



Office of Utility Regulation

# **Update of OUR's Regulatory Accounting Guidelines for C&W Guernsey**

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## **Consultation Paper**

**Document No: OUR 04/15**

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**Office of Utility Regulation**  
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# 1 Introduction

Under the regulatory framework for telecommunications in Guernsey, Cable & Wireless Guernsey Limited (“C&W Guernsey”) as a dominant operator, is required to prepare Regulatory Accounts, submit these to the OUR and publish them.

To assist in this process, in March 2002<sup>1</sup> the Director General published Regulatory Accounting Guidelines (“The Guidelines”) on how to prepare separated Regulatory Accounts. The Guidelines comprise a living document which is subject to change to reflect, amongst other things, developments within the Guernsey telecommunications market as well as wider international markets, C&W Guernsey’s progress in developing its Regulatory Accounts and accounting systems and changes in international practice.

The OUR is now, in July 2004, publishing a revised set of draft Guidelines (“the draft Guidelines”) for consultation. These are attached to this consultation paper. It should be noted that the Guidelines are likely to continue to develop over time and they should not be considered as immutable. In particular the draft Guidelines are without prejudice to the outcome of any existing consultations, the conclusion of which might result in further changes to the Guidelines.

The Director General seeks comments and views from interested parties on these revised draft Guidelines before publishing a final set of the Guidelines.

## 2 Structure, Procedure and Timetable of Consultation

### 2.1 Structure of the Paper

This paper is structured as follows:

**Section 3:** describes the background to the changes that are being proposed to the Guidelines and developments since March 2002;

**Section 4:** provides a summary of the proposed changes and poses a number of questions. The section refers to the draft Guidelines which are attached to this consultation paper in Document 04/xx in Annex 1;

**Section 5:** concludes the paper and sets out the next steps in this consultation; and

**Annex 1:** is a copy of Document OUR 04/xx which is the revised draft Guidelines document.

This consultation paper should be read in conjunction with the existing Guidelines (Document OUR 02/12) issued to C&WG and published by the OUR in March 2002 which is available at [www.regutil.gg](http://www.regutil.gg). Interested parties may also wish to review C&W Guernsey’s 2002/03 published regulatory accounts which are available from the company’s website<sup>2</sup>.

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<sup>1</sup> Document OUR 02/12 Accounting Separation – Regulatory Accounting Guidelines to Guernsey Telecoms, March 2002

<sup>2</sup> [www.cw.com/guernsey/products\\_services/wholesale/accounts/index.html](http://www.cw.com/guernsey/products_services/wholesale/accounts/index.html)

*This consultative document does not constitute legal, commercial or technical advice. The Director General is not bound by it. The consultation is without prejudice to the legal position of the Director General or her rights and duties to regulate the market generally.*

## **2.2 Consultation Procedure and Timetable**

The consultation is scheduled to run from Monday 2<sup>nd</sup> August 2004 and the closing date for the submission of comments to the OUR is 5pm on Tuesday 31<sup>st</sup> August 2004. Comments should be submitted in writing to:

Office of Utility Regulation  
Suite B1 & B2,  
Hirzel Court,  
St. Peter Port,  
Guernsey GY1 2NH.

Email: [info@regutil.gg](mailto:info@regutil.gg)

All copies of comments should be clearly marked “**Comments on Update of OUR’s Regulatory Accounting Guidelines for C&W Guernsey**”.

In line with the policy set out in Document OUR 04/01 – “Regulation in Guernsey; Revised Consultation Procedures”, the DG intends to make responses to the consultation available on the OUR website. Any material that is confidential should be put in a separate Annex and clearly marked so that it can be kept confidential.

The Director General regrets that she is not in a position to respond individually to the responses to this consultation, but she will publish a report on the consultation after all comments have been considered.

### **3 Background to Revision of OUR Guidelines**

This section briefly revisits the contents of the OUR Guidelines and provides a summary of the key updates and changes that the OUR proposes to make. Respondents are invited to comment on the proposed changes in response to the specific questions posed in section 4. Any more general comments on the Guidelines would be welcome with an explanation of the reasons for the comments.

The detailed text changes can be read in the attached draft Guidelines which are proposed for publication, subject to any amendments arising from this consultation or further developments in the interim.

