

29 October 2010

Gibraltar Regulatory Authority
Attn. Mr Gavin Santos
Electronic Communications Division
Suite 603
Europort
Gibraltar

Dear Gavin,

Public Consultation 06/10 Accounting Separation and Cost Accounting Systems

Enclosed please find Gibtelecom's response to the GRA's latest public consultation on accounting separation and cost accounting systems – compliance under SMP obligations (Public Consultation 06/10).

In general it appears that the majority of the proposals being put forward by the Authority in this new public consultation, in terms of the information sought and the format this has to meet is already being provided by Gibtelecom through the Company's annual submission of audited accounting separation reports (ASRs).

Having said this, the production and submission of annual audited accounting separation reports (ASRs) continues to be a significantly onerous and costly exercise for an SME such as Gibtelecom. The Company still has trouble in reconciling the Authority's belief (as stated throughout last year's consultation process on the application of significant market power obligations on another local service provider) that the application of a cost-orientation obligation and its associated requirement to submit regular compliance statements (which includes ASRs) would impose a considerable regulatory burden on a small operation, with the fact that Gibtelecom itself is a small company by any standard.

Yours sincerely,



Kayleigh Buhagiar
Regulatory Officer

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Gibtelecom Response to GRA Public Consultation on Accounting Separation and Cost Accounting Systems Compliance under SMP Obligations

Gibtelecom presents its comments in response to public consultation 06/10 published by the Gibraltar Regulatory Authority (GRA) on 30 September 2010 on its proposals to build upon the existing requirements set out under their Statement 07/08 of 11 August 2008 on Accounting Separation, Cost Orientation, Cost Accounting methods and compliance under SMP obligations.

The GRA's aim is to promote and establish consistent accounting policies and methodologies at national level with the added benefit of increasing transparency of such cost accounting systems. At present, Gibtelecom is the only operator subject to these obligations and as such the proposals will only apply to Gibtelecom's ASR 2010 figures onwards. Invariably, many of the Company's responses therefore focus on what is currently being provided through the audited ASR and its ability to meet any new reporting proposals.

Preliminary Remarks

This consultation seems to propose, for the first time, a clearer set of guidelines on the level of information to be provided, together with the format of certain elements of the reporting regime, as part of a notified operator's obligation to submit separated accounts.

Gibtelecom notes that the GRA appears to have based its proposals in large part on the guidelines previously issued by the European Regulator's Group (ERG) common position on implementing the EU commission's recommendation C (2005) 3480 on accounting separation & cost accounting systems under the regulatory framework for electronic communications.¹ Gibtelecom must caution the Authority that it should take into consideration national circumstances and resources when assessing the suitability of (in this case) guidelines that have been designed with much larger jurisdictions and markets in mind. A case in point, and by no means the only one, is the application of long range incremental costing techniques, which the GRA intimates it may be looking into developing with the next round of market reviews. The Company has previously recorded its views in this respect, believing that such a complex and time-consuming costing methodology would not provide any real additional benefit to what is already a byzantine process.

The GRA should be aware that the submission of annual audited ASRs continues to be a burdensome and costly exercise for a small Company the size of Gibtelecom. With this in mind, the Company would not be in favour of any additional requirements that would compound these circumstances. The GRA should introduce realistic proposals and not attach unnecessary complications. Gibtelecom feels that the same reasoning that the GRA employed to defend its decision not to impose a cost orientation, and by implication an ASR obligation on an alternative service provider because it was deemed too invasive for a small company, should also be applied to Gibtelecom as an SME.

Gibtelecom also has to question the timing of this public consultation, as the GRA gives indications that some of the proposals now being put forward could change during the next round of market reviews (for instance the cost accounting methodologies). Gibtelecom reckons that some of the next market reviews are imminent (in fact, the Company has very recently already received a first set of questions related to a new mobile market review). If there are going to be changes to the way ASRs are to be produced, Gibtelecom is of the

¹ ERG (05) 29

view that perhaps it would have been more practicable to encapsulate these proposals as part of the forthcoming market reviews.

