



ILR

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## Accounting separation guidelines for the SMP operator

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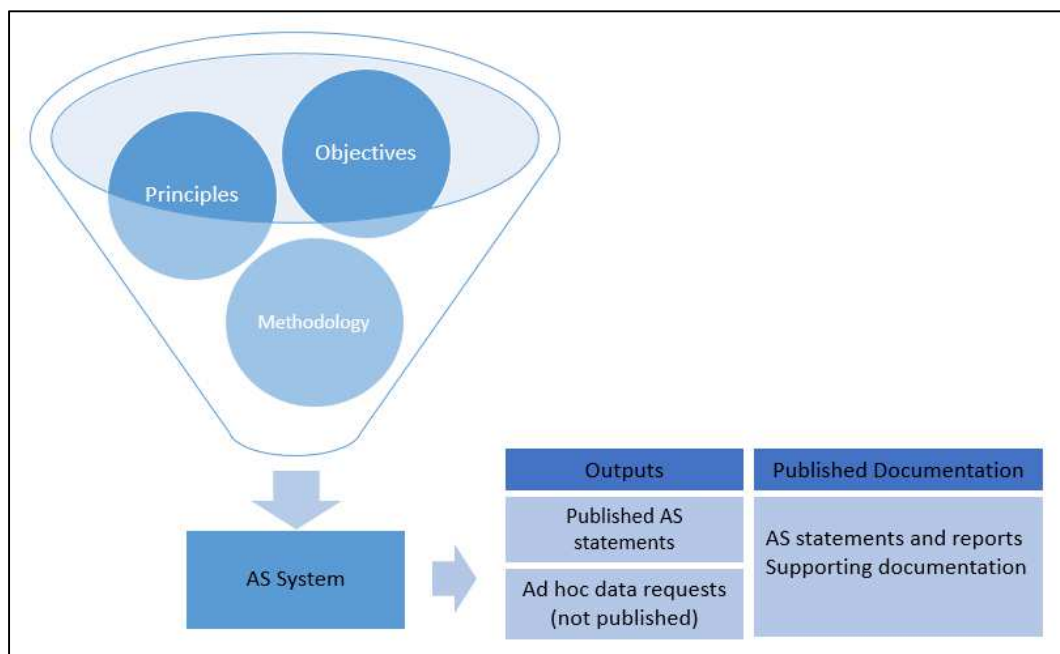
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# 1 Overview

- (1) In the EU Electronic Communications framework, accounting separation obligations can be applied as an ex ante market remedy to operators determined to have significant market power (SMP) in relevant markets. Such obligations form a key part of the telecommunication regulatory framework in fixed markets. The ILR has imposed accounting separation obligations on an SMP operator in some markets.
- (2) In order to provide an SMP operator with guidance on how to comply with these obligations, this document sets out the accounting separation guidelines for an SMP operator's telecommunications activities. The figure below provides an overview of the content of these guidelines. These are described in further detail in the rest of this section.

Figure 1-1 Overview of the AS guidelines



- (3) As described in Section 3, the overall objectives for accounting separation are to support the effective implementation of other SMP remedies such as cost orientation, non-discrimination and transparency. Further, they will help to ensure that an SMP operator has an appropriate and robust costing system in place, so that it is able to respond to any ad hoc data requests necessary for the ILR to make future regulatory decisions.
- (4) Given these objectives, there are a number of principles that underlie the accounting separation guidelines to ensure that the accounting separation information that an SMP operator produces is fit for purpose. These are described in Section 4 of this document.
- (5) Based on the overall objectives and principles, Section 5 of this document sets out the methodology that an SMP operator shall use in order to develop the separated accounting information required.
- (6) Section 6 of this document outlines the required format of the separated accounts that an SMP operator will be required to submit to the ILR. In addition to the separated accounts submitted to

the ILR, an SMP operator will also be required to respond to ad hoc data requests as necessary, drawing on data from the underlying accounting separation (AS) system.

- (7) In addition to the statements described in Section 6, an SMP operator is required to provide to the ILR with supporting documentation setting out the approach that it has adopted in preparing its separated accounts (see Section 7). This is to enable an independent audit of the accounts. This will also provide transparency to the ILR and to other stakeholders on the approach used.
- (8) In order to provide assurance that the guidelines set out in this document have been followed, the separated accounts and relevant supporting documentation will be subject to an independent audit (see Section 8). An SMP operator will also have to sign off the separated accounts and supporting documents.
- (9) An SMP operator shall be required to publish and submit its audited separated accounts to the ILR within six months of the end of the financial year. The timeline for preparing and submitting the separated accounts is described in further detail in Section 9.
- (10) There may also be very exceptional circumstances where an SMP operator may request to restate its separated accounts in order to correct for a serious error that was unknown at the time of preparation.
- (11) Section 10 contains a glossary of terms used in these guidelines.

