



# **EXPLANATORY STATEMENT**

## **Telecommunications Industry Regulatory Accounting Framework (Record-keeping rules)**

*Issued under section 151BU of the Trade Practices Act 1974*

**May 2001**

### ***Legislative background***

Under section 151BU of the *Trade Practices Act 1974* (the Act), the Australian Competition and Consumer Commission has the power to make record-keeping rules by written instrument and require that carriers and carriage service providers comply with these rules.

The rules may specify what records are kept, how reports are prepared and when these reports are provided to the Commission. If the Commission notifies a carrier or carriage service provider that particular record-keeping rules apply to them then the Commission must give that carrier or carriage service provider a copy of the rules.

The Commission cannot require the keeping of records unless they contain information that is relevant to the responsibilities of the Commission. For the purpose of section 151BU, these responsibilities include the operation of Parts XIB and XIC of the Act, establishing if the competition rule or tariff filing directions have been complied with, Part 9 of the *Telecommunications Act 1999* (which deals with retail price controls on Telstra), and Division 3 of Part 20 of the *Telecommunications Act 1997* (which deals with rules of conduct relating to dealings with international telecommunications operators).

Sections 151BUA-BUE give the Commission the power to disclose, or require the disclosure of, reports prepared in accordance with the record-keeping rules to the public or specified persons. The Commission is not using these powers at this time.

### ***Overview of the Telecommunications Industry Regulatory Accounting Framework***

The written instrument containing the new record-keeping rules for the telecommunications industry is the *Telecommunications Industry Regulatory Accounting Framework* (RAF). This title has been chosen to differentiate these record-keeping rules from other record-keeping rules issued by the Commission or the Australian Communications Authority.

The RAF consists of twenty-two rules and eleven schedules that detail the financial reporting requirements that apply to carriers or carriage service providers notified by the Commission. The RAF introduces a vertical and horizontal accounting separation model that requires revenue and cost information for wholesale and retail services to be reported to the Commission. The RAF also requires that service usage information, such as the number of local calls and the number of national long distance minutes, to be reported. As well as facilitating accounting separation (which can particularly assist investigations of possible anti-competitive conduct and in arbitrations of access disputes), the RAF will provide the Commission with a base of regular and audited financial information to assist it in performing its regulatory functions, such as declaration (and revocation) inquiries and potentially in reports on competition.

Under the RAF, the Commission is able to notify any carrier or carriage service provider that supplies or uses a declared service that the Rules apply to them. In practice, the Commission

will only notify such a carrier or carriage service provider if it considers information from that carrier or carriage service provider is, or will be, relevant to the Commission's functions. Notified carriers and carriage service providers will then be required to keep records and prepare reports in accordance with the Rules set out in the RAF. The RAF also requires that reporting carriers and carriage service providers develop a regulatory accounting procedures manual (Manual), that describes how it will comply with the Rules and details the allocation and accounting methodologies it has used. Reporting carriers and carriage service providers will be required to engage an auditor to confirm its compliance with the RAF.

Reporting carriers or carriage service providers are able to apply for an exemption from these Rules, or certain provisions of these Rules, from the Commission.

The Commission expects to assist reporting carriers and carriage service providers with implementation of the new recording and reporting framework. The Commission may make minor amendments to the RAF to overcome any practical problems that may emerge over the initial implementation phase and plans to undertake a review of the RAF in 2003.

## **THE RULES**

### **PART 1. – INTRODUCTION, INTERPRETATION AND OBJECT**

This Part deals with the title, the commencement, interpretation and the object of the RAF.

#### **Rule 1: Title**

This rule provides that the full name of these Rules is the 'Telecommunications Industry Regulatory Accounting Framework' (RAF). These Rules may also be referred to as 'record-keeping rules'.

#### **Rule 2: Commencement**

This rule states that the RAF shall take effect on the date that the RAF is issued by the Commission. The Commission will issue the RAF by making a public announcement and placing the RAF on its website the same day.