Specific GRA Questions

Q1: Do you agree that the Notified Operator shall prepare an ASR containing the above listed documents? Please give reasons for your answer.

Gibtelecom accepts that the notified operator shall prepare an ASR containing the listed documents. The Company currently provides all the information now being proposed although not in the exact same sequence and arrangement now being put forward. Gibtelecom does not foresee any major problems in adapting its current extensive set of documents to that now being suggested.

Q2: Do you agree that the Profit and Loss statement shall be produced for a relevant market based on the template in section 1 of Annex B? Please give reasons for your answer.

Gibtelecom already provides profit and loss statements in much the same format as now being proposed at section 1 of Annex B to the consultation document. The Company anticipate any major problem in reviewing the titles for each segment used under Turnover and Operating costs in order to be in line with the template. The current profit and loss statement also includes a "Return on Mean Capital Employed" statement, which can be moved to the "Statement of Mean Capital Employed" statement proposed by the GRA under section 2 of Annex B. Please see our reply to question 3.

Q3: Do you agree that the Mean Capital Employed statement shall be stated for a relevant market based on the template in section 2 of Annex B? Please give reasons for your answer.

Gibtelecom accepts that the "Mean Capital Employed" statement shall be stated for a relevant market based on the template in section 2 of Annex B as this is already being provided by the Company in much the same way, with the exception of the small "Return on Mean Capital Employed Statement" which Gibtelecom currently provides under its profit and loss statements.

Q4: Do you agree that the Notified Operator shall provide a Reconciliation statement of the key financial captions of the ASR with the statutory accounts to ensure reliability and consistency among the financial statements? Please give reasons for your answer.

Gibtelecom accepts that the notified operator shall provide a Reconciliation statement of the key financial captions of the ASR with the statutory accounts to ensure reliability and consistency with the statutory financial statements. At present the Company submits the reconciliation statements in line with the template provided in section 3 of Annex B and additionally provides a "Reconciliation returns to financial records" which can be excluded in future ASRs.

Q5: Do you agree that Notified Operators shall provide a statement of unit costs for a relevant wholesale market, including the elements outlined in this section in order to check compliance with non-discrimination and/or cost orientation obligations? Please give reasons for your answer.

Gibtelecom agrees that notified operators shall provide a statement of unit costs for a relevant wholesale market. At present, this information is already being included in Gibtelecom's ASRs as part of the fixed and mobile termination rate calculations. To the extent that additional information can be extracted from the current costing model to provide expanded unitary costs on other wholesale markets, Gibtelecom does not foresee any problems in submitting this data.

Q6: Do you agree that the ASR must be prepared in accordance with the requirements of the relevant governing EU and Gibraltar communications legislation? Please give reasons for you answer.

Gibtelecom accepts that the ASR must be prepared in accordance with the requirements of the relevant governing EU and Gibraltar communications legislation. It is a legal requirement to do so. The Company notes the contents of the Communications (Access) Regulations 2006 and EU Directive 2002/21/EC; together with the Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications, (2005/698/EC) and proposes to continue submitting this data, as it has done for a number of years.

Q7: Do you agree that the auditors' opinion shall include the elements outlined in this section? Please give reasons for your answer.

Gibtelecom's audit of the ASR is already carried out on a properly prepared in accordance with basis. The Company therefore does not foresee any major problems with the proposals now being put forward by the Authority, although to some extent the auditors themselves will have to confirm whether they can commit to these requirements if they consider any to materially change the current process.

Q8: Do you agree that a 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, and that transfer charges/prices shall be calculated as follows:

- **There shall 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 separated accounts;**
- **Transfer charges shall be determined as the product of usage and unit charges;**
- **Where a service is sold externally, the transfer charge shall be equal to the price stated in the Reference interconnection offer (RIO) and Reference unbundling offer (RUO) or any other Reference offer;**
- **Where a service is rendered only internally, the transfer charge for the service is equal to the unit cost of service according to the notified accounting basis and accounting methodology; and**

- **There shall be consistency of treatment of transfer charges from year to year. Any change shall be consistent, transparent and satisfactory to the Authority?**

Please give reasons for your answer.

