



Telecom New Zealand Limited

Submission in respect of the

**Commerce Commission's Draft Principles and
Regulatory Reporting Requirements for the
Accounting Separation of Telecom**

Public Version

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A EXECUTIVE SUMMARY

- 1 Telecom welcomes the Commission's consultation on its paper "Draft Principles and Regulatory Reporting Requirements for the Accounting Separation of Telecom" (the Draft Principles Paper). Telecom looks forward to working with the Commission to develop practical, fit for purpose reports.
- 2 Telecom has proposed in this submission a set of template financial statements for discussion. This is intended to complement the Commission's consultation process by providing a specific proposal to consider. In some areas Telecom has proposed omitting unnecessary complexity, while in other areas Telecom's proposal goes further than what is proposed in the Draft Principles Paper. For example, Telecom is proposing to prepare income statements for each business unit for the transitional year.
- 3 When developing this proposal Telecom has had regard to both international precedents and the New Zealand context. In particular:
 - New Zealand is unique in regulating for accounting separation after operational separation. A number of regulatory objectives – including preventing cross-subsidies and discrimination – are dealt with comprehensively by operational separation. This means we have the opportunity to develop a more targeted form of accounting separation. Where we can avoid the complexity and cost of some international models, without compromising the overall objective of the Telecommunications Act (the Act), we should.
 - Telecom's operational separation undertakings reporting requirements, annual statutory accounts and quarterly market disclosures will provide comprehensive financial and non-financial reporting.
 - The Act recognises the accounting separation requirements must be reasonable.
- 4 Given this context, a key question is what other information is necessary? Telecom submits that its proposed financial statements will provide the Commission and the industry with the information necessary to ensure that accounting separation meets its objectives of providing transparency, identifying any cross subsidies and supporting non-discrimination.
- 5 These financial statements will give the Commission and other stakeholders visibility of:
 - business unit performance (earnings before interest and taxation (EBIT)) on both historical and forward looking bases;

- business unit capital employed on both historical and forward looking bases;
 - product performance (EBIT);
 - the equivalence of product prices paid by Telecom downstream businesses and other service providers.
- 6 The template financial statements proposed by Telecom are a good faith attempt to identify a level of reporting that meets the objectives of accounting separation without creating unwieldy reports which are costly to produce and difficult to use.
- 7 There are areas where Telecom's proposal departs from the Commission's Draft Principles Paper. In particular:
- Business unit earnings and capital employed statements will be produced in the transitional year;
 - The Wholesale unit is treated as a single reporting unit. This is because the cost of splitting into artificial sub-units would outweigh the benefits that would be gained. This approach is consistent with the requirements of operational separation;
 - Abbreviated capital employed statements for each individual business unit, similar to those required by other regulators, are proposed instead of full balance sheets. The items omitted by this proposal relate to the Telecom corporate entity – such as taxation and equity, which are not meaningful at the level of separated business units;
 - The designated access service "interconnection with Telecom's fixed PSTN" is excluded from the list of product statements, on the basis that no standard terms determination has been required or requested by any party to date;
 - Audit procedures are introduced after the transitional year.
- 8 Accounting separation is a significant undertaking for Telecom. Telecom agrees a transitional year will be needed. Telecom submits it will also be crucial that methodologies and formats are settled up front, rather than worked out as the process unfolds as suggested in the Draft Principles Paper.
- 9 For this reason, Telecom proposes the following timetable:
- Methodologies and reporting formally settled by 30 June 2009. This is a very aggressive timeframe having regard to the complex and detailed

methodological issues that will need to be resolved by the Commission and Telecom. The successful resolution of all such issues by this date will determine whether any downstream reporting milestones are achievable or not.

- Accounts for the transitional year (08/09) (including income statements, as noted above, but not including product statements) submitted to the Commission by 30 June 2010.
- Accounts for 09/10 (including income statements, product statements and supporting reconciliation statements) submitted to the Commission by 31 March 2011.
- Thereafter accounts would be submitted within six months of the balance sheet date (including product statements).

B LEGAL FRAMEWORK

The Commission's discretion

- 10 Section 69Y of the Act establishes that the purpose of information disclosure under Part 2B is to promote competition by ensuring that information prescribed by the Commission is made available so that a wide range of people are informed about the operation and behaviour of Telecom's operationally separated business activities.
- 11 To that end, sections 69ZB(2) to (8) and 69ZD afford the Commission a broad discretion in terms of:
- the information it requires;
 - the methodology and manner in which that information is prepared; and
 - the form and manner in which that information is disclosed.
- 12 Any information required of Telecom by the Commission must be prepared and disclosed as if Telecom's operationally separated business activities were operated as independent or unrelated companies: section 69ZB(1). However, pursuant to section 69Z, the Commission's requirements must be reasonable, having regard to the purpose of Part 2B.
- 13 Telecom understands that the Commission's view is that:
- it is a mandatory requirement that the Commission require Telecom to prepare and disclose information about the operation of all or any of its network, wholesale or retail business activities as if those activities were operated as independent or unrelated companies; and
 - the Commission has a discretion as to what information and how much information it chooses to require.
- 14 This view is based on paragraph (ii) of the Executive Summary where the Commission states:
- Telecom is required, at a minimum, to prepare and disclose such information which the Commission requires as if all or any of its network, wholesale and retail activities were operated as independent or unrelated companies.*
- 15 To put it another way, whatever information the Commission, in its discretion, requires, Telecom must prepare the information as if its business units were operated as independent companies. Telecom agrees this

accurately captures the requirements of section 69ZB(1) and proceeds on this basis in this submission.

16 For the avoidance of doubt, and in accordance with the view above, Telecom submits the Commission is not bound by the Act to require the disclosure from each business unit of a full set of accounts, reflecting the statutory¹ financial reporting requirements imposed on ordinary independent companies (unless the Commission, in its discretion, decides this is reasonable and the best way to promote the section 69Y purposes). Telecom submits the proper interpretation of section 69ZB(1) is that it requires any information disclosed by Telecom to reflect operational separation, but the level of information required is within the Commission's discretion. This is consistent with:

- the purpose of Part 2B, which is satisfied by the level of information disclosure proposed by Telecom in this submission;
- the scheme of Part 2B, which sets a purpose (section 69Y), a general requirement that any information be provided on a separated basis (section 69ZB(1)), and a broad discretion to set requirements (sections 69ZB(2) to (8) and section 69ZD). If the Commission had no discretion as to whether to require a full set of accounts, this would render sections 69ZB(2) to (8) and section 69ZD redundant for most of accounting separation, and section 69ZB(4)(a) completely redundant;
- the drafting of section 69ZB(1), which employs the disjunctive "all or any" phrasing to confirm the Commission has a discretion in relation to whether a business unit is subject to any requirements at all, let alone the form of the requirements;
- the reasonableness requirement in section 69Z, which is a strong indication that the cost and complexity of the Commission's requirements should be at the level required to meet the objectives of accounting separation, and no more. In particular, cost and complexity beyond what the Commission believes is required to achieve the section 69Y purpose is clearly unreasonable.

The process going forward

17 Telecom would also like clarify the process that is going to be used by the Commission to implement accounting separation. In its Draft Principles Paper the Commission has indicated that it is going to issue a Final Principles Paper in August 2008. Telecom understands from the Draft

¹ Using that term as it is used in paragraph (i) of the Executive Summary of the Commission's Draft Principles Paper.

Principles Paper that details of the methodologies that will be used for accounting separation will not be included in this paper and that these will be developed at a later date. Telecom would like the Final Principles Paper to provide details of the process for developing and publishing these methodologies. Telecom also notes that it has provided a greater level of detail in this submission on the form accounting separation reporting will take than is provided in the Draft Principles Paper. In order to provide certainty to all parties Telecom requests that the Commission provides a similar level of detail in its Final Principles Paper.

