Romtelecom comments

on draft ANRC Decision for approval of Regulation on accounting separation as part of the management accounts of Romtelecom

September 2003

1 Romtelecom commentary on the second draft decision

1.1 Following the publication of an initial draft decision in April 2003[1], ANRC has published a second draft decision in August 2003[2].

1.2 As the second draft decisions contains no material concessions relative to the first draft decision, Romtelecom believes that the comments submitted in response to the first draft decision continue to be of the utmost relevance to the Romanian telecommunications sector and would refer the reader to Romtelecom's response to the first draft decision at Appendix A.

1.3 Romtelecom is disappointed and surprised to find that ANRC has substantially ignored the material criticisms levelled at its proposals by Romtelecom and the rest of the telecommunications sector in Romania. These criticisms concerned the timing, expense and lack of benefit to industry of the data reporting proposed.[3]

1.4 In Romtelecom's view, this refusal on the part of the ANRC to address the views expressed in Romtelecom's response to the first draft decision reflects a critical failure of the consultation process. In contrast with most countries around the world, the consultation process is not a public one in which operator opinion on specific items of regulatory policy is polled and published and in which decisions are given with specific reference to the operator opinions expressed as well to the precise benefit expected as a result of each decision.

1.5 This worldwide precedent contrasts with the process initiated by ANRC, in which operator opinion on specific items of regulatory policy is not polled but rather draft decisions are published with no indication of the specific items on which the regulator is seeking regulatory guidance. Operator responses on entire draft decisions are made public, but subsequent draft decisions make no reference whatever to the questions those responses pose to ANRC, nor to the suggestions made. This process of simply "re-issuing" draft decisions does not correspond to the precedent of public consultation observed in most countries around the world.

1.6 Romtelecom requests with the utmost urgency that in the future ANRC undertakes redress this critical shortfall in the "consultation" process. Specifically, Romtelecom requests that ANRC undertake in future decisions to

- highlight those aspects of regulatory policy on which it is seeking industry comment;

[1] Regulation on accounting separation as part of the management accounts of Romtelecom
[2] Regulation concerning the realization by "Romtelecom" S.A. of accounting separation within the internal cost accounting system
[3] Responses to the initial draft decision by each of Orange Romania and MobiFon refer directly to these issues and support the views expressed by Romtelecom in its response.

- list and individually address the opinions expressed by operators in the subsequent decision;

- demonstrate the benefit which the telecommunications sector will gain as a direct result of each obligation ANRC is proposing

- demonstrate the advantages and/or shortcomings of each operator's response relative to ANRC's proposal in order to provide a context for ANRC's final decision.

1.7 Romtelecom believes that it is ANRC's responsibility as the primary representative of the Romanian telecommunications sector – both end users and new entrants – to accompany all future draft and final decisions with such an analysis. It will only be through the demonstration of the sustainable improvements being made to the telecommunications sector that the Romanian telecommunications sector will benefit from long-term investment.

1.8 At a superficial level, ANRC's second draft decision would appear to have made the following concessions:

- The date for publication of the first set of separated accounts to be August 1st 2005 instead of August 1st 2004;

- Romtelecom no longer to provide separated profit and loss and capital employed statements for each of the sub-businesses of retail;

- Romtelecom no longer to provide separated profit and loss and capital employed statements prepared on both historical and current cost accounting principles, but rather on current cost accounting principles alone; and

- Romtelecom no longer required to publish the audit opinion.

1.9 However, these concessions do not reflect the substance of the second draft decision. Specifically:

- Romtelecom is required to prepare and submit to ANRC a statement of costs of services, the scope of which is identical to the retail sub-businesses for which the initial draft decision required separated profit and loss and capital employed statements;

- Romtelecom is required to prepare and submit to ANRC a statement of costs of network components and a statement of costs of services prepared on both historical and current cost accounting principles – in so doing substantially complying with ANRC's initial requirement to prepare separate financial statements on both historical and current cost accounting principles; and

- The appointment of the auditor to review the separated financial statements is to be subject to the approval of

ANRC, with the contract to incorporate ANRC's right to request any additional review as it sees fit, and with the completion of that contract to be dependent on the approval of the audit report by ANRC – this despite ANRC's refusal to take responsibility for the audit of the financial statements on the grounds of having insufficient experience in regulatory reporting.

1.10 In short, this second draft decision Is substantially unchanged from the first draft decision in that it fails to address the disproportionate cost of compliance to be borne by Romtelecom and, ultimately, the Romanian consumer: the level of disaggregation of reporting is unchanged, but has merely changed in format from an extended series of profit and loss and capital employed statements to an extended series of statement of costs of network components and services.

1.11 Indeed, the second draft decision enumerates a number of requirements which are additional to those provided for in the first draft decision. In requiring the preparation of additional information, these additional requirements will serve only to increase the cost of compliance with no apparent incremental benefit to users. Specifically:

- The first draft decision required that Romtelecom report on the costs associated with the core and access components of the leased line service. The second draft decision requires that these components be further broken down by capacity and technology. Considering that there are no less than 32 leased line capacities commonly sold, this requires the calculation of 64 cost values for a single service. Not only is this level of detail unprecedented in the world and being applied to a market in which leased line revenue represents only 9% of the total[4], but ANRC fails to explain adequately the manner in which this breakdown is to be calculated. In addition, ANRC has failed to demonstrate how the proposed breakdown of leased line costs detailed in this draft decision will map onto the breakdown of costs requested in a separate draft decision on leased line terminating segments[5], despite Romtelecom's specific request for clarification on this issue[6].

- The first draft decision required that the network statement of costs and statement of service costs be prepared based on both historic and current cost accounting principles. The second draft decision requires not only that the two statements be prepared based on both historic and current cost accounting principles, but also that they prepared based on fully allocated, incremental and stand alone cost principles. For any one service, Romtelecom will therefore be required to provide and reconcile four different cost values.

[4] This figure of 9% for Romania contrasts with 20% for the UK.
[5] Decision related to the interconnection for leased lines – terminating segments with the fixed public telephone network
[6] Romtelecom comments on decision related to the interconnection for leased lines – terminating segments with the fixed public telephony network –para 3.17

- The first draft decision required that reconciliations be prepared between the statutory accounts and the consolidated separated accounts; between the consolidated separated accounts and the separated accounts of the business units; and between the separated accounts of the business units and the separated accounts of the business sub-units. The second draft decision has added a fourth level of reconciliation, with the requirement that the separated accounts of the sub-businesses be reconciled with the statements of cost of the services provided by that sub-business.

1.12 In its comments on the first draft decision, Romtelecom emphasised that "the cost of the regulatory reporting function appears.. to be a function of the level of disaggregation of the businesses for which accounts are prepared".[7] In imposing additional reporting requirements on Romtelecom, ANRC is seeking to increase rather than decrease the cost of compliance.

1.13 Romtelecom is alarmed to note that the second draft decision also introduces a number of measures which run counter to ANRC's stated objectives of transparency and consistency of treatment.

1.14 Specifically, in the second draft decision ANRC has introduced the concept of the selective exclusion of costs from the separated accounts: "the Separated Financial Statements will include only relevant costs. Relevant costs are those cost categories incurred by a hypothetically efficient new entrant operator. Extraordinary and exceptional items (as compensatory payments) are not considered relevant costs and therefore shall not be included in the Separated Financial Statements. The operator will present a description of non-relevant costs within the reconciliation of separated financial statements with statutory accounts".

1.15 At a superficial level, this arbitrary exclusion of costs will further complicate an already labyrinthine set of reconciliation statements, resulting in wasted time and cost. However, of more concern is the fact that ANRC's proposals do not seek to increase transparency of financial reporting but to decrease it. ANRC has offered no objective means of assessing whether costs are to be excluded or included, instead reserving the right to "adjust" the statements on a unilateral basis. This process can only serve to confuse rather than enlighten users of the financial statements. Equally, the amendment introduces the opportunity to impose obligations on Romtelecom in a discriminatory manner relative to other participants in the Romanian telecommunications sector.

1.16 ANRC also proposes to reserve the right to "impose changes in the Costing Methodology, indicating the separated financial statements to be modified in order to reflect these changes".

[7] Comments on Consultation Document "Regulation on accounting separation as part of the management accounts of Romtelecom", para 6.2

Romtelecom notes with some alarm that ANRC does not refer to any overarching cost methodology on which such changes would be based – in its present form, the regulation allows no transparency at all in terms of the principles on which a Costing Methodology will be accepted, rejected or amended. Romtelecom contends that this aspect of the second draft decision constitutes a direct contravention of the European Commission's recommendation on the subject, namely that

It is recommended that the NRA undertakes a public consultation with market players on the adoption of sound allocation methods.. it is recommended that the methodology and criteria for the evaluation of network assets at current value is fixed by the NRA after a public consultation with market players.[8]

1.17 It is clear that the European Commission's guidelines recommend that the methodology for the allocation of costs be the product of public consultation; permanent; and applied without prejudice to all operators concerned.

1.18 Romtelecom strongly rejects any measure that will result in the discriminatory treatment of Romtelecom's financial or operational records and contends that the Costing Methodology to be used for the preparation of any separated financial statements should be agreed by means of a public consultation process and should be applied without prejudice to all operators in the Romanian telecommunications sector.

