

COMMERCE COMMISSION

**Draft Notification of Information Disclosure Requirements on  
Telecom New Zealand under Part 2B of the Telecommunications Act**

**Date:** 23 October 2008

## INTRODUCTION & OBJECTIVES

1. Part 2B of the Telecommunications Act 2001 provides for the public disclosure of information about Telecom and other providers of regulated services in accordance with requirements made from time to time by the Commission. These requirements are separate and in addition to any disclosure requirements in Part 2A which relate to the operational separation of Telecom. These requirements are made to meet regulatory objectives and therefore the published information will be different from both Telecom's statutory financial reporting and their management accounts, though they will use the same core financial and operational systems and data.
2. The purpose and parameters of the Part 2B information disclosure regime are set out in sections 69Y and 69Z of the Telecommunications Act:

### **69Y Purpose**

The purpose of this Part is to promote competition in telecommunications markets for the long-term benefit of end-users of telecommunications services in New Zealand by requiring that reliable and timely information prescribed by the Commission is made publicly available—

(a) by Telecom, so that a wide range of people are informed about the operation and behaviour of Telecom's network, wholesale, and retail business activities and services; and

(b) by access providers, including Telecom, so that a wide range of people are informed about the operation and behaviour of prescribed businesses that provide prescribed services, in order to monitor and facilitate compliance with prescribed applicable access principles.

3. Section 69ZB(1) sets out the mandatory regulatory reporting disclosure for accounting separation of Telecom:

The Commission must require Telecom to prepare and disclose information about the operation and behaviour of all or part of its network, wholesale, or retail activities as if those activities were operated as independent or unrelated companies.

4. These information disclosure powers are not limited to regulated services but extend to unregulated network, wholesale and retail services. Section 69ZB(2) extends to any activity or service within the network, wholesale or retail categories.
5. Section 69ZB(4) contains a list of other information that the Commission may require Telecom to disclose, including financial statements; asset valuations; prices, terms and conditions; costs and cost allocation methodologies; contacts; related party transactions; financial and non-financial performance measures; plans and forecasts, transfer payments; network capacity information; and policies and methodologies. Under Section 69ZB(5) the Commission may define business activities and services, require the adoption of certain methodologies, and the information to be included in financial statements.
6. Under section 69Z the Commission's requirements must be reasonable having regard to the purpose in section 69Y, the confidentiality of the information in question, and the time required to prepare the information. In developing these requirements the Commission has sought to utilise as much of the systems and information which Telecom maintains for existing financial purposes as possible.

7. This paper gives public notice of the information disclosure requirements under section 69ZB of the Telecommunications Act 2001 ('the Act') in relation to the transitional year ending 30 June 2009 and the full reporting year ending 30 June 2010. This paper identifies the regulatory reports which Telecom will be required to prepare, definitions of the business activities which Telecom must prepare and disclose information on, the accounting methodologies which Telecom must follow, the audit requirements and the transitional provisions, including the transitional milestone dates. These regulatory reporting requirements are different from and in addition to statutory financial reporting requirements and the reporting required by the operational separation undertakings.

## **COMMISSION APPROACH TO REGULATORY FINANCIAL REPORTING**

8. In making these requirements the Commission has considered both its specific responsibilities under the legislation as well as the responses from the consultation process on the Draft Principles Paper<sup>1</sup> that was publicly released in June 2008.
9. As noted above, section 69ZB(1) of the Act sets out the accounting separation requirements for the disclosure of financial statements of Telecom's business activities. The network, wholesale or retail business activities referred to in this section of the Act will not necessarily correspond to the managerial structure of Telecom. The Commission defines the network, wholesale or retail business activities through "groups of services" on the basis that Telecom's business activities enable the delivery of services or products to the markets, in a manner consistent with Telecom's separation undertakings. These groups of services (as defined later in this document) represent a robust, market-orientated structure against which interested parties can assess some aspects of Telecom's operation and behaviour.
10. Section 69ZB(2) extends this information disclosure to any activity or service within the network, wholesale or retail categories. The Commission considers that the publication of information relating to the performance of regulated and commercial (not-regulated) services is essential to provide transparency of financial performance especially with respect to the relationship between costs and prices for services.

### **Regulatory View of Telecom's Products and Services**

11. A key element in the Commission's approach to regulatory financial reporting is defining the financial relationship between inputs (resources such as capital invested in assets, people and other inputs that are used in the production process) and output markets (the products and services, delivered to customers). The Commission defines this relationship in terms of the fundamental activities that Telecom undertakes to produce outputs and how the network assets are used in the same production process.
12. The financial measures of revenues, costs, assets and short-term liabilities are each related in some way to the activities that Telecom undertakes to produce services and products and the attribution methodology described in Appendix E sets out the Commission's method for defining that relationship.