#### **Rule 3: Interpretation**

This rule specifies the interpretation of terms and acronyms as they appear in the RAF. Subrule 3(2)-(4) describe the term subsidiary as it appears in these Rules.

#### **Rule 4: Object**

This rule describes the object of the RAF, which to establish a vertical and horizontal reporting architecture. The RAF provides detail on the information to be reported for each service, descriptions of the financial statements required and the frequency of the reports.

The RAF also sets out principles to be applied by reporting carriers and carriage service providers in developing detailed allocation methodologies and rules for developing their Manual and audit requirements.

## **PART 2 – APPLICATION OF THE RULES**

This Part deals with the application of the RAF, the consolidated reports and the circumstances where exemptions may be granted to carriers or carriage service providers from these Rules.

### **Rule 5: Application**

This rule establishes that the RAF may be applied to any carrier or carriage service provider and to its subsidiaries which supply or use a declared service and is notified in writing by the Commission.

The Commission will notify a carrier or carriage service provider in writing that the RAF apply to them.

A carrier or carriage service provider who has been notified that the Rules apply to them will be required to provide reports covering the first full reporting period after these Rules take effect, or as otherwise notified by the Commission. In practice all the reporting carriers and carriage service providers except Primus will be required to report in relation to financial years 2001-2002 and following. Primus, which reports on a calendar year basis will report from 1 July 2001.

This rule gives the Commission wide discretion of who it can require to report under the RAF. The Commission is aware that applying the RAF too broadly may impose costs on the industry which outweigh the benefits of the Commission receiving regulatory reports from all carriers or carriage service providers that supply or use a declared service.

In deciding which carriers and carriage service providers to notify the Commission will have regard to the relevance of information from those carriers and carriage service providers to the Commission's functions.

Carriers and carriage service providers who are notified by the Commission still have the opportunity to apply for an exemption. However, the Commission would expect that an exemption application will relate to a particular circumstance, such as the requested exemption for a particular subsidiary, report or service, rather than an application to exempt the entire entity from the RAF.

## **Rule 6: Consolidated reports**

This rule provides that related carriers or carriage service providers may provide consolidated reports to the Commission. If a carrier or carriage service provider has been notified that the Rules apply to it and it is related to another carrier or carriage service provider, then it may submit a single consolidated report. It is expected in general related carriers or carriage service providers will report together via a consolidated report.

However, the obligations apply to each notified carrier and carriage service provider and related bodies must seek the consent of the Commission to submit consolidated reports. If the Commission considers that consolidated reports may be inappropriate the Commission can withhold its consent and separate reports will need to be prepared. The circumstances that may make it appropriate for the one or more related companies to report separately include if the businesses of related companies differ substantially from each other.

Where related companies do provide consolidated reports, these companies will only be required to develop one Manual and undertake one annual audit under the RAF.

## **Rule 7: Exemptions**

This rule establishes that a carrier or carriage service provider may apply to the Commission for an exemption from complying with these Rules or certain provisions of these Rules in relation to one, more than one or all services. A carrier or carriage service provider may also apply to vary an exemption that has previously been made, or to no longer be exempted.

This rule requires that any application for exemption be in writing and address matters set out in subrule 7(13). These matters include whether a particular service or the particular carrier or carriage service provider applying for an exemption has generated significant revenues or costs and whether information about these revenues and costs are relevant having regard to subsection 151BU(4) of the Act.

The Commission may grant exemptions under this rule subject to certain conditions. These conditions may include specifying that a certain exemption ceased at a particular date or event or that the carrier or carriage service provider provides certain information to the Commission from time to time. The Commission may also revoke, vary or amend an existing exemption that applies to a particular carrier or carriage service provider.

## **PART 3 – REPORTING REQUIREMENTS**

This Part establishes the statements and reports required under the RAF. It also specifies the format of the statements and reports and allocation methodology that must be used by reporting carriers and carriage service providers.