1.19 In short, in this second draft decision, ANRC appears to be increasing the reporting requirements to be imposed on Romtelecom with no regard for the cost of compliance or for the priority of the sector's needs. These additional reporting requirements are being imposed in the cause of increased transparency. However, in the provision for undisclosed alterations to the costing methodology on which the reporting is to be based; in the provision for the arbitrary exclusion of costs; and in the dependence of an independent auditor on ANRC sign-off, ANRC is reducing the transparency of the regulatory reporting process.

1.20 Romtelecom is appealing to ANRC to reconsider its position regarding the framework for accounting separation – specifically in the context of:

- the appropriate level of disaggregation of data,
- the appropriate process for the agreement of the methodology to be used for the preparation of reports; and
- the appropriate level of independent review of those reports.

1.21 In the following sections, Romtelecom summarises the history

[8] COMMISSION RECOMMENDATION of 8 April 1998 on interconnection in a liberalized telecommunications market (Part 2 - Accounting separation and cost accounting)

of the accounting separation consultation process before providing a detailed commentary on the individual sections of the most recent draft decision.

2 Accounting separation consultation process

2.1 ANRC issued a draft decision entitled "Regulation on Accounting Separation As Part Of The Management Accounts Of Romtelecom'" in April 2003. This document is hereinafter referred to as "the first draft decision".

2.2 The substantive points of the first draft decision are as follows:

- Romtelecom is to implement accounting separation within its internal cost accounting system
- Separate financial statements are to be prepared for each of 28 businesses and sub-businesses
- The first set of separate financial statements, relating to the financial year 2003, are to be submitted to ANRC within 4 months of the publication of the statutory financial statements (ie August 31st 2004)
- The first set of separate financial statements, relating to the financial year 2003, are to be prepared on a historical cost basis; the second set, relating to the financial year 2004, are to be prepared on current cost basis and should contain details of the reconciliation of the current and historical cost statements
- The costing methodology on which the separate financial statements are based is to be submitted to ANRC at least 8 months prior to the submission of the first set of financial statements (ie December 31st 2003)
- The separate financial statements are to be subject to a financial audit, with separate audit opinions being prepared for the historical cost and current cost statements
- The appointment of the auditor is subject to ANRC's approval; this approval is to be secured at least six months before the submission of the first set of financial statements (ie February 28th 2004)

2.3 Romtelecom provided ANRC with its response to this draft decision in June 2003. This document is attached at Appendix 1 and is hereinafter referred to as "response to the first draft decision".

2.4 The substantive points of the response to the first draft decision are as follows:

- The preparation of separated accounts is of low priority in the context of the Romanian telecom sector's more pressing need for tariff rebalancing
- The request for separate financial statements for 28 businesses and sub-businesses is unprecedented in the

European telecoms sector and is disproportionate in the context of the Romanian market

- The number of separate financial statements to be prepared is a driver of cost; the incremental benefit to be derived by producing statements for 28 businesses and sub-businesses is outweighed by the incremental cost of production

- The production of separate financial statements is dependent on the implementation of several data and process improvement exercises currently being undertaken by Romtelecom; the production of financial statements by August 31st 2004 in unfeasible as this precedes the completion of the requisite exercises

- As a more practical way forward, Romtelecom will submit separate financial statements for eight businesses and sub-businesses (Retail, Core, Interconnection, Co-location, Leased Lines – Transportation, Other Core, Access, Other); these statements will be prepared on a current cost basis and will be submitted in respect of the financial year 2004

- The cost of engaging regulatory auditors is likely to be in the region of €1.5 million per annum and is excessive in the context of the Romanian economy; a more cost effective solution would be for ANRC to undertake the review of these financial statements itself

- The requirement to publish the separate financial statements is unnecessary: the requirement is currently applied only to two operators in Europe; the requirement to publish separate financial statements on a current cost basis is applied to one operator in Europe; the requirement to publish separate financial statements on a current cost basis for 28 businesses and sub-businesses exceeds that imposed on any operator in Europe

- In anticipation of significant change in the format of separate financial statements to be prepared over the first few years of implementation, the publication of the statements is inappropriate and would lead to erroneous signals being provided to the market regarding the return or loss generated by individual businesses

2.5 ANRC has subsequently issued a revised draft decision entitled "Decision for approval of rules related to the performing of the separate accounting records within the internal management accounting by Commercial Company "Romtelecom" – SA" in August 2003. This document is hereinafter referred to as "the second draft decision".

2.6 The next section sets out Romtelecom's comments on the substantive amendments to the first draft decision contained within this second draft decision.

3 Romtelecom commentary on the amendments made by ANRC to the first draft decision

3.1 In addition to its response to the first draft decision, Romtelecom would like to make the following comments on the following specific amendments made by ANRC in the second draft decision.

Section	Removal/ addition	Amendment	Romtelecom comment
1.2.2 – Sub-business units of the Core Network	Paragraph 1.2.4.2 of first draft decision removed	"Collocation – interconnection" no longer considered to represent a sub-business unit	Romtelecom welcomes ANRC's recognition of the fact the service "collocation – interconnection" does not constitute an individual service in its own right and therefore does not merit the preparation of separated financial statements.
1.2.3 – Sub-business units of the Access Network	Paragraph 1.2.5.2 of first draft decision removed	"Collocation – access" no longer considered to represent a sub-business unit	Romtelecom welcomes ANRC's recognition of the fact the service "collocation – access" does not constitute an individual service in its own right and therefore does not merit the preparation of separated financial statements.
1.2 – Definitions	Paragraph 1.2.6 of first draft decision removed	The sub-business units of the retail business are no longer defined	See comments on section 3.1 below
3.2 – Sub-business units to be included in the separate financial statements	Paragraph 3.2.3 of first draft decision removed	Retail sub-business units removed from the list of sub-business units for which separate financial statements need to be prepared	ANRC continues to demand from Romtelecom a higher level of disclosure than any regulator in Europe. Due to ANRC's insistence on reporting requirements at the service level (cf section 4.3), the apparent concession on the disaggregation of retail businesses is illusory. ANRC continues to insist on a level of disaggregation of cost information on the retail business which is disproportionate to the low priority of

Section	Removal/ addition	Amendment	Romtelecom comment
			information of the disaggregated retail businesses.
3.2 – The sub-business units of the core network	Paragraph 3.2.1 bullet (b) of first draft decision removed	“Collocation – interconnection” removed from the list of business sub-units for which separate financial statements need to be prepared	Romtelecom welcomes ANRC’s recognition of the fact the service “collocation – interconnection” does not constitute an individual service in its own right and therefore does not merit the preparation of separated financial statements.
3.2 – The business sub-units of the access network	Paragraph 3.2.2 bullet (b) of first draft decision removed	“Collocation – access” removed from the list of business sub-units for which separate financial statements need to be prepared	Romtelecom welcomes ANRC’s recognition of the fact the service “collocation – access” does not constitute an individual service in its own right and therefore does not merit the preparation of separated financial statements.
4.1.2 – The conditions for preparation of the Separated Financial Statements	Paragraph 4.1.2 bullet (g) of first draft decision removed	Removal of requirement that “the Separated Financial Statements shall be subject to a financial audit, in accordance with the legislation in force and with the national and international audit standards”	Romtelecom does not understand ANRC’s objective in introducing this amendment without wholly removing the requirement to have the financial statements independently audited, as was argued in the response to the first submission. Taken in conjunction with the amendment made to section 7.2 of the first draft decision – that the audit no longer needs to establish that the statements have been prepared in accordance with the approved costing methodology – this amendment takes on a more sinister tone. In effect, ANRC will reserve the right to dictate and to alter without notice the audit standards against which the statements are to be judged. ANRC must clarify what the purpose of this amendment is.

Section	Removal/ addition	Amendment	Romtelecom comment
4.1.2 – The conditions for preparation of the Separated Financial Statements	Wording of Paragraph 4.1.2 bullet (h) of first draft decision altered	The Separated Financial Statements shall be prepared on the basis of current costs, rather than current *and* historical costs	This apparent reduction in volume of cost information to be prepared does not represent a reduction in substance. While the financial statements will be based current costs alone, the network and service statements of cost are to be based on both historical and current costs. This does not in any way reduce the cost of compliance and continues to be of questionable benefit to the end user. Specifically, Romtelecom strongly requests that ANRC demonstrate the benefit to be gained from the preparation of historical cost data for network elements and services.
4.1.2 – The conditions for preparation of the Separated Financial Statements	Paragraph 4.1.2 bullet (h) of second draft decision added	ANRC has introduced a restriction on the costs to be included in the Separated Financial Statements: “the Separated Financial Statements will include only relevant costs. Relevant costs are those cost categories incurred by a hypothetically efficient new entrant operator. Extraordinary and exceptional items (as compensatory payments) are not considered relevant costs and therefore shall not be included in the Separated Financial Statements. The operator	ANRC’s proposal will serve only to reduce transparency. Firstly, no objective framework for the inclusion or exclusion of costs is provided. Secondly, the process of selectively including costs and the resulting complications of reconciliation will undermine any value to be gained by comparing the separated accounts to the statutory accounts and to the output of the LRIC model. Romtelecom requests that ANRC provide some justification for the proposed approach, together with some assurance that the process by which any framework for cost exclusion/ inclusion is agreed will be both public and equally binding for all operators.