- Section 1 and 2 of the guidelines provide an introduction and background to the role of Regulatory Accounts.
- Section 3 of these Guidelines sets out the OUR's Regulatory Accounting Principles which must be applied by C&W Guernsey in preparing its Regulatory Accounts and discusses the application of these principles to the various elements of the Regulatory Accounts including methodologies, Accounting Principles and the underlying Regulatory Accounting data.
- Section 4 sets out the format and scope of C&W Guernsey's Regulatory Accounts including the format of the financial statements, the level of disaggregation and the definitions of the main businesses to be separated.
- Section 5 concludes the paper and notes various other consultations and developments that may influence further changes in these Guidelines in the near future.
- Annex 1 provides detailed guidance on the Principle of Cost Causality and on cost accounting systems. Annexes 2, 3 and 4 discuss the application of the Principles to operating costs, the cost of capital and capital employed, transfer charging and revenues.
- Annex 5 contains the definition of the disaggregated services that make up the Retail Business. Annex 6 sets out pro forma reporting formats for the financial statements and reports on transfer charging and Annex 7 provides some information on the use of current cost accounting.

#### **3.1 Background to Proposed Changes**

In the first set of Guidelines the Director General stated that the document was a living document and likely to change over time. There have been a number of developments since March 2002 which have prompted the OUR to revise the Guidelines and publish this document and the attached draft Guidelines for consultation. The key developments are:

- The experience that C&W Guernsey has now gained in the development of its separated accounting systems and the preparation of its Regulatory Accounts;
- The outcome of a review of C&W Guernsey's Regulatory Accounts on behalf of OUR by international consultants; and
- The further development of international practice in the preparation of Regulatory Accounts.

Each of these developments is summarised briefly below.

### **3.1.1 C&W Guernsey Separated Accounting Systems**

C&WG has developed and pursued the systems originally purchased by Guernsey Telecoms for the purpose of developing its regulatory accounts, specifically using a software package called Oros and has produced Regulatory Accounts (unaudited) for 2001 and subsequently provided a full audited set of 2002/03 Regulatory Accounts and supporting documents.

### **3.1.2 Review of C&W Guernsey's Regulatory Accounts**

On receipt of the 2002/3 audited Regulatory Accounts, the OUR appointed Europe Economics to review C&W Guernsey's regulatory accounts to determine whether they met the OUR guidelines and were fit for regulatory purposes. Europe Economics concluded that there were a significant number of failings in the Accounts and made recommendations for further steps that C&W Guernsey should undertake to improve the accounts<sup>3</sup>.

A number of key issues were addressed and it was recommended that C&W Guernsey needed to;

- make significant improvements in transparency so as to enable greater verification of the accounts,
- improve cost causality in a number of areas where specific problems could be identified (lack of transparency obscured some of the cost causality issues and so the consultants were unable to identify all areas where changes might be needed);
- remedy a lack of objectivity by removing certain costs from charges to other operators;
- review and revise the transfer charge methodology; and
- implement the current cost accounting methodology.

### **3.1.3 International Developments**

The OUR's draft Guidelines to C&W Guernsey are based on best practice and benefit from a considerable amount of international experience and research in the development of separated accounts while also taking into account local circumstances.

In 1998 the European Commission published a comprehensive set of guidelines and recommendations on accounting separation (Commission Recommendation 98/322/EC)<sup>4</sup> and this document was considered by OUR when drawing up the first set of Guidelines in March 2002. The Commission document has recently been updated and consulted upon by the European Regulator's Group ("ERG") in close cooperation with the European Commission.

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<sup>3</sup> See Document OUR 04/12R: Review of Cable & Wireless Guernsey's Regulatory Accounts

<sup>4</sup> Commission of the European Communities Recommendation of 8 April 1998 on interconnection in a liberalised telecommunications market, Part 2 – Accounting separation and cost accounting Brussels, 8.04.1998 C(1998) 960 final.

At the time of publication of this consultation document, the ERG had published a draft Opinion on proposed changes to the Commission Recommendation 98/322/EC<sup>5</sup> which was open to consultation<sup>6</sup>. A report on a public hearing on the consultation was also available<sup>7</sup> as were contributions from a range of parties<sup>8</sup>. Because that consultation is still open, the ERG has not expressed a formal opinion on the changes proposed to the Commission Recommendation and indeed the Commission has made no final definitive statement on the changes it will make to the Recommendation.

However, the OUR has reviewed the proposed changes to the Commission Recommendation, the reasons for those changes and the reasons for the ERG proposed opinion and has considered these in the context of the OUR draft Guidelines for C&W Guernsey.

The following sections set out the key categories of changes and the reasons for changes proposed in the Recommendation and makes some observations as to how those changes may relate to the draft Guidelines for C&W Guernsey.

