Please note: this is an abstract of the annex of the Opinion on a revision of the Commission's Recommendation on Accounting separation and cost accounting. It is a short outline and is neither comprehensive nor complete. For more information or interpretation, please always refer to the annex as the original document.

A- Annex

i. *Section 1A Cost accounting*

1. This section defines the main cost accounting system requirements. In particular the recommended principles for allocating costs, capital employed and revenues when preparing regulatory accounts.

ii. Section 1B Accounting separation

2. An accounting separation system is 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 anti-competitive cross-subsidies.

3. 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.

4. Accounting separation requirements may be developed starting from either historical cost accounting (HCA) or current cost accounting (CCA).

5. There should be a clear rationale for the transfer charges used and each charge should be justifiable. Charges should be non-discriminatory and there should be transparency of transfer charges in the separate accounts.

iii. Section 2 Attribution methodologies and the application of the cost causality principle

6. This section sets out the principles that should be followed in order to attribute costs, capital employed and revenues for the purposes of cost accounting and accounting separation.

7. The principle of causality implies that costs are allocated, directly or indirectly, to the services that "cause" the costs (and revenues) to arise. This requires the implementation of appropriate and detailed cost allocation methodologies.

8. Cost allocation methodologies must be satisfactory to the NRA and may also be subject to public consultation.

9. The attribution methodologies should be comprehensively documented and transparent to the satisfaction of the NRAs. A description of attribution methodologies should also be published by the notified operator.

iv. Section 3 The implementation of current cost methodologies.

10. Historical cost information is generally accepted as being adequate for financial stewardship purposes but may provide unsatisfactory indicators for regulatory decision making.

11. The use of current cost evaluation is intended to measure the financial performance of notified operators in a way that is broadly consistent with the costs faced by new or potential competitors in a market wishing to offer services at a price that would allow them to recover their current costs. . However, there may be significant transitional issues raised when CCA is implemented. For example, the valuation of the asset base may result in significant windfall holding gains and losses for the undertaking subject to accounting separation regulation. It may not be appropriate, depending on the specific regulatory objectives of the NRA, to allow those windfall gains and losses to be reflected in pricing decisions.

12. It is important that the notified operator makes transparent and explicit the factors employed in its current cost valuation methods. The parameters and the factors used must be satisfactory to the NRA and may also be subject to public consultation.

13. There are two different approaches to measuring a company’s capital. The approaches differ in their definition of 'capital maintenance`. That is, the way in which the capital of the company is viewed when determining profit.

14. Capital can either be viewed in operational terms (i.e. as the company's capacity to produce goods and services) or in financial terms (i.e. as the value of shareholder's equity). These concepts are both accepted and are known respectively as operating capital maintenance (“OCM”) and financial capital maintenance (“FCM”).

v. Section 4 Long run incremental cost methodology

15. Conceptually, the LRIC (Long Run Incremental Cost) methodology calculates the cost of providing a defined increment of output, on the basis of forward looking costs incurred by an efficient operator.

16. When applying a long run perspective, all costs (including capital investments) are assumed to be variable (or avoidable). LRIC therefore provides NRAs with a methodology by which the costs of the capital-intensive electronic communications market, which, at the wholesale market level, is characterized by significant investment costs and long term asset lives, can be analysed and used for cost-orientation and pricing purposes.

17. The economic rational behind this methodology is that it identifies the range (between the incremental cost 'floor' and stand-alone cost 'ceiling') between which a pricing signal could be considered rational assuming common costs are also fully recovered. It therefore helps NRAs in setting prices that neither encourages inefficient investment nor discourages efficient investment.

vi. Section 5 Cost of capital calculation

18. The cost of capital of operators should reflect the opportunity cost of funds invested in network components and other related assets. Therefore, the cost of capital includes a reasonable profit for the underlying business. The calculation of the cost of capital ensures that additional profit mark-ups on top of the cost of capital are not required.

19. The calculation of the WACC for an individual operator in total would be relatively straightforward – notwithstanding that there is scope for discussion about the precise derivation and value of inputs into the WACC formulae.

20. Once the parameters have been set, NRAs may need to consider whether application of the global cost of capital represented by the WACC is appropriate for the regulated activities of notified operators. Otherwise, NRAs may take into account that different risks normally apply to different activities (divisional WACC).

vii. Section 6 Main qualitative characteristics expected of regulatory accounting information

21. The purpose of this section is to provide guidance and explanatory material on the qualitative characteristics that an NRA would expect from the information prepared and presented by notified operators under any cost accounting or accounting separation obligations. These characteristics also provide an analytical framework that can be used in specifying financial information.

22. One way for an NRA to ensure this happens is to explicitly require International Accounting Standards (IAS) or International Financial Reporting Standards (IFRS) in accordance with European regulations to apply in the absence of regulatory accounting guidelines

23. For an NRA to meet its objectives, regulatory financial information should be relevant, reliable, comparable, and capable of being subject to review.

viii. Section 7 Transparency, confidentiality, market definition limitation and publication

24. The EU regulatory framework makes several explicit references to the need to implement and maintain a transparency. Firstly, the NRA and the auditor should have access to all information (including confidential information) needed to fulfil their respective tasks related to compliance with the requirements of non-discrimination, cost accounting, price controls and accounting separation.

25. The notified operator shall ensure that any data, information, description, material or explanatory document prepared in respect of accounting and other methods used in the preparation of the accounting records and Cost Accounting Financial Statements shall be sufficiently transparent and prepared such that a suitably informed reader can easily gain a clear understanding of such data, information, description, material or explanatory document.

ix. Section 8 Reporting and verification requirements.

26. This section outlines the periodic reporting framework and publication issues concerning the auditor’s control and the statement of compliance.

27. Pursuant to the guidelines further defined in this document, cost accounting and accounting separation systems must produce financial information with the degree of detail necessary to demonstrate compliance with the principle of non-discrimination and transparency, adequately identifying and attributing revenues, costs and volumes for the several activities performed by the operator.

28. Such accounting information should be made available in a prompt manner to the NRA.