Section	Removal/ addition	Amendment	Romtelecom comment
		will present a description of non-relevant costs within the reconciliation of separated financial statements with statutory accounts".	
4.2 – Statement of Average Costs of Network Components	Paragraph 4.2.1 bullets (a) to (d) of first draft decision removed	The requirement to include the routing factors, time of day gradients and final tariffs in the statement of costs has been removed.	Romtelecom welcomes ANRC's recognition in this small area at least that in its current stage of development, the market has no use for time of day gradient information as applied to network component costs. Equally, Romtelecom welcomes ANRC's recognition that final tariffs for network components do not exist and therefore cannot be disclosed.
4.2 – Statement of Average Costs of Network Components	Paragraph 4.2.5 of second draft decision added	ANRC has added the requirement that following the implementation of the long run incremental costing model, the statement of average costs of network components must be prepared using three cost standards: incremental cost, fully-allocated cost and stand-alone cost.	Romtelecom fails to understand ANRC's objective in introducing an additional cost standard to the reporting requirements proposed by the first draft decision. This additional cost standard will carry no incremental benefit for the industry or the end user and will add to the cost of compliance. In a mature market, the charging of prices above stand alone costs can be an indication of abuse of dominant market power. However, ANRC appears once again to fail to recognise that Romtelecom is unable to charge sufficiently high prices to meet its cost of capital at present; the costs of the business are not being recovered. The benefit to be gained by comparing price to standalone cost is therefore nil. In contrast,

Section	Removal/ addition	Amendment	Romtelecom comment
			the cost of producing the information is high, with additional functionality for the allocation of fixed and common costs needing to be built in to the Romtelecom LRIC model. ANRC should be aware that if in the future Romtelecom were able to recover costs in excess of stand-alone costs through its pricing of retail products, ANRC would be free to carry out tests by exception on the competitiveness of individual markets. These tests would be much cheaper and of greater practical value to the industry.
4.2 – Statement of Average Costs of Network Components	Paragraph 4.2.7 of the second draft decision added	The obligation to publish the Statement of Average Costs of Network Components has been changed to a requirement to submit the statement to ANRC	Romtelecom welcomes this concession by ANRC and continues to request that the same policy be adopted for the submission of separated financial statements at least until such time as the methodology for the preparation of those statements has matured and been wholly agreed. Otherwise, the cost of demonstrating the effects of changes in methodology on prior year statements will be unnecessarily high.
4.3 – Statement of Costs of Services	Paragraph 4.3.1 Part I bullet (e) of second draft decision added	Wholesale and retail leased line services were originally broken down into access and core components. In the second draft decision the core components have	In requesting an additional level of detail in the reporting of leased line data, ANRC appears once again to be requesting information for its own sake, without regard for the cost or benefit of preparing it. Only one operator in Europe publishes

Section	Removal/ addition	Amendment	Romtelecom comment
		been further broken down into leased lines core components at the national level as against leased lines core components at the local or regional level. These components have then been broken down in turn by capacity and technology	information on the cost of leased lines by capacity[9]; while no operator publishes leased line costs by technology or by location in the regional or local networks. Romtelecom believes that both requests are inappropriate: - the value to the sector of such information is small as leased lines revenue represents only 9% of the value of the Romanian telecommunications market – in comparison with 20% in the UK; - the comparative value of such statements would be nil as no other operator produces this data; - the format does not allow for the reconciliation of costs and revenues associated with leased line terminating segments[10]
4.3 – Statement of Costs of Services	Wording of paragraph 4.3.1 Part II bullet (e) of first draft decision amended	Wholesale and retail leased line services were originally broken down into access and core components. In this second draft decision the access components are to be further broken down by capacity and technology	See comment above
4.3 – Statement of Average Costs of Services	Paragraphs 4.3.4 to 4.3.6 of second draft decision added	ANRC has added the requirement that following the implementation of the long run incremental	See comment on section 4.2 above

[9] British Telecom

[10] Leased line terminating segments are subject to a separate draft decision issued by ANRC in June 2003 entitled "Decision related to the interconnection for leased lines – terminating segments with the fixed public telephone network"

Section	Removal/ addition	Amendment	Romtelecom comment
		costing model, the statement of average costs of services must be prepared using three cost standards: incremental cost, fully-allocated cost and stand-alone cost.	
4.3 – Statement of Average Costs of Network Components	Paragraph 4.3.8 of second draft decision added	The obligation to publish all Statements of Average Costs of Services has been changed to a requirement to publish only those relating to markets in which Romtelecom has been designated as having significant market power. All other Statements of Average Costs of Services will be submitted to ANRC.	While ANRC has recognised that it would be acting ultra vires in requiring Romtelecom to publish information on services in the provision of which it does not have Significant Market Power, ANRC has paid no heed to Romtelecom's concerns regarding the high cost and low end user benefit of producing statements of cost at such a low level of detail. ANRC continues to impose a more onerous cost reporting obligation than any other operator in Europe.
4.4 – Explicative Information	Wording of paragraph 4.4 bullets 3 and 4 of first draft decision amended	The requirement to provide a reconciliation of the current cost and historical cost separated accounts has been removed.	See comment on section 4.1.2 above
4.4 – Explicative Information	Wording of paragraph 4.4 bullet 4 of first draft decision amended	ANRC has added the requirement to provide a reconciliation of the costs of services and the profit and loss statements of the sub-business units.	In requiring this fourth level of reconciliation, ANRC is again requesting a level of detail in regulatory reporting which is unprecedented in Europe. It is also introducing a level of detail that is completely impractical given the proposed selective exclusion of costs. In those two EU countries that do publish

Section	Removal/ addition	Amendment	Romtelecom comment
			separated financial statements, reconciliation is limited to the demonstration of the equivalence of the transfer charges between businesses and the prices for network services contained within the reference interconnect offer. Romtelecom requests that ANRC -demonstrate the incremental benefit to be gained by the introduction of the proposed reconciliation - assure Romtelecom that the obligation to provide such information will be imposed without prejudice on all operators; and - demonstrate how it proposes to incorporate its proposals for selective cost exclusion into the reconciliation process, perhaps through the provision of a suggested format.
5.1 – Audit opinion	Wording of paragraph 5.1.3 of first draft decision amended	ANRC has added the requirement that the scope of the audit be extended to encompass the cost allocation methodology used to produce the separated financial statements	Romtelecom continues to contend that no incremental benefit is to be gained through an independent audit of the separated financial statements as opposed to ANRC carrying out the review. In view of ANRC's stated intent to retain a supervisory role over the audit of the separated financial statements, Romtelecom questions ANRC's claim to have insufficient experience in regulatory audit to allow it review the material itself. Were ANRC to carry out the review itself, Romtelecom would accord ANRC complete discretion in setting the scope for the review; in the absence of this policy, Romtelecom requests that the independent

Section	Removal/ addition	Amendment	Romtelecom comment
			auditor be allowed to define the scope of the audit.
5.1 – Audit opinion	Paragraphs 5.1.4 to 5.1.5 of second draft decision added	ANRC has extended the requirement that the choice of auditor of the separated financial statements must be approved by ANRC. The auditor must incorporate into its contract with Romtelecom ANRC's power to request further analysis as it sees fit and ANRC's power to approve/ reject the final audit opinion.	In introducing this amendment, ANRC is once again imposing an arrangement which is unprecedented in Europe. Romtelecom does not accept ANRC's proposal that it retain veto rights over any audit process on the basis that ANRC has claimed that it has insufficient experience in this area to carry out the review itself.
7.1 – Description of the Operator's costing system	Wording of paragraph 7.1.4 of first draft decision amended	ANRC has extended the requirement that Romtelecom submit its Costing Methodology to ANRC at least 3 months before publication of the Separated Financial Statements. This Costing Methodology must now be *published* at least 3 months before publication of the Separated Financial Statements.	ANRC has issued contradictory requirements on the publication of the Costing Methodology. Paragraph 7.1.1 of the second draft decision states that the methodology and statements shall be published simultaneously; paragraph 7.1.5 of the second draft decision states that the methodology will be published at least 3 months before the statements.
7.1 – Description of the Operator's costing system	Paragraph 7.1.6 of second draft decision added	ANRC has introduced a clause in which it reserves the right to "impose changes in the Costing Methodology, indicating the separated financial	Romtelecom notes with some alarm that ANRC does not refer to any overarching cost methodology on which such changes would be based – in its present form, the regulation allows no transparency at all in terms of the principles on which a Costing

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		statements to be modified in order to reflect these changes".	Methodology will be accepted, rejected or amended. The effect of this measure on the consistency of reporting will also serve to undermine the value of the separated accounts to the end user. Romtelecom requests that ANRC provide some justification for the proposed approach, together with some assurance that the process by which any changes to the methodology are agreed will be both public and equally binding for all operators.
7.2 – Principles of allocation of costs, revenues and capital employed	Wording of paragraph 7.2 bullet (e) of first draft decision amended	ANRC has removed the requirement that "the audit report on the Separated Financial Statements shall state that the Separated Financial Statements have been prepared in accordance with the methodologies of allocation detailed within the Costing Methodology".	Romtelecom does not understand ANRC's objective in introducing this amendment without wholly removing the requirement to have the financial statements independently audited, as was argued in the response to the first submission. Referring to the precedent set by BT and eircom, two audit opinions exist in the context of regulatory reporting: "a true and fair view" and "prepared in accordance with". It is apparent from the wording that the latter is less stringent than the former, and was used in the UK and Ireland during the period in which the incumbent was developing its financial and operational data reporting capabilities. Taken in conjunction with the amendment introduced at section 4.1.2 – that the statements no longer need to be prepared in accordance with national or international audit standards – this amendment takes on a more sinister tone. In effect, ANRC will