### **New Legal Framework in Europe**

One reason for the proposed changes, as described by the ERG, is to update legal references in the Commission Recommendation to reflect the new regulatory framework which came into effect in Europe in 2003. For example, the Recommendation needs to be adjusted so as to;

- cover, in principle, all kind of electronic communications networks (and not only the fixed network like in the old Recommendation);
- cover access (and not interconnection only like in the old Recommendation);

Such changes are not relevant in the Guernsey context, as the Guernsey legal framework has not changed since 2001 and indeed, has always embraced the principle of technology neutrality (i.e. covering all kinds of electronic communications networks, not just the fixed network), and also includes both interconnection and access already.

### **Current Cost Accounting**

Another reason for proposed changes is to provide clear guidance on the implementation of current cost accounting to enable regulators to adopt a harmonised approach across Europe.

It is in particular proposed to leave it up to national Regulators to make specific choices on a number of technical parameters in relation to current cost accounting including, for example;

- the choice to use Financial Capital Maintenance or Operational Capital Maintenance (previously FCM was favoured);
- the choices as to the appropriate parameters used in the calculation of the cost of capital, in particular for the choice of the market risk (choice between capital asset pricing model and other methodologies i.e. factorial models).

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<sup>5</sup> [http://www.erg.eu.int/doc/publications/consult\\_accounting\\_sep/erg\\_0415\\_draft\\_ca\\_and\\_as\\_opinion.pdf](http://www.erg.eu.int/doc/publications/consult_accounting_sep/erg_0415_draft_ca_and_as_opinion.pdf) and [www.erg.eu.int/doc/publications/consult\\_accounting\\_sep/annex\\_to\\_erg0415.pdf](http://www.erg.eu.int/doc/publications/consult_accounting_sep/annex_to_erg0415.pdf)

<sup>6</sup> [http://www.erg.eu.int/doc/publications/consult\\_accounting\\_sep/cover\\_letter\\_draft\\_opinion.pdf](http://www.erg.eu.int/doc/publications/consult_accounting_sep/cover_letter_draft_opinion.pdf)

<sup>7</sup> [http://www.erg.eu.int/doc/publications/consult\\_accounting\\_sep/erg\\_0424\\_asca\\_hearing\\_note.pdf](http://www.erg.eu.int/doc/publications/consult_accounting_sep/erg_0424_asca_hearing_note.pdf)

<sup>8</sup> [http://www.erg.eu.int/documents/index\\_en.htm#publicconsultations](http://www.erg.eu.int/documents/index_en.htm#publicconsultations)

The OUR notes these changes and will review with interest the choices made by national regulators in relation to these technical parameters. This will be relevant as C&W Guernsey implements current cost accounting methodologies – something which has not yet been put in place in Guernsey. The OUR will continue its ongoing discussions with C&WG on these technical parameters during the implementation of that process and will keep up to date on international developments in this area.

The OUR is currently consulting separately on the appropriate cost of capital for C&WG<sup>9</sup>, including on technical inputs such as the market risk and this is not therefore considered in more detail in this consultation or in the draft Guidelines at this stage. However, the Guidelines may be subject to further change following the conclusion of the outstanding consultation.

Another matter currently under consultation (in the same paper) is the calculation of the appropriate level of allowed revenue for price control purposes. The conclusion of this consultation may also lead to further changes to the Guidelines particularly relating to the identification of assets and the valuation of assets.

### **Publication and Verification**

The ERG notes a number of other reasons driving the review of the Commission Recommendation, and proposes that the new Recommendation;

- would be more detailed on the preparation and publication of data and in general more precise about the transparency which should be inherent to the process of regulatory accounting;
- would place more emphasis on data conservation/traceability; and
- would be more detailed with regards to the verification and auditing process of the regulatory accounting data.

The OUR considers that these are important points and has reviewed the draft Guidelines to take them into account. In particular the OUR has included some additional guidance on the application of the various principles to the Regulatory Accounting documents, such as the principle of transparency, and has considered the underlying integrity of the data used and the audit of the Accounts. These amendments are in section 3 of the draft Guidelines.

### **Conclusion**

In conclusion, while the OUR notes that the review of the Commission Recommendation is ongoing, the review has highlighted a number of areas where improvements may be considered necessary. The OUR has considered those areas that are relevant to the Guernsey environment, and has adjusted the draft Guidelines at this stage to take those factors into account.

Other factors are not considered relevant (e.g. the updating of the European legal framework) and certain proposals remain open to interpretation by national Regulators and the OUR will monitor developments in those issues and may update the draft Guidelines further in the light of experience.

