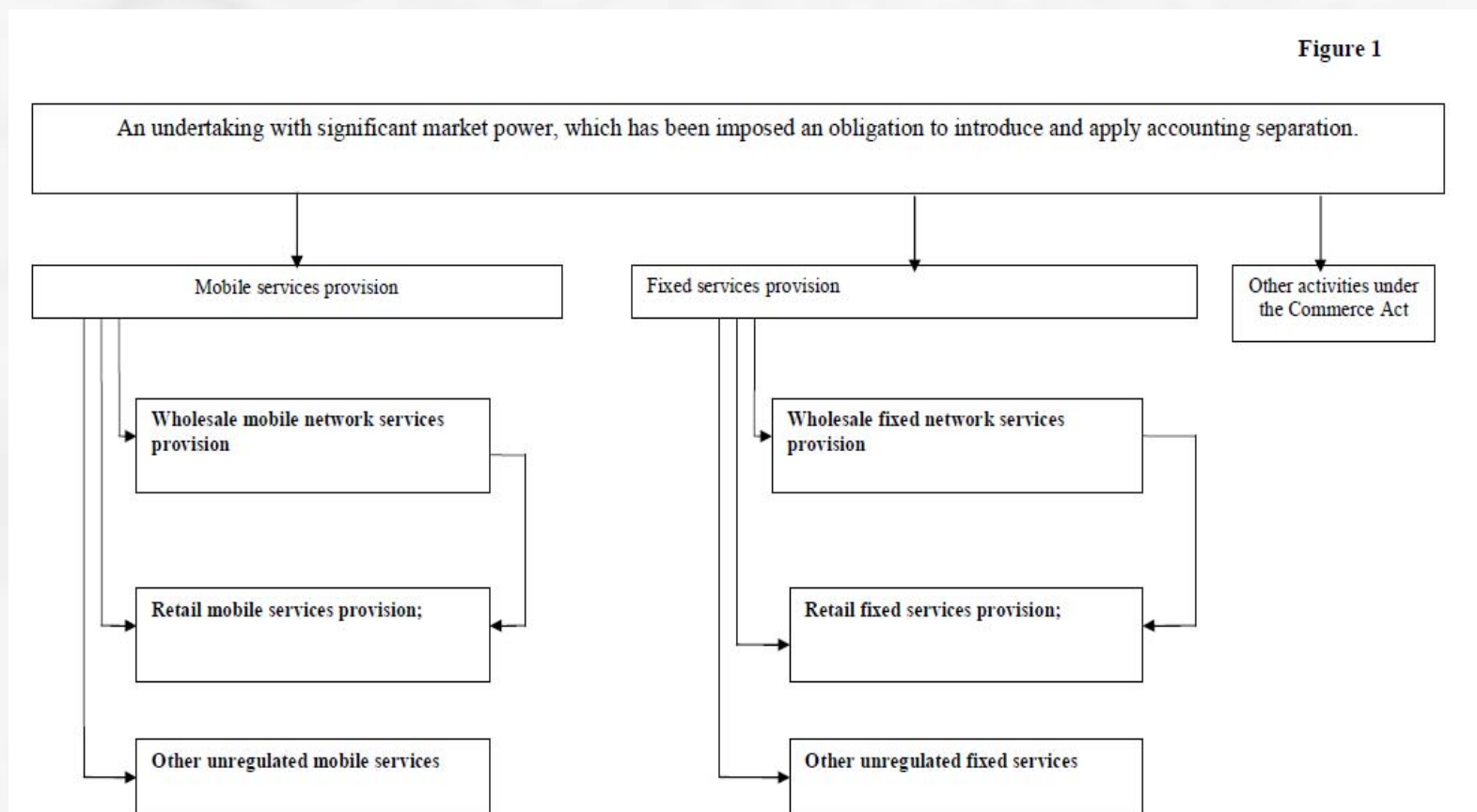
In regard to provision of fixed services (B)

- 1) Wholesale fixed network services provision;
- 2) Retail fixed services provision;
- 3) Other unregulated mobile services which differ from the ones in items 1) and 2).



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Figure 1 shows distinction between fixed and mobile activities and disaggregation them into wholesale and retail services' business units.





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8. Need to include in the regulatory reports product markets which are not part of the analyzed markets
9. The causal principle or the so-called Activity Based Costing (ABC) method has a leading role in the disaggregation of costs, revenues, assets and liabilities
10. Each cost and revenue must be attributed to a service/product under the so-called Fully Allocated Cost (FAC) or Fully Distributed Cost (FDC) approach
11. It is necessary the assets values be assessed on the cost base the so-called current prices (Current Cost Accounting – CCA) to account the effect of price change as a consequence of inflation and the quick technology development in the sector.
12. The undertaking's capital cost should reflect the alternative cost of the capital invested in networking elements and other related assets so called WACC. Determination of the WACC is subject to public consultation (CRC intends to use same approach for WACC in AS and Cost Accounting model (BULRIC)).
13. Transfer costs and revenues for retail services which have no direct wholesale equivalent should be determined based on a national wholesale equivalent service



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Some of the most important requirements to the form and contents of regulatory reports are as follow:

1. Obligated undertakings should draft regulatory reports for each fiscal year using the samples under Application 4 of the document (you can see at this link:

http://www.crc.bg/files/_bg/RA_Methodology_final.pdf)

2. Obligated undertakings should provide to the CRC a hard and soft copy of the regulatory reports, as well as the accompanying explanations and documents after the end of the fiscal year but no later than 30 June of the year following the reporting period.



Organization regarding the imposed by the CRC obligation for AS as an instrument for control and monitoring of the prices

3. Accompanying explanations and documents, together with the regulatory reports:
 - Detailed allocation methods (FDC/FAC and ABC), cost allocation bases and method to determine the value of the used cost allocation bases;
 - List of the networking elements in the network of the undertaking;
 - Detailed methodology for asset revaluation and determination of their present value and WACC calculation;
 - Applied accounting policy in regulatory report preparation;
 - Matrix (form) summarizing all transfer costs/revenues between the various regulatory reports of business units;
 - Reports for average cost of a network element;
 - Exhaustive definitions for disaggregated activities/services of business units so as to clarify their concrete contents;
 - Description of the process of reflecting transfer costs/revenues that is applied for the purposes of accounting separation.



Challenges and steps from the imposition of the AS on the SMP operator to the final CRC's decision on assessment of the "Form and methodology for introduction and application of accounting separation"

1. Main difficulties are related to the answers of the following questions

- How to define activities and business units having in mind development of the NGN technology?
- For which services is a need of accounting separation?
- For what is need AS reports and what information must present in them?

2. Obligated operators are unwillingness to cooperate with CRC.

3. CRC do not have access to the current accounting system and data of the operators.



Challenges and steps from the imposition of the AS on the SMP operator to the final CRC's decision on assessment of the "Form and methodology for introduction and application of accounting separation"

Steps:

1. Team of CRC's experts prepared Draft consultation documents "Form and methodology for introduction and application of accounting separation", including samples of the regulatory reports.
2. Consultation of the draft documents with engaged consultant as part of public procurement for evaluation and development of BULRIC models for fixed and mobile network in Bulgaria.
3. Opening of public consultation with interested parties on Draft consultation documents after the consultant's recommendations.
4. According to article 7 of the Framework Directive CRC sent Draft decision for assessing on AS document "Form and methodology for introduction and application of accounting separation" to the EC
5. Final decision 1882 from 23 August 2012 determines "Form and methodology for introduction and application of accounting separation" by CRC.



Thank you for your attention!