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<sup>1</sup> Copies of this draft paper, submissions and cross-submissions can be found on the Commission's website at <http://www.comcom.govt.nz/IndustryRegulation/Telecommunications/AccSepofTelecom/documents.aspx>

### **Other Significant Points Regarding the Commission's Approach**

13. The following points are noted as especially significant in the Commission's approach to regulatory financial reporting:

- Regulatory financial statements are required on the basis of those services and service groups prescribed by the Commission. Appendix A summarises the regulatory statements that are required and Appendix B presents example templates of some of these regulatory statements. The final format and presentation of the regulatory statements will be determined by Telecom in consultation with the Commission;
- The Commission requires Telecom to adopt a particular attribution methodology when preparing the required regulatory statements. The methodology is based on the requirements that revenues, costs, assets, and short-term liabilities must be fully attributed to the prescribed business activities and services, and that causality is the key to the attribution process;
- Assets will be valued using both the historical cost (HCA) and current cost (CCA) methodologies. Since Telecom already prepares statutory accounts using the historical cost methodology, the implementation of this methodology for the purposes of regulatory financial reporting will be achievable during the 2008/09 transitional year. In its submission on the Draft Principles Paper, Telecom supported the use of the current cost methodology and has already valued its network assets using this methodology including those assets controlled by Chorus;
- Detailed information on access and wholesale service costs, and retail product costs are required to enable the Commission to monitor compliance with the attribution methodology. This information will also enable the Commission to monitor the implementation of the access principles and the equivalence of inputs requirements embedded in the operational separation undertakings;
- Telecom must disclose the way in which it applies the accounting policies and attribution methodologies prescribed by the Commission, in a manner that a reasonably informed person can read and understand both the documented processes and the regulatory financial statements; and
- The timeline is a significant factor in the implementation process. The year to 30 June 2009 is a transition year which allows details of methodologies, system changes etc to be determined and implemented in advance of 1 July 2009 from when the Commission requires full regulatory reporting to commence. The Commission will therefore require a limited set of regulatory reports for the 2008/09 transitional year.

### **REGULATORY REPORTING REQUIREMENTS**

14. This section specifies the regulatory financial reports required for years ending 30 June 2009 and 30 June 2010. The Commission's requirements are based on two regulatory financial statements, being a regulatory statement of financial performance and a regulatory statement of mean capital employed, for prescribed business activities under section 69ZB(1), or for specific services under section 69ZB(2). These regulatory statements are supported by a regulatory statements of assets for some service groups

which is required under section 69ZB(2). Appendix A summarises the regulatory financial statements that are required. Appendix B presents templates for several statements, however Telecom will determine the regulatory report's final format and presentation in consultation with the Commission. The Commission also requires the initial regulatory financial statements to be prepared on both an historical cost and a current cost basis and requires reconciliation between the two reporting standards as well as to the statutory accounts.

15. For the transitional year ending 30 June 2009, Telecom is required to prepare and disclose the following regulatory financial statements:
  - a. Regulatory Consolidated Statements of Financial Performance and Mean Capital Employed, that shows a summary regulatory financial overview of the revenues, costs and mean capital employed in all of Telecom's service groups (service groups are as defined in these requirements);
  - b. A separate Regulatory Statement of Financial Performance for each of the Access, Wholesale (regulated and commercial services), Retail, and Corporate and International service groups;
  - c. A separate Regulatory Statement of Mean Capital Employed for each of the Access, Wholesale (regulated services and commercial services), Retail, and Corporate and International service groups;
  - d. An opening Regulatory Statement of Assets for the Wholesale (regulated services and commercial services) service group; and
  - e. A closing Regulatory Statement of Assets for each of the Access and Wholesale (regulated services and commercial services) service groups.
  
16. For the financial year ending 30 June 2010, Telecom is required to prepare and disclose full regulatory financial statements, as follows:
  - a. Regulatory Consolidated Statements of Financial Performance and Mean Capital Employed that shows a summary regulatory financial overview of the revenues, costs and mean capital employed in all of Telecom service groups (service groups are as defined in these requirements);
  - b. A separate Regulatory Statement of Financial Performance for each of the Access, Wholesale (regulated services), Wholesale (commercial services)<sup>2</sup>, Retail, and Corporate and International service groups;
  - c. A separate Regulatory Statement of Mean Capital Employed for each of the Access, Wholesale (regulated services), Wholesale (commercial services), Retail, and Corporate and International service groups;
  - d. A closing Regulatory Statement of Assets for each of the Access, Wholesale (regulated services), and Wholesale (commercial services) service groups; and

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<sup>2</sup> The Wholesale Service Group is to have separate reporting of the regulated and commercial services to reflect the fact that this service group includes the core network assets which are used to deliver regulated and commercial services to external service providers and to Telecom's own internal retail business units. As the product migration plans in the Operational Separation Undertakings are delivered on through to 2012, the mix of regulated and commercial services that make up the Wholesale Service Group will change.

- e. Product Statements as required by the Commission. The Commission's initial requirement is that Telecom will prepare Product Statements for all regulated services in a format similar to the template in Appendix B. Given that Telecom will have attributed its assets and costs to individual services, this requirement is both reasonable and achievable.
17. For both reporting years Telecom must reconcile the regulatory Consolidated Statements of Financial Performance and Mean Capital Employed to the financial statements published in its Annual Report, and explain any reconciling items to the satisfaction of the Commission. The reconciliation procedures will be subject to approval by the Commission under section 69ZB(5)(b) and (d). The procedures will include the reconciliation of the assets, as valued using the historical cost methodology, in the statutory financial statements to the assets as valued using the historical cost methodology in the regulatory Consolidated Statement of Mean Capital Employed.
  18. Under section 69ZB(4), Telecom is also required to reconcile the differences between the historical cost and current cost asset valuations and disclose details of the underlying methodology.
  19. For both reporting years the regulatory statements must be completed in accordance with the templates in Appendix B and any amendments, as determined by Telecom in consultation with the Commission, or advised in writing by the Commission that may be required.
  20. Where possible, the Commission requires prior year comparisons to be provided for all regulatory financial statements prepared for the year ending 30 June 2010. If there is a change of regulatory reporting format the prior year comparisons must be restated in the new format.