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<sup>9</sup> See Document OUR 04/11: Price Control for Telecommunications Services in Guernsey: Calculating the Allowed Revenue and Cost of Capital: Consultation Paper



### **3.2 Other Factors Affecting Guidelines**

As already noted, the Guidelines are a living document and may be subject to change from time to time. At the time of publication of this consultation and the draft Guidelines, the OUR is engaged in a number of consultations that may affect the Guidelines in the near future including:

#### **Consultation Document OUR 04/09: Market Dominance in the Telecommunications Sector in Guernsey.**

This paper looks at the market developments since the opening of the telecommunications sector to competitive entry and addresses the Director General's finding that C&WG is dominant in the fixed and mobile telecommunications markets in Guernsey. If there were to be a new finding of dominance that affected the Guidelines, appropriate adjustments would be necessary. The Director General expects that this consultation will be concluded in Q4 2003

#### **Consultation Document OUR 04/11: "Price Control for Telecommunications Services in Guernsey: Calculating Allowed Revenue and the Cost of Capital"**

This document addresses some specific technical aspects of telecommunications price control including the inputs into calculating the allowed revenue of the price controlled business over the price control, e.g. calculating the asset base and allowance for capital investment and setting the cost of capital. Decisions on the issues being consulted on may affect the Guidelines and if this is the case, appropriate adjustments will be made

This consultation and the draft Guidelines are without prejudice to any decisions that the Director General may make arising from the above consultations or otherwise in the course of carrying out her statutory functions.

## **4 Proposed Changes to March 2002 Guidelines**

This section describes the changes in the draft Guidelines compared to the March 2002 Guidelines and invites respondents to comment on whether the proposed changes are appropriate.

### **4.1 Introduction (Section 1)**

Section 1 of the draft Guidelines, “Introduction” is broadly similar to the text in the March 2002 Introduction and has been updated to reflect international developments and experience in the preparation of Regulatory Accounts and regulatory accounting systems in Guernsey since March 2002.

### **4.2 Background (Section 2)**

This section includes all of the text that was in the Background section of the March 2002 Guidelines, with some textual updates. It has also been updated to include a section outlining international developments and provides some useful references to current European documents. This section also incorporates the text that was formerly in Section 3 of the March 2002 Guidelines: “Structure of These Guidelines”. The reason for this is to improve the structure of the document.

### **4.3 Regulatory Accounting Principles (Section 3)**

This section replaces sections 4.3 and 5.2 in the March 2002 Guidelines and also summarises sections 4.4 and 4.5 while the detailed text formerly in these sections is included, along with other text in annexes 1, 2, 3 and 4. In some cases there have not been significant changes whereas in others the text has been updated. Each section is addressed below and the reasons for changes given. In general the grouping of these sections together is designed to improve the structure of the document.

**Section 3.1 “Regulatory Accounting Principles”** contains all of the text formerly in section 4.3. However the text has been updated to place more emphasis on the need to ensure that, in applying the regulatory principles, C&W Guernsey is aware of the need to ensure that it applies them in a proportional and appropriate manner. A balance must be struck between the level of detail in the C&W Guernsey cost accounting system and the need for transparency as identified in the consultants report on C&W Guernsey’s Regulatory Accounts. This text also reflects the increased emphasis on transparency that is proposed by the ERG opinion.

**Section 3.2 “Cost Allocation Principles”** is new and replaces the text in sections 4.4 “Principles of Cost Allocation” and 4.5 “Principles for a Transfer Charging System”. The detailed text from these sections has been put in annexes and is referred to later. The new Section 3.2 summarises the importance of cost allocation systems and refers readers to the annexes for details on the treatment of various costs and revenues including operating costs, cost of capital, capital employed, transfer charges and all revenues. The text also refers to the role of Current Cost Accounting as a cost accounting methodology and once again refers readers to an Annex for more detail.

This change is designed to improve the structure of the Guidelines.

**Section 3.3 “Regulatory Accounting Documentation”** is new and seeks to provide greater guidance on the application of the Regulatory Principles to supporting documentation to improve and assist the transparency of the financial statements. In

particular it emphasises the need for clear and complete documentation of methodologies and accounting policies. This change reflects the findings in relation to C&W Guernsey's Regulatory Accounts and the current text of the draft ERG opinion, both of which have noted a need to concentrate on transparency.

**Section 3.4 “Quality of Regulatory Accounting Data”** is new and provides guidance on the need to ensure that the data used in the accounts are relevant, reliable, comparable and consistent.

**Section 3.5 “Audit of the Regulatory Accounts”** comments on the need to ensure the integrity of the data and the accounts and describes the importance of the role of the auditors in this respect. It also provides some high level guidance on the scope of the audit required of the Regulatory Accounts. This section is in response to requests from C&W Guernsey and its auditors for guidance.

