

Implementation of Cost Based Accounting Systems for the Telecommunications Sector

Report on Consultation and Decision

July 2002

Malta Communications Authority

"Il-Piazzetta" Suite 43/44, Tower Road, Sliema SLM 16, MALTA

Telephone: +356 21 336 840 Fax: +356 21 336 846

Web: <http://www.mca.org.mt>

Table of Contents

1	Introduction	1
1.1	Background	1
1.2	Related Consultation	1
1.3	Legal Authority	2
2	Responses to Consultation	4
2.1	Costing Methodology	4
2.2	Timetable for Preparation of Reference Interconnection Offers	5
2.3	Specific Matters Raised	6
3	Conclusion	7

1 Introduction

1.1 Background

In February 2002 the Malta Communications Authority (“MCA”) published a consultative paper on the implementation of cost-based accounting systems for the telecommunications sector¹. The consultative paper set out the legislative background, described different costing methodologies, outlined the principles that should underlie cost allocations and set out the timeframes and the consultative framework.

At the same time a consultative paper on accounting separation and publication of financial information for telecommunications operators was published dealing with the requirements to be mandated on operators to provide financial information².

This document is the report on the consultative paper dealing with Cost Accounting Systems. A separate report will be issued on the consultative paper dealing with Accounting Separation.

1.2 Related Consultation

In January 2002, the MCA issued a consultative paper on dominant market position in telecommunications announcing the initiation of the review of organisations which have a DMP in the Maltese telecommunications market³.

The obligations applicable to operators designated as having a DMP vary in accordance with the respective Regulations, but include an obligation to:

- Interconnect promptly, publish a Reference Interconnection Offer (RIO) and ensure that charges for access / services are cost-oriented, transparent, unbundled and independent of the application to which they are put; and
- Operate a cost accounting system, which is suitable for implementation of the tariff requirements imposed on DMP operators and the calculation of charges for network elements used to provide interconnection.

¹ “Implementation of Cost Based Accounting Systems for the Telecommunications Sector – Consultative Paper”, MCA, February 2002.

² “Accounting Separation and Publication of Financial Information for Telecommunications Operators – Consultative Paper”, MCA, February 2002.

³ “Dominant Market Position in Telecommunications – Consultative Paper”, MCA, January 2002.

The MCA has recently issued the report on that consultation⁴ and has designated three operators as having a DMP in the following specific markets:

- Maltacom plc has been designated in the Fixed Telephony Market;
- Melita Cable plc has been designated in the Cable TV Market;
- Vodafone (Malta) Limited has been designated in the Mobile Telephony Market.

1.3 Legal Authority

Article 38 of the Telecommunications (Regulation) Act provides that regulations may be made, requiring authorised providers to adopt cost accounting systems as may be prescribed and to keep such operational, accounting, financial, statistical and technical records as may be specified in the regulations, and to furnish to the Authority such statements, returns and other information.

Regulation 13 of the Telecommunications Services (General) Regulations provides that an operator with a DMP shall develop an accounting system based on Long Run Incremental Costs (LRIC) for network elements used to provide interconnection, excluding overheads such as marketing, personnel or headquarters maintenance.

Regulation 45 of the same Regulations provides that an operator shall furnish to the regulator, accounts which show separately the annual turnover per service category and accounts which show annual costs using cost accounting methods to be defined by the Regulator, for network services provided to other operators and for services provided under the universal services obligations. This latter requirement is also contained in Regulation 25 of the Cable Systems (General) Regulations.

⁴ "Dominant Market Position in Telecommunications – Responses to Consultation and Designations", MCA, May 2002.

This decision shall be implemented in the following manner:

- The MCA will recommend the competent Minister to amend Regulation 13 of the Telecommunications Services (General) Regulations by substituting LRIC with an obligation to implement an accounting system as defined by the Regulator.
- Decision 2.1 below shall constitute a requirement pursuant to Regulation 45 of the Telecommunications Services (General) Regulations and Regulation 25 of the Cable Systems (General) Regulations.
- Decision 2.1 below shall not apply to operators that do not have a DMP.

2 Responses to Consultation

Responses were received from the following parties:

- The Malta Institute of Accountants;
- Maltacom plc;
- Melita Cable plc;
- Mobisle Communications Limited;
- Vodafone Malta Limited.

2.1 Costing Methodology

In the consultative paper the MCA clearly set out that it planned to mandate operators with a dominant market position to adopt the Fully Allocated Costs on a historic cost basis ("FAC (Historic)") methodology for the preparation of regulatory accounts. This was set as a first priority and the MCA further stated that development to a CCA/LRIC based system would be assessed but not before June 2003.

