



COMMERCE COMMISSION

**ACCOUNTING SEPARATION**

**Decision on Changes to the Telecom Regulatory Financial Statements  
Information Disclosure Requirements**

**Date:** 17 May 2010

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## APPENDICES

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*APPENDIX B – SAMPLE REGULATORY FINANCIAL REPORT*

# 1. INTRODUCTION AND BACKGROUND

1. Under requirements issued by the Commerce Commission (**Commission**) pursuant to Part 2B of the Telecommunications Act 2001 (the **Act**), Telecom must publish financial and other information about its network, wholesale and retail business activities and services.
2. This document sets out final changes to the requirements issued by the Commission (known as the Telecom Accounting Separation Information Disclosure Requirements for Financial Years ending 2009 and 2010 (the **Requirements**)). The changes are to improve the quality and presentation of the regulatory financial statements and regulatory reporting manual which Telecom is required to publish under Part 2B of the Act, and to prescribe the specific methodologies to be used for asset valuation and attribution.
3. The final changes follow the Commission's review of Telecom's 2009 regulatory financial statements, regulatory reporting manuals, and other information provided to the Commission. The review considered, among other items, the reasonableness of both Telecom's regulatory financial statements, and the methodologies that Telecom applied when preparing the regulatory financial statements.
4. The Commission published the Requirements for the financial years ending 2009 and 2010 on 25 March 2009. The Commission, at the same time, published a Companion Paper<sup>1</sup> to the Requirements explaining the reasoning and final decisions of the Commission in relation to the Requirements.
5. The Commission stated in its Companion Paper that it intended to review and amend the Requirements after the first year to give best effect to Part 2B of the Act. Telecom publicly released its first set of regulatory financial statements and the regulatory reporting