## 2 Legal background

- (12) According to article 28 (1) c) of the law on electronic communication networks and services (« Loi du 27 février 2011 sur les réseaux et les services de communications électroniques » i.e. hereafter the “Law of 2011”), the ILR may impose accounting separation obligations as an ex ante market remedy to operators identified as having significant market power (SMP) in the relevant wholesale markets.
- (13) The Law of 2011 further specifies in its article 31 the accounting separation remedy by allowing the ILR to specify the format as well as the methodologies to be used by the SMP operator.
- (14) It is within this context, that the ILR had developed, in its decision 02/50/ILR (“Principes directeurs de séparation comptable”), initial guidelines to be followed by the SMP operator.
- (15) The present underlying “règlement” updates the guidelines 02/50/ILR by incorporating the current regulatory and technical framework.
- (16) The ILR would like to emphasize that, in any regulated market where an accounting separation obligation has been imposed on the SMP operator, the SMP operator has to comply with the guidelines in this “règlement”.
- (17) The European Commission has issued a recommendation on accounting separation and cost accounting systems<sup>1</sup>, which seeks to promote consistent application of accounting principles and methodologies at EU level. With this recommendation, the Commission elaborates on the accounting systems and methodologies to be used together with the specific data to be elaborated as well as the auditing and reporting process. The present underlying “règlement” is consistent with the recommendation.

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

### 3 Objectives and scope of accounting separation

- (18) The accounting separation guidelines in this document apply to the SMP operator's telecommunications activities. These guidelines are intended to be independent of how the SMP operator organises itself internally unless there is explicit agreement otherwise from the ILR. For example, if the SMP operator decides for commercial reasons to separate its different functions or divisions, this would not have an impact on any of the guidelines in this document or the separated accounts.
- (19) The overall objectives of accounting separation are to support the implementation and monitoring of the SMP operator's other regulatory obligations and also to provide transparency. Separated accounts can serve several different purposes including:
- **Monitoring compliance with other SMP obligations.** Accounting separation obligations compliment the use of other remedies, including transparency, non-discrimination and cost orientation. The separated accounts will make the SMP operator's regulated cost base more transparent to other stakeholders. The internal transfer charges shown in the separated accounts help ensure that the SMP operator is charging the same wholesale prices externally that it is charging to its own downstream retail operations. The separated accounts may also allow the ILR and other operators to do an initial check of whether the SMP operator is following relevant cost orientation obligations by comparing costs with the average revenues for different services.
  - **Informing regulatory decisions.** Information from the separated accounts can be either used directly to inform regulatory decisions or it can be used to cross-check information submitted by the SMP operator in data requests.
  - **Informing market analyses and setting SMP obligations.** Information from the separated accounts can be used in market analyses to monitor the evolution of markets, and to enable the ILR to decide on appropriate remedies in such markets.
  - **Ex post competition investigations and resolving disputes.** The requirement to produce accounting separation can be useful for ensuring that the SMP operator has sufficient information in its underlying costing system to enable necessary ex post competition investigations or dispute resolution.
- (20) As described in Section 6 and 9, there is certain AS information that the SMP operator will be required to submit to the ILR and make publicly available as part of its AS obligation. However, the ILR reserves the option to request additional data from the SMP operator on an ad hoc basis. This is because it is not possible to anticipate every piece of information that the ILR may require for regulatory decision making purposes. It would also be disproportionate to require the SMP operator to produce a wide range of information which may not be used. Instead, these guidelines require the SMP operator to ensure that its underlying AS system has the flexibility to produce more granular information for both its wholesale and retail activities on costs, revenues and services than is required to produce the standard outputs described by these accounting separation guidelines.

- (21) This means that there are two main outputs of the AS process. First, the separated accounts and supporting documents described in these guidelines. Second, underlying the production of these accounts should be a robust and audited costing system that will allow the SMP operator to respond to ad hoc data requests efficiently. Having consistency between the system used to produce the separated accounts and that used to produce ad hoc analyses will increase confidence in the accuracy and consistency of the data provided by the SMP operator.
- (22) The guidelines in this document are focussed on the markets where an operator has SMP and as a result AS has been mandated as a remedy. However, given that some costs and revenues are shared between products and services in AS markets and other products where the operator does not face an accounting separation remedy, the accounting system will necessarily need to have a wider scope than the AS markets alone. Therefore, the SMP operator is also required to provide some high-level information on products and services outside the AS markets. This is to ensure that the operator produces accurate information for the AS markets. Information on other products and services is also required so that the SMP operator can demonstrate how its separated accounts can be reconciled with its statutory accounts.