C THE NEW ZEALAND CONTEXT

18 Telecom supports the Commission's statement in paragraph 23 of the draft principles paper as to the appropriate considerations for assessing the exercise of its discretion. The Commission recognises the relevance of Telecom's other reporting requirements at paragraph 23 of the Draft Principles paper.

19 The broader commercial and regulatory context is discussed below.

The role of accounting separation

20 The Commission identifies the objectives of accounting separation as transparency, identifying cross-subsidies, and supporting non-discrimination (paragraphs (iii) and 2).

21 The question in the New Zealand context is what further information is needed to pursue these objectives? An objective of transparency for transparency's sake risks replicating reporting requirements elsewhere. Further, the concerns of identifying cross-subsidies and preventing non-discrimination are comprehensively addressed by the Commission setting the prices of regulated products, and operational separation establishing arms length business units and Equivalence of Input (EOI) standards.

22 Clearly accounting separation has a role to play in the regulatory framework. But equally, when considering the scope and detail of accounting separation requirements it is important to have regard to the market and regulatory context in which it is being introduced.

Operational separation

23 The situation in New Zealand is unusual in that operational separation preceded accounting separation. Operational separation is a more intrusive remedy, which comprehensively addresses concerns regarding price and non-price discrimination, EOI standards, and the potential for cross-subsidisation in a transparent way. It affords the industry and the regulator much greater transparency of the internal supply of regulated services, which in other jurisdictions can only be achieved through the introduction of extremely detailed accounting separation requirements.

24 Because in New Zealand we are introducing these two forms of separation in reverse order to the rest of the world, we can and should adopt a more targeted form of accounting separation than has been the case in other jurisdictions. Where we can cut cost and complexity from international accounting separation models, without compromising the overall objective of the Act, we should do so.

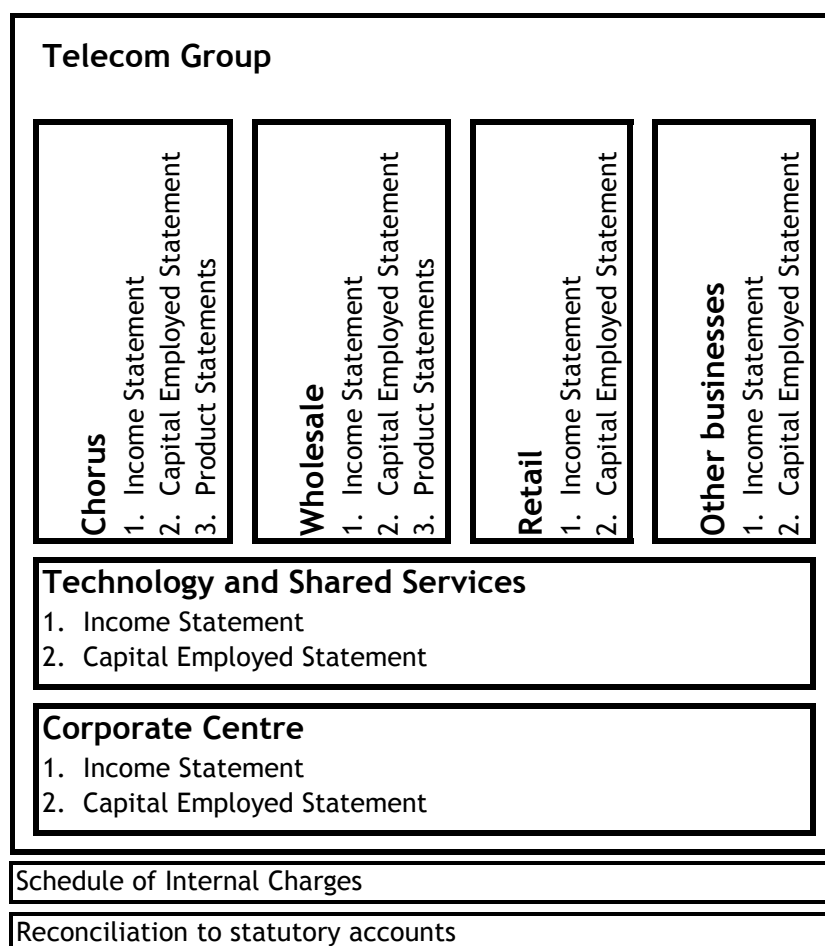
Telecom's operational separation Undertakings

- 25 The Undertakings require Telecom to disclose detailed information on important aspects of the operational separation.
- 26 While not all of this information is made public, it nevertheless gives the regulators in the operational separation context – the Independent Oversight Group (IOG) and the Commission - a clear picture of Chorus, Wholesale and Retail's business activities and services in order to assess whether the non-discrimination and cross subsidy regulatory objectives are being met.
- 27 For example the IOG and the Commission will have access to:
- *Internal trading arrangements:* If Chorus provides a Relevant Service to another Telecom Business Unit, there must be a written arrangement in place setting out the terms of supply, including price or appropriate transfer charge. Copies of any trading arrangements must be provided to the IOG (clause 32). There is an equivalent requirement if Wholesale provides Relevant Services to Retail (clause 57).
 - *Control and influence of assets:* Telecom must have written arrangements in place providing for Chorus and Wholesale to have control and/or influence over assets required to provide Relevant Services. The arrangements need to include all of the terms of the control and/or influence, including price or appropriate transfer charge (if any). Copies of those arrangements must be provided to the IOG as soon as they are entered into, and after any material change (clauses 14.4, 15.3, 16.3 and 44.3);
 - *Technical and operational work:* If Chorus does technical or operational work for another part of Telecom, there must be a written agreement in place for Chorus to do that work on commercial terms. Those agreements must be provided to the IOG (clause 26.2). There are equivalent requirements where Wholesale does technical or operational work for Retail (clause 54.2) and where Retail does technical or operational work for Chorus or Wholesale (clause 71);
 - *Statement of assets:* Telecom must prepare a statement of assets controlled by Chorus as at 1 July 2008 for the Commission, IOG and Minister (clause 104);
 - *Chorus plans:* Chorus must provide the IOG with a copy of its annual and long-term corporate plans and technology plans approved by the Board (clause 27.2);

- *Chorus has sufficient resources:* The Board and CEO must certify annually that Chorus has sufficient resources for the CEO of Chorus to manage Chorus (clause 28.2);
 - *Process for Chorus requests:* The IOG oversees Chorus' process for making, considering, advising and implementing decisions about requests in respect of Chorus Relevant Services and/or the Access Network (including whether requests are dealt with in accordance with the process) (clause 41(c));
 - *CEO of Chorus' delegated authority:* If Telecom makes a material change to the CEO of Chorus' delegated authority, the IOG and Commission must be notified (clause 28.4);
 - *Notice of material change in Chorus scope:* If the Board or CEO materially changes the scope of Chorus' business, they must notify the IOG and Commission of the change (clause 13.2);
 - *List of Relevant Services:* Both Chorus and Wholesale must have a list of Relevant Services that are available to Service Providers on their websites (clauses 18.3 and 45.4);
 - *Participation by the Board and CEO:* If the Board or CEO directs a Telecom Business Unit to act in a way that the unit would not itself resolve to act under the Undertakings, a copy of the direction must be given to the Commission and IOG (clause 7.2). The direction must be accompanied by a certificate dealing with various matters. There are also reporting obligations to the IOG when the Board or CEO participates in a significant Chorus or Wholesale decision (clause 7.3);
 - *Migration plan when Telecom becomes legally required to provide a Relevant Service:* clauses 21.2, 47.2.
- 28 Telecom is also committed to comprehensive key performance indicator reporting that will demonstrate commercial and behavioural non-discrimination, and demonstrate compliance with the undertakings and product level equivalence. This information will be publicly available.
- 29 Clearly Telecom is committed to significant reporting requirements as part of operational separation.
- 30 These operational separation requirements would not already exist in other jurisdictions where accounting separation has been rolled out some years before operational separation has been contemplated. This existing platform is an important part of the context for the development of additional accounting separation requirements.