Gibtelecom concurs that a transparent and verifiable transfer charging system goes a long way to demonstrate non-discrimination and calculate internal costs revenues for cost-orientation purposes. The Company already provides detailed information on its transfer charges through the annual ASR it submits to the Authority.

With regards to the methods of calculation for transfer charges, where services are provided by one business unit to another (i.e. internally), revenues and costs should be attributed between the business units in accordance with the activities that cause the revenues to be earned, or the costs to be incurred. According to the ERG paper (05) 29, which itself interprets EU Commission Recommendation C (2005) 3480 on accounting separation requirements, transfer charges should be equivalent to the charges that would be levied if the product or service were sold externally rather than internally. It is assumed that a notified operator's retail business pays the same charge for the same input service as it would (bought on its own wholesale market) if bought externally by an alternative operator. This is the approach that is adopted by Gibtelecom in calculating and documenting transfer charges, both for external and internal purposes. The Company assumes that when the Authority refers to having to calculate transfer charges for externally supplied services based on RIO/RUO prices, it refers to the **revenue** that is earned from the sale of such external services.

In this case Gibtelecom accepts that revenues from other operators for regulated wholesale services should be calculated and reported in this way. Gibtelecom also accepts the other proposals set out under this particular question.

On the subject of rates set out under the RIO / RUO, can Gibtelecom now assume that new rates are to be implemented as soon as these are calculated and submitted through the annual submission of the ASR? Please see our reply to question 13.

Q9: Do you agree that the statement of Transfer Charges shall include the elements outlined in this section and shall be stated based on the template in section 4 of Annex B? Please give reasons for your answer.

The current proposals by the Authority in transfer charge reporting requirements expands on the information already being provided to the GRA through Gibtelecom's ASR submissions. Gibtelecom does not expect to encounter any major problems in adapting its current transfer charging reporting format to that now being put forward.

Q10: Do you agree that the Accounting documents shall include the elements outlined in this section? Please give reasons for your answer.

Gibtelecom accepts that the accounting documents shall include the elements outlined in this section. In doing so the Company would have to adapt the arrangement of its current set of documents to meet those now being put forward by the Authority.

Q11: Do you agree that the Attribution methodology document shall include the elements outlined in this section? Please give reasons for your answer.

Gibtelecom agrees that the Attribution methodology document shall include the elements outlined in this section as this has already been provided to the GRA on previous occasions.

Q12: Do you agree that in terms of the audit process the Notified Operator shall appoint suitably qualified auditors and notify the authority of the appointment annually within two months of the end of the company's financial year? Please give reasons for your answer.

Independently of the high costs associated with the performance of an independent audit of the ASR, Gibtelecom agrees that in terms of the audit process the notified operator shall appoint **suitably qualified** auditors.

However, before passing comment on the notification requirements suggested by the Authority, can the GRA please clarify what is its aim in having to be provided the notification within two months of the end of the company's financial year? Gibtelecom contracts auditors on a tendering basis, which invariably can take some time to complete. It may be the case that their appointment can take place after February for the audit of the previous financial year's ASR data, which is due by September of the current year. The Authority should also bear in mind that the Company may have different auditors for the audit of the statutory accounts to those who carry out audit of the ASR – their appointment dates and contract periods may therefore vary.

Gibtelecom is therefore of the opinion that it would therefore be impracticable to try to tie down a notified operator to notifying the GRA within two months of each year end, when it may not be possible to appoint auditors before this time.

Q13: Do you agree that publicly available documents include the following:

- **The Regulatory Financial Statements for the relevant markets and services including the auditor's opinion regarding the ASR;**
- **The accompanying documentation explaining the accounting assumptions invoked within the Regulatory Financial Statements (namely Accounting documents and the Attribution methodology document), provided they do not contain absolute numbers or percentages; and**

They shall be made public on the website of the Notified Operator annually within two months after the submission of its ASR to the Authority.