## **DEFINITIONS OF THE SERVICE GROUPS**

21. For reporting under section 69ZB(1), the Commission has determined that all of Telecom's business activities will be assigned to one (and only one) of four prescribed service groups in the manner set out below. The following definitions apply to these four prescribed service groups (as noted earlier, the term "service groups" is the equivalent to "business activities" referred to in section 69ZB(1)):
  - a. The service group associated with network access is defined as those Relevant Network Access Services provided by the Local Access Network, as defined in clause 18.2 of the Telecom separation undertakings. (To be reported as Access Services);
  - b. The service group associated with wholesale services is the Relevant Wholesale Services as described in clause 45.2 of the Telecom separation undertakings plus any other services, other than Relevant Network Access Services, provided on a wholesale basis, whether internally to Telecom or to other service providers. (To be reported as Wholesale Services);
  - c. The service group associated with Telecom's retail business is defined as those products that are sold by Telecom's retail functions, as referred to in clause 68 of the Telecom separation undertakings. (To be reported as Retail Products); and

- d. The service group associated with Telecom's corporate management and international services are those activities that are not included in any of the above definitions. (To be reported as Corporate and International Services).

## REGULATORY REPORTING CONDITIONS

22. In meeting these regulatory reporting requirements Telecom must comply with the following requirements which relate to quality standards and processes; methodologies for attribution and valuation; and documentation, publication and record keeping.

### Use of Generally Accepted Accounting Practices (GAAP)

23. Where the Commission has issued specific requirements under Part 2B of the Act relating to accounting policies or practices, then those requirements will have priority when preparing these regulatory financial statements. Otherwise, Telecom should conform to the New Zealand accounting standards (NZ GAAP), when disclosing accounting information.

### Qualitative Characteristics

24. The regulatory financial statements that Telecom is required to publish must be in a form which a reasonably informed person can read and understand. As a guideline, Telecom must adhere to the qualitative characteristics of financial reports as specified by the New Zealand accounting profession in the paper, *New Zealand Equivalent to the IASB Framework for the Preparation and Presentation of Financial Statements*.<sup>3</sup> This includes compliance with the four principal qualitative characteristics of understandability, relevance, reliability and comparability.<sup>4</sup>
25. Telecom's regulatory reporting must be consistent both across regulatory financial statements in the same year and between years. Any change of methodology resulting from the 2008/09 transitional requirements must be approved by the Commission in advance and the extent of the impact of the change disclosed.

### Attribution

26. Telecom must attribute its revenues, costs, assets, and short-term liabilities on the basis of causality in accordance with the methodology outlined in Appendix E. All non-financial data used for attributions must be current, objective, and auditable.

### Transfer Charges

27. Appendix E sets out the Commission's methodology for the attribution of revenues, costs, assets, and short-term liabilities to services and products supplied to Telecom customers. For clarity in understanding the Commission's approach to monitoring the supply of services from one Telecom group to another, the following should be noted.
28. Where there is an arm's length, documented, arrangement in place for a Telecom group to supply another with services, then income from the resulting transactions should be recorded as internal revenue in the financial statements. As set out in the Undertakings<sup>5</sup>,

<sup>3</sup> FRSB of NZICA, *New Zealand Equivalent to the IASB Framework for the Preparation and Presentation of Financial Statements*, June 2005, amended January 2008

<sup>4</sup> *ibid*, F.24

<sup>5</sup> A copy of the undertakings is located at

<http://www.comcom.govt.nz/IndustryRegulation/Telecommunications/OperationalSeparationofTelecom/ContentFiles/Documents/Telecom%20Separation%20Undertakings.pdf>

these trading arrangements should include terms of supply including a price or transfer charge.

29. Where there is no arm's length documented arrangement for the supply of internal services but the attribution methodology requires (for instance) all costs from a support group like T&SS to be attributed to market facing activities or to network components, then these costs need to be charged in accordance with the cost attribution methodology detailed in Appendix E.

### **Asset Valuation**

30. Telecom is required to apply both the historical cost and current cost methodologies when preparing the required regulatory financial statements (including product statements) for the initial reporting years. This requirement applies to both the asset valuations and those financial items, such as depreciation charges, which are derived from the asset valuations.
31. All methodologies used in the asset valuation process, and the details of the reconciliation between the historical cost and current cost asset valuations must be disclosed.

### **Mean Capital Employed**

32. For the Regulatory Statements of Mean Capital Employed, Telecom must determine mean capital employed as the sum of fixed assets, intangible assets, inventories and debtors less creditors, and any short term provisions. The mean is computed as the average of the start capital employed and end value for the year. This definition excludes taxes, dividends payable, debt (short and long term), and goodwill. In simple terms the Mean Capital Employed is equivalent to the sum of Telecom's fixed assets and working capital.

### **Deficiencies in Regulatory Financial Statements**

33. Should either the Commission or the external auditor identify any deficiencies in any regulatory financial statement or other disclosed information, under section 69ZD the Commission may require Telecom to address the deficiency and publish the revised statements.

### **Publication**

34. Telecom will publish the required regulatory reports by way of:
- Public disclosure of all required regulatory financial statements & information on an appropriate internet website, and
  - Making regulatory reports available at specified offices.
35. In addition as per section 69ZF, Telecom must supply a copy of this information to the Commission. As per section 69ZD(1) the information supplied to the Commission is to be in a format to be prescribed by the Commission.