D TELECOM'S PROPOSAL

- 31 Telecom proposes in this submission a set of pro forma financial statements (**attached** in Appendix 1). It is useful to have a concrete proposal to consider, and to illustrate statements of general description. In this submission Telecom explains the key features of its proposal. We would be happy to discuss any detailed questions the Commission has about the proposed statements.
- 32 The following diagram summarises Telecom's proposals for accounting separation business unit structure and reporting obligations.



- Business units**
- 33 Telecom submits the following business units should be subject to the accounting separation requirements:
- Chorus;
 - Wholesale;
 - Retail (excluding gen-i);

- Technology and Shared Services (T&SS);
 - Other Businesses (overseas operations and gen-i);
 - Corporate centre.
- 34 While the Draft Principles Paper allows for the possibility, Telecom can confirm there is no “other” Fixed Network Business Unit.
- 35 Wholesale is treated as a single reporting unit, separate from International. It is not clear how splitting the Wholesale Unit’s accounts into relevant and non-relevant services will facilitate the objectives that the Commission has laid out for accounting separation. The benefits from splitting out a non-relevant component of the Wholesale Unit will be outweighed by the considerable expense required to allocate all of Wholesale’s costs and assets between two parts. Telecom cannot at present allocate the wholesale unit’s costs and assets between relevant and non-relevant parts of the unit in a meaningful way because it does not operate separate relevant and non-relevant service sub units or teams within our Wholesale unit, meaning that the costs are almost all shared. The proposal to treat Wholesale as a single reporting unit is also consistent with the operational separation of Telecom, as required by section 69ZB(3). The Undertakings permit the operation of a combined wholesale unit which provides both relevant and non-relevant services.
- 36 The Commission excluded gen-i from the list of business units subject to specific business unit reporting. Telecom agrees with this approach because gen-i incorporates both New Zealand and Australian activities. It also incorporates both communications and non-communications revenues. Typically prices are defined for customers across packages including both communications and non-communications services, making isolation of communications revenue difficult. It would be even more difficult to split costs. Telecom proposes to include gen-i in the Other Businesses accounts.
- 37 “Other Businesses” will include overseas operations (e.g. AAPT, International and gen-i). The inclusion of Other Businesses as a residual category will facilitate transparent reconciliation to Telecom Group’s statutory accounts while maintaining visibility of New Zealand telecommunications activities.
- 38 This structure provides a clear and concise description of Telecom’s business in a way that reflects the business unit structure and is consistent with the structure that has been used for operational separation.
- Financial disclosures overview**
- 39 The income statements and capital employed statements of the six separated businesses will provide the reader with a picture of the

performance and the financial situation of each business in a clear and easily understandable way. The distinction between internal and external revenues and costs will be made on the face of the earnings statements (and summarised on the schedule of internal charges) so that readers can readily ascertain the extent and nature of internal charges. For key relevant products the internal charges are further disaggregated in the Chorus and Wholesale product statements to demonstrate that Telecom's own downstream businesses pay the same amount for the same products as Access Seekers.

- 40 Financial performance and situation will be shown in historic cost terms and, when available, in forward looking cost terms. The historic cost view will be entirely consistent with Telecom's statutory accounts and will provide a firm basis for reconciliation between regulatory and statutory accounts.
- 41 The format of the statements will be familiar to readers since they are consistent with NZ GAAP to the greatest extent possible while meeting the objectives of accounting separation. Insofar as the primary statements (income statements and capital employed statements) are concerned, the only differences from NZ GAAP relate to:
- the exposure of inter-business trading, which is fundamental to operational and accounting separation;
 - the presentation of results on a forward looking as well as on a historical costs basis;
 - the omission of items relating to payments to providers of capital and taxation, which are only meaningful at the level of the corporate entity not at the level of separated businesses. This is similar to the approach taken by other regulators.
- 42 The structure of the six businesses will mean that readers can identify the New Zealand telecommunications businesses (Chorus, Wholesale and Retail), the back office support functions serving New Zealand and overseas businesses (Corporate Centre and Technology and Shared Services) and, by virtue of having a separate Other Businesses unit, still see and reconcile to the entire Group. The separate reconciliation statements for income statement and capital employed statement will reference discrete line items from Telecom's statutory and regulatory accounts - both of which are or will be audited.

Proposed financial statements

- 43 Telecom proposes the following financial statements:
- Business unit income statement;

- Business unit capital employed statement;
- Product statement;
- Reconciliation of income statement;
- Reconciliation of capital employed;
- Schedule of internal charges.

44 Pro forma examples of each statement are **attached** in Appendix 1.

45 The proposed financial statements will be supplemented by brief notes and commentary sufficient to provide the reader with an understanding of the financial situation and performance of the separated business entities.

Income statement

46 Telecom proposes that the following business units would produce an income statement:

- Chorus;
- Wholesale;
- Retail;
- Technology and Shared Services;
- Other Businesses;
- Corporate Centre.

47 The Income Statement would have the following format:

Chorus

Income Statement

for the year ended 30 June 200x

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | 200X \$ | 200Y \$ |
|--|------------|------------|
| Operating revenues | | |
| External sales | x | x |
| Internal sales to Wholesale | x | x |
| Internal sales to Retail | x | x |
| Total operating revenues | x | x |
| Operating expenses | | |
| Labour | x | x |
| Intercarrier costs | x | x |
| Other operating expenses | x | x |
| Depreciation and amortisation | x | x |
| Other expenses | x | x |
| Internal expenses from Wholesale | x | x |
| Internal expenses from T&SS | x | x |
| Internal expenses from Corporate Centre | x | x |
| Total operating expenses | x | x |
| Earnings / (loss) before interest and taxation (EBIT) | x | x |
| <i>Net assets (historic cost)</i> | x | x |
| <i>Forward looking EBIT</i> | x | x |
| <i>Forward looking net assets</i> | x | x |

48 The proposed income statement format, shown above, is based on figures which comply with NZ GAAP but the format has been modified for the accounting separation context. In particular:

- internal sales and expenses relating to transactions between the separated businesses are shown on the face of the income statement;
- results are presented on a forward looking and historic cost basis;
- items below the EBIT line which relate to the corporate entity – taxation and payments to providers of capital - are omitted. These items are not meaningful at the level of separated businesses, and the regulatory cost orientation is based on operating costs plus a pre tax cost of capital.

Capital employed statement

49 Telecom proposes that the following business units would produce a capital employed statement:

- Chorus;
- Wholesale;
- Retail;
- Technology and Shared Services;
- Other Businesses;
- Corporate Centre.