There was support from all operators for this position with most respondents arguing that the incremental benefits of more detailed methodologies would be outweighed by the associated costs. The MCA has taken the views expressed by the operators into consideration along with the capabilities of each operator, their state of preparedness and the development of the overall market in Malta. It believes that the most practical approach in the short term is to mandate a system of FAC (Historic) basis to be used for cost-based accounting systems in the telecommunications sector.

Decision 2.1:

The MCA requires the use of Fully Allocated Costs (on a Historic Cost Basis) to be used for the production of cost-based accounting systems by all operators having a Dominant Market Position.

Taking the overall development of the market into account, the MCA will not consider reviewing the need to move from a FAC (Historic) regime to a current cost regime before 2005.

The MCA is mindful of the deficiencies in a FAC (Historic) based approach and is anxious to ensure that legacy costs and inefficiencies do not get passed on to other operators through incorporation in a RIO.

The consultation paper set out four general principles to be followed in the preparation of any set of regulated accounts:

- **Cost causality:** revenues, costs, assets and liabilities should be attributed to network components, services or businesses in accordance with the activities that give rise to the revenues, costs, assets or liabilities concerned.
- **Objectivity:** the attribution of revenues, costs, assets and liabilities should be objective and not designed to benefit one operator or user over others.
- **Consistency:** there should be consistency of treatment from one year to the next.
- **Transparency:** the attribution methods used should be transparent.

Under the principle of cost causality there must be a causal relationship between the activities that give rise to the cost and the associated components, services or businesses. The MCA will seek to ensure that those costs that do not have a causal relationship are disallowed in the calculation of an interconnection rate based on FAC (Historic).

2.2 Timetable for Preparation of Reference Interconnection Offers

In the consultation document the MCA set out detailed timetables for the production by the fixed, mobile and cable operators of cost based separated accounts and the process steps to be followed.

Arising from the DMP designations set out above there is an urgent need for designated operators to produce cost based Reference Interconnection Offers (RIOs) comprising both the technical, operational and financial terms.

In order to meet the liberalisation deadline of 01 January 2003 the MCA has requested Maltacom and Vodafone Malta Limited to produce cost based RIOs as a matter of urgency and in any event no later than 30 September 2002. The RIOs are to be based on a FAC (Historic) basis and fully cost justified. Of necessity these RIOs will be interim in nature and apply until

such time as the relevant interconnection rates can be based on separated accounts.

Cost based RIOs are an essential prerequisite to the liberalisation of the market and the MCA encourages operators to develop their offers in a timely manner. The MCA will examine the RIOs and supporting documentation when submitted for conformity with best practice and consistency with EU guidelines and rates.

The MCA will be meeting with operators individually to monitor the preparation of RIOs cost allocation bases and the timescales for finalisation.

2.3 Specific Matters Raised

Accounting Treatment

Some queries were raised on the treatment of specific cost categories for FAC (Historic) purposes and the process by which consistency across operators would be ensured.

The MCA points out that the lists provided in the consultation paper are for guidance only and where necessary will be adapted to the specific circumstances of Malta and extended where required. The MCA intends to deal with variations to the guidance provided on a case-by-case basis.

Costs

Some concerns were raised regarding the costs that would be incurred in preparing cost based accounting systems. At the same time it was stated that moving to cost based systems was in the interests of operators.

The MCA recognises that there will be costs incurred but that there will be commensurate business benefits to operators and encourages operators to seek to minimise these costs as much as possible.

Scope

The mobile and cable operators noted that fixed incumbent operators should be the main entities subjected to regulatory accounting obligations, and that other operators should only be subjected to proportionate obligations depending on the extent to which regulatory intervention is objectively justified.

The MCA recognises this point, which will be reflected fairly in the report on accounting separation and publication of financial information.

3 Conclusion

A key issue of importance to the telecommunications sector is that of facilitating and sustaining effective competition. One of the key tools available to the MCA in this area is that of accounting separation, whose primary purpose is to ensure that charges of a DMP operator are cost based, transparent and non-discriminatory.

This decision establishes that separated accounts should be based on the FAC (Historic) costing methodology.

The MCA will in the coming weeks publish a detailed report on the consultative paper dealing with Accounting Separation (following conclusion of the consultative process), which will address the level of disaggregation envisaged and publication of financial information.

Joseph V Tabone

Chairman

08 July 2002