### **Maintenance of Accounting Records**

36. Telecom will maintain accounting records on which regulatory financial statements are based for six years from when the statements were first disclosed.

## Supporting Documentation

37. For both the transitional and the full regulatory reporting year Telecom must disclose the manner in which the methodologies prescribed by the Commission in accordance with sections 69ZB(5)(b) and (c) have been applied.
38. At a minimum, this disclosure shall include:
- Attribution Methodologies Manual which includes descriptions of both the systems and processes used to implement the attribution methodology in appendix E as well as the development of the Network Component schedule in appendix F. This manual will also include detail of the calculation of WACC used for this regulatory reporting, and the procedures for managing changes to the systems and processes used in preparing these regulatory reports;
  - Asset Valuation Manual which details the application of both the historical cost and current cost asset valuation methodologies;
  - Accounting Policies Manual which details the application of all other accounting principles and policies;
  - Audit scope and the audit letter of engagement; and
  - Detailed templates for all required regulatory financial statements, and any statutory declarations required by the Commission under section 69ZF(3)(b).
39. In preparing the Attribution Methodologies Manual, Asset Valuation Manual, and the Accounting Policies Manual, Telecom is not required to re-document procedures which are already documented to the required level of detail in their statutory accounts and are consistent with the regulatory reporting conditions.

## AUDIT

40. Telecom is required to engage an independent auditor(s) to review the required regulatory financial statements for the transitional year ending 30 June 2009 and the full reporting year ending 30 June 2010.
41. For both years Telecom is required to include the Commission's specific requirements in the audit scope. The Commission will discuss its requirements of the audit process with Telecom in advance of the respective implementation dates specified in Appendix C.
42. The Commission's audit requirements are set out in detail in Appendix D.

## TRANSITIONAL PROVISIONS

43. Telecom is required to meet, or in the case of the audit opinions engage an independent auditor to meet, the transitional milestones specified in Appendix C in relation to implementing capability and regulatory reporting on the transitional year ending 30 June 2009 and for regulatory reporting on the financial year ending 30 June 2010.
44. In order to ensure that transitional milestones are met, and that information is produced in a timely manner, Telecom is required to meet with and report to the Commission on progress in meeting these milestones on a monthly basis.

## COMPLIANCE MONITORING

45. Section 69ZF(1)(b) allows the Commission to request in writing further information for the purposes of monitoring Telecom's compliance with the regulatory reporting requirements under part 2B of the Act. This information is to be supplied to the Commission and will not be publicly disclosed.
46. The information requested for monitoring purposes is largely detailed information which is derived from the information that Telecom will have used in preparing the regulatory financial statements. Comparison of this information to the regulatory financial statements will help the Commission to monitor Telecom's compliance with the Commission's requirements.
47. Telecom is requested to provide:
- Separate closing Detailed Regulatory Statements of Assets for each of Wholesale Services and Access Services. These statements will list to the same level of detail as Telecom's fixed asset register all of the assets for each service group. This statement will be prepared using the same asset classifications as used in the Regulatory Statement of Assets. For the reporting year ending 30 June 2010 Wholesale Services should be divided between regulated and commercial services;
  - A Regulatory Statement of Capital Investment which lists all capital expenditure made during each reporting year relating to those assets covered by the Regulatory Statements of Assets. This Statement will describe the investment, the purpose of the investment, the dollar amount invested, the asset type and the relevant service groups using the same classifications as used for the Regulatory Statements of Assets;
  - A Schedule of Network Components and a Network Activity Statement. These schedules are to be prepared at a component specific level and will detail each functional element of the network that enable the delivery of a service or retail product delivered by the Access, Wholesale or Retail Service Groups. The network component schedules are described in detail in appendix F;
  - Standalone (ceiling) and variable only (floor) unit cost data for each product or service that requires a product statement, as defined by the Commission. This unit cost information is not required for the year ending 30 June 2009; and
  - Other information to enable the Commission to monitor the application of the attribution methodologies and to give transparency to efficiency and non-discrimination objectives in the Act. The Commission will confirm these other information needs in writing during the transitional year.
48. During the transition year, the Commission will discuss with Telecom the methodologies used in preparing the requested information and the format in which it will be provided to the Commission. The Commission will advise Telecom of any clarification(s) to this request under section 69ZF(1)(b) in writing.

## APPENDIX A: SUMMARY OF REGULATORY REPORTING & COMPLIANCE MONITORING REQUIREMENTS

This appendix presents a summary table of Telecom's regulatory reporting requirements and compliance monitoring requests for the transitional year ending 30 June 2009 and the full reporting year ending 30 June 2010. The table sets out the minimum requirements.

<b>Regulatory Financial Statements</b>	<b>2008/09</b>	<b>2009/10</b>
Regulatory Consolidated Statement of Financial Performance (Current cost and Historical cost)	Y	Y
Reconciliation of Consolidated Statement of Financial Performance	Y	Y
Regulatory Consolidated Statement of Mean Capital Employed (Current cost and Historical cost)	Y	Y
Reconciliation of Mean Capital Employed Statement	Y	Y
Regulatory Statement of Financial Performance for each Service Group (Current cost and Historical cost)	Y	Y
Regulatory Statement of Mean Capital Employed for each Service Group (Current cost and Historical cost)	Y	Y
Regulatory Statement of Assets for Access Services	Y	Y
Regulatory Statement of Assets for Wholesale Services	Y	Y
Consolidated Product Statement of Financial Performance		Y
Consolidated Product Statement of Mean Capital Employed		Y
Access, Wholesale and Retail Services Product Statements		Y

<b>Compliance Monitoring Requests</b>	<b>2008/09</b>	<b>2009/10</b>
Detailed Regulatory Statement of Assets for Access Services	Y	Y
Detailed Regulatory Statement of Assets for Wholesale Services	Y	Y
Regulatory Statement of Capital Investment	Y	Y
Schedule of Network Components	Y	Y
Network Activity Statement	Y	Y
Standalone and Variable Unit Costs		Y
Other information (to be requested)	Y	Y

## APPENDIX B: REGULATORY REPORTING TEMPLATES

This appendix contains some examples of the regulatory reporting templates, including the minimum information content, for the schedule of regulatory financial statements set out in appendix A. As noted earlier the form and presentation can be determined by Telecom within these minimum requirements.