50 The Capital Employed statement would have the following format:

Chorus

Capital Employed Statement

for the year ended 30 June 200x

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | 200X \$ | 200Y \$ |
|---|------------|------------|
| Current assets: | | |
| Cash and short-term investments | x | x |
| Receivables and prepayments | x | x |
| Inventories | x | x |
| Total current assets | x | x |
| Current liabilities: | | |
| Accounts payable and accruals | x | x |
| Short-term provisions | x | x |
| Other short term liabilities and provisions | x | x |
| Total current liabilities | x | x |
| Net current assets | x | x |
| Non current assets: | | |
| Receivables due after one year | x | x |
| Long-term investments | x | x |
| Intangible assets | x | x |
| Property, plant and equipment | x | x |
| Total non current assets | x | x |
| Non current liabilities: | x | x |
| Long term liabilities | x | x |
| Long term provisions | x | x |
| Total non current liabilities | x | x |
| Net assets (historic cost) | x | x |
| <i>Forward looking net assets</i> | <i>y</i> | <i>y</i> |

51 The proposed capital employed statement would illustrate, by key line item, the capital employed for each business unit. Further detail on Chorus capital expenditure, depreciation and disposals will also be available from the Chorus Statement of Assets.

- 52 Again, the proposed capital employed statement format, shown above, is based on NZ GAAP Balance Sheet formats but has been modified for the accounting separation context. In particular:
- assets and liabilities relating to payments to providers of capital or payments of tax are excluded. These items relate to either financing or taxation, which is only meaningful at the corporate level; and
 - equity and debt holders' funds are not shown since these simply represent the residual balancing items whose composition (i.e. gearing) is only meaningful at the level of the corporate entity.
- 53 In Appendix 2 we have included examples of regulatory accounts provided by BT and Eircom. In these accounts, profit and loss information is also limited to the EBIT level. Similarly, capital employed statements are used in place of statutory accounting balance sheets. Even allowing for operational separation pre-existing in the New Zealand context, Telecom's proposal lines up with these international comparators.

Forward looking valuations

- 54 The Commission proposes that for the transitional year assets be valued on a historic basis, with supplementary reporting based on a forward looking methodology. It further proposes that in subsequent years, if a forward looking approach is adopted for regulatory purposes, it will be necessary to make greater use of forward looking methodologies in the regulatory accounts. However, at this stage the Commission envisages historic cost will be the primary basis for asset valuation.
- 55 Historic cost is an accounting cost measure. However, as the ITU notes² "The ***economic cost*** of an activity is the actual ***forward-looking cost*** of that activity. This is the cost of accomplishing that activity in the most efficient way possible, given technological, geographical and other real world constraints. Forward-looking costs are the costs of present and future uses of a firm's (or society's) resources. Only forward-looking costs are relevant for making pricing, production, and investment decisions in the present, or the future." Presumably, stakeholders will use the accounting separation information to assess Telecom's economic performance, so the only meaningful assessment of Telecom's costs will be forward-looking. It is also for these reasons that regulated prices are required to be determined on a forward-looking basis.

² <http://www.ictregulationtoolkit.org/en/Section.2164.html#Forward-looking>

- 56 Telecom submits that historic cost accounts, on the other hand, will potentially be misleading for accounting separation purposes. The results could be misunderstood and/or misrepresented.
- 57 Telecom will work with the Commission to develop a methodology for valuing assets on a forward looking basis. As a practical matter, for some time at least, the regulatory accounts will need to value assets on an historic cost basis. Telecom submits it will be important for the Commission to make clear that historic cost regulatory accounts are not appropriate to be used for the purposes of evaluating prices, and that comparisons should not be made between asset values and depreciation in the regulatory accounts and the methodologies used for setting prices.

Product statements

- 58 Telecom has followed the Commission's proposal that product statements should be produced for "key regulated services" and more specifically the key regulated input services for which charges have been identified in Standards Terms Determinations (Telecom has taken this to include comparable legacy products that are being traded internally).
- 59 Telecom proposes that the following business units would produce product statements:
- Chorus;
 - Wholesale.
- 60 Telecom notes that the key regulated input services that should be reported on for accounting separation requirements should be:

| |
|--|
| Chorus: |
| UCLL and co-lo – urban (including legacy services) |
| UCLL and co-lo – non-urban (including legacy services) |
| UCLL Backhaul (including legacy services) |
| Sub-loop (delayed) |
| Wholesale: |
| UBA (including EUBA and legacy services) |
| UBA Backhaul (including legacy services) |

- 61 Unbundled Copper Local Loop (UCLL) and co-location (co-lo) should be reported together as there is a commonality of assets at the exchange, and

one cannot practically be purchased without the other. Individual line items within the product statements would split out the UCLL from the co-location components.

- 62 Telecom also proposes that the sub-loop statement be delayed until at least the 2011 financial year. This is partly because the sub-loop standard terms determination (STD) does not yet exist, making it difficult to assess what will be required. Also, given current expectations of external volumes in the 2009 and 2010 years, the preparation of a separate statement would be of little value. Telecom proposes for the first year to report the revenue figures for internal and external sub-loop metallic path facility (MPF), co-lo, plus backhaul as part of the UCLL statement, but the costs of these services will not be split from the UCLL costs. If the reported revenues show that this has become a significant service then a separate statement could be considered, but Telecom anticipates that this is unlikely.
- 63 The Draft Principles Paper proposes to include the service of interconnection with Telecom's fixed PSTN in the list of service requiring product statements. This service is a legacy product with a commercially agreed price. Despite all interconnected parties having had the option for some time now of applying to the Commission for a standard terms determination in relation to this service, no party has considered this necessary. This suggests the commercial arrangements in place are effective and efficient, and there is no clear need for a product statement (noting that if such a need became apparent, it would be open to the Commission to require this at that time). If a product statement were to be required, it would seem appropriate to request similar disclosures from access providers of the designated access service of interconnection with fixed PSTN other than Telecom's.

Chorus

Product Statements

for the year ended 30 June 200x

| YEAR ENDED 30 JUNE 200X (DOLLARS IN MILLION) | Relevant product | |
|--|------------------|----------------|
| | Internal \$ | External \$ |
| Operating revenues | | |
| - Principal core | x | x |
| - Other core | x | x |
| - Sundry | x | x |
| Operating expenses | | |
| - Labour | | |
| - Intercarrier costs | | |
| - Other operating expenses | | |
| - Depreciation and amortisation | | |
| - Other expenses | | |
| Earnings / (loss) before interest and taxation | x | x |
| Capital employed | x | x |
| Cost of capital (x%) | x | x |
| Total operating costs including cost of capital | x | x |
| Core product volumes: | | |
| External sales | x | x |
| Internal sales to wholesale | x | x |
| Internal sales to retail | x | x |
| Total core product volumes | x | x |

- 64 The preparation of product statements is particularly onerous since they require the apportionment of costs and capital employed below the separated business level.
- 65 It is also important to recognise that the meaningfulness of product statements prepared on a historic cost basis is strictly limited for the reasons outlined below.
- 66 Consider the regulated price of unbundled copper loops, which is intended to represent the efficient costs of a hypothetical efficient new entrant. The historic costs recorded in Telecom's financial records will reflect the costs of digging trenches and laying copper cable many years ago when prices, costs, wages and the cost of living were all much lower than they are today. Telecom's historic cost accounts will not give a good indication of the current costs faced by a new entrant. UCLL product statements prepared on an historic cost basis could show significant profits which would

not exist if the product statements were properly expressed in forward looking economic terms.

