
Executive Summary on Consultation Responses
“Draft ERG Opinion on the revision of the Commission Recommendation
98/322 on Cost Accounting and Accounting Separation”

September 2004

Background

11 June 2004 marked the closing date of the public consultation on a paper prepared by the ERG (“Draft ERG Opinion on the revision of the Commission Recommendation 98/322 on Cost Accounting and Accounting Separation” ERG 04 (15) - the draft Recommendation). This consultation paper represented ERG’s view on updating the previous Recommendation in order to bring it in line with the EC’s 2003 new regulatory framework.

The consultation attracted responses from 37 interested parties and totalled almost 700 pages. This level of interest is most encouraging and reflects a strong interest in this topic and represents a strong contribution to the overall aims of the new regulatory framework Europe.

Objective

This paper summarises the responses and groups them in main themes organised in the order of the original consultation document ERG 04 (15); it is divided in three main sections where general and specific comments are addressed. These sections are organised as described below:

1. **General Comments from Respondents:**
It properly addresses and analyses general comments of the respondents that do not fit in the recommendation or the annex texts; .
2. **Comments to the Recommendation Text:**
It duly addresses and analyses comments and viewpoints of the respondents that are referring to the recommendation text .
3. **Comments to the Annex:**
It duly addresses and analyses comments and viewpoints of the respondents that are referring to a specific part of the Annex .

The purpose of this paper is to provide a summary of the key themes and issues arising from the consultation.

The ERG has taken into account all relevant comments made during the course of this consultation. In consultation with the Commission, the draft Recommendation has been reviewed or amended as appropriate.

I. General Comments from Respondents

Scope of AS/CA rules

- (1) There is a view, primarily from the mobile community, that AS/CA rules were mainly specified for fixed networks and therefore are not relevant for other situations. The examples used in the draft Recommendation seem to reinforce this view.

In the new Recommendation on Accounting Separation and Cost Accounting regulatory remedies are technology neutral and generally applicable to all the situations in which NRAs decide that it is appropriate and proportionate to impose such an obligation. Therefore the comment raised here is not completely correct. However the document has been adapted to take into account this viewpoint and, to reduce possible misinterpretations, all examples that might be too technology specific and might be misleading have been rephrased or deleted.

Proportionality/Burden on SMP operators

- (2) For those that may be subject to AS/CA, it was felt important that the resource burden be acknowledged and taken into account when considering the imposition of these obligations. It was felt that a cost benefit analysis should be performed to assess the impact.

The Recommendation has been adapted to take into account this viewpoint.

Link between prices and costs/the “cost-orientation” obligation

- (3) There was some concern that costs, derived from applying the principles contained in the draft Recommendation, applied “directly” to the setting of prices would not be appropriate. This issue recurs in many contributions to the consultation where, for example, it is mentioned either the use of EPMU as a mark-up or the use of the Ramsey pricing rules.

The Recommendation has not been adapted to take into account this viewpoint. This comment, although relevant for general regulatory policy settings, is not pertinent in the case of a recommendation on accounting regulation. NRAs, when appropriate, can impose such a pricing obligation when they fill it is proportionate to the regulatory purposes.

Application of specific methodologies

- (4) There were mixed comments where some saw the draft Recommendation as being too specific and not flexible enough to deal with local conditions or too general and inadequate to ensure the consistent application of these obligations across Europe.

The Recommendation has not been adapted to take into account this viewpoint.
The Recommendation is technology neutral and applicable, when relevant, to all situations where cost orientation is required.

Examples

- (5) There was a view that the examples were insufficiently detailed to be of much value. The suggestion was that they should be reduced in number and key examples expanded. Others felt that some examples were too “fixed” network specific. Others asked for more detailed “worked” examples to assist implementation and understanding. Others believed that was better to delete them.

The Recommendation has been adapted to take into account these viewpoints.
Some examples have been reduced in number and key examples expanded. Others, too “fixed” network specific, have been deleted or reviewed. The Recommendation has been reviewed to be fully technology neutral and generally applicable to situations where cost orientation is imposed.

Implementation timetables

- (6) There were some comments that phased implementation timetables make some sense given the complexity of the subject. The draft Recommendation may offer guidance on a final position but some thoughts on key stages in the implementation may be helpful, for example starting with robust FCA HCA data moving to CCA and then to LRIC.

The Recommendation has been adapted to take into account these viewpoints.

II. Comments to the Recommendation Text

Cost orientation and use of FDC or LRIC

- (7) One respondent suggested that there may be more than one valid accounting methodology for assessing cost orientation.