## 4 Principles

- (23) The SMP operator's separated accounts shall be based on the following overarching principles.
1. **Reliability.** The SMP operator should endeavour to ensure that the separated accounts are free from errors.
  2. **Objectivity.** The accounts shall present a fair view of the SMP operator's business, should be based on objective evidence as far as possible and shall not contain any systematic biases.
  3. **Cost causality.** Costs shall be attributed based on causation wherever possible.
  4. **Transparency.** The approach and processes that the SMP operator has used to prepare its separated accounts shall be clear.
  5. **Materiality.** The SMP operator shall use a more rigorous approach for those products or cost categories that are more material.
  6. **Consistency with the regulatory accounts<sup>2</sup> as a whole and from one period to another.** As far as possible the SMP operator shall use consistent assumptions throughout its separated accounts and the accounts shall be comparable across time periods.
  7. **Compliance with statutory accounting standards.** Except for those areas where the accounting separation guidelines specify otherwise, the separated accounts should be consistent with the accounting standards used in the SMP operator's statutory accounts ("comptes annuels").
- (24) If there is any conflict between the overarching principles, then the SMP operator shall give priority to the principles in the order listed above.

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<sup>2</sup> This relates solely to the separated accounts for the SMP operator's telecommunications activities and not for any separated accounts that the SMP operator has to produce for other industries.

## 5 Methodology

- (25) This section sets out the methodology that the SMP operator shall follow in preparing its separated accounts. Section 7 explains the supporting accounting documentation that the SMP has to produce, which describes how it has implemented the methodology described in this section.

### Products, services and markets

- (26) Services shall relate to groups of individual products which have common characteristics, but which may differ in certain parameters.
- (27) Each AS market shall be broken down into different services. The SMP operator shall define separate services where there is a distinction between one off charges such as connection charges, periodic per user rental charges and/or charges relating to usage. For example, unbundling services would be split between the connection services and the rental service.
- (28) Where services correspond to different technologies and the pricing reflects this, the SMP operator shall distinguish between services by technology. For example, within the physical and virtual wholesale broadband access market, there would be a distinction between lower speed bitstream typically provided over the copper access network and higher speed bitstream typically provided over a fibre access network. However call termination on fixed networks is not charged based on the technology used to terminate the call. Therefore, separate services for call termination should not be defined based on technology.
- (29) The SMP operator is not required to provide a detailed split based on other parameters of the products. For example, a NGA bitstream service could include a number of individual products offering different bandwidths and with different prices. The SMP operator shall take account of the materiality of the revenues when deciding on how many services shall be contained within a given market.
- (30) As an SMP operator introduces new products and services into the market, these shall be added to the accounts. The separated accounts shall split out wholesale services tied with other wholesale services.

### Revenue and volume allocation

- (31) External revenues shall be directly assigned to a particular product or service where possible. In general in AS markets we would expect wholesale products to be sufficiently delimited to ensure direct attribution of revenues to individual services. Where this is not possible, volumes and revenues shall be attributed on an appropriate basis.
- (32) Where there is a simple measure of the volume of services, for example call minutes or number of subscribers, this should also be shown.

## Cost allocation

- (33) The SMP operator shall use fully allocated costs (FAC) based on an Activity Based Costing (ABC) approach. The FAC should include a return on capital employed (ROCE).
- (34) The SMP operator shall use the following approach when allocating costs to services and products.
- Costs shall be directly allocated where possible based on an analysis of the driver of the cost.
  - Common or shared costs that cannot be directly assigned shall be attributed:
    - Based on an appropriate direct or indirect cost driver; and
    - Where neither direct nor indirect cost allocations are possible through the use of an equi-proportional mark-up (EPMU).
- (35) Where applicable, sampling techniques can be used to allocate costs (see below).

## Asset valuation

- (36) The SMP operator shall present its separated accounts on a current cost accounting (CCA) basis. CCA should be implemented with an indexation approach. This approach to valuing assets is intended to reflect the replacement costs of assets as a proxy for the costs that a new entrant would face.
- (37) The SMP operator shall use appropriate price indices to calculate the value of assets on a CCA basis. In order to reflect how the replacement cost of assets change over time taking account of development of technology and the functionality offered by assets develop over time.
- (38) In the interests of proportionality, where a category of assets represents a low proportion of total asset costs, historical costs may be used.
- (39) Where assets have short asset lives (less than five years), historic asset valuations may be used to proxy the CCA valuation.

## Depreciation

- (40) Depreciation shall be calculated on a straight-line basis.
- (41) The SMP operator shall use financial capital maintenance (FCM) when estimating capital charges. This is to allow the SMP operator to fully recover the value of the capital originally invested. Using FCM will mean that the P&L will need to recognise historical depreciation, supplementary depreciation and holding gains or losses.
- (42) Fully depreciated assets shall be excluded from the net asset base and calculation of capital charges since, by definition, the cost of these assets will have already been recovered.