**Section 3.6 “Summary of Guiding Principles”** pulls together the principles for ease of reference and reflects the text formerly in section 5.2 of the March 2002 Guidelines

- Q1. Do respondents consider that the expanded guidance on the application of the Regulatory Principles is appropriate, useful and in line with international practice? If not what changes would you propose and why?*
- Q2. Do respondents consider that the proposed audit guidance provides interested parties with confidence in C&WG's regulatory accounts? If not, please explain what additional guidance would be helpful with reasons for your position.*

#### **4.4 C&W Guernsey's Regulatory Accounts (Section 4)**

This section replaces sections 4.1, 4.2, 5.1, 5.3, 5.4, 5.5 and 5.6 of the March 2002 Guidelines. In some cases there have not been significant changes whereas in others the text has been updated. Each section is addressed below and the reasons for changes given. In general the grouping of these sections together is designed to improve the structure of the document.:

**Section 4.1 “Level of Accounting Separation”**, formerly section 4.1 “Appropriate Level of Accounting Separation”: This section is mostly unchanged and sets out the level of disaggregation required in C&W Guernsey's Regulatory Accounts.

**Section 4.2 “Definition of Main Business Areas”**, formerly section 4.2 in the March 2002 Document: This section remains unchanged

**Section 4.3 “Documentation to be Prepared by C&W Guernsey”**, replaces section 5.1 “Financial Statements” and 5.4 “Submission of Other Information”. It brings together in one section a description of the information that C&WG Guernsey must submit as part of its Regulatory Accounts, including the financial statements, the reconciliations, the audit opinion, the methodologies, the accounting policies, etc. New text is added to stress the requirement for transparency and clarity in this documentation.

**Section 4.4 “Reporting Period”** replaces sections 5.5 “Timetable for submission of separated accounts and 5.6 “Duration”. This section replaces out of date text that was relevant to the first sets of Regulatory Accounts and confirms the requirement for regular annual reporting.

**Section 4.5 “Publication of Information”** replaces section 5.3 “Submission of Confidential Information” and once again updates the text to clarify the ongoing publication requirements on C&W Guernsey.

- Q3. Do respondents consider that the grouping and expansion of the issues in this section is appropriate, useful and in line with international practice? If not what changes would you propose and why?*

#### **4.5 Conclusion (Section 5)**

This section replaces sections 6 in the March 2002 Guidelines and updates the Direction on production and submission of Regulatory Accounts by C&W Guernsey.

#### **4.6 Cost Accounting Systems (Annex 1)**

This Annex is new and contains some of the text previously in section 4.4 of the March 2002 Guidelines along with some additional text. The purpose of the annex is to provide some high level guidance on the development of cost accounting systems and reflect international practice.

#### **4.7 Cost Causality Principle (Annex 2)**

This section includes some of the text previously contained in section 4.4 of the March 2002 Guidelines (text describing the cost causality principle), as well as the text previously in Annex 2 (Operating Costs) and Annex 3 (The Cost of Capital and Capital Employed). It also contains the text on transfer charging previously contained in section 4.5 and the text on Revenues previously contained in Annex 4.

These have been brought together into one annex to improve the structure of the document. This annex now provides, in one place, guidance on the application of the cost causality principle to all types of costs and revenues.

#### **4.8 Definition of Disaggregated Retail Services (Annex 3)**

This Annex is the same as the previous Annex 1.

#### **4.9 Proforma Reporting Formats (Annex 4)**

This Annex is the same as the previous Annex 5.

#### **4.10 Current Cost Accounting (Annex 5)**

This Annex is the same as the previous Annex 6 and provides high level information on the Current Cost Accounting methodology. The text has been adjusted to reflect some of the comments in the ERG draft opinion.

- Q4. Do respondents consider that the grouping of these issues in Annexes is appropriate, useful and in line with international practice? If not what changes would you propose and why?*

## **5 Conclusion and Next Steps**

The Director General is pleased to present this document and the Draft Guidelines for comment as part of the ongoing development of the regulatory regime and in particular the framework for the preparation of separated Regulatory Accounts and looks forward to receiving comments.

The updated Guidelines that will be published following the conclusion of this consultation continue to be subject to further development and updating from time to time in the light of experience, international developments and the needs of the Director General in performing her duties.

This consultation paper and the draft Guidelines are without prejudice to any decisions that the Director General may make arising from current or future consultations or otherwise in the course of carrying out her statutory functions.

**/ENDS**