Please give reasons for your answer.

Gibtelecom acknowledges the broad rationale for the publication of the documents set out under this question, but only for those markets where a notified operator has been designated as having SMP and which do not contain commercially confidential information. With this in mind, the Company welcomes the Authority's assurance that no publication will take place until the operator has been given the opportunity to demonstrate which information is sensitive. In such cases, data that may damage Gibtelecom and the competitive process, which would include specific documents that contain absolute values or percentages would be withheld. With regards to publishing audit opinions, permission would have to be sought from the same auditors for doing so.

With regards the proposal to publish the relevant documents on the notified operator's website annually within two months of the submission of its ASR to the Authority, can Gibtelecom therefore assume that this will lead to the introduction of the pertinent wholesale rates at the same time? The Company has recently been on the receiving end of some confusing and conflictive requests from the Authority on the matter of the introduction of wholesale rates. The GRA a short time ago informed the Company that it should introduce these rates as soon as the relevant documents were submitted, only to be informed shortly thereafter that it could not introduce the rates coming out from the 2008 and 2009 ASR until the GRA completed its review. The Company would therefore appreciate some clarity and consistency from the GRA on the application of wholesale rates, together with receiving information as to when the Authority intends to complete its reviews of the two outstanding ASRs.

Q14: Do you agree that in case of non-compliance of the ASR the Notified Operator follow the steps outlined in this section? Please give reasons for your answer.

Gibtelecom agrees that in case of non-compliance of the ASR the Notified Operator shall follow the steps outlined in this section as this is nothing new to what the Company is already subjected to. However, the Company would be grateful for more clarity on what the GRA considers to be 'in period defined by Authority'. The Authority should note that Gibtelecom is regularly exposed to a number of deadlines, sometimes concurrent, and being clear on timescales would allow for legal and regulatory certainty. The Company would therefore welcome the Authority to pre-determine appropriate timescales for reviews.

Q15: Do you agree there shall be consistency of treatment from year to year for the ASR? Please give reasons for your answer.

Gibtelecom is of the view that if a material change needs to be implemented as a result of a regulatory requirement then the Company should not be penalised and placed in the unfair and burdensome position of having to completely rewrite the previous year's ASR. The Company has on many occasions recorded its views on the complexity and cost of producing ASRs and would not be in favour of having to revisit previously submitted reports as a result of external influences

In addition, Gibtelecom takes it that since any new requirements that are taken to the eventual decision notice will only apply as from Gibtelecom's 2010 figures ASR, no "prior-year adjustments" will be necessary.

Q16: Do you agree that Notified Operators shall preserve records sufficient to provide an adequate explanation of each regulatory ASR for a period of five years from the reporting date? Please give reasons for your answer.

At this point in time Gibtelecom does not anticipate any important difficulties in preserving records for the proposed time, other than the cost of having to hold such data. The Company would like to point out that it may be the case that even if the data is stored, this may not be readily available. Having said this, Gibtelecom would assume that the Authority would not take this long to conclude reviews of ASRs and that therefore requests for data going back a number of years back should be exceptional.

Q17: Do you agree that Notified Operators shall provide the accounting records based on requests for information or queries made by the Authority within a reasonable and proportional timeframe? Please give reasons for your answer.

Gibtelecom would appreciate a definition of what the Authority considers to be 'within a reasonable and proportional timeframe'. It is the Company's experience that reasonableness is open to interpretation and what may appear reasonable to the requesting party may not appear so to the party required to provide the information. It is the Company's view that in developing a "reasonable and proportionate" timeframe the GRA should consider the timing of requests and their impact on the limited resources available. In making any such requests, Gibtelecom would also be grateful for the Authority to supply as much information as practicable on the nature and reasons for said requests. This will assist notified operators to provide relevant and timely information.

Q18: Do you agree that the ASR covering all relevant markets and services shall be based on CCA as a cost base and FAC as an accounting methodology (notwithstanding the results of the forthcoming analysis with respect to cost orientation)? Please give reasons for your answer.