A reporting carrier or carriage service provider must report in relation to each individual service and revenue, cost or asset line item. This may require reporting not applicable ('na') against a particular service or line item rather than zero, where the carrier or carriage service provider does not provide that service.

## **Rule 8: Capital Adjusted Profit and Loss Statements**

This rule sets out the requirements for the capital adjusted profit and loss statements (CAPLs). Reporting carriers or carriage service providers are required to submit to the Commission three CAPLs for each 6 month period and full-year. A separate CAPL is constructed for retail, internal wholesale and external wholesale services.

When producing the CAPLs, the reporting carrier or carriage service provider must have regard to schedules 4(a)-(c) of the RAF which list each retail service, internal wholesale service and external wholesale service covered by this rule. Schedules 5(a)-(c) set out the format of the CAPLs. The revenue line items are described in schedule 2 of the RAF and the cost items are described in schedules 3(a)(c).

The key elements of these reports are the:

- identification, for each service and in total, of the revenue and expense streams separated into direct, attributable and unattributable categories which are generated from the allocation principles described in rule 11;
- subtraction of costs of capital employed in the provision of each service and in total, calculated from the capital employed statements (CESs);
- transfer of internal wholesale costs for each service to the related internal retail service; and
- adjustments to distribute the costs and revenues of end-user access across internal and external wholesale services.

## **Rule 9: Capital Employed Statements**

This rule sets out the requirements for the CESs. Reporting carriers or carriage service providers must provide to the Commission three CESs. A separate CES is submitted for retail, internal wholesale and external wholesale services. The purpose of the statements is to provide annual cost of capital calculations.

The reporting carrier or carriage service provider must report against each asset (listed in schedules 1(a)-(d)), employed in the provision of each service and must report on all assets other than minority interest and cash assets. The CESs must be provided in the format established in schedules 6(a)-(c).

The key elements of the CESs are:

- the identification, for each service and in total, of the written down value of non-current assets and working capital as at the appropriate statutory reporting date and separated into direct, attributable and unattributable categories. The written down value is based on information from the fixed asset statements (FAS) described in rule 10 and is the difference between the historical/revalued value and the accumulated depreciation;

- a weighted average cost of capital (WACC) which is described in rule 12; and
- an annual cost of capital for each service and in total, which is calculated by multiplying the WACC by the value of assets for that service.

### **Rule 10: Fixed Asset Statements**

This rule requires that FASs must be submitted to the Commission. Reporting carriers and carriage service providers are required to provide to the Commission three FASs. A separate FAS must be provided for retail, internal wholesale and external wholesale services.

The FASs report on all assets, listed in schedules 1(b)-(d), as at the end of the relevant reporting period. The reporting carrier or carriage service provider must report, for each service and in total, the historical/revalued value and the accumulated depreciation for each fixed asset separated into direct, attributable and unattributable categories. The FASs must be provided in the format set out in schedules 7(a)-(c).

### **Rule 11: Allocation of Costs, Revenues and Capital Employed**

This rule provides the allocation methods for costs, revenues and capital. Allocation rules are important because they ensure that costs, revenues and capital are appropriately matched for each of the defined services.

Column 4 in schedules 1–3 detail the allocation methods that should be used in relation to each line by reporting carriers and carriage service providers for CAPLs, CESs and FASs.

Under this rule each cost (including expenses and capital cost) and revenue included in a report in relation to a particular service must be reported as either:

- a direct cost or revenue;
- an attributable cost or revenue; or
- an unattributable cost or revenue.

A direct cost or revenue is solely generated by the particular service. This is the preferred method of assignment. An attributable cost or revenue is part of a pool of common costs or revenues that are identifiable to a particular service by a cause and effect relationship. Attributable costs require allocation between services and the driver of this allocator is usage related. An unattributable cost or revenue is part of a pool of common costs or revenues but is not identifiably related to a particular service by a cause and effect relationship. Unattributable costs and revenues still need to be allocated between services, but the allocator driver may be arbitrary.