### Service Group

#### Regulatory Financial Performance Statement

Year to 30 June 200X	HCA		CCA	
	200X	200Y	200X	200Y
<b>Revenues</b>				
Internal Revenues				
Internal sales to Wholesale				
Internal sales to Retail				
Internal sales - Other				
External Revenues				
External Sales				
<b>Total Revenue</b>				
<b>Expenses</b>				
Planning & development				
Provision/maintenance				
Network support				
General support				
General management				
Finance & billing				
Accommodation				
Personnel & admin				
Marketing and sales				
Other operating expenses				
<b>Total Expenses</b>				
<b>EBITDA</b>				
Depreciation				
Amortisation				
<b>EBIT</b>				
Capital Charge				
<b>Regulatory Earnings before Tax</b>				

## Service Group

### Regulatory Statement of Mean Capital Employed

Year to 30 June 200X

	HCA		CCA	
	200X	200Y	200X	200Y
<b>Assets</b>				
Current assets:				
Receivables and prepayments				
Inventories				
<b>Total current assets</b>				
Non-current assets:				
Property, plant and equipment				
<b>Total non-current assets</b>				
<b>Total assets</b>				
Short-term liabilities:				
Accounts payable and accruals				
Short-term provisions				
<b>Total short-term liabilities</b>				
<b>Total Capital Employed</b>				
<b>Mean Capital Employed</b>		X		X





## Regulated Service - Proforma

### Regulatory Product Financial Performance Statement

Year to 30 June 200X

	HCA		Vol	CCA		Vol
	200X	200Y		200X	200Y	
<b>Revenues</b>						
Internal Revenue						
External Revenue						
<b>Total Revenue</b>						
<b>Expenses</b>						
Directly Attributable Costs						
Network Costs						
Shared Costs from:						
Access						
Wholesale (inc T&SS)						
Corporate						
Retail						
<b>Total Expenses</b>						
<b>EBITDA</b>						
Depreciation						
Amortisation						
<b>EBIT</b>						
Capital Charge						
<b>Regulatory Earnings before Tax</b>						
Revenue per Unit - Internal	X	X		X	X	
Revenue per Unit - External	X	X		X	X	
Average Cost per Unit	X	X		X	X	

## APPENDIX C: TRANSITIONAL MILESTONES

Telecom is required to meet, or in the case of the audit opinions engage an independent auditor to meet, the transitional milestones specified in the table below in relation to implementing capability and regulatory reporting on the financial year ending 30 June 2009.

### Transitional Milestone for year ending 30 June 2009

Month	Milestone
14 November 2008	Advise Commission in writing of financial systems, processes and input data sources available for preparing regulatory accounts
12 December 2008	Preliminary Accounting Policies Manual, Attribution Methodologies Manual and Asset Valuation Manual. Preliminary details to be the process level
19 December 2008	Issue tender for the regulatory audit work which includes a detailed audit scope
20 March 2009	Telecom publishes opening Statement of Assets controlled by the Wholesale Services Group.
27 March 2009	Telecom provides a copy of the opening Statement of Assets controlled by the Wholesale Services Group to the Commission along with any related confidential information
27 March 2009	Complete initial Accounting Policies Manual, Attribution Methodologies Manual and Asset Valuation Manual
27 March 2009	Preliminary Schedule of Network Components
31 March 2009	Auditor formally engaged
30 June 2009	Auditor provides draft audit opinion on manuals to the Commission
12 November 2009	Draft regulatory financial statements provided to the Commission
18 November 2009	Auditor provides draft audit opinion on regulatory financial statements to the Commission

### Reporting milestones for year ending 30 June 2009

Month	Milestone
2 December 2009	Telecom publicly discloses required regulatory statements & information not previously publicly disclosed.
2 December 2009	Auditor provides final audit opinions to the Commission
9 December 2009	Telecom provides to the Commission all remaining information required under section 69ZF(1)(a) and (b)

Telecom is required to meet, or in the case of the audit opinions engage an independent auditor to meet, the milestones specified in the table below in relation to regulatory reporting on the transitional year ending 30 June 2010.