The Recommendation has not been adapted to take into account this viewpoint.

This view is already addressed in point 2 of the body of the Recommendation:

“It is recommended that NRAs satisfy themselves as to the adequacy and effectiveness of the cost accounting systems and that they may also be subject to public consultation [...] or can prepare financial information against agreed long run incremental cost methodologies.”

Regarding point 5 of the body of the Recommendation about provisioning of accounting information and publication

- (8) One respondent commented that the application of these guidelines to undertakings with special or exclusive rights requires specific rules.

The Recommendation has not been adapted to take into account this viewpoint.

The Recommendation is technology neutral and applicable, when relevant, to all situations where cost orientation is required.

III. Comments to the Annex

Introduction note:

This part of the summary is organised in the order of the original consultation document ERG 04 (15) Annex. For example Section 2.2 refers to “Section 2.2 Cost allocation methodology: Activity-based costing”, page 10 of the original document.

Section 1: Cost accounting and accounting separation

(9) Repeated concerns in this section from respondents include:

- the examples/templates being insufficiently detailed or inappropriate;
- the costs of implementation are smaller than suggested by SMP operators;
- the proposed methodologies should not be too detailed so as to allow local flexibility.

Some respondents claimed that the implied or explicit link made in the draft Recommendation between the cost accounting obligation (Art 13 AD) and the accounting separation obligation (Art 11 AD) is incorrect and that these obligations are separate and distinct. As such they can not be treated “jointly” in the draft Recommendation. This issue is of significant importance to some respondents.

The Annex has been updated to take into account some of these viewpoints. In particular:

- some examples have been deleted or reviewed;
- the chapter has been designed to give a clear distinction of cost accounting and accounting separation.

Accounting separation and cost accounting obligations are treated jointly because they are not separate and distinct obligations, but they are part of the process of imposing cost orientation.

A: COST ACCOUNTING

(10) Many respondents commented on the specified cost categories (directly attributable, indirectly attributable and unattributable costs) and raised issues about them such as their relevance to “modern” accounting systems, overlap or confusion with “common/joint costs” and compliance with the complexities of new technologies.

The document has been adapted to take into account this viewpoint.

Section 1A now defines two categories of costs (direct and indirect attributable costs). Unattributable and common/joint costs are part of the indirect attributable costs. Common/joint costs are used as a terminology for the LRIC section

(11) A related issue raised is the impact of attributing common costs in a way that leads to a “false” presentation of financial performance. This concern is expressed in a number of responses where the recovery of common costs is seen as important.

The document has been adapted to take into account this viewpoint.

In Section 2 par. 2.3: "For certain types of indirectly attributable costs the cost driver is difficult to identify or very weak. In this case an alternative cost driver or method can be chosen as long as these are fair and objective, that is they do not favour the notified operator or materially distort the results. In these circumstances, an NRA may set specific guidelines in order to limit the potential arbitrary and material effect of these allocations."

- (12) One respondent considered that transfer charges performed a special role in ensuring compliance with non-discrimination obligations and that the use of internal contracts should be recommended.

The document has not been adapted to take into account this viewpoint.

A well-defined, transparent and verifiable transfer charging system is necessary for notified operators to demonstrate non-discrimination and calculate internal costs and revenues for both cost-orientation and non-discrimination purposes. They typically reflect the vertically integrated nature of notified operators and will enumerate the wholesale/retail relationships between the economic markets and services within the undertaking's scope of activity. The charge should be equivalent to the charge that would be levied if the product or service were sold externally rather than internally.

It is not necessary the use of internal contracts for to demonstrate non-discrimination and calculate internal costs and revenues for both cost-orientation and non-discrimination purposes. A well-defined, transparent and verifiable transfer charging system is enough.

- (13) One respondent felt that the imposition of CCA places an additional burden on companies and should therefore be carefully evaluated and not automatically imposed.

The document has not been adapted to take into account this viewpoint.

Historical cost information is generally accepted as being adequate for financial stewardship purposes but may provide unsatisfactory indicators for regulatory decision making. Current cost accounting concepts were originally developed to remedy the limitations of historical cost accounting in a world of changing prices either due to inflation or other reasons such as rapid technological change. NRAs can adopt a cost accounting system based on current costs or they can adopt a cost accounting based on historical costs depending to the regulatory object.

b) Indirectly attributable costs

- (14) Further specific comments (consistent with earlier comments) on this categorisation of cost reinforcing need for draft Recommendation to be clearer.