## Return on capital

- (43) For services, where the ILR has imposed a price cap, the SMP operator shall use the pre-tax nominal weighted average cost of capital (WACC), which is underlying the regulated price cap. For other services, the SMP operator shall determine himself the pre-tax nominal weighted average cost of capital (WACC).
- (44) The return on capital employed shall be calculated by applying the WACC to the mean capital employed (MCE). The MCE should be calculated as the fixed assets plus the current assets minus the liabilities.

## Internal transfer charges

- (45) The SMP operator shall show the internal transfer charges to demonstrate non-discrimination and/or equivalence between an SMP operator's own downstream business and competitors.
- (46) The SMP operator shall calculate the internal transfer charges as follows.
- Internal transfer charges shall be calculated by multiplying the unit charges by the volume of services delivered internally.
  - The unit charges shall be based on the wholesale prices that an SMP operator charges other operators externally.
  - Where there is no equivalent wholesale price, an SMP operator shall calculate the unit price based on unit costs including a return on capital. The methodology used to derive these costs shall be consistent with the one used to derive wholesale prices used in the same downstream markets. For example, the cost of on-net calls would be calculated using the same methodology used to estimate call origination and call termination.

## Efficiency adjustments

- (47) The SMP operator shall exclude inefficiently incurred costs from its separated accounts.
- (48) The SMP operator should separately identify excluded inefficiently incurred costs when reconciling the separated accounts to its statutory accounts.

## Sampling

- (49) Where sampled data is used, it should provide an objective, accurate and fair representation of the underlying data. An SMP operator shall ensure that the sampled data is based on either generally accepted statistical techniques or other appropriate methods. An SMP operator shall be required to demonstrate that:
- The sampled data and use of the sampled data is unbiased and objective;

- The sample size is statistically significant and representative of the entire population, including over time (i.e. not subject to seasonality); and
- The sampled data is updated on an annual basis or remains representative of the current operations.

## 6 Format and content of the separated accounts

- (50) The SMP operator is required to show data for the complete financial year. This shall cover the same dates as the SMP operator's statutory accounts. This is to allow for reconciliation of the regulatory accounts to the statutory accounts.
- (51) The rest of this section sets out the list of statements/reports an SMP operator is required to submit to the ILR.
- (52) Before preparing the separated accounts, an SMP operator is required to develop pro formas for each of the statements and reports required. These pro formas shall specify the detail that an SMP operator intends to provide in order to comply with the guidelines set out in this document. In particular, they should show the level of detail that an SMP operator will provide in its separated accounts (in terms of the rows and columns of data) but without the actual AS results. In this section, some illustrative examples are included to provide guidance on the expected format of these pro formas.
- (53) The SMP operator is required to submit these pro formas to the ILR for review (Section 0 below sets out the timeline for doing this).
- (54) The precise specification of the format of the separated accounts is likely to vary from year to year (e.g. because of changes in technology resulting in different network elements or because of the introduction of new services over time).
- (55) Therefore, in the first year of implementing these accounting separation guidelines, an SMP operator shall be required to develop a pro forma for each of the statements and reports required by these guidelines. These are specified in the list below. In subsequent financial years, an SMP operator shall only be required to submit to the ILR revised pro formas for reports and statements which have changed.

### AS statements and reports

- (56) This sub-section provides a list and description of the AS statements and reports that an SMP operator is required to produce.
- (57) **Sign off.** The SMP operator is required to provide a signed confirmation that the accounts represent an accurate reflection of the SMP operator's telecommunications activities. This is to provide assurance on the reliability of the separated accounts.
- (58) **Consolidated Profit and Loss (P&L) statement.** Consolidated P&L for the SMP operator's telecoms activities (including both wholesale and retail activities) showing:
- External revenues,
  - Internal revenues,
  - Total revenues,

- The cost types described in paragraph (64),
- The return on external revenues (excluding cost of capital),
- The MCE; and
- The ROCE.

The following snapshot shows the required structure that the SMP operator should use for the consolidated P&L.

Table 6-1 Consolidated P&L for financial year X

<i>Consolidated P&amp;L for financial year X</i>	
External revenues	X
Internal revenues	X
<b>Total revenues</b>	X
[Insert a row for each of the different cost types – see paragraph(65)]	X
<b>Return</b>	X
<b>Return on external revenues (excluding cost of capital)</b>	X%
<b>Mean Capital Employed</b>	X
<b>Return On Capital Employed</b>	X%

(59) **Consolidated MCE Statement.** Consolidated MCE statement for the SMP operator’s telecoms activities (including both wholesale and retail activities) showing:

- Fixed assets (split by tangible and intangible assets),
- Current assets (split by stocks, work in progress),
- Debtors,
- Cash and near cash,
- Liabilities (split by creditors, provisions and accruals).