Gibtelecom already provides its ASRs using these cost accounting methods and therefore proposes to continue doing so. Following a steep learning curve as a result of the many complexities surrounding the valuation of assets and capital maintenance adjustments required et al, the Company can now say that is now fairly knowledgeable and practised with these methodologies since they were first introduced a number of years ago. With regards the GRA's indication that it reserves the right to change costing methodologies with a view to applying LRIC principles, the Company has previously recorded its views on the matter. The Company has been advised by experts in the field that LRIC would provide little, if any, benefits as a result of the size of the territory and the network topologies currently in place. Gibtelecom therefore continues to strongly believe that the use of LRIC would be out of place and unrealistic in the context of the Gibraltar market.

Q19: In summary, do you agree that the appropriate methodology used to derive replacement cost shall be selected based on the following rules:

- **Historical cost can be used if:**
 - **The asset has no significant value or short useful lifetime;**
 - **The asset is not exposed to significant price changes;**
 - **There has been no technological change regarding the asset or the change is not significant; and**
 - **The effect of revaluation would be immaterial for the regulated cost base.**

- **Indexation can be used if:**
 - **There has been no technological change regarding the asset or the change is not significant;**
 - **The operator's databases and the fixed asset register deliver sufficient and accurate information about the asset subject to valuation; and**
 - **The asset group is homogenous in respect of price changes.**

- **Absolute valuation shall be used if:**

- **There has been a significant technological change regarding the asset;**
- **The operator's databases and the fixed asset register cannot deliver sufficient and accurate information about the asset subject to valuation; or**
- **The asset group is not homogenous in respect of price changes?**

Please give reasons for your answer.

Gibtelecom does not agree with having discrete replacement cost methodologies for different types of assets. The Company's asset base is quite extensive (the GRA has previously been provided with a list of these assets) and it would therefore be tremendously impracticable and costly with the limited resources available, to have to sift through each and every asset, or class of asset, in order to determine which replacement method would apply according to the different criteria being suggested. It would also be extremely onerous to have to obtain individual quotes from suppliers, for example in the case of absolute valuation, to be able to assign current purchase prices to each asset that would fall under this particular asset valuation methodology. From past experience, Gibtelecom has found that in cases where suppliers can actually supply current information (it is not uncommon for them to be unable to provide quotes on individual assets) they usually take inordinate amounts of time to return the necessary information, if at all. In addition, both Gibtelecom, and the GRA would have to rely on the accuracy and relevance of the information provided.

Gibtelecom therefore proposes to continue solely applying indexation valuation methods, as it has done for some time. The Company believes this to be the most practicable, reasonable, consistent and transparent (the relevant data is obtained straight from publicly available government data) way to revalue assets to a more current basis. Furthermore, the effect on bottom-line asset valuations would in all probability be minimal should different individual assessments be used in comparison to the established indexation technique.

Q20: Do you agree that the Notified Operators shall specify what MEA technologies have been used for the revaluation of assets under the CCA approach and that the choice of the MEA shall be clearly explained and documented? Please give reasons for your answer.

Gibtelecom is unclear as to the information that the GRA requires under this question. Based on the information supplied in the consultation document, together with Gibtelecom's familiarity of the subject matter, there are two overall types of asset valuation methodologies. These are replacement cost and mean equivalent asset (MEA). It is Gibtelecom's understanding that both are mutually exclusive, where MEA is a complex method that is only used to place values on assets that do not have direct replacements. In other instances, replacement cost can be used. If this is the case then in the event that MEA has to be employed, because no replacement asset value can be determined, Gibtelecom does not foresee any major problems with specifying and documenting the choice of MEA and technologies used and that this shall be clearly explained. Nevertheless, Gibtelecom adopts an indexation policy which calculates current (replacement) values for all relevant assets, and there has not therefore been a need to identify MEA values to date. The Company expects this to be the case going forward.