The document [has](#) been adapted to take into account this viewpoint.
See also the answer to (10) of this document.

c) Unattributable costs

- (15) Significant “push-back” from respondents on the 10% rule and general criticism of specifying any limit. Respondents pointed out that no empirical evidence exists to support the draft Recommendation proposal. There was also some confusion with the application of this rule when identifying common costs.

The document [has](#) been adapted to take into account this viewpoint.
See also the answer to (10) and (11) of this document.

d) Evaluation of capital employed

- (16) A number of comments in this section follow on from similar comments made earlier dealing on cost attribution rules particularly with the use of EPMU.

The document [has not](#) been adapted to take into account this viewpoint.
See also the answer to (3) of this document.

e) Rules for cost allocation of common/joint costs

- (17) Some discussion on identifying appropriate allocation keys and the difficulty of finding a direct cost causal driver.

The document [has not](#) been adapted to take into account this viewpoint.
See also the answer to (10) and (11) of this document.

f) Definition of transfer charges

- (18) Respondents called for more clarification about, or even exclusion of, the terms “satisfactory” and “supportable” on p3 of the annex.

One significant contribution challenged the definition of transfer charges commenting that the application of cost allocation methodologies automatically leads to compliance with non-discrimination obligations. A

closely related comment also stated that often the internal service was different from the external service. It went on to propose an alternative definition of transfer charges for internal services.

One respondent suggested that the transfer charging rules should follow national or international rules such as those set out by the OECD.

The document has been partially adapted to take into account these viewpoints. In particular the definition has been rewritten and extended

B: ACCOUNTING SEPARATION**a) Example of accounting separation for the Fixed Network**

- (19) Many comments on this example picking up the theme of lack of clarity (insufficient detail) or irrelevant concepts (such as “Access aggregate”).

The document has been adapted to take into account these viewpoints. The example has been deleted.

b) Example of accounting separation for the Mobile network

- (20) A number of comments stated that the example was invalid and should focus on regulated markets. Another pointed out that in their view the AS framework does not match the structure of the mobile sector.

The document has been adapted to take into account these viewpoints. The example has been deleted.

c) Average cost of network component

- (21) A respondent felt that this level of detail is commercially sensitive and should only be available to the NRA.

The document has been adapted to take into account this viewpoint. The example has been deleted.

Section 2: Principles for cost causality, drivers definition and attribution methodologies

- (22) Respondent's asked for clarification of the term "justify" in section 2.1 and whether this is linked to the concept of "efficiently incurred cost".

Concern about the 10% unattributable cost limit was repeated here along with some concerns about the examples.

The chapter has been rewritten and extended to take into account the comments received.

2.2 Cost allocation methodology: Activity based costing

- (23) A respondent asked that the ERG adds the principle of "objectivity" to ensure costing methodologies do not benefit the SMP operator.

Another respondent wanted to exclude the use of revenue as a cost driver.

The document has been partially adapted to take into account these viewpoints. The paragraph has completely been rewritten. In particular cost drivers must be fair and objective, and must not be in favour of the notified operator or materially distort the results.

2.3 The cost allocation process

- (24) A number of respondents criticised the table for a number of reasons (e.g. looks very out of date against current technologies and services, is insufficiently detailed, inappropriate for mobile networks, needs worked examples, not that helpful to practitioners).

A respondent suggested it was wrong to prescribe ABC as general costing tool as a more analytical economic model may work better.

A respondent suggested that it was not possible to fix the allocation keys as they will change as communication networks evolve.

The document has been partially adapted to take into account these viewpoints. The paragraph has been rewritten. In particular attribution methodologies should be comprehensively documented and transparent to the satisfaction of NRAs. A description of attribution methodologies should also be published by the notified operator.

2.4 Operating costs

- (25) Some criticisms about the table being incomplete and not applicable to mobile networks.

The Recommendation has not been adapted to take into account this viewpoint.
The Recommendation is technology neutral and applicable, when relevant, to all situations where cost orientation is required.

Section 3: Current cost accounting – guidelines for implementation

- (26) A respondent pointed out that in some situations it may not be relevant to carry out extensive CCA valuation work (for example, where assets have a short life).

A respondent also took issue with MEA asset valuations possibly resulting in a different valuation from a new entrant. This finding seemed contradictory.

The document has been partially adapted to take into account these viewpoints.
The paragraph has been rewritten and extended.

3.1 Calculation of current cost asset values

- (27) Some respondents believed that it is impractical and ineffective to have a public consultation on proposed CCA methods in advance of implementation. .