The following snapshot shows the required structure that the SMP operator should use for the consolidated MCE statement.

Table 6-2 Consolidated MCE statement for financial year X

<i>Consolidated MCE statement for financial year X</i>	
<b>Fixed assets</b>	X
<i>Tangible assets</i>	X
<i>Intangible assets</i>	X
<b>Current assets</b>	X
<i>Stocks</i>	X

<i>Work in progress</i>	X
<i>Debtors</i>	X
<i>Cash and near cash</i>	X
<b>Total assets</b>	X
<b>Liabilities</b>	X
<i>Creditors</i>	X
<i>Provisions</i>	X
<i>Accruals</i>	X
<b>Total mean capital employed</b>	X

- (60) The following reports (as described in paragraphs (62) to (69)) have to be established only for the markets where the ILR has imposed an accounting separation remedy on the SMP operator. In addition, for all products where the SMP operator does not face an accounting separation remedy, the SMP operator shall group these products into categories called “other wholesale” and “other retail”. For the avoidance of doubt, this means that at present the market/categories, are defined as:
- Wholesale line rental (WLR);
  - Fixed call origination;
  - Wholesale (physical) network (including unbundled access of the local loop and the sub loop) at a fixed location;
  - Physical and virtual wholesale broadband access (including bitstream access);
  - Wholesale terminating segments of leased lines (technology neutral);
  - Other wholesale (e.g. fixed call termination); and
  - Other retail.
- (61) All products and services provided by the SMP operator’s telecommunications activities shall be covered by these markets and categories. If the ILR redefines the markets in which there is an accounting separation remedy, then the above list will need to change. Therefore, the SMP operator is required to submit to the ILR an updated pro forma for this report on an annual basis.
- (62) **Breakdown of network cost by AS market.** This shall show the composition of each AS market’s total costs by network element. The list of network elements shall be defined by the SMP operator in its pro formas (see below). Given that the list of network elements is likely to vary over time, the SMP operator shall submit to the ILR an updated pro forma for this report on an annual basis. The following snapshot shows the required structure that the SMP operator should use for the consolidated MCE statement.



Table 6-3 Breakdowns of network cost by AS market

<i>Breakdowns of network cost by AS market</i>						
	AS market 1	AS market 2	.....	Other wholesale	Other retail	Total telecoms activities (wholesale and retail)
Network element 1	X	X	X	X	X	X
Network element 2	X	X	X	X	X	X
Network element 3	X	X	X	X	X	X
.....	X	X	X	X	X	X

- (63) **Internal transfer charges.** A matrix showing the internal transfer charges between the different AS markets and with the rest of the SMP operator's telecoms business (i.e. the provision of products and services not included in the AS markets)<sup>3</sup>. Given that the list of markets is likely to vary over time, the SMP operator is required to submit to the ILR an updated pro forma for this report on an annual basis. The following snapshot shows the required structure that the SMP operator should use for the information on internal transfer charges.

Table 6-4 Internal transfer charges

<i>Internal transfer charges</i>						
From/To	AS market 1	AS market 2	.....	Other wholesale	Other retail	Total telecoms activities (wholesale and retail)
AS market 1	X	X	X	X	X	X
AS market 2	X	X	X	X	X	X
.....	X	X	X	X	X	X
Other wholesale	X	X	X	X	X	X
Other retail	X	X	X	X	X	X
Total telecoms	X	X	X	X	X	X

<sup>3</sup> For the avoidance of doubt, the internal transfer charges should only show transfers between the different parts of the SMP operator's telecoms division. Any products sold or purchased from non-telecoms divisions should be charged at the appropriate retail rates.

<b>activities (wholesale and retail)</b>						
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- (64) **P&Ls for different markets.** For each of the AS markets, the SMP operator shall show a separate P&L. Each P&L shall include data on external revenues, internal revenues, total revenues, different cost types (see below), different resource categories, the return (excluding cost of capital), the MCE and the ROCE. The total cost of the different cost types should sum up to the total costs of the resource categories.
- (65) Cost types should be defined by the SMP operator in its pro formas, but should at a minimum include (the cost types should not include a return on capital):
- Operating expenses (excluding internal transfer charges);
  - Internal transfer charges;
  - Historical depreciation;
  - Supplementary depreciation; and
  - Holding gains and losses.
- (66) Resource categories should be defined by the SMP operator in its pro formas (the resource categories should not include a return on capital employed). It should include categories such as buildings, support IT and network elements.
- (67) The following snapshot shows the required structure that the SMP operator should use for the P&L information for different markets. The “Total revenues”, “Return” and “Mean Capital Employed” in the “Total telecoms activities” column should be consistent with the data shown in the consolidated P&L and MCE statement.