Q21: Do you agree that the cost accounting system of the Notified Operator shall use an accounting based approach to calculate annual capital charges? Please give reasons for your answer.

Gibtelecom believes that the methodology used to determine annual capital charges should be the most realistic and least complex to compute. With this in mind, the Company has been operating an accounting based approach to determine gross and net replacement asset values and ancillary computations. Gibtelecom therefore accepts continuing to employ such a costing regime, which will also allow it some flexibility in ascertaining whether to use the rolling forward or NBV/GBV methodologies (as long as the treatment of specific assets or asset classes is consistent).

Q22: Do you agree that the applicable cost of capital calculation is the pre-tax WACC formula, using the CAPM for the calculation of the equity price? Please give reasons for your answer.

Gibtelecom is already subjected to a regulated cost of capital in the form of a WACC percentage, which it uses in its ASR cost calculations. The WACC and CAPM formulae, together with descriptions of their constituent parts are already included in Gibtelecom's ASRs. The Company therefore accepts the use of WACC and CAPM to calculate the applicable cost of capital.

Q23: Do you agree that Notified Operator shall follow FCM as the appropriate capital maintenance approach? Please give reasons for your answer.

Gibtelecom's cost accounting records and ASR are already based on the financial capital maintenance model. Therefore Gibtelecom accepts continuing with this approach.

Q24: Do you agree that Notified Operators shall:

- **Review and justify each item of cost, capital employed and revenue;**
- **Establish and quantify the factor or "driver" that caused each item to arise;**
- **Use the driver to allocate each item to individual businesses/ activities/ network components or services; and**
- **Pool costs that cannot be related on a causation basis to activities (i.e. unattributable costs) and allocate them on a predetermined basis?**

Please give reasons for your answer.

Gibtelecom already carries out these processes meticulously, and explains them in the ASR documents provided to the GRA every year. The Company therefore accepts continuing with these same processes.

Q25: Do you agree that key relevant information for the understanding of the attribution of directly attributable costs are:

- **The routing factors matrix, which provides the usage of network element for each type of product/network service; and**
- **The wholesale-retail service mapping matrix, which provides the usage of wholesale services for each type of retail service.**

Please give reasons for your answer.

The routing factors and wholesale-retail mapping matrices are integral parts of Gibtelecom's ASR costing model. The Company already provides this information to the GRA and therefore accepts continuing to do so. However, the matrices are quite complex to understand and Gibtelecom therefore has reservations as to whether they would assist in the understanding of the attribution of directly attributable costs to anyone who does not have the sufficient expertise or familiarity with the preparation of regulated separated accounts.

Q26: Do you agree that the Notified Operator should use the ABC method for cost allocation, in particular for indirectly attributable costs? Please give reasons for your answer.

Gibtelecom accepts using the ABC method to attribute costs, in particular indirectly attributable costs. The Company has been employing such methodologies in its ASR's for a number of years.

Q27: Do you agree that the Notified Operator should use EPMU method for the cost allocation of unattributable costs such as common costs? Please give reasons for your answer.

Gibtelecom has been applying EPMU cost allocation processes in its ASRs for a number of years and therefore foresees no major problems in continuing with this approach.

Q28: Do you agree that the Authority shall have full access to the Notified Operator's cost accounting system at the Notified Operator's premises and that the Notified Operator shall provide any kind of data related to the cost accounting system if requested to do so by the Authority? Please give reasons for your answer.

Gibtelecom has on many occasions, some not directly related to the verification of ASR data, offered the GRA access to its cost accounting systems with the intention of aiding transparency and seeing first-hand how the complex and comprehensive cost models work. Gibtelecom therefore is agreeable, within the confines of commercial confidentiality and the condition that access would only be allowed if accompanied by Gibtelecom personnel, to allowing the Authority access to its cost accounting systems. However, the Company would like to point out that in order to provide meaningful data and assistance, the Authority should ensure that the attending GRA personnel are suitably qualified and familiar with cost accounting systems, in particular they should be fully versed with the intricacies of regulated separated accounts.

End of submission