- 67 For these reasons, product statements should not be viewed as a mechanism to review the appropriateness of regulated prices. Where products statements will have a role, however, is in providing a first order test of non-discrimination in pricing by Telecom between its external and internal customers. They can show that the prices Telecom charges its internal businesses are the same as the prices it charges externally to other service providers.
- 68 In order to achieve this, Telecom is proposing product statements that will have information on the prices of the principal service charges set out in the STDs. These would be aggregated for the more minor core charges and for sundry charges, but the key core charges representing the significant majority of the revenues would be split out. If this is not done then a difference in reported overall average price of a product might be due to proportionately higher purchases of higher priced components rather than being evidence of discrimination.
- 69 Telecom notes however that it would not be meaningful to report costs at the same level of detail as the revenue disaggregation. The total costs appearing in a product statement against specific price components should be only those directly associated with the product. For example in relation to UCLL, the UCLL rental (internal and external) would be reported. Telecom would report the direct costs of providing UCLL rental as distinct from the more general UCLL costs, but it is not meaningful to try to determine how much of this is associated with internal UCLL versus external UCLL as the assets and operational costs are completely common.
- 70 The draft principles paper also requires that the Commerce Commission approve all methodologies used for the internal transfer pricing. Telecom's Undertakings also contain strict requirements for the terms of any internal arrangements for Relevant Services. The requirements should be clarified to only extend to trading arrangements for those services for which product statements are required.

Reconciliation of income statement

- 71 The reconciliation of the income statements to the statutory accounts would have the following format:

Reconciliation of Income Statement

for the year ended 30 June 200x

for the year ended 30 June 200y

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | Operating revenues \$ | Operating expenses \$ | Earnings / (loss) before interest and taxation \$ | Operating revenues \$ | Operating expenses \$ | Earnings / (loss) before interest and taxation \$ |
|---|-----------------------------|-----------------------------|---|-----------------------------|-----------------------------|---|
| EBIT per separated accounts | | | | | | |
| Chorus | x | x | x | x | x | x |
| Wholesale | x | x | x | x | x | x |
| Retail | x | x | x | x | x | x |
| T&S | x | x | x | x | x | x |
| Other business | x | x | x | x | x | x |
| Corporate centre | x | x | x | x | x | x |
| Total EBIT per separated accounts | x | x | x | x | x | x |
| Adjustments: | | | | | | |
| Intra company transfer charges | x | x | x | x | x | x |
| Other adjustments | x | x | x | x | x | x |
| EBIT per Telecom statutory accounts | x | x | x | x | x | x |

The proposed reconciliation of income statement takes each of the individual business unit income statements and then reconciles it to the historic cost EBIT from the Telecom statutory accounts. This provides added clarity and assurance that the results are consistent with each other and identifies any differences between the two.

Reconciliation of capital employed

72 The reconciliation of the capital employed statements to the statutory accounts would have the following format:

Reconciliation of Capital Employed Statement

for the year ended 30 June 200x

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | 200x \$ | 200y \$ |
|--|------------|------------|
| Net assets per separated accounts | | |
| Chorus | x | x |
| Wholesale | x | x |
| Retail | x | x |
| T&SS | x | x |
| Other business | x | x |
| Corporate centre | x | x |
| Total net assets per separated accounts | x | x |
| Per Telecom statutory accounts | | |
| Total assets | x | x |
| Total liabilities | x | x |
| Adjustments: | | |
| Taxation recoverable | x | x |
| Taxation payable | x | x |
| Dividends payable | x | x |
| Debt due within one year | x | x |
| Deferred taxation | x | x |
| Long term debt | x | x |
| Other items | x | x |
| Total net assets per Telecom statutory accounts | x | x |

The proposed reconciliation of capital employed takes the net assets for each of the individual business units and then reconciles it to the Telecom statutory accounts. This identifies the items that have not been included in the business unit statements of capital employed and identifies any other differences between the two.

Schedule of internal charges

- 73 In addition to the reconciliation statements Telecom proposes that an additional schedule providing a summary of internal charges be included to enhance transparency of the separated accounts.

Not proposed: statement of capital investments

- 76 There is a distinction to be made between disclosing information on levels of capital expenditure, which Telecom will do in its divisional reporting for statutory purposes, and the proposal in the Draft Principles Paper of an annotated description of capital investments and their purposes. A requirement for a detailed statement of capital investments, over and above information on levels of capital expenditure, will not advance the objectives of accounting separation of transparency, indentifying cross-subsidies and supporting non-discrimination (paragraph iii). It will, however, impose a detailed and burdensome requirement on Telecom.
- 77 Such a requirement will also put Telecom at an unreasonable competitive disadvantage. Detailed capital investment information, produced on an annual basis, would be very valuable to Telecom's competitors. This information would put Telecom's competitors in a material competitive advantage in knowing where to most favourably target their own investments.
- 78 A level playing field in the market could be maintained and this issue managed by making all of the capital investment information confidential to the Commission. However, it is then difficult to see how any benefits at all could be delivered to end users.
- 79 For the reasons discussed above and noting the criteria in paragraph 23 of the Draft Principles Paper, Telecom submits that the costs associated with a detailed statement of capital investments outweigh the benefits and that a statement of capital employed and statement of assets provides adequate information on investments.

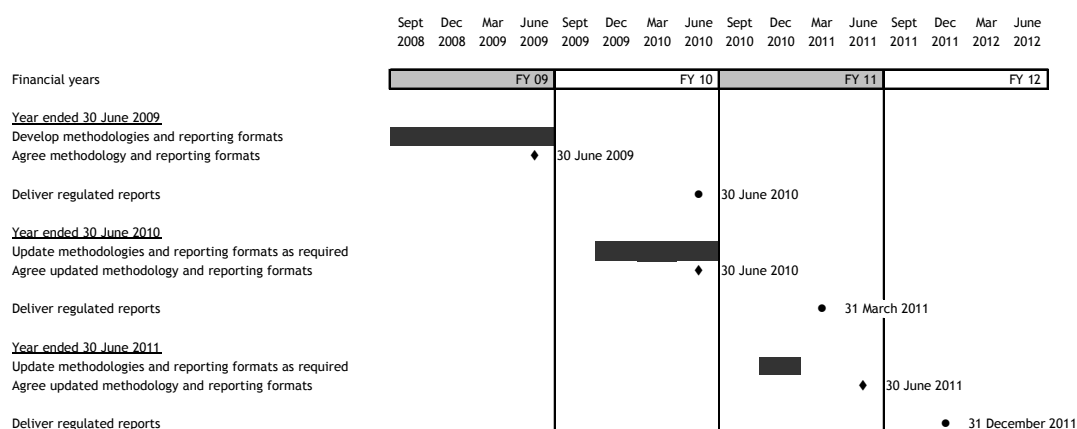
Audit requirements

- 80 The transitional year should be treated as a year of trial and learning. It is important that, during this year, no formal audit takes place and that no reliance be placed on the regulatory accounts for the purposes of informing regulatory decisions. Telecom submits that a requirement to perform an audit during this year would provide an unnecessary distraction that would prevent resources being focused on the task at hand.
- 81 The form of audit review should confirm that the separated accounts have been prepared in accordance with the agreed methodologies. Since the methodology will have been established with and agreed by the Commission, Telecom submits it is not appropriate to have a broader audit scope which requires the auditor to opine on whether the agreed methodology is appropriate.

Process

Timing

- 82 The development and implementation by Telecom of an accounting separation capability is a significant undertaking, and the timetable for its introduction should reflect this.
- 83 Telecom agrees in principle with the concept of a transitional period, followed by full implementation. However, Telecom submits that the period proposed – just one year – is very aggressive and depends heavily on the prior agreement of a clear and detailed methodology and reporting rules. This is a problem, as the timetable proposed in the Draft Principles Paper does not allow for this level of detailed agreement upfront, and instead the suggestion is that detailed methodologies be worked out as the process goes along. This is highly likely to result in delays. Telecom has significant concerns as to its ability to meet the timeframes proposed.
- 84 Telecom submits a realistic timetable and approach below.