Some respondents expressed concern about the suggestion (section 3.1) that some types of costs representing large data sets could be grouped into a few categories. They saw significant dangers in this approach which may not provide for the vigour expected of this exercise.

There were many comments on the detailed valuation process and how this should be conducted. Many took the view that it could only be the operator that could effectively undertake this task.

There were some detailed comments about efficiency adjustments, valuation of fully depreciated assets, inconsistent drafting.

The document has been partially adapted to take into account these viewpoints.
The paragraph has been rewritten and extended.

Economic value

- (28) A respondent suggests that the ERG considers the need to differentiate the evaluation of the current cost of its network depending on whether the

operator is already in place or is a new entrant. There are important methodological differences with these approaches which should be set out in the Recommendation. Two respondents specifically mentioned that it should be possible to change asset lives in the re-evaluation process.

A respondent argued strongly that where assets have an intrinsic economic value, but are fully amortised, should not be valued at zero. This would have serious implications for encouraging competition.

The document has been partially adapted to take into account these viewpoints. The paragraph has been rewritten and extended.

Modern equivalent asset valuation

A respondent suggested that often there is no choice in the replacement technologies being purchased and that adjustments for additional functionality in this situation were unreasonable.

The document has not been adapted to take into account these viewpoints. The paragraph has been rewritten and extended.

Current cost accounting adjustments

(29) A respondent asked that the Recommendation explicitly refers to all potential CCA adjustments (not just asset revaluations and depreciation charges).

A respondent believed that there was no need for a consultation on parameters and factors to be chosen for a “current cost accounting model”.

The document has been partially adapted to take into account these viewpoints. The paragraph has been rewritten and extended.

The main adjustments under OCM

(30) A respondent thought that the definitions of OCM and FCM were insufficiently clear or too abstract. Some reference to or description of holding gains and losses would be helpful.

A respondent thought that the concept of CCA was that it measured costs of the SMP operator on a MEA basis. The recommendation that fully

amortised assets should be valued at a zero NRC was therefore inconsistent with this as they still retained economic value.

A respondent thought that the CCA approach should take into account “migration” costs from an existing to a new technology. These transition costs can be significant.

A respondent stated that the draft lacks a statement on the structural differences between OCM and FCM. This respondent then links the use of FCM closely with the market value of the firm as well as suggesting some alternative definitions of “gross replacement cost” and “net replacement cost”.

The document has been partially adapted to take into account these viewpoints. The paragraph has been rewritten and extended.

Further adjustments under financial capital maintenance (FCM)

- (31) Generally, respondents seem to be asking for more clarification in this area and a consistent view of its application in practise.

The document has been adapted to take into account these viewpoints.

Cost of capital

- (32) General acknowledgement that CAPM is a legitimate methodology but respondents have raised a significant number of issues ranging from fundamental comments on the limitations of CAPM to technical comments on the parameters needed to calculate a cost of capital.

The document has not been adapted to take into account these viewpoints. CAPM is a well established methodology that has a broad consensus among NRAs.

The WACC and capital value

- (33) There was some comment that other models or methodologies should be used in place of or at least in addition to CAPM. There was some comment on differing risks faced by operators and problems relating historic data to inform forward looking decisions.

On the parameters used in a WACC calculation, respondents raised a number of specific issues against most parameters including the derivation of the Beta, risk free instruments and debt/equity ratios.

On the issue of applying different calculations to different business lines of one operator, there were some comments weighted against such an approach. The main argument being that there were strong commercial links between different lines of business that may perform commercially very differently but are to some extent interdependent on each other.

The document has not been adapted to take into account these viewpoints. WACC is a well established methodology. The way of calculating it and the parameters used have a broad consensus among NRAs.

Capital employed

- (34) A respondent from the mobile sector believed all relevant technologies should be included.

The Recommendation has not been adapted to take into account this viewpoint. The Recommendation is technology neutral and applicable, when relevant, to all situations where cost orientation is required.

Qualitative characteristics of accounting information

- (35) The application of IAS was disputed by some respondents although supported by others.

The document has been adapted to take into account these viewpoints. IAS or similar national accounting standards has been recommended.

Comparability

- (36) A respondent thought that scrutiny of changes in the levels disclosed should not be restricted just to the NRA.

The Recommendation has not been adapted to take into account this viewpoint.

Materiality

- (37) Further clarification of the materiality concept was requested.

The Recommendation has been partially adapted to take into account this viewpoint.

Transparency, confidentiality, market related limitations and publication of accounting data and methodologies

- (38) One general comment suggested that this was an important area where “open inspection” by all interested parties was important.