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			reserve the right to dictate and to alter which if the two audit opinions will be required of Romtelecom's statements. Romtelecom requests that ANRC clarify its position on this issue.
7.8 – Asset Lives and Depreciation Method	Paragraph 7.8.7 of second draft decision added	ANRC has added the requirement that "Fully depreciated assets will have zero current net value and their costs will not be accounted for within the current costs of services"	In imposing this condition, ANRC is once again assuming that Romtelecom has been in a position to recover the cost of an asset over its lifetime; that an interconnecting operator's contribution to a fully depreciated asset still in use in the network would constitute a double-recovery of costs. While this assumption could reasonably made of more affluent markets, the same is unlikely to be true of Romania. If Romtelecom has been unable to recover the cost of a fully depreciated asset over the course of its life through the pricing of its own retail products, it would seem equitable that an interconnecting operator wishing to make use of that asset should contribute to its net cost to Romtelecom.
7.8 – Asset Lives and Depreciation Method	Paragraph 7.8.8 of second draft decision added	ANRC has added the requirement that "Romtelecom shall present, within the Costing Methodology, the description of the depreciation method used within the separated accounts"	
8 – Final provisions	Wording of paragraphs 8.1 to	ANRC has changed the period to which the first	In providing this apparent concession, ANRC is finally recognising the impossibility of

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	8.5 of first draft decision amended	Separated Financial Statements will relate from the financial year 2003 to the financial year 2004.	Romtelecom's compliance with the timeline set by the first draft decision. Romtelecom welcomes this recognition.

4 Conclusions

4.1 Romtelecom would again like to emphasise ANRC's responsibility as the representative of the end user to demonstrate the cost-benefit balance of each and every proposed form of regulatory intervention in the context of the end user.

4.2 In the absence of this demonstration, Romtelecom rejects ANRC's proposals on the following grounds:

- lack of transparency in the process by which the proposals will be subject to public consultation and be applied without prejudice to all operators;
- lack of international precendent in terms of the burden of regulatory reporting imposed on Romtelecom;
- insufficient benefit accruing to end users;
- disproportionate cost of compliance; and
- low priority in the context of the Romanian telecommunication sector's need for more fundamental reforms.

4.3 With the exception of a small number of material additions to the requirements imposed on Romtelecom, the second draft decision is substantially unchanged from the first draft decision.

4.4 As a result, Romtelecom continues to contend that the alternative methodology for the preparation and review of separated accounts proposed in its response to the first draft decision represents the most pragmatic solution to ANRC's need for financial and operational data on Romtelecom's activities.

4.5 Accordingly, Romtelecom has restated below its original proposal concerning the realization by "Romtelecom" S.A. of accounting separation within the internal cost accounting system.

<u>Original Romtelecom proposal</u>

4.6 Romtelecom believes that its existing TeleCompass service costing capability, taken together with the fixed asset reconstruction (FAR) project and the CCA costing work initiated to support the interconnection RIO, will provide ANRC with a substantial level of accounting disaggregtion.

<u>4.7</u> In the following paragraphs, we elaborate on what Romtelecom will be able to provide to ANRC and over what period.

4.8 The implementation of the FAR project mentioned above, coupled with the existing allocations and output functionality of the TeleCompass model will enable Romtelecom to provide ANRC with profit and loss accounts and statements of average capital employed (disclosing return on average capital employed) for the following business units and sub-units in respect of the year ending 31 December 2004:

- Retail business;
- Core network business, including the sub-units "interconnection", "co-location – interconnection", "leased lines – transportation", "other activities of the transport network";
- Access network business;
- Other business

4.9 Romtelecom agrees with the definitions of the business units and sub-business units provided by ANRC in paragraphs 1.2.3.1 – 1.2.3.4 and 1.2.4.1 – 1.2.4.4 of the first draft decision.

4.10 In addition to the above statements, Romtelecom proposes to provide ANRC with the following in respect of the year ending 31 December 2004:

- Statement of average costs of the Core network as described in paragraph 4.3 of the first draft decision;
- Statement of network costs of the services offered by the core network on the wholesale market, as defined in the Reference Interconnect Offer;
- Statement of internal charges between the core network business and the retail business;
- An appropriate reconciliation between the separated accounts and the statutory accounts using the IAS standard;
- Explanatory notes for the accounts described in paragraph 8.4 of Romtelecom's response to the first draft decision (attached at Appendix A below);
- Accounting policies used in the preparation of the accounts;
- Definitions of the business units and sub-units for which accounts have been provided; and
- Supporting documentation on the allocation methodology used to produce the separated accounts described in paragraph 8.4 of Romtelecom's response to the first draft decision (attached at Appendix A below).

4.11 The definitions of the business units and sub-units described in paragraph 8.4 of Romtelecom's response to the first draft decision (attached at Appendix A below) will be aligned with those provided in the relevant paragraphs of ANRC's first draft decision.

4.12 Romtelecom agrees that ANRC's proposed formats for the Separated Accounts set out in Appendix 2 of the first draft decision are generally sensible and appropriate. However, the proposed disaggregation of current assets and liabilities in the capital employed statement is excessive and confers little or no benefit. Romtelecom therefore proposes that a more

	Current Year	Prior Year
Fixed assets	X	X
Current assets less current liabilities and provisions for liabilities and charges	X	X
Capital employed	**X**	**X**

aggregate statement of capital employed be adopted in the form set out below.

4.13 Romtelecom proposes to submit the separated accounts for review by ANRC. For the reasons already stated, there is no case for a formal audit.

- Romtelecom proposes that any separated accounts submitted to ANRC be treated as commercially confidential documents in order to protect potential users from the risk of material misstatement.

4.14 In summary, Romtelecom believes that its proposed alternative way forward provides ANRC with accounting separation to a level consistent with international experience at minimum cost to the future development of the Romanian telecommunications sector.

Appendix A - Romtelecom's response to the first draft decision

1 Executive Summary

1.1 The ANRC has issued a consultation document entitled "Regulation on Accounting Separation As Part Of The Management Accounts Of Romtelecom'" in April 2002.

1.2 Romtelecom welcomes this opportunity to provide its views as part of wider public debate on proposals for the future of telecommunications in Romania.

1.3 It is a principle of good regulation that regulatory interventions and obligations should be the least intrusive and costly required to address any legitimate regulatory concerns.

1.4 Romtelecom understands the broad principles underlying ANRC's proposals for accounting separation set out in its consultation document.

1.5 However, RomTelecom believes that the preparation of separated accounts is of lower priority in the development of the telecommunications sector in Romania than the development of a common sector strategy. Accounting separation as a form of regulatory intervention does not address Romania's need for sustainable, facilities-based competition.

1.6 ANRC has proposed that Romtelecom prepare separated accounts (profit & loss accounts and statements of capital employed) at an unprecedented level of detail, specifically 28 businesses and subdivided activities. This is a more detailed and onerous Accounting Separation requirement than is imposed on any other telecommunications operator in the world

1.7 The accounting separation requirements proposed by ANRC are neither appropriate nor proportionate given:

- ANRC's policy on sector development;
- the economics of the telecommunications sector in Romania;
- international precedents; or
- the practical issues of Romtelecom's existing service cost model and its development; the cost of compliance with ANRC's recommendations; and the incremental benefit of publication.

1.8 In addition, ANRC must not underestimate the importance of the cost standard on which the inputs are based. Fixed asset values based on historical cost **cannot** be used to measure the economic return on capital employed of disaggregated retail services in countries where high inflation exists.

1.9 Whilst Romtelecom rejects on grounds of principle and practicality the accounting separation proposals of ANRC, the company is willing to discuss how Romtelecom's existing service costing capability and planned enhancements can be refined to partially meet ANRC's requirements.

1.10 Romtelecom believes that its existing TeleCompass service costing capability, the fixed asset reconstruction (FAR) project and the current cost accounting (CCA) costing work, both initiated to support the interconnection RIO, will, taken together, provide ANRC with appropriate cost information

1.11 The effects of such a phased approach would be to:

- provide ANRC with a Reference Interconnect Offer based on CCA costs and in so doing provide ANRC with the service cost information which is of highest relevance to the Romanian telecommunications sector;

- provide ANRC with separated accounts for financial year ending 31 December 2004 on a reduced number of separated businesses (access, core, retail and other) following submission of the Reference Interconnect Offer based on CCA costs;

- replace the proposed requirement for an independent audit of Separated Accounts with a review of separated accounts by ANRC; and

- dispense with the requirement to publish the Separated Accounts.

1.12 In summary, Romtelecom believes that its proposed alternative way forward provides ANRC with accounting separation to a level consistent with EU and international experience but at minimum cost to the future development of the Romanian telecommunications sector and to Romanian consumers.