- 85 Under this timetable:
- methodologies and reporting formats would be agreed by 30 June 2009;
 - transitional year (year ending 30 June 2009) accounts would be submitted to the Commission by 30 June 2010.
- 86 The transitional accounts would comprise income statements and capital employed statements for Chorus, Wholesale, Retail, T&SS, Other Businesses and Corporate Centre, reconciliation to the statutory accounts, as well as a schedule of internal charges between these businesses.
- 87 Telecom's proposal for the transitional year delivers more than the Commission's proposed requirements in its Draft Principles Paper. The Commission limited its proposal to a requirement to prepare statements of

financial position. Telecom believes that it should be possible to go beyond these requirements and prepare income statements as well as capital employed statements for the transitional year - if Telecom's proposed formats and separated business unit structures are acceptable.

- 88 Telecom submits it will not, however, be feasible to include product statements within these timescales. Producing cost and capital employed at the product level is substantially more complex than at the business unit level because such information is not systematically produced with the standard management accounts.
- 89 It is worth noting in this regard that in the UK, Oftel published its proposals for the content and format of separated accounts in June 1992; the licence modification of accounting separation was not agreed until January 1995 and the first set of accounts were not published until September 1995. While the time taken reflected the lack of international precedents at the time, it does demonstrate the need for a substantial development and implementation lead-time. In other cases where accounting separation has been implemented, the detailed methodologies and requirements were under discussion long before the imposition of a regulatory requirement.
- 90 The timetable proposed by Telecom is still ambitious. If the timetable is to be achieved, it is important that a clear and complete methodology and reporting rules are developed and agreed by 30 June 2009. However, if this is not achieved, given the enforceable nature of these requirements, Telecom may need more time.
- 91 It is clear that the Commission recognises the importance of its role in developing the methodologies and rules, but Telecom reiterates that this will be a significant undertaking which will require a major commitment from both Telecom and the Commission. Telecom is making that commitment here.

APPENDIX 1

Pro forma financial statements

Chorus

Income Statement

for the year ended 30 June 200x

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | 200X \$ | 200Y \$ |
|--|------------|------------|
| Operating revenues | | |
| External sales | x | x |
| Internal sales to Wholesale | x | x |
| Internal sales to Retail | x | x |
| Total operating revenues | x | x |
| Operating expenses | | |
| Labour | x | x |
| Intercarrier costs | x | x |
| Other operating expenses | x | x |
| Depreciation and amortisation | x | x |
| Other expenses | x | x |
| Internal expenses from Wholesale | x | x |
| Internal expenses from T&SS | x | x |
| Internal expenses from Corporate Centre | x | x |
| Total operating expenses | x | x |
| Earnings / (loss) before interest and taxation (EBIT) | x | x |
| <hr/> | | |
| <i>Net assets (historic cost)</i> | x | x |
| <i>Forward looking EBIT</i> | x | x |
| <i>Forward looking net assets</i> | x | x |

Chorus

Capital Employed Statement

for the year ended 30 June 200x

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | 200X \$ | 200Y \$ |
|---|------------|------------|
| Current assets: | | |
| Cash and short-term investments | x | x |
| Receivables and prepayments | x | x |
| Inventories | x | x |
| Total current assets | x | x |
| Current liabilities: | | |
| Accounts payable and accruals | x | x |
| Short-term provisions | x | x |
| Other short term liabilities and provisions | x | x |
| Total current liabilities | x | x |
| Net current assets | x | x |
| Non current assets: | | |
| Receivables due after one year | x | x |
| Long-term investments | x | x |
| Intangible assets | x | x |
| Property, plant and equipment | x | x |
| Total non current assets | x | x |
| Non current liabilities: | | |
| Long term liabilities | x | x |
| Long term provisions | x | x |
| Total non current liabilities | x | x |
| Net assets (historic cost) | x | x |
| <i>Forward looking net assets</i> | <i>y</i> | <i>y</i> |

Wholesale

Income Statement

for the year ended 30 June 200x

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | 200X \$ | 200Y \$ |
|---|------------|------------|
| Operating revenues | | |
| External sales | x | x |
| Internal sales to Chorus | x | x |
| Internal sales to Retail | x | x |
| Total operating revenues | x | x |
| Operating expenses | | |
| Labour | x | x |
| Intercarrier costs | x | x |
| Other operating expenses | x | x |
| Depreciation and amortisation | x | x |
| Other expenses | x | x |
| Internal expenses from Chorus | x | x |
| Internal expenses from T&SS | x | x |
| Internal expenses from Corporate Centre | x | x |
| Total operating expenses | x | x |
| Earnings / (loss) before interest and taxation | x | x |
| <i>Net assets (historic cost)</i> | x | x |
| <i>Forward looking EBIT</i> | x | x |
| <i>Forward looking net assets</i> | x | x |

Wholesale

Capital Employed Statement

for the year ended 30 June 200x

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | 200X \$ | 200Y \$ |
|---|------------|------------|
| Current assets: | | |
| Cash and short-term investments | x | x |
| Receivables and prepayments | x | x |
| Inventories | x | x |
| Total current assets | x | x |
| Current liabilities: | | |
| Accounts payable and accruals | x | x |
| Short-term provisions | x | x |
| Other short term liabilities and provisions | x | x |
| Total current liabilities | x | x |
| Net current assets | x | x |
| Non current assets: | | |
| Receivables due after one year | x | x |
| Long-term investments | x | x |
| Intangible assets | x | x |
| Property, plant and equipment | x | x |
| Total non current assets | x | x |
| Non current liabilities: | | |
| Long term liabilities | x | x |
| Long term provisions | x | x |
| Total non current liabilities | x | x |
| Net assets (historic cost) | x | x |
| <i>Forward looking net assets</i> | <i>y</i> | <i>y</i> |

Wholesale

Product Statements

for the year ended 30 June 200x

| YEAR ENDED 30 JUNE 200X (DOLLARS IN MILLION) | Relevant product | |
|--|------------------|----------------|
| | Internal \$ | External \$ |
| Operating revenues | | |
| - Principal core | x | x |
| - Other core | x | x |
| - Sundry | x | x |
| Operating expenses | | |
| - Labour | | |
| - Intercarrier costs | | |
| - Other operating expenses | | |
| - Depreciation and amortisation | | |
| - Other expenses | | |
| Earnings / (loss) before interest and taxation | x | x |
| Capital employed | x | x |
| Cost of capital (x%) | x | x |
| Total operating costs including cost of capital | x | x |
| Core product volumes: | | |
| External sales | x | x |
| Internal sales to Chorus | x | x |
| Internal sales to retail | x | x |
| Total core product volumes | x | x |

Retail

Income Statement

for the year ended 30 June 200x

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | 200X \$ | 200Y \$ |
|---|------------|------------|
| Operating revenues | | |
| External sales | x | x |
| Total operating revenues | x | x |
| Operating expenses | | |
| Labour | x | x |
| Intercarrier costs | x | x |
| Other operating expenses | x | x |
| Depreciation and amortisation | x | x |
| Other expenses | x | x |
| Internal expenses from Chorus | x | x |
| Internal expenses from Wholesale | x | x |
| Internal expenses from T&SS | x | x |
| Internal expenses from Corporate Centre | x | x |
| Total operating expenses | x | x |
| Earnings / (loss) before interest and taxation | x | x |
| <i>Net assets (historic cost)</i> | x | x |