The Recommendation has not been adapted to take into account this viewpoint.
The request is too general and not pertinent.

NRA’s access to the undertakings accounting data

- (39) One respondent believed that publication of data on network components was not necessary and beyond the scope of the obligation.

The Recommendation has not been adapted to take into account this viewpoint.

Confidentiality

- (40) This issue received many comments from respondents.

On the whole most prospective SMP operators stressed the importance of confidentiality and potential conflicts with the requirements of capital markets whilst new entrants stressed the importance of transparency and access to cost data to the promotion of competition.

The document has been partially adapted to take into account these viewpoints.
The paragraph has been rewritten and extended.

Publication of accounting data and methodologies

- (41) Respondents in this section tended to repeat the comments above. There was however little evidence provided by SMP operators of why cost information may be sensitive.

The document has been partially adapted to take into account these viewpoints.
The paragraph has been rewritten and extended.

Relevant market related limitations

Principles

- (42) There was some disagreement about extending accounting separation obligations outside of SMP markets.

The document has not been adapted to take into account these viewpoints. The paragraph has been confirmed by the Commission. NRAs can impose accounting separation outside of SMP markets.

Audit scope and verification

- (43) A respondent wanted the draft to be clear that the scope of the audit includes the derivation of CCA and LRIC information.

A respondent commented that the audit placed a significant cost burden and this needs to be recognised.

Another respondent suggested in some detail an alternative audit “attestation”.

The document has been partially adapted to take into account these viewpoints.

Annual control performed by NRA's

- (44) There was a comment that an NRA may be seen as judge and jury in carrying this work and that use of an external auditor was important.

The document has not been adapted to take into account these viewpoints. The NRAs can act as an auditor.

Publication of information

- (45) A respondent asked that the draft make it clear that an NRA can require publication of other information if justified.

A respondent also suggested that this section could refer to International Auditing Standards, which in turn would improve harmonisation of approach across Europe.

The document has been partially adapted to take into account these viewpoints. The recommendation refers to IAS and to national accounting standards. See also number 42.

Long Run Incremental Cost

- (46) A respondent from the mobile sector suggested that LRIC would understate the return required in a high risk business.

Another commented that LRIC models imply a stable market and do not recognise rapid technological and demand changes.

The document has not been adapted to take into account these viewpoints. The recommendation is technology neutral. LRIC is one of the cost accounting methodologies that can be used and can be selected by NRA in imposing cost orientation.

Concept and rationale of long run incremental cost

- (47) A respondent suggested that LRIC cannot be used for accounting separation purposes and this should be clear in the draft. They also suggest that LRIC data cannot be reconciled with statutory accounting information.

The document has not been adapted to take into account these viewpoints. An accounting separation system is a kind of cost accounting system able to transparently demonstrate the compliance with non-discrimination obligations and absence of anti-competitive cross-subsidies can be demonstrated by, inter alia, the attribution of relevant operator revenues and costs assets and liabilities between product and service markets”

Imposition of LRIC cost modelling

- (48) One respondent pointed out the importance of reconciling “bottom-up” models with “top-down” models given the innate downward bias of “bottom-up” models.

The document has not been adapted to take into account these viewpoints. The decision to reconcile the models must remain to the NRAs.

Relation between IC, SAC and FAC

- (49) A respondent criticised the definition of stand-alone cost as being inconsistent with case-law.

The document has been adapted to take into account this viewpoint. The definition has been updated.

Practical implementation of LRIC cost modelling

- (50) A respondent claimed that the draft should not state a preference for top-down or bottom-up models. If cost-orientation obligations are few or lesser importance then it is disproportionate to require the development and implementation of top-down LRIC models.

The document has been adapted to take into account this viewpoint.

Allocation of common costs

- (51) A respondent from the mobile sector pointed out that mobile service exhibit significant common costs and gave examples. In this context it was unhelpful that “Ramsey” pricing should be dismissed as impractical.

This line was supported by other respondents who believed data could be obtained to implement Ramsey pricing and that EPMU could prove to be sub-optimal.

The document has not been adapted to take into account these viewpoints.

The EPMU methodology is a robust and well established methodology. Ramsey pricing is rarely used in practice where regulation is concerned. An important reason for this is that this method is practically unfeasible due to the complex and dynamic information requirements on demand elasticities. Furthermore, Ramsey pricing may lead to price-setting that is detrimental for competition. Often, the services with the highest demand elasticity are those where competition is most intense. Not allocating common costs to these services results in relatively low prices, which may prove to be too low for competitors.

Ends