2 Accounting separation and Sector Development

Policy context

2.1 Romtelecom is concerned that ANRC's focus on accounting separation is detracting from the pursuit of other, far more important policy objectives. The accounting separation requirements proposed by ANRC are more onerous than the requirements imposed on any other telecommunications organisation in Europe. At the time of writing audited and published accounting information of the type proposed by ANRC are not available in Germany, France, Spain, Italy, Belgium or in any other EU country with the exception of two. The time and expense incurred in producing the cost information will be huge and ultimately borne by Romanian consumers. Their production will be a major distraction of management time within Romtelecom

2.2 Unlike Germany, France and other EU countries, Romania is characterised by an under-developed fixed communications infrastructure and low penetration rates for PSTN and internet access services. In addition, no progress has been made towards tariff rebalancing – a pre-requisite for an efficient competitive market. Romtelecom is committed to working with ANRC to rectify these obstacles to Romania's economic development. However, instead of focusing on these critical issues, ANRC, through its own actions, appears to be more preoccupied with the production of largely superfluous accounting information than in the development of the Romanian sector.

2.3 Romtelecom believes ANRC needs to re-evaluate its priorities and to re-focus on policy objectives that directly address the needs of Romania. The emphasis of public policy must be shifted to the following:

- promotion of facilities-based competition (both cable and telecommunications) and active discouragement of service-based competition which seeks to cream-skim profits on call traffic without making any contribution to the subsidy of access line rentals;
- promotion of investment in Romania's infrastructure, particularly in the telecommunications and cable tv access networks;
- promotion of an information society in which the positive network externalities of high DSL, ISDN and cable penetration can be captured; and
- promotion of efficient market entry through the rebalancing of tariffs and the creation of appropriate market signals.

2.4 Accounting separation does little to promote the achievement of these objectives.

Accounting separation - benefits

2.5 Accounting separation can theoretically provide a regulator with the following:

- evidence of the equivalence of transfer charges and interconnection tariffs; and
- evidence of the return generated by individual businesses, usually in support of some form of retail price control.

2.6 However, accounting separation is not the only tool available to monitor the equity of interconnection rates in respect of transfer charges. Through the submission of a Reference Interconnect Offer supported by a statement of CCA network costs, Romtelecom will be in a position to demonstrate exactly this. This comparison of outputs to ANRC requirements is provided in section 5.4 below.

Accounting separation - drawbacks

2.7 Furthermore, accounting separation has significant drawbacks which ANRC needs to consider carefully, including:

- No equivalence of transfer charges and interconnection tariffs can be demonstrated via separated accounts or by any other means, so long as transfer charges are based on cost incurred and interconnection tariffs are based on international benchmarks.
- The data and information technology required to support accounting separation takes several years to accumulate, as attested to by the experience of British Telecom and eircom – the only two operators in Europe who publish separated accounts.
- The accuracy of the returns calculated for individual businesses decreases exponentially with the level of disaggregation, such that the process becomes an arithmetical exercise as opposed to an economic test of market conditions.
- Accounting separation based on historic cost accounting (HCA) in a country with a history of high inflation is of little value and unsuitable for retail price control. This effect is illustrated by an analysis of the separated accounts of a European incumbent: a 10% change in the value of the trench network produces an 80% change in the profitability of its retail business.
- Accounting separation as a regulatory tool assumes the development of a cost-based Reference Interconnect Offer; the demonstration of Significant Market Power; and the

imminent likelihood of competition in the markets to which it is applied. In contrast, in Romania no cost-based Reference Interconnect Offer is in place and accounting separation is being proposed for access services - in which Romtelecom is incurring significant losses due to imbalanced tariffs.

- As a regulatory tool in isolation, accounting separation focuses on retail prices and interconnection tariffs. It is therefore more suited to the regulation of service-based competition than facilities-based competition. Furthermore, ANRC has not yet consulted the industry on whether Romtelecom has SMP in retail markets.

- The expense incurred in the implementation of accounting separation is significant and increases in proportion to the level of granularity with which it is applied. As a consequence, regulators around the world have tended to apply accounting separation in response to market failure. In contrast, ANRC is proposing to apply it in anticipation of market failure.

2.8 The lack of published separate accounts in most EU countries suggests that most national regulatory authorities in Europe have concluded that, to date at least, the policy costs of accounting separation exceed the policy benefits. Furthermore, the implementation of any form of accounting separation prior to the rebalancing of tariffs and the implementation of cost-based interconnection rates will decrease rather than increase transparency of information. On balance, the benefit to be gained from applying accounting separation in Romania is unproven, particularly for markets in which no Significant Market Power has been designated.

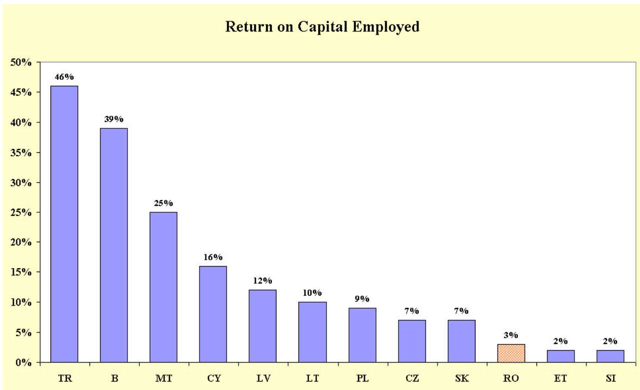
<u>Economics of the telecommunications sector in Romania</u>

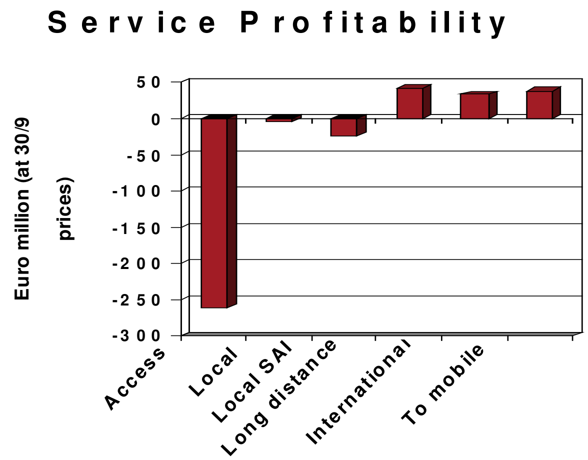
2.9 The accounting separation framework proposed by ANRC's consultation document draws heavily on the *Commission Recommendation of 8 April 1998 on interconnection in a liberalized telecommunications market (Part 2 – Accounting separation and cost accounting)*.

2.10 This recommendation was developed largely with reference to countries in which fixed-line penetration was already high, excess returns were being generated by the incumbent operators and in which price elasticity of demand for telecommunications services was relatively low.

2.11 In addition, the EU recommendation assumed that tariff rebalancing was being addressed and in most cases completed: "the Commission has indicated that tariff rebalancing should be completed by 1 January 2000.."

2.12 However, none of these assumptions are true of Romania. In contrast, fixed-line penetration is low in Romania relative to the rest of Europe; a significant access deficit continues to be subsidised by high call prices in the absence of tariff rebalancing; and the return generated by Romtelecom is amongst the lowest in Eastern Europe.





2.13 Accounting separation is not the most appropriate form of regulatory intervention given the current economics of the Romanian sector: the apparently high margins available on particular services offered in isolation will attract speculative competition with no corresponding increase in infrastructure investment and in fixed line telecoms and cable penetration.

2.14 It is essential that the implementation of any form of accounting separation be preceded by the rebalancing of retail tariffs and the implementation of cost-based interconnect tariffs. Failure to do so will result in misleading market signals, with potentially disastrous results for investment in the Romanian economy. In summary, by pursuing a policy of accounting separation at this time, ANRC is contradicting rather than complying with EU recommendations and experience.

3 International precedents

3.1 ANRC has proposed that Romtelecom prepare separated accounts (profit & loss accounts and statements of capital employed) to an unprecedented level of detail, specifically for 28 businesses and subdivided activities. **This is a more detailed and onerous Accounting Separation requirement than is imposed on any other telecommunications operator in the world.**

3.2 In the EU only two member countries publish audited separated accounts of the type proposed by ANRC:

	Audited separated accounts published	Audit final report published
Belgium	No	No
Denmark	No	No
Germany	No	No
Greece	No	No
Spain	No	No
France	No	No
Ireland	Yes	No
Italy	No	No
Luxemburg	No	No
Netherlands	No	No
Austria	No	No
Portugal	No	No
Finland	No	No
Sweden	No	No
UK	Yes	No
Romania	*Proposed*	*Proposed*

source: Andersen Business Consulting, *Study of the implementation of cost accounting methodologies and accounting separation by telecommunications operators with significant market power (2002)*

3.3 The two EU countries who publish audited separate accounts are the UK and Ireland. ANRC provide no justification for why Romania should emulate these two countries rather than the other 13 countries of the EU including large countries in central Europe such as Germany. What is even more astonishing is that ANRC should also require separated accounts at a greater level of disaggregation than is applied to BT in the UK and eircom in Ireland.

3.4 In the following table we compare the Accounting Separation requirements on BT plc and eircom ltd (UK and Ireland respectively) with those proposed by ANRC.