Table 6-5 P&amp;Ls for different markets

<i>P&amp;Ls for different markets</i>						
	<b>AS market 1</b>	<b>AS market 2</b>	<b>....</b>	<b>Other wholesale</b>	<b>Other retail</b>	<b>Total telecoms activities (wholesale and retail)</b>
<b>Total revenues</b>	X	X	X	X	X	X
<b>External revenues</b>	X	X	X	X	X	X
<b>Internal revenues</b>	X	X	X	X	X	X
<b>[Insert a separate row</b>	X	X	X	X	X	X

<b>for each cost types as defined in paragraph (65)]</b>						
<b>Total cost of different cost types</b>	X	X	X	X	X	X
<b>[Insert a separate row for each resource category – as defined in paragraph(66)]</b>	X	X	X	X	X	X
<b>Total cost of different resource categories (this should equal the total cost of different cost types)</b>	X	X	X	X	X	X
<b>Return</b>	X	X	X	X	X	X
<b>Return on revenues</b>	X%	X%	X%	X%	X%	X%
<b>Mean Capital Employed</b>	X	X	X	X	X	X
<b>Return On Capital Employed</b>	X%	X%	X%	X%	X%	X%

(68) **Information on individual services within AS markets.** For each of the services (see above), the SMP operator shall show data on:

- Total revenues (internal plus external),
- Volumes,
- Revenue per unit,
- FAC,
- FAC per unit and

- Revenues as a percentage of FAC.

(69) The following snapshot shows the required structure that the SMP operator should use for the information on services within markets with accounting separation obligations. As shown by the snapshot, the SMP operator is not required to provide any information on non-AS markets at this level of detail.

Table 6-6 Information on individual services within markets

<i>Information on individual services within markets</i>						
	<b>Total revenue</b>	<b>Volumes</b>	<b>Total revenue per unit</b>	<b>FAC</b>	<b>FAC per unit</b>	<b>Total revenue as a percentage of FAC</b>
<b>AS market 1</b>	X			X		X%
<b>Service 1</b>	X	X	X	X	X	X%
<b>Service 2</b>	X	X	X	X	X	X%
<b>.....</b>	X	X	X	X	X	X%
<b>AS market 2</b>	X		X			X%
<b>Service 1</b>	X	X	X	X	X	X%
<b>Service 2</b>	X	X	X	X	X	X%
<b>.....</b>	X	X	X	X	X	X%
<b>AS market X</b>	X			X		X%
<b>Service 1</b>	X	X	X	X	X	X%
<b>Service 2</b>	X	X	X	X	X	X%
<b>.....</b>	X	X	X	X	X	X%

(70) **Reconciliation of P&L to statutory accounts.** The SMP operator shall show how the consolidated P&L in its separated accounts can be reconciled to the P&L in its statutory accounts. It shall show the impact of adjustments, such as CCA adjustments, internal transfer charges and removing inefficient costs. The following snapshot shows the required structure that the SMP operator should use for the P&L reconciliation.

Table 6-7 Reconciliation of P&L to statutory accounts

<i>Reconciliation of P&amp;L to statutory accounts</i>			
	<b>Total revenue</b>	<b>Operating costs</b>	<b>Return</b>
<b>Separated accounts</b>	X	X	X
<b>CCA adjustments</b>	X	X	X
<b>Removing inefficient costs</b>	X	X	X

<b>Internal transfer charges</b>	X	X	X
<b>Adjustment X</b>	X	X	X
.....	X	X	X
<b>Non-telecoms activities</b>	X	X	X
<b>Statutory accounts</b>	X	X	X

- (71) **Reconciliation of MCE to statutory accounts.** The SMP operator shall show how the consolidated MCE statement in its separated accounts can be reconciled to the MCE Statement in its statutory accounts. Where applicable, this shall show separately the difference in the MCE resulting from the use of different assets lives in the separated accounts compared to the statutory accounts. The following snapshot shows the required structure that the SMP operator should use for the MCE reconciliation.

Table 6-8 Reconciliation of MCE to statutory accounts

<i>Reconciliation of MCE to statutory accounts</i>	
	<b>Capital employed</b>
<b>MCE in separated accounts</b>	X
<b>Impact of using different asset lives</b>	X
<b>Impact of CCA adjustment</b>	X
<b>Impact of efficiency adjustments</b>	X
<b>Adjustment X</b>	X
.....	X
<b>Non-telecoms activities</b>	X
<b>Shareholders' funds in statutory accounts</b>	X

- (72) **Significant changes compared to the previous year.** The SMP operator shall describe any significant changes to the results in its separated accounts relative to the previous year.
- (73) **Description of any material one-off items.** The SMP operator shall provide a description of any material one-off costs or revenue (see Section 7).