### **Milestone dates for year ending 30 June 2010**

<b>Month</b>	<b>Milestone</b>
27 March 2010	Revised Accounting Policies Manual, Attribution Methodologies Manual and Asset Valuation Manual
27 March 2010	Identify areas for revision to Schedule of Network Components
16 June 2010	Auditor provides draft audit opinion on change process and material changes to the Commission
30 June 2010	Auditor provides final audit opinion on change process and material changes to the Commission
11 October 2010	Draft regulatory statements provided to the Commission
18 October 2010	Auditor provides draft audit opinion on the regulatory financial statements to the Commission

### **Reporting milestones for year ending 30 June 2010**

<b>Month</b>	<b>Milestone</b>
1 November 2010	Telecom publicly discloses all required regulatory statements & information
1 November 2010	Auditor provides final audit opinion to the Commission
8 November 2010	Telecom provides to the Commission all remaining information required under section 69ZF(1)(a),(b)

## **APPENDIX D: REQUIREMENTS FOR AUDIT OF REGULATORY FINANCIAL STATEMENTS AND MANUALS**

### **Overview**

The Commission requires Telecom to engage an independent regulatory auditor(s) to review the regulatory manuals and the regulatory financial statements required for the reporting years ending 30 June 2009 and 30 June 2010. These audits will include the auditing of information and processes which are not audited as part of the statutory reporting process.

### **Letter of Engagement**

For both years Telecom is required to include the Commission's detailed expectations in the audit scope which will be incorporated in the letter of engagement. The Commission will discuss its expectations of the audit process with Telecom in advance of the respective implementation dates specified in Appendix C.

The letter of engagement will include, but is not limited to:

- the duty of care owed by the auditor to the Commission;
- the process for meetings and discussions between Telecom, the auditor and the Commission;
- the scope of the audit; and
- the level of materiality, to be determined by the Commission.

Telecom shall notify the Commission in writing of any proposed change of regulatory auditor twenty-five (25) working days before effect is given to that change.

### **Audit Opinions**

The regulatory auditor(s) must report their findings to the Commission and the summary audit reports and recommendations must be publicly disclosed. The auditor is required to provide the Commission with advance drafts of the audit reports on the dates specified in Appendix C.

The following audit opinions are required:

- Audit opinion of the initial regulatory manuals for 2008/09;
  - Audit opinion on whether the manuals identify and document all relevant systems, processes and information sources that are being or will be used to prepare the regulatory financial statements;
  - Audit opinion on whether the documented procedures and accounting practices are consistent with the Commission's written requirements; and
  - Audit opinion on whether the pro forma statements are consistent with the Commission's written requirements.
- Audit opinion of the regulatory financial statements for 2008/09;
  - Audit opinion on whether each regulatory financial statement complies with the Commission's requirements; and

- Audit opinion on whether each regulatory financial statement has been properly prepared in accordance with the relevant regulatory manuals.
- Audit opinion on whether anything has come to their attention that leads them to conclude that the regulatory manuals have not been properly applied in the preparation of the relevant regulatory financial statement
- Audit opinion on the change process for 2009/10;
  - Audit opinion on whether procedures exist to effectively manage changes to the systems and processes used to prepare the regulatory financial statements, and whether these procedures are followed;
  - Audit opinion on whether any additions, retractions, or revisions to the Commission's written requirements have been implemented, and when necessary that the Regulatory Manuals have been updated accordingly;
  - Audit opinion on whether any changes initiated by Telecom are documented, consistent with the Commission's written requirements and correctly implemented;
  - Audit opinion on whether the Regulatory Manuals have been updated as required; and
  - Audit opinion on whether Telecom's information disclosure relating to any material changes is free from material misstatement.
- Audit opinion of the regulatory financial statements for 2009/10.
  - Audit opinion on whether each regulatory financial statement complies with the Commission's requirements; and
  - Audit opinion on whether each regulatory financial statement has been properly prepared in accordance with the relevant regulatory manuals.
  - Audit opinion on whether anything has come to their attention that leads them to conclude that the regulatory manuals have not been properly applied in the preparation of the relevant regulatory financial statement

## **Relevant Audit Experience**

Telecom is required to ensure that the regulatory auditor(s) assigns an adequate number of staff who collectively have experience in regulatory auditing and the telecommunications industry to each regulatory audit. This includes having staff with such experience involved in the planning and oversight of each regulatory audit.

## **Scope for the Audit of the Regulatory Manuals**

For the audit of the initial regulatory manuals the regulatory auditor is required to provide a written assurance report to the level required for a reasonable assurance engagement. The audit conclusion must be expressed in the positive form (subject to such a conclusion being justified).

Telecom is required to ensure that the auditor assesses whether the regulatory manuals implement the Commission's written requirements. The scope of this audit will include:

- Assessing if the manuals identify and document all relevant systems, processes and information sources that are being or will be used to prepare the regulatory financial statements;

- Assessing if the documented procedures and accounting practices are consistent with the Commission's written requirements; and
- Assessing if the pro forma statements are consistent with the Commission's written requirements.

In undertaking this audit, the auditor is required to examine the Commission's written requirements, all relevant documented procedures and accounting practices, and all information systems that are or will be used to prepare the regulatory financial statements.

### **Scope for the Audits of the Regulatory Financial Statements**

The audits of the regulatory financial statements will be undertaken to form an opinion at the highest level of assurance for each of the regulatory financial statements required by the Commission.

Telecom is required to ensure that in relation to each of the regulatory financial statements, the auditor forms an opinion to the highest level of assurance that:

- The regulatory financial statement complies with the Commission's requirements; and
- The regulatory financial statement has been properly prepared in accordance with the relevant regulatory manuals.

Telecom is also required to ensure that the auditor in forming their opinions:

- Plans the audit approach so as to undertake such procedures and examinations as the auditor considers necessary;
- Examines the statements and undertakes such procedures and examinations, so as to obtain all the information and explanations, which the auditor considers necessary to provide them with sufficient assurance;
- Evaluates the overall adequacy of the presentation of information in the regulatory financial statements;
- States anything which came to their attention that leads them to conclude that the regulatory manuals have not been properly applied in the preparation of the relevant regulatory financial statement and disclose where practicable any adjustments the auditor considers to be required in respect of any such matter; and
- Reviews any changes to the regulatory manuals made since the manuals were last audited (should these have not been covered by the audit of the change process). In reviewing these changes the auditor is required to provide a written assurance report relating to the change to the level required from a reasonable assurance engagement.