	BT (2002)	Eircom (2002)	ANRC Proposal
Access	No breakdown	No breakdown	Access to the local loop (detailed by service: bitstream, shared access, total access) Co-location access Leased lines access Other activities of the access network
Core Network	Not applicable	No breakdown	Interconnection business Co-location – interconnection Leased lines – transport Other activities
Retail Fixed	Business exchange line rental and connection Residential exchange line rental and connection	Exchange line rental & connection	Access
	Local calls	Local calls Calls to internet	Local calls Special internet access Internet access
	National calls	National calls	Long distance calls
	International calls	International calls	International calls
	Calls to mobile	Calls to mobile	Calls to the mobile public telephony networks
		Internet	
	Directory enquiries	Directory enquiries	Directory enquiries
	Public payphones	Public payphones	Public payphones
	Leased lines	Leased lines	Leased lines – retail
			Value-added services
			Telex and telegraph
	Other Retail Systems Business	Remaining activities Supplemental services	Other activities of the retail business unit
Other	Apparatus supply	Apparatus supply	Equipment provision

	Supplemental services Residual	Other remaining activities Indigo Other activities	Others External billing services
Total units & sub-units	16	20	28
HCA FAC	YES	YES	YES
CCA FAC	YES	NO	YES
Accounting standards	UK GAAP	Local GAAP (identical to UK GAAP)	National accounting standards AND International Accounting Standards

Oana – please note that we have deleted a row from the table above

3.5 In the case of both BT and eircom, the production of separated accounts followed a consultation period of several years during which time the data and modelling developments required to support such reports were agreed and undertaken. For example, the UK PSTN market was initially liberalised in 1986 but Oftel did not publish its proposals for the content and format of separated accounts until June 1992; the licence modification for accounting separation was not agreed until January 1995, almost three years later, and the first set of accounts were not published until September of 1995. In other words, the EU country in which accounting separation is most advanced took more than 10-years to implement it, while in Romania, ANRC believes that an even more detailed accounting separation process can be implemented within 2-years of liberalisation.

3.6 In contrast with the UK and Ireland, no separated accounts are produced by Deutsche Telekom in Germany; the French regulator provides no indication regarding France Telecom's accounting separation obligations; and OTE in Greece only produces separated accounts for the businesses of Core, Access, Retail and Other and for the sub-units of Interconnection and Other within the Core business.

3.7 In Hungary, separated accounts are produced on a fully allocated basis for the four vertically integrated businesses of voice telephony, leased lines, mobile services and other.

3.8 ANRC's requirements appear disproportionately onerous in the context of European precedents:

- The level of disaggregation required is excessive - more detailed than in any other country in Europe and wholly inappropriate;
- The requirement to publish audited accounts is unjustified – only two other countries in the EU have such a requirement; and
- The requirement for separated accounts to be submitted based on two sets of accounting standards (local and international) is, again, excessive – the only two EU

countries who publish regulatory accounts prepare them based on a single set of accounting standards.

4 Practical Issues

4.1 Over the past two years Romtelecom has developed a service costing capability within the TeleComPass system. Romtelecom has previously drawn ANRC's attention to this cost reporting capability and specifically, Romtelecom provided ANRC with a summary of its cost information in the course of a presentation entitled "Romtelecom – Service Costing and Profitability Project" in November 2002

In a meeting with ANRC on 13th May 2003, ANRC stated that the reporting capability outlined in this presentation met the majority of the reporting requirements set out in their draft decision document. Furthermore, ANRC appeared to conclude that the availability of such detailed reporting information indicated that Romtelecom would need only a small incremental effort in order to fully comply with their accounting separation requirements. However, ANRC is mistaken in this regard and would appeared to have mis-understood the nature of Romtelecom's existing service costing model.

4.2 The main purpose of the model is to provide a conservative indication of the extent of the access deficit (the difference between the cost of providing access lines and the revenue derived from the monthly access line rentals and connection charges).

4.3 Romtelecom's existing service costing capability is based on historical costs; in a country with high inflation like Romania, this means that the output would be of little use to ANRC for the purposes of retail price control as the returns shown by retail business would be materially misleading.

4.4 In the follow paragraphs we explain why the current model should not be used for accounting separation and what additional effort would be required to comply with ANRC's requirements. It will be self-evident that the incremental effort required to comply with ANRC's accounting separation requirements is huge, and far in excess of any conceivable benefits derived.

<u>Features of Romtelecom's existing service costing model</u>

4.5 In assessing the suitability or otherwise of the information currently contained in Romtelecom's TeleComPass service costing model, Romtelecom would like to draw the distinction between the following critical components of any service cost model:

- Outputs – the services for which Romtelecom currently produces profit and loss statements;
- Allocations – the methods used to allocate values from generic revenue and cost pools to products and services; and

- Inputs – the cost, volume and revenue information which is allocated to products and services;

- Applications – the appropriate uses for the current service cost model e.g. the monitoring of returns at a disaggregated business level; and the monitoring of the access deficit generated by Romtelecom.

Outputs

4.6 Romtelecom's TeleComPass system currently defines 76 services and can produce profit and loss and balance sheet information for each of these services.

4.7 Many of these services are common to those defined as sub-units of the access network, transport network, retail and other business units in section 1.2 of ANRC's consultation document.

4.8 However the outputs of any model can only be relied on insofar as the allocations and inputs are fit for purpose.

Allocations

4.9 At the level of allocations, Romtelecom believes that it has followed international best practice in the implementation of TeleComPass. The TeleCompass system has been implemented in many leading European operators including KPN, France Telecoms, OTE, TeleDenmark, Eircom and Vodafone

4.10 Romtelecom is willing to share with ANRC the allocation rules used in the construction of TeleComPass and in so doing comply with ANRC's requirement expressed in para 7.1.2.

4.11 In anticipation of a future series of meetings with ANRC in which the allocation rules of TeleComPass can be discussed, Romtelecom hereby declines the opportunity to discuss the validity or otherwise of the cost allocation methods provided in ANRC's consultation document (Appendix 8). In declining to comment on Appendix 8 as part of this submission, Romtelecom is in no way acknowledging or denying its validity, by implication or otherwise.

4.12 For the purposes of this submission, it is sufficient to note that insofar as an allocation process is dependent on input data on volumes and costs in order to perform calculations, the allocation process used in TeleComPass is fit for purpose.

Inputs

4.13 ANRC must not underestimate the importance of the cost standard on which the inputs are based. Fixed asset values based on historical cost **cannot** be used to measure the economic return on capital employed of disaggregated retail services in countries where high inflation exists.

4.14 In considering returns on the access business, ANRC must consider the effect of the age profile of capital employed in the access network: separated accounts based on historical cost inputs will tend to understate the value of access network assets. Capital employed in the access network will tend to rise in economic value over time as it is largely made up of labour and land values. In addition, the assets will be the oldest in a network and will therefore suffer the effects of inflation more heavily.

4.15 Therefore on the issue of cost standards alone, historical cost inputs may be used as a conservative estimate of the access deficit, but should in no way be used as a measure of the economic value generated by retail businesses.

4.16 As regards the accuracy of the data inputs, Romtelecom suffers from the same problem of harmonisation of antiquated data sources as any incumbent former state-owned monopoly. This in itself is a substantial exercise and is a necessary prerequisite to the generation of reliable values for returns earned by retail businesses.

4.17 The company is in the midst of substantial organisational change in order address these problems. In particular, it is in the process of harmonising and reconciling inputs currently sourced independently from all 41 judets in varying forms and to varying levels of detail.

4.18 In addition, the company is in the process of harmonising the 41 different judets' policies concerning the recording of fixed asset commissioning and decommissioning, the recording of network equipment volumes and activity analysis. This process of harmonisation is common to most state enterprises. ANRC must recognise that these organisational system and process developments are complex and time consuming.

4.19 The consultation document is unclear in the intended application of national accounting standards (para 4.1.2 bullet c). However, Romtelecom's current inputs are derived using **international** accounting standards only. Outputs could not currently be produced based on national accounting standards.

Applications

4.20 ANRC must be clear on how it should use separated Accounts based on historical costs prior to the data reconstruction exercises described above.

Monitoring of returns earned by disaggregated businesses

4.21 Separated accounts based on historical costs would be a misleading guide to the relative cost and profitability of disaggregated services, both wholesale and retail.

4.22 ANRC's recent decision to impose interconnection rates based on international benchmarks rather than on costs means that any Separated Accounts submitted prior to the implementation of a cost-based RIO would also fail to meet ANRC's objective of non-discrimination. Specifically, no equivalence could be demonstrated between the cost-based rates for wholesale services charged by the Interconnection business unit to the Retail business unit on the one hand, and the RIO rates for interconnection services based on international benchmarks on the other hand.

Monitoring of access deficit

4.23 In contrast, at the more aggregated business unit level (e.g. Core, Access, Retail, Other), the output of TeleComPass is a useful initial indication of the loss generated by the access business as a whole and should be used to initiate discussions on the rebalancing of tariffs.

Conclusion

4.24 It is clear that the separated accounts produced by the TeleComPass system based on historical costs should be used only for the purpose of initiating tariff rebalancing discussions.

4.25 The use of separated accounts for the monitoring of returns earned by businesses cannot be allowed before the revaluation of the asset base and the completion of the various internal projects described above.