## 7 Supporting documentation

- (74) The SMP operator shall produce supporting documentation for the regulatory accounts that describe the approach that it has used in its separated accounts. This is to enable an independent audit of the accounts (see Section 8) to ensure their reliability. This is also to provide transparency.
- (75) The SMP operator's supporting accounting documentation shall at a minimum cover:
- **A description of the SMP operator's business.** This should explain how the firm's telecommunications activities fit into the overall structure of the business. The explanation should be complemented by a diagram showing the structure of the business.
  - **Basis of preparation.** A description of how the SMP operator has prepared the accounts and confirmation that it has adhered to the overarching principles set out in section 4. This is to ensure transparency.
  - **An overview of which products are contained within the different services, and which services are contained within each market (for AS markets only).** This does not need to list every single product contained within all of the services, but it should provide sufficient information so that a user of the separated accounts could work out for themselves under which a service a given products falls.
  - **An overview of any significant changes in the approach compared to the previous year and the justification for changing the approach.** For example, if the SMP operator has changed one of the price indices used for asset valuation or has changed one of the cost drivers used for cost allocation, then this should be explained and justified in this section. This is to understand the consistency for the regulatory accounts from one period to another.
  - **A description of the source of information for its separated accounts and underlying costing system.** This should include a description of whether the SMP operator uses different costing systems for its wholesale and retail activities, and if so, it should explain how these systems interrelate.
  - **A description of internal safeguards that the SMP operator has used to ensure that its accounts are accurate and complete.** This should include a description of any cross-checks performed by the SMP operator.
  - **The SMP operator's approach to cost allocation.** This should include a description of:
    - The main cost categories that can be directly allocated to network elements or services;
    - The approach used to identify the appropriate cost drivers to allocate shared or common costs;
    - The main cost categories where the SMP operator has had to use an EPMU; and

- Any sampling techniques used.
- **The SMP operator's approach to asset valuation.** This should include a description of:
  - The assets that are valued on a CCA basis and the price indices used to value these assets;
  - Why the specific price indices used were considered the most appropriate;
  - The reason for not valuing certain assets on a CCA basis, for example due to short asset lives or low asset values; and
  - The percentage of the asset base that is valued on a CCA basis, based on the net book value of the assets.
- **The SMP operator's approach to depreciation including the asset lives used.** If the SMP operator uses different asset lives to those used in its statutory accounts (either because the ILR has required it do so or because the ILR has given the SMP operator permission to do so), then the SMP operator should explain this. The SMP operator should also explain how it has calculated supplementary depreciation and holding gains or losses.
- **The return on capital used.** For the services, for which a price cap has been fixed by the ILR, the SMP operator should confirm that it has used the pre-tax WACC, which is underlying the corresponding price cap. For the other services, the SMP operator shall specify the used WACC, as well as its underlying values.
- **The SMP operator's approach to internal transfer charges.** The SMP operator should explain for which services and products it has been able to use external prices to determine the internal transfer charges and the approach used to estimate transfer charges for the other services.
- **Methodology and data used to determine any efficiency adjustments.** The SMP operator should explain the logic for any efficiency adjustments and how it has performed such adjustments.
- **An overview of new services that have been added since the previous reporting year and the impact of this.** If the new services have replaced legacy services, then the SMP operator should explain this.
- **The SMP operator's approach to allocating the revenues and costs for any wholesale services sold jointly with other wholesale services.**

(76) The SMP operator shall publish this supporting accounting documentation on its website alongside its separated accounts.

## 8 Audit of separated accounts

- (77) The audit of the separated accounts relates to the examination and verification of the SMP operator's accounting reports and supporting documents. This includes systematic checking and verification of the accounting information to ensure that these AS guidelines have been correctly applied.
- (78) The SMP operator's separated accounts shall be subject to an independent audit. The SMP operator is responsible for choosing its auditor.
- (79) As part of the audit, the SMP operator shall grant access to the independent auditor to all information used to prepare the separated accounts, supporting documents, source systems and related documentation, including confidential information.
- (80) The elements covered by the audit shall include:
- The scope of costs included in the model and the scope of costs allocated to individual regulated products;
  - Reconciliation between the separated accounts and the statutory accounts;
  - The correctness of figures, including operational data; and
  - Methodologies used for cost allocation, asset valuation, depreciation, return on capital, internal transfer charges, efficiency adjustments, the approach used for separating out revenues and costs for wholesale services sold jointly with other wholesale services.
- (81) The SMP operator shall make available to the auditor the appropriate resources to explain and respond to questions arising during the review.
- (82) For each financial year, the SMP operator shall ensure that the auditor provides a published statement which includes an overview of how they have audited the accounts, the overall conclusion of the auditor, their opinion on the accuracy of the accounts as well as a confirmation that the accounts have been produced in line with the guidelines set out in this document as well as the underlying "règlement". This is to provide assurance on the reliability of the separated accounts.
- (83) For each financial year, the SMP operator shall ensure that the auditor also provides to him and to the ILR the management letter (i.e. does not need to be published), which shall cover the following, at a minimum:
- All identified irregularities;
  - Recommendations made by the auditor with a description of the corresponding effect;
  - Full description of the verification methodology followed; and



- Some aggregate financial and accounting data (such as CCA adjustments, main assumptions made on attribution methodologies, levels of costs allocated and the level of the granularity of the model).