Retail**Capital Employed Statement**

for the year ended 30 June 200x

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | 200X \$ | 200Y \$ |
|---|------------|------------|
| Current assets: | | |
| Cash and short-term investments | x | x |
| Receivables and prepayments | x | x |
| Inventories | x | x |
| Total current assets | x | x |
| Current liabilities: | | |
| Accounts payable and accruals | x | x |
| Short-term provisions | x | x |
| Other short term liabilities and provisions | x | x |
| Total current liabilities | x | x |
| Net current assets | x | x |
| Non current assets: | | |
| Receivables due after one year | x | x |
| Long-term investments | x | x |
| Intangible assets | x | x |
| Property, plant and equipment | x | x |
| Total non current assets | x | x |
| Non current liabilities: | | |
| Long term liabilities | x | x |
| Long term provisions | x | x |
| Total non current liabilities | x | x |
| Net assets (historic cost) | x | x |

Technology and Shared Services

Income Statement

for the year ended 30 June 200x

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | 200X \$ | 200Y \$ |
|---|------------|------------|
| Operating revenues | | |
| External sales | x | x |
| Internal sales to Chorus | x | x |
| Internal sales to Wholesale | x | x |
| Internal sales to Retail | x | x |
| Internal sales to Other Business | x | x |
| Total operating revenues | x | x |
| Operating expenses | | |
| Labour | x | x |
| Intercarrier costs | x | x |
| Other operating expenses | x | x |
| Depreciation and amortisation | x | x |
| Other expenses | x | x |
| Internal expenses from Corporate Centre | x | x |
| Total operating expenses | x | x |
| Earnings / (loss) before interest and taxation | x | x |
| <i>Net assets (historic cost)</i> | x | x |

Technology and Shared Services

Capital Employed Statement

for the year ended 30 June 200x

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | 200X \$ | 200Y \$ |
|---|------------|------------|
| Current assets: | | |
| Cash and short-term investments | x | x |
| Receivables and prepayments | x | x |
| Inventories | x | x |
| Total current assets | x | x |
| Current liabilities: | | |
| Accounts payable and accruals | x | x |
| Short-term provisions | x | x |
| Other short term liabilities and provisions | x | x |
| Total current liabilities | x | x |
| Net current assets | x | x |
| Non current assets: | | |
| Receivables due after one year | x | x |
| Long-term investments | x | x |
| Intangible assets | x | x |
| Property, plant and equipment | x | x |
| Total non current assets | x | x |
| Non current liabilities: | | |
| Long term liabilities | x | x |
| Long term provisions | x | x |
| Total non current liabilities | x | x |
| Net assets (historic cost) | x | x |

Other Business

Income Statement

for the year ended 30 June 200x

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | 200X \$ | 200Y \$ |
|---|------------|------------|
| Operating revenues | | |
| External sales | x | x |
| Total operating revenues | x | x |
| Operating expenses | | |
| Labour | x | x |
| Intercarrier costs | x | x |
| Other operating expenses | x | x |
| Depreciation and amortisation | x | x |
| Other expenses | x | x |
| Internal expenses from T&SS | x | x |
| Internal expenses from Corporate Centre | x | x |
| Total operating expenses | x | x |
| Earnings / (loss) before interest and taxation | x | x |
| <i>Net assets (historic cost)</i> | x | x |

Other Business

Capital Employed Statement

for the year ended 30 June 200x

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | 200X \$ | 200Y \$ |
|---|------------|------------|
| Current assets: | | |
| Cash and short-term investments | x | x |
| Receivables and prepayments | x | x |
| Inventories | x | x |
| Total current assets | x | x |
| Current liabilities: | | |
| Accounts payable and accruals | x | x |
| Short-term provisions | x | x |
| Other short term liabilities and provisions | x | x |
| Total current liabilities | x | x |
| Net current assets | x | x |
| Non current assets: | | |
| Receivables due after one year | x | x |
| Long-term investments | x | x |
| Intangible assets | x | x |
| Property, plant and equipment | x | x |
| Total non current assets | x | x |
| Non current liabilities: | | |
| Long term liabilities | x | x |
| Long term provisions | x | x |
| Total non current liabilities | x | x |
| Net assets (historic cost) | x | x |

Corporate Centre

Income Statement

for the year ended 30 June 200x

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | 200X \$ | 200Y \$ |
|---|------------|------------|
| Operating revenues | | |
| External sales | x | x |
| Internal sales to Chorus | x | x |
| Internal sales to Wholesale | x | x |
| Internal sales to T&SS | x | x |
| Internal sales to Retail | x | x |
| Internal sales to Other Business | x | x |
| Total operating revenues | x | x |
| Operating expenses | | |
| Labour | x | x |
| Intercarrier costs | x | x |
| Other operating expenses | x | x |
| Depreciation and amortisation | x | x |
| Other expenses | x | x |
| Total operating expenses | x | x |
| Earnings / (loss) before interest and taxation | x | x |
| <i>Net assets (historic cost)</i> | x | x |

Corporate Centre

Capital Employed Statement

for the year ended 30 June 200x

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | 200X \$ | 200Y \$ |
|---|------------|------------|
| Current assets: | | |
| Cash and short-term investments | x | x |
| Receivables and prepayments | x | x |
| Inventories | x | x |
| Total current assets | x | x |
| Current liabilities: | | |
| Accounts payable and accruals | x | x |
| Short-term provisions | x | x |
| Other short term liabilities and provisions | x | x |
| Total current liabilities | x | x |
| Net current assets | x | x |
| Non current assets: | | |
| Receivables due after one year | x | x |
| Long-term investments | x | x |
| Intangible assets | x | x |
| Property, plant and equipment | x | x |
| Total non current assets | x | x |
| Non current liabilities: | | |
| Long term liabilities | x | x |
| Long term provisions | x | x |
| Total non current liabilities | x | x |
| Net assets (historic cost) | x | x |

Reconciliation of Income Statement

for the year ended 30 June 200x

for the year ended 30 June 200y

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | Operating revenues \$ | Operating expenses \$ | Earnings / (loss) before interest and taxation \$ | Operating revenues \$ | Operating expenses \$ | Earnings / (loss) before interest and taxation \$ |
|---|-----------------------------|-----------------------------|---|-----------------------------|-----------------------------|---|
| EBIT per separated accounts | | | | | | |
| Chorus | x | x | x | x | x | x |
| Wholesale | x | x | x | x | x | x |
| Retail | x | x | x | x | x | x |
| T&SS | x | x | x | x | x | x |
| Other business | x | x | x | x | x | x |
| Corporate centre | x | x | x | x | x | x |
| Total EBIT per separated accounts | x | x | x | x | x | x |
| Adjustments: | | | | | | |
| Intra company transfer charges | x | x | x | x | x | x |
| Other adjustments | x | x | x | x | x | x |
| EBIT per Telecom statutory accounts | x | x | x | x | x | x |

Reconciliation of Capital Employed Statement

for the year ended 30 June 200x

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | 200x \$ | 200y \$ |
|--|------------|------------|
| Net assets per separated accounts | | |
| Chorus | x | x |
| Wholesale | x | x |
| Retail | x | x |
| T&SS | x | x |
| Other business | x | x |
| Corporate centre | x | x |
| Total net assets per separated accounts | x | x |
| Per Telecom statutory accounts | | |
| Total assets | x | x |
| Total liabilities | x | x |
| Adjustments: | | |
| Taxation recoverable | x | x |
| Taxation payable | x | x |
| Dividends payable | x | x |
| Debt due within one year | x | x |
| Deferred taxation | x | x |
| Long term debt | x | x |
| Other items | x | x |
| Total net assets per Telecom statutory accounts | x | x |

Schedule of Internal Charges

for the year ended 30 June 200x

Internal charges from:

| YEAR ENDED 30 JUNE (DOLLARS IN MILLIONS) | Chorus \$ | Wholesale \$ | T&SS \$ | Corporate Centre \$ | Total internal revenues \$ |
|---|--------------|-----------------|------------|---------------------------|-------------------------------------|
| Internal charges to: | | | | | |
| Chorus | x | x | x | x | x |
| Wholesale | x | x | x | x | x |
| Retail | x | x | x | x | x |
| T&SS | x | x | x | x | x |
| Other business | x | x | x | x | x |
| Total internal expenses | x | x | x | x | x |