4.26 The fact that the outputs can be applied in one area and not the other is due to the fact that a current cost valuation of the trench and copper cable in the access network will almost certainly increase the loss calculated for the access business and decrease any returns shown for retail businesses.

5 Development of the TeleComPass model

Introduction

5.1 In this section Romtelecom describes the incremental work that would need to be performed in order to comply with ANRC's accounting separation requirements.

5.2 This development process covers:

- The incremental effort being initiated by Romtelecom to produce RIO tariffs based on current cost in order to comply with ANRC's previous decision on interconnection; and

- The incremental effort required from Romtelecom to produce separated accounts that can be relied on to monitor returns earned on businesses.

Incremental effort required to produce RIO tariffs based on current costs

TeleComPass system following implementation of RIO based on current costs

	Inputs	Allocations	Outputs
Retail	CCA	SUBJECT TO CONSULTATION	Complete
Core	CCA	Complete	Complete
Access	CCA	SUBJECT TO CONSULTATION	Complete
Other	CCA	SUBJECT TO CONSULTATION	Complete

5.3 The table above summarises the changes that will be made to the inputs, allocations and outputs of the TeleComPass system in the course of the next 18-24 months in order to produce rates for interconnection services based on current costs. Specifically, the indicative cost and nature of the initiatives to be undertaken include the following:

- The reconstruction of the fixed asset register based on verification of assets (cost: up to $5 million);

- The revaluation of assets based on current cost principles of current market value and asset life (included in cost of the reconstruction of FAR);

- The cleansing of asset classes, many of which currently contain a mix of functionally distinct network elements such as transmission and switching assets (included in cost of reconstruction of FAR);.

- The standardisation of data sources used for traffic volumes. (cost: up to $3 million)

- The standardisation of data sources used for equipment volumes currently held at a regional (judet) level in various formats and to varying levels of granularity. (included in cost of data source harmonisation above)

- The standardisation of finance processes including timesheet coding and control and fixed asset accounting currently performed differently according to the individual judet. (cost: up to $2 million)

5.4 Following the completion of these initiatives, the outputs of the TeleComPass system will meet to the following requirements of ANRC expressed in its consultation document:

- Para 3.1, bullet (a): “The operator will issue.. separated accounts for.. the transport network business unit”;

- Para 3.1, bullet (b): “The operator will issue.. separated accounts for.. the access network business unit”;

- Para 3.2.1: “The (transport network) business unit will be divided into the following business sub-units: interconnection; co-location – interconnection; leased lines – transportation; other activities of the transport network.”

- Para 4.2.1: “a statement regarding the average costs of the transport.. network component, which will include.. the average cost per minute for each network component (including the cost of capital), making a distinction between the distance dependent and distance independent costs; the usage factors of the network components; .. the final tariffs”

- Para 4.3.1.: “a statement of the costs incurred with the services provided, which will separately disclose.. services offered by the transport network on the wholesale market included in the Reference Interconnect Offer.. interconnection services for call origination or call termination at fixed locations (local, regional or national level); interconnection services for switched transit; co-location services; leased line services at the transportation network level (including interconnect extension circuits); provision of access to non-geographic numbers for sundry services and Premium Rate services; operator services; directory inquiry services; other relevant services.”

5.5 In addition, the output of TeleComPass will comply with ANRC’s requirement for current costs; with the principles of the internal charges system described in para 6; and with the allocation described in para 7 insofar as it concerns the transport network business unit and its sub-units and the access network business unit and its sub-units.

<u>Incremental effort required to produce separated accounts</u>

5.6 Significant additional resource would be required for Romtelecom to add the required level of detail to cost allocations within the business units of “access”, “retail” and “other” to meet the proposals made by ANRC in its consultation document.

5.7 The developments outlined in paragraph 5.3 above would not address the following requirements given by ANRC:

- The preparation of weighted average capital employed values. A weighted average is of greater accuracy than a straight average only when the underlying data has reached an appropriate level of accuracy. It is likely that the greatest single value for capital employed – the trench network – will continue to fluctuate in value as the sampling process used to quantify it evolves over the years to come. In these circumstances, ANRC’s requirement that a weighted average be used appears excessive.. Indeed, Romtelecom notes that by explicitly excluding alternative means of calculating average capital employed, ANRC overrides the EC recommendation that weighted average values should only be used “where possible and material”.

- The analysis of hour-weighted gradients of tariffs for peak hours and off-peak hours. The requirement for such an analysis also appears excessive; indeed, no such requirement appears in the EC recommendation.

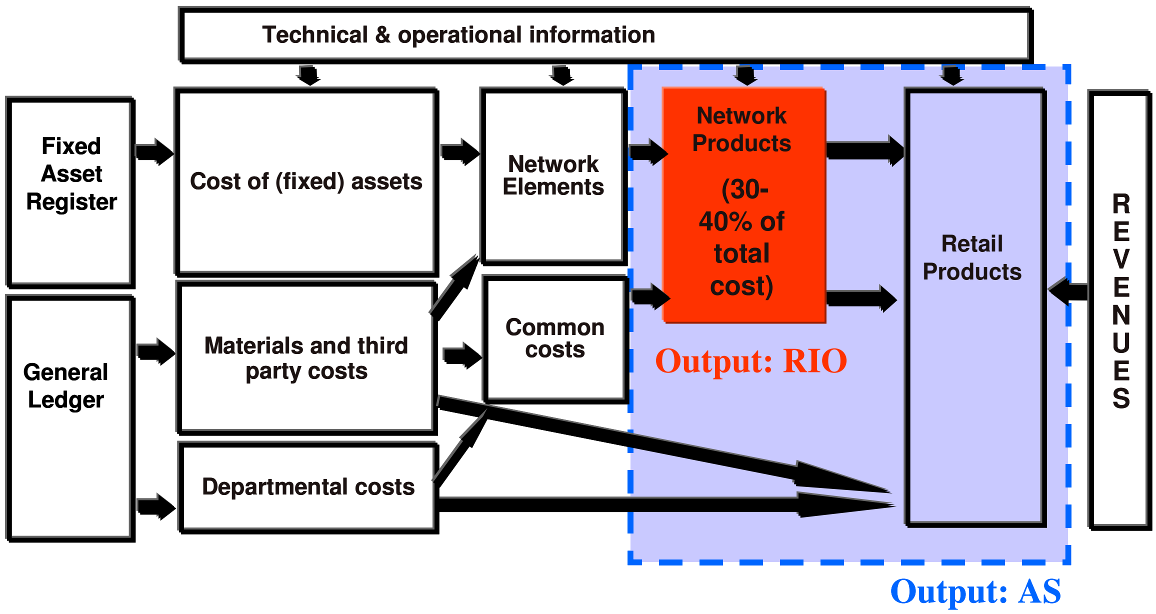
- The gathering of cable pair km, trench bore km and surface type data for different services within the access network. As the correct allocation of trench, cable and accommodation costs to bit-stream and shared access services continues to be debated in countries where the LLU market has matured, the preparation of an access network statement of costs is of low importance in Romania, where access is a loss-making service;

- The gathering and control of timesheet data on disaggregated access network services or disaggregated retail services. As an example, control of staff cost data will focus on the distinction between network-specific activities; activities common to network and retail; and retail-specific activities. Any further analysis of retail-specific activities would be extraneous to the development of a reference interconnect offer based on current costs.

- The gathering and control of non-staff expenses for diaggregated access network services and disaggregated retail services, for the same reasons as outlined above.

- The reconciliation of leased line data sourced from network mangement systems and billing systems. For the purposes of producing a Reference Interconnect Offer, Romtelecom is focussed instead on the derivation of reliable data on aggregate core network capacity requirements for the leased line business.

5.8 To place this in the context of the development of TeleComPass, the diagram below compares the focus of the initiatives being undertaken by Romtelecom over the next 18-24 months in order to produce a RIO based on current costs and the incremental effort required over and above this to do accounting separation (AS).



5.9 Each of the initiatives outlined in para 5.6 would need to be undertaken in order to produce separated accounts to the level of detail suggested by ANRC. It is not appropriate for Romtelecom to incur the additional expense required to do so, given the relative importance of detailed accounting separation and international precedents described in the previous sections.

6 Cost of compliance with ANRC's requirements

6.1 Public information relating to the costs of preparing Separated Accounts is not readily available. However, we present in the following table certain relevant information for BT, eircom, OTE and, for comparison only, illustrative information for Romtelecom.

	BT (UK)	eircom (Ireland)	OTE	Romtelecom
Total staff (thousands)	109 [1]	12 [2]	17 [4]	30 [5]
Turnover (m)	34,745 [1]	1,785 [2]	4,312 [4]	942 [5]
Number of lines (thousands)	29,113 [1]	1,848 [3]	6,293 [4]	4,200 [5]
Regulatory audit fees (m)	1.6 [1]	Not separately disclosed	Not applicable	1.6?
Estimated number of full time equivalents working on production of regulatory accounting information [6]	40	30	10	40+? (the Company currently employs less than 3 FTE) [5]

Notes
1. BT report and accounts for the year ended 31 March. Regulatory audit fee of £1.1 million, turnover £26,642m;
2. eircom report and accounts for the year ended 31 March 2001 e
3. sub 2Mb line equivalents, eircom regulatory accounts for the year ended 31 March 2002
4. OTE report and accounts for the year ended 31 December 2002
5. Romtelecom report and accounts for the year ended 31 December 2002. Currently employs 2.5 full-time equivalents (FTE) in service costing
6. Estimate based on discussions with BT, eircom and OTE

6.2 It is notable that the costs and resources associated with preparing regulatory accounts and the audit of these accounts appear to be largely independent of scale. Indeed, the cost of the regulatory reporting function appears rather to be a function of the level of disaggregation of the businesses for which accounts are prepared, with OTE requiring significantly fewer staff than BT and eircom - reflecting the significantly lower level of disaggregation required.