### **Scope for the Audit of the Change Process and Material Changes**

For the audit of the change process and any resulting material changes the regulatory auditor is required to provide a written assurance report to the level required for a reasonable assurance engagement. The audit conclusion must be expressed in the positive form (subject to such a conclusion being justified).

Telecom is required to ensure that the auditor assesses the procedures used to manage changes to the systems and processes used to prepare the regulatory financial statements and assesses Telecom disclosure on any resulting material changes. The scope of this audit will include:

- Assessing if procedures exist to effectively manage changes to the systems and processes used to prepare the regulatory financial statements, and that these procedures are followed;
- Verifying that any additions, retractions, or revisions to the Commission's written requirements have been implemented, and when necessary that the Regulatory Manuals have been updated accordingly;
- Verifying that any changes initiated by Telecom are documented, consistent with the Commission's written requirements and correctly implemented. When necessary verify that the Regulatory Manuals have been updated accordingly; and
- Assessing Telecom's information disclosure relating to any material changes which result from any changes to the systems and processes used to prepare the regulatory financial statements.

### **Alternative Regulatory Auditor**

In the event that the independent regulatory auditor is in the opinion of the Commission unsatisfactory, Telecom shall appoint and instruct an alternative regulatory auditor that is at all times satisfactory to the Commission having regard to such matters as the Commission consider appropriate. The resulting audit engagement letter will be a tripartite agreement between Telecom, the Commission and the alternative regulatory auditor(s).

Telecom shall ensure that the alternative regulatory auditor:

- Carries out such on going duties as are required to secure compliance with the Commission's requirements;
- Carries out work or further work, in addition to that performed by the statutory auditor and/or by the former regulatory auditor, in relation to such matters connected to compliance with these conditions as are of concern to the Commission and notified to Telecom in writing; and/or
- Re-performs work previously performed by the statutory auditor and/or by the former regulatory auditor in relation to such matters connected to compliance with the audit requirements as are of concern to the Commission and notified to Telecom in writing.

Telecom shall extend to the alternative regulatory auditor such assistance and cooperation as would be extended to the statutory auditor and/or to the regulatory auditor.

## APPENDIX E: ATTRIBUTION METHODOLOGY

This section sets out the Commission's high-level requirements regarding the attribution methodology which will be used to fully attribute Telecom's revenues, costs, assets and short-term liabilities to the products and services that it provides. The methodology describes how costs are treated from their initial appearance in Telecom's accounting records to their final attribution to market serving activities or to network components. The attribution methodology is the linkage between the inputs from Telecom's financial records and the regulatory financial performance of the output service groups.

The objectives of the attribution methodology are;

- To provide a high quality mechanism for producing Regulatory Financial Statements that fully attributes Telecom's costs, revenues, assets and short term liabilities;
- To provide a sound basis for the derivation of efficient costs;
- To provide transparency of cost attribution;
- To demonstrate equivalence of input costs in Telecom's downstream markets;
- To provide a common platform for the production of regulatory and product financial reporting; and
- To provide a mechanism for deriving the mean capital employed by service and service group.

The fundamental requirement is to have Telecom's revenues, costs, assets, and short term liabilities fully attributed to the following "cost objects" on the basis of causality;

- *Activities* associated with Telecom wholesale and retail markets;
- *Support functions* associated with Telecom's network plant and equipment;
- *Support plant and equipment* that is used to support primary plant and equipment; and
- *Primary plant and equipment* that represents primary functions of the network