Where possible a cost or revenue must be reported as a direct cost or revenue. Costs relating to excess capacity of communications plant and equipment are to be incorporated as part of the total costs for reporting purposes and allocated in proportion to their existing level of usage of plant and equipment.

A reporting carrier or carriage service provider must provide justification to the Commission if unattributable costs, prior to any capital adjustment, are greater than 10 per cent of a reporting carrier's or carriage service provider's aggregate costs.

#### *The end user access adjustment*

Adjustments to distribute the costs and revenues of end user access across internal and external wholesale services that rely on end user access are necessary to ensure that internal and wholesale services are reported on a similar basis so that appropriate comparisons can be made between them.

Carriers typically receive revenue from retail customers or access lines that are then used to provide services for external wholesale clients. To prevent double counting this revenue should be allocated across all non-access services in order to provide a consistent basis for comparisons. These adjustments are to:

- distribute the cost of end user access across the non-access services of the internal and external business; and
- allocate end user revenue across the other internal and external services.

As end user access revenue is partially responsible for covering retail specific costs, these costs need to be subtracted prior to allocation. Revenue is then allocated based on the share of total customer end minutes for all access infrastructure both internally and externally.

Similarly, end user access costs are allocated to internal and external services based on their usage of customer end minutes. To do this, a unit cost factor is developed that incorporates its expenses and cost of capital and is divided by the total end minutes which pass through it.

#### **Rule 12: Weighted Average Cost of Capital Report**

This rule requires that reporting carriers and carriage service providers develop a WACC to apply to the capital employed for each service. The WACC is included in the CESs, which then provide the cost of capital.

This rule requires that the WACC should be calculated on a pre-tax nominal basis. Within that parameter, the actual format of the WACC is left to the discretion of the reporting carrier or carriage service provider. The reporting carrier or carriage service provider must, however, provide the Commission with information detailing the values and source of all variables used in WACC calculations, including any assumptions made.

#### **Rule 13: Service Usage Reports**

This rule requires that reporting carriers and carriage service providers must provide usage information to the Commission on retail and external wholesale services. The usage will be reported on the basis of the number of call attempts, calls connected, minutes and number of lines or other information as relevant. Transmission should be reported on the basis of the number of lines at each bandwidth and leased lines on the basis of capacity.



Service usage reports are very important because in combination with reported financial data allows for the development of indicative unit prices for the services listed in schedules 4(a)-(c). This unit price information will significantly assist the Commission in a number of its responsibilities including in the arbitration of access disputes and benchmarking.

#### **Rule 14: Lodgement of Reports**

This rule requires that reporting carriers or carriage service providers must lodge with the Commission two six monthly reports and a full year report.

The full year report covering the financial year and the second half yearly report, must be submitted to the Commission within four weeks of the date the carrier or carriage service provider is required to lodge its annual report with the Australian Securities and Investment Commission (ASIC).

The first half yearly report is required to be lodged with the Commission within two weeks of the date the carrier or carriage service provider is required to lodge its half yearly reports with ASIC.

If the carrier or carriage service provider is not required to lodge full or half yearly reports with ASIC, it must still submit a full year and six monthly reports to the Commission, using the same reporting timetable outlined above.

#### **Rule 15: Format of Reports**

This rule establishes that the Commission can stipulate the format of the reports required under the RAF. The reporting carrier or carriage service provider must prepare and lodge its report in the format established by the Commission, unless otherwise notified. This rule requires that reporting carriers or carriage service providers must lodge each report in both hard copy and in an electronic form.

It is the Commission's intention, at this time, to stipulate the electronic format of the reports once the Instrument comes into effect, as per sub-rule 15(2). The Commission will provide this format to all reporting carriers and carriage service providers.