6.3 At the time of writing Romtelecom resources employed on service costing amount to 2.5 full-time equivalents. The company estimates that a minimum of 40 people - and potentially far more will be required to implement ANRC's current proposal.

6.4 The table above also demonstrates that ANRC's proposals for the audit of Separated Accounts set out in paragraph 4.1 bullet (g) and in paragraph 5.1 are unduly onerous and costly. In the year ended March 2002 BT disclosed fees to its auditors in respect of regulatory audit work of €1.6 million. Such a level of fees would likely be the same in Romania since the audit personnel with the skills and experience required to undertake such an audit are likely to be sourced from the auditor's western European practices.

6.5 The value of an external audit is reduced if ANRC is in a position to review the suitability of the Separated Accounts methodology and the detail behind their production. This is the case in Romania.

6.6 Romtelecom believes that the additional cost of an external audit, particularly of the form proposed by ANRC, is not warranted, particularly where ANRC is in a position to review the Separated Accounts itself. ANRC's own draft decision on accounting separation indicates that it potentially has the capability to review the suitability of the separated accounts without resorting to costly third party review. Indeed, ANRC is extremely well resourced by international standards. employing 155 staff after only 8 months in operation. ANRC confirmed that it has 3 full-time equivalents (FTE) focused on accounting separation compared. This compares with only 2.5 FTE employed by Romtelecom on service costing.

6.7 In the context of costs ultimately borne by the customers of Romtelecom, both wholesale and retail, the cost of Romtelecom's compliance would be minimised by:

- substantially reducing the number of separated businesses and activities for which separated accounts are prepared through the aggregation of minor activities (see section 8); and

- replacing the proposed requirement for an independent audit of Separated Accounts with a review of separated accounts by ANRC.

7 Incremental benefit of publication

7.1 Separated accounts are not published in EU countries with the exception of two. The EU acknowledges the limited use of publication of separated accounts in the initial years of implementation: "information that is proven to be commercially confidential should not be published"…"NRAs should consider the extent to which information is published in the first year after adoption" (source: *Commission Recommendation of 8 April 1998 on interconnection in a liberalized telecommunications market (Part 2 – Accounting separation and cost accounting)*)

7.2 As a general rule, published financial statements should meet the following criteria:

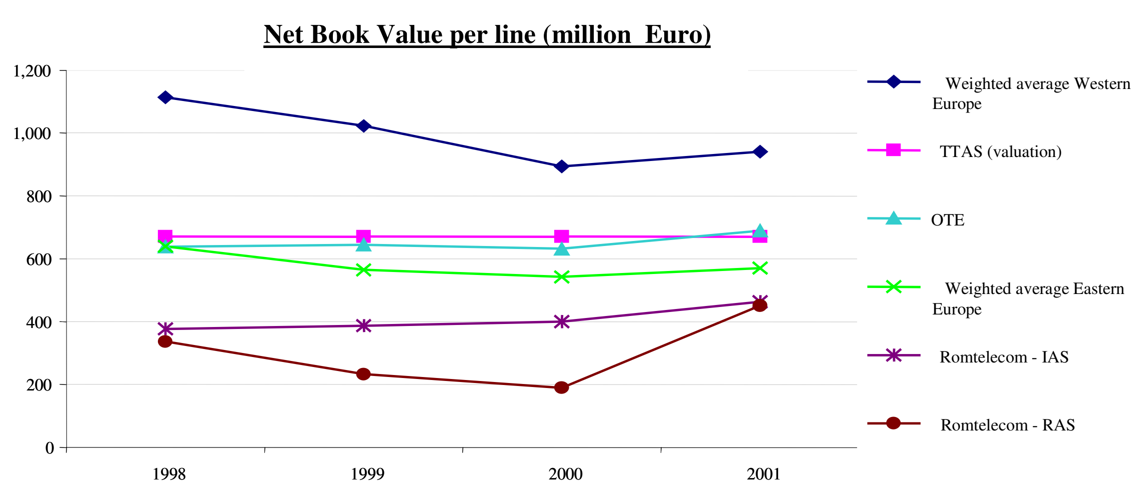
- consistency of one reporting period to the next;
- comparative value - between different reporting entities (in this case other operators); and
- meeting users' information requirements.

<u>Consistency</u>

7.3 As set out in section 6, any values reported by Romtelecom to ANRC will be subject to an unquantifiable risk of misstatement as long as the verification of input data through sampling continues. Consistency of values reported from one period to the next will be materially jeopardised as a result.

<u>Comparative value</u>

7.4 The scale of change in comparative value of any outputs produced prior to the completion of the developments set out in section 6 can be illustrated by the graph below. Romtelecom appears to employ a markedly low level of capital relative to other operators in Eastern and Western Europe. This comparison is likely to change dramatically following the completion of the developments set out in chapter 6.



User requirements

7.5 In terms of user requirements, the combination of materially changing input values and the continuing existence of tariff imbalances reduces the value of separated accounts to virtually nil.

7.6 Until such time as Romtelecom can agree with ANRC a form of accounting separation that is of value to the development of the Romanian telecommunications sector, none of these criteria on which the value of published financial statements will be met.

7.7 Romtelecom is of the view that the risk of providing the market with inappropriate signals regarding the apparent return or loss generated by individual businesses outweighs any potential benefit of publication.

8 Alternative way forward

8.1 Romtelecom rejects on grounds of principle and practicality the accounting separation proposals of ANRC. However, the company is willing to discuss how Romtelecom's existing service costing capabilities and planned enhancements can be refined to meet ANRC's requirements.

8.2 Romtelecom believe that its existing TeleCompass service costing capability, the fixed asset reconstruction (FAR) project and the CCA costing work, both initiated to support the interconnection RIO, will, taken together, provide ANRC with a substantial level of accounting disaggregtion.

8.3 In the following paragraphs, we elaborate on what Romtelecom will be able to provide to ANRC and over what period.

<u>Level of disaggregation</u>

8.4 The implementation of the FAR project mentioned above, coupled with the existing allocations and output functionality of the TeleCompass model will enable Romtelecom to provide ANRC with profit and loss accounts and statements of average captial employed (disclosing return on average capital employed) for the following business units and sub-units in respect of the year ending 31 December 2004:

- Retail business;
- Core network business, including the sub-units "interconnection", "co-location – interconnection", "leased lines – transportation", "other activities of the transport network";
- Access network business;
- Other business

8.5 Romtelecom agrees with the definitions of the business units and sub-business units provided by ANRC in paragraphs 1.2.3.1 – 1.2.3.4 and 1.2.4.1 – 1.2.4.4.

8.6 In addition to the above statements, Romtelecom proposes to provide ANRC with the following in respect of the year ending 31 December 2004:

- Statement of average costs of the Core network as described in paragraph 4.3 of the consultation document;
- Statement of network costs of the services offered by the core network on the wholesale market, as defined in the Reference Interconnect Offer;
- Statement of internal charges between the core network business and the retail business;

- An appropriate reconciliation between the separated accounts and the statutory accounts using the IAS standard;

- Explanatory notes for the accounts described in paragraph 8.4 above;

- Accounting policies used in the preparation of the accounts;

- Definitions of the business units and sub-units for which accounts have been provided; and

- Supporting documentation on the allocation methodology used to produce the separated accounts described in section 8.4 above.

8.7 The definitions of the business units and sub-units listed in paragraph 8.4 above will be aligned with those provided in the relevant paragraphs of ANRC's consultation document

Implementation timeframe

8.8 Romtelecom proposes that an initial reduced set of separated accounts be submitted following the implementation of a Reference Interconnect Offer based on current costs, specifically for the year ending 31 December 2004.

Format of statements

8.9 Romtelecom agrees that ANRC's proposed formats for the Separated Accounts set out in Appendix 2 of the consultation document are generally sensible and appropriate. However, the proposed disaggregation of current assets and liabilities in

	Current Year	**Prior Year**
Fixed assets	X	X
Current assets less current liabilities and provisions for liabilities and charges	X	X
Capital employed	**X**	**X**

the capital employed statement is excessive and confers little or no benefit. Romtelecom therefore proposes that a more aggregate statement of capital employed be adopted in the form set out below.

Audit requirements

8.10 Romtelecom proposes to submit the separated accounts for review by ANRC. For the reasons already stated, there is no case for a formal audit.

Publication requirements

- Romtelecom proposes that any separated accounts submitted to ANRC be treated as commercially confidential documents in order to protect potential users from the risk of material misstatement.

8.11 In summary, Romtelecom believes that its proposed alternative way forward provides ANRC with accounting separation to a level consistent with international experience at minimum cost to the future development of the Romanian telecommunications sector.