(84) The whole of the separated accounts shall be audited in accordance with the international accounting standard of assurance engagements other than audits or reviews of historical financial information (“ISAE 3000”), issued by the International Federation of Accountants and adopted by “l’assemblée générale des réviseurs d’entreprises”.

## 9 Timings & Revisions

### Pro formas

- (85) As described in Section 6, the SMP operator shall produce and submit to the ILR the pro formas for each of the listed AS statements and reports within 6 months of the ILR publishing the “règlement” on the accounting separation guidelines.
- (86) In future years, the SMP operator shall submit the pro formas, as specified in Section 6, to the ILR one month after the end of the financial year. That is, the SMP operator shall submit these pro formas to the ILR by the end of January in each year assuming calendar year reporting periods.

### Separated accounts & supporting documentation

- (87) The SMP operator shall publish the following documents on its website:
- AS statements and reports (as described in Section 6);
  - Supporting documentation (as described in Section 7).
- (88) For the first time, the SMP operator shall provide to the ILR and publish on its website the separated accounts and the supporting documentation for the financial year 2016.
- (89) The audited separated accounts and supporting accounting documentation shall be published on the SMP operator’s website and transmitted to the ILR six months after the end of the financial year (that is, by the end of June in each year assuming calendar year reporting). This should provide the SMP operator with sufficient time to produce the accounts, whilst ensuring that the ILR still receives the separated accounts in a timely manner.
- (90) The SMP operator should submit the AS statements to the ILR in editable spreadsheet format. However, the SMP operator does not need to publish the AS statements in editable spreadsheet format.
- (91) The statement of the auditor as described in paragraph (82) shall be published and submitted to the ILR at the same moment than the separated accounts (i.e. 6 months after the end of the financial year).
- (92) The management letter of the auditor shall also be provided to the ILR within 6 months after the end of the financial year.

### Revisions

- (93) In exceptional circumstances, the SMP operator may request a restatement of its AS in the event of finding a serious error which was not known at the time of preparation (i.e. not a judgement call) with supporting evidence.

## 10 Glossary

- (94) **Activity based costing (ABC)** – Cost allocation methodology where costs are assigned to the services based on allocation keys presenting a causal link with the costs incurred.
- (95) **Current Cost Accounting (CCA)** - An accounting methodology, where assets are valued and depreciated according to their current replacement cost.
- (96) **Equi-proportional mark-up (EPMU)** - A method of allocating the shared or common costs to a service or product in proportion to the costs already assigned
- (97) **Fully allocated costs (FAC)** - An accounting approach under which all the costs of the company are distributed between its various products and services. The fully allocated cost of a given product or service may therefore include some common costs that are not directly attributable to the service.
- (98) **Financial capital maintenance (FCM)** – An approach under which the financial capital of the company is maintained in current price terms. Capital is assumed to be maintained if shareholders' funds at the end of the period are maintained in real terms at the same level as at the beginning of the period. This means that the depreciation charge to the profit and loss account includes holding gains or losses due to changes in asset prices. This is in contrast to operational capital maintenance (see below).
- (99) **Historical cost accounting (HCA)** - The conventional accounting methodology, where assets are valued and depreciated according to their cost at the time of purchase.
- (100) **Holding gains and losses** – The annual change in the value of an asset
- (101) **Mean capital employed (MCE)** - It is equal to total assets less current liabilities with the mean computed from the start and end values for the financial year.
- (102) **Operational capital maintenance (OCM)** - This approach requires the company to have as much operating capability, or productive capacity, at the end of the period as at the beginning of the period. This means that holding gains and losses due to asset price changes are not included in the profit and loss statements.
- (103) **Profit and loss (P&L)** - A statement showing all items of income and expense in a given period
- (104) **Return on capital employed (ROCE)** – A measure of how efficiently capital is being used. It is calculated as accounting profit divided by the capital employed.
- (105) **Supplementary depreciation** - The difference between historic depreciation and current cost depreciation
- (106) **Weighted average cost of capital (WACC)** - The rate that an operator is expecting to pay on average to all its security holders (equity and debt) to finance its assets.