#### **Rule 16: Record-Keeping Declarations**

This rule requires record-keeping declarations, signed by a reporting carrier's or carriage service provider's Chief Executive Officer and Chief Financial Officer, to be submitted to the Commission with each six monthly and full year report. Schedule 9 specifies the format of these declarations.

### **PART 4 – REGULATORY ACCOUNTING PROCEDURES MANUAL**

This Part establishes the rules related to the development and maintenance of the Manual.

## **Rule 17: Regulatory Accounting Procedures Manual**

This rule requires that reporting carriers and carriage service providers develop and maintain a Manual, that provides information on how the carrier or carriage service provider is complying with the requirements of the RAF. The Commission envisages that this document should stand on its own and references to the RAF should be incorporated in such a way as to show the relevance for the particular carrier or carriage service provider.

The Manual requires various types of background information including organisational structures and financial and accounting software packages used to capture and generate information used in the RAF. The Manual should contain reference to, and a summary of, all studies, surveys and models that are used for allocation purposes and provided worked examples of all the allocation methods that are undertaken. The Commission may request additional detail relating to specific studies, models, or allocation methods if it considers it requires clarification of these.

The Manual must identify, for each RAF line item, the:

- General Ledger account number and description;
- allocation principle;
- allocation method; and
- allocation driver.

This rule requires that reporting carriers or carriage service providers must submit a draft copy of the Manual to the Commission 2 months before submitting its reports for the full financial year in which it is reporting, and provide a final copy of the Manual at the time of submitting its reports for the full financial year, unless the Commission indicates otherwise.

## **PART 5 – AUDITING OF REPORTS AND MANUAL**

This Part sets out the audit rules for the RAF.

### **Rule 18: Auditing of Reports and Manual**

This rule specifies that a reporting carrier or carriage service provider must use an external auditor to audit its compliance with the RAF. The audit must be done annually and in accordance with the Australian Auditing Standards.

### **Rule 19: Audit Terms of Reference**

This rule requires that a reporting carrier or carriage service provider submit terms of reference to an external auditor within one month of the end of the financial year.

If the Commission wants to provide a reporting carrier or carriage service provider with certain terms of reference for the audit, it must notify the carrier or carriage service provider in writing no later than seven days after the financial year. If the Commission does not do so

then the carrier or carriage service provider must submit draft terms of reference to the Commission by the fourteenth day after the end of the financial year. The Commission may write to the carrier or carriage service provider to require changes to the draft terms of reference up to the twenty-first day after the end of the financial year.

#### **Rule 20: Content of Audit**

This rule sets out what must be included in an audit report. The audit report must include an audit plan and memorandum and an opinion as to whether the carrier or carriage service provider has complied with the RAF.

Under this rule the reporting carrier or carriage service provider must take necessary steps to ensure that the auditor has complied with any terms of reference issued under rule 19 and provides an audit report consistent with rule 20.

#### **Rule 21: Audit Reporting Requirements to the Commission**

This rule requires that a reporting carrier or carriage service provider provides the Commission with documents complying with rule 20.

#### **Rule 22: Reserve Audit Powers of the Commission**

This rule establishes that the Commission can require an ad hoc audit of a carrier or carriage service provider's compliance with the RAF. The Commission may also require a re-audit if it considers an initial audit inadequate. The Commission can require that a reporting carrier or carriage service provider contract specific auditors to audit compliance with these Rules, including ad hoc or re-audits. The Commission must give reasons to the carrier or carriage service provider if it exercises its powers under subrule 22(1).

### **SCHEDULES**

The Instrument incorporates eleven schedules that detail the specific aspects and requirements of the RAF. These schedules are summarised as follows:

- schedules 1-3 list the line items for asset values, revenues and costs;
- schedule 4 lists retail, internal wholesale and external wholesale services to which the RAF apply;
- schedules 5-8 establish the format of the regulatory reports;
- schedule 9 relates to record-keeping declarations;
- schedule 10 relates to account mapping in the Manual; and
- schedule 11 sets out guidelines for the Manual.