APPENDIX 2

Sample regulatory accounts for BT and Eircom

BT

BT Wholesale markets consolidation statement

| CURRENT COST PROFIT AND LOSS ACCOUNT for the year ended 31 March 2005 | | | | | | | |
|--|------|--------|--------------------------|------|---------------------------------------|--------------------------|--|
| | €m | €m | % per line Item/total | €m | Re-presented (see note 2(c)) €m | % per line Item/total | Better/(worse) % change Year on Year |
| | 2006 | 2005 | | 2005 | 2005 | | |
| Turnover (No Discounts) | | | | | | | |
| Internal Sales | | | | | | | |
| - service(s) which are also available externally | | 5,821 | | | 5,781 | | 1 % |
| - service(s) provided internally only | | 18 | | | 26 | | (31)% |
| External Sales | | 1,039 | | | 814 | | 28 % |
| Roundings | | - | | | 1 | | |
| Total Turnover | | 6,878 | | | 6,622 | | 4 % |
| HCA Operating Costs: | | | | | | | |
| Charges from Other BT Wholesale Markets | | n/a | | | n/a | | n/a |
| Operating Costs of Wholesale Service: | | | | | | | |
| Provision / Maintenance | | 559 | 11 % | | 536 | 11 % | (4)% |
| Network Support | | 358 | 8 % | | 379 | 8 % | (5)% |
| General Support | | 542 | 11 % | | 580 | 12 % | 7 % |
| General Management | | 708 | 16 % | | 802 | 17 % | 0 % |
| Finance and Billing | | 90 | 2 % | | 92 | 2 % | 2 % |
| Accommodation | | 548 | 11 % | | 459 | 9 % | (19)% |
| Bad Debts | | - | 0 % | | (25) | (1)% | (100)% |
| Other Costs | | 84 | 1 % | | 118 | 2 % | 48 % |
| Depreciation - Land & Building | 89 | | | 80 | | | (10)% |
| - Access | 793 | | | 729 | | | (8)% |
| - Switch and Transmission | 773 | | | 743 | | | (4)% |
| - Other related | 257 | | | 354 | | | 33 % |
| Sub total Depreciation | | 1,892 | 39 % | | 1,916 | 39 % | 1 % |
| Sub total HCA Operating Costs | | 4,891 | | | 4,857 | | |
| CCA adjustments: | | | | | | | |
| Holding (gain)/loss | | (580) | | | (157) | | 199 % |
| Supplementary depreciation | | 97 | | | 6 | | (1,517)% |
| Other adjustments | | 275 | | | 163 | | (50)% |
| Roundings | | 25 | | | 31 | | |
| Total CCA Operating Costs | | 4,728 | | | 4,890 | | 3 % |
| Return | | 2,150 | | | 1,732 | | 24 % |
| RETURN ON MEAN CAPITAL EMPLOYED AND TURNOVER for the year ended 31 March 2005 | | | | | | | |
| | | 2006 | | | 2005 | | |
| Return on mean capital employed | | 15.4 % | | | 11.9 % | | 3.5 % |
| Return on turnover | | 31.3 % | | | 26.2 % | | 5.1 % |

BT Wholesale markets consolidation statement

| | Re-presented (see note 2(o)) | | Better/(worse) % change Year on Year |
|---|---------------------------------|---------------|--|
| | £m 2006 | £m 2005 | |
| Fixed assets: | | | |
| Tangible fixed assets | | | |
| - Land & Buildings | 490 | 551 | (11)% |
| - Access - Copper | 3,871 | 3,402 | 14 % |
| - Fibre | 635 | 640 | (1)% |
| - Duct | 4,551 | 4,498 | 1 % |
| - Switch and Transmission - Switch | 1,144 | 1,394 | (18)% |
| - Transmission | 1,958 | 2,202 | (11)% |
| - Other | 1,129 | 1,053 | 7 % |
| Investments | n/a | n/a | n/a |
| Total fixed assets | 13,778 | 13,740 | 0 % |
| Current assets: | | | |
| Stocks | 2 | 5 | (60)% |
| Debtors | | | |
| - Internal | 1,117 | 1,067 | 5 % |
| - external | 53 | 665 | (92)% |
| Total current assets | 1,172 | 1,737 | (33)% |
| Creditors: amounts falling due within one year | | | |
| Other creditors | | | |
| - Internal | n/a | n/a | n/a |
| - external | (880) | (831) | (6)% |
| Total creditors: amounts falling due within one year | (880) | (831) | (5)% |
| Net current assets | 292 | 906 | (68)% |
| Total assets less current liabilities | 14,070 | 14,646 | (4)% |
| Provisions for liabilities and charges | (127) | (139) | 9 % |
| Roundings | 5 | 37 | |
| Mean capital employed | 13,948 | 14,544 | (4)% |

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Core Network Business

| <i>PROFIT AND LOSS ACCOUNT INCLUDING CCA ADJUSTMENTS</i> for the fifteen months ended 30 June 2007 | 15 months to 30-Jun-07 | 12 months to 31-Mar-06 Restated |
|---|---------------------------|---------------------------------------|
| | €'000 | €'000 |
| Turnover | | |
| From Other Operators | 238,710 | 163,582 |
| Regulated Rate of Return Adjustment | (24,943) | (31,782) |
| Transfer Charges to Retail and Other | 448,660 | 379,802 |
| Total Turnover | 662,427 | 511,602 |
| Operating Costs | 622,751 | 511,175 |
| Exceptional Operating Costs | - | - |
| Holding (Gain) and Other Adjustments | (6,648) | (33,505) |
| Supplementary Depreciation | 4,056 | (682) |
| Total Operating Costs | 620,159 | 476,988 |
| Return | 42,268 | 34,614 |
| RETURN ON MEAN CAPITAL EMPLOYED | | |
| | 15 months to 30-Jun-07 | 12 months to 31-Mar-06 Restated |
| | €'000 | €'000 |
| Return | 42,268 | 34,614 |
| Mean Capital Employed | 294,040 | 300,981 |
| Return on Mean Capital Employed | 14.375% | 11.5% |
| Return on Turnover | 6% | 7% |

The basic inland services covering call origination, call termination and domestic transit carry a current cost valuation. All other core network services are included at their historical costs, as modified by the revaluation of assets shared with the basic inland services.

Core Network Business

STATEMENT OF MEAN CAPITAL EMPLOYED INCLUDING CCA ADJUSTMENTS
as at 30 June 2007

| | 30-Jun-07 | 31-Mar-06 |
|---|------------------|-------------------|
| | €'000 | Restated €'000 |
| Fixed assets | | |
| Tangible Fixed Assets | 425,370 | 448,569 |
| Intangible Fixed Assets | 2,096 | 653 |
| Total Fixed Assets | 427,466 | 449,222 |
| Current Assets | | |
| Stocks | 1,450 | 1,255 |
| Debtors | 30,444 | 26,302 |
| Cash at Bank and in Hand | 50,374 | 42,478 |
| Total Current Assets | 82,268 | 70,035 |
| Creditors | (199,912) | (207,266) |
| Provisions for Liabilities and Charges | (15,782) | (11,010) |
| Mean Capital Employed | 294,040 | 300,981 |

The basic inland services covering call origination, call termination and domestic transit carry a current cost valuation. All other core network services are included at their historical costs, as modified by the revaluation of assets shared with the basic inland service.