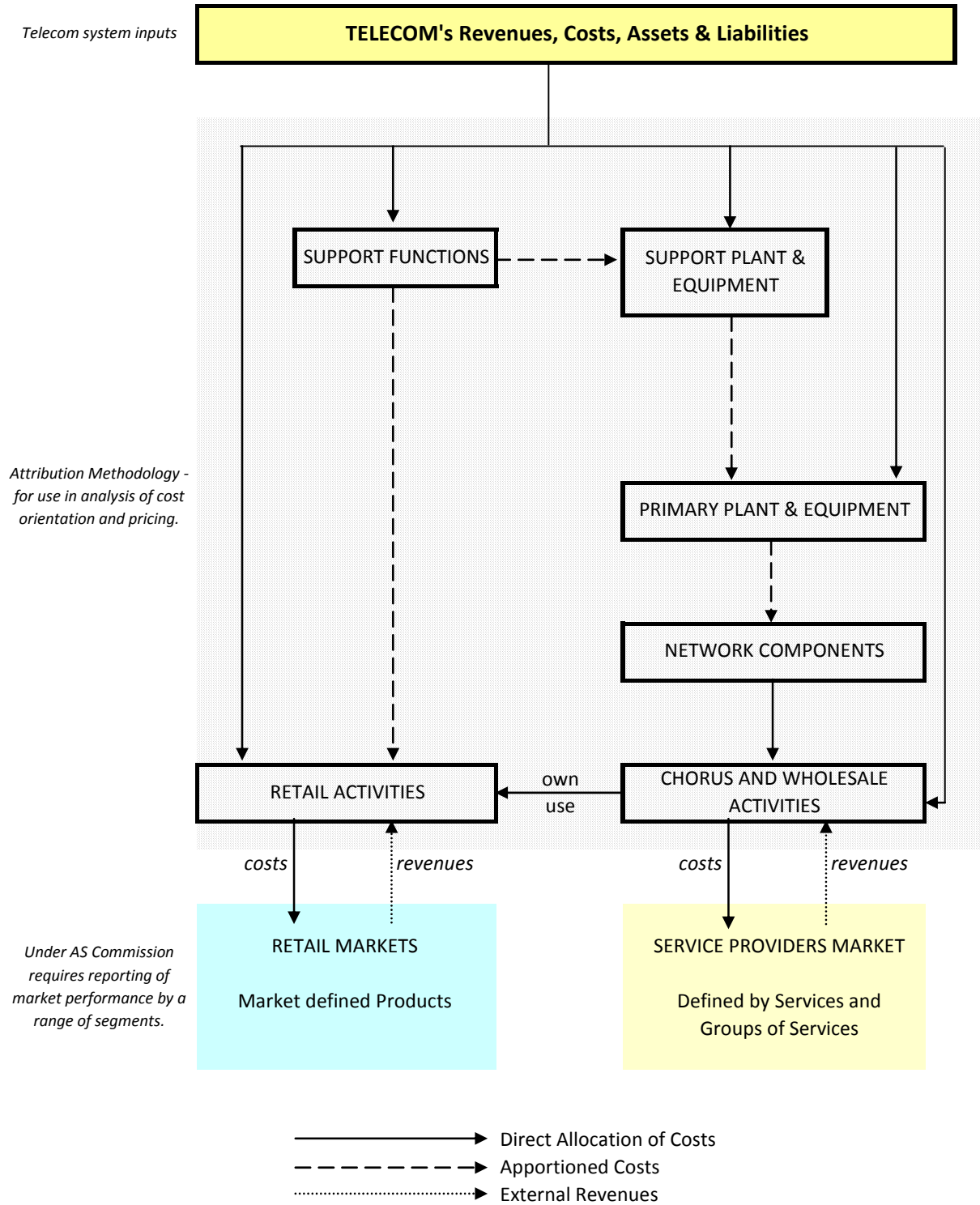
These last three categories of "cost objects" are further attributed to the network components and eventually to services and groups of services so that ultimately all revenues, costs, assets and short term liabilities are attached to market facing activities or to network components (and thereby to the services and products delivered by Telecom's separated activities).

The attribution of the revenues, costs and short-term liabilities to the relevant activities and components occurs by either allocation or by apportionment, as follows:

- Allocated items are those that have a direct causal relationship and can be assigned to a network component or a service on the basis of information in Telecom's accounting records; and

- Apportioned items are those that cannot be directly assigned to a component or service and have to be shared between two or more components or services on an appropriate basis.

**Overview of Required Attribution Methodology**



This approach to the process of attribution of financial information to components, services and products can be summarized as follows;

- Review each item of revenue, cost, asset and short-term liabilities;
- Establish the driver, ie: the process that caused the cost to be incurred or the revenue to be earned;
- Use the driver to attribute cost to components, services or products; and
- Use the driver to attribute revenue to retail products or wholesale services.

## APPENDIX F: NETWORK COMPONENTS LIST

An essential part of the attribution methodology is the development of a Schedule of Network Components. The Network Components are the functional link between the network plant and equipment and the services that are provided to customers using that network plant. As such, the classification and definition of network components is vital to the integrity of the attribution methodology described in Appendix E. The Network Component List, the capital and current costs that are attached to the Network Components and a schedule of component volumes will enable the development of a Statement of Network Activity which sets out the average unit cost on a current cost basis for all network components. The average costs per component are combined with a Network Component “Usage by Service” schedule to provide fully allocated costs for all services and products.

The Schedule of Network Components will identify at the functional level each network component (or element) which contributes to a service or retail product delivered by the Access, Wholesale or Retail Service Groups as defined in this requirements document. The schedule is to include the following information for each combination of network component and controlling service group:

- Component Name at a functional level;
- Description of function (e.g.: call set up);
- Controlling Service Group;
- Element Count (total number of such elements controlled by the service group);
- Location in Network (e.g. remote cabinet);
- Average Historic Cost Value;
- Average Current Cost Value;
- Average Designed Maximum Capacity;
- Metric of Volume (e.g. minute of use or call setup or circuit etc); and
- Average Capacity Utilisation (percentage).

The Network Activity Statement will detail the average unit cost for each network component as listed in the Schedule of Network Components. The capital and operating costs are to be calculated according to the attribution methodologies specified in Appendix E. The Network Activity Statement is to include the following information for each combination of network component:

- Component Name at a functional level (e.g. transit exchange circuit);
- Controlling Service Group;
- Region (ie; geographic region in NZ);
- Operating cost (HCA) per component;
- CCA Adjustments;
- Operating cost (CCA);
- Mean Capital Employed (CCA);
- WACC;
- Total Cost (Capital, depreciation and Operating cost);
- Unit of Usage and Volume; and
- Average Cost per Unit (CCA)

The “Usage by Service” schedule for Network Components will identify how much use is made of each network component by each service or product prescribed by the Commission. The schedule is to include the following information for each relevant service;

- Product or Service Name (e.g. national toll call);
- Component Name at a functional level (e.g. transit exchange circuit);
- Controlling Service Group; and
- Average Component Usage (e.g. “4” if the average duration of a national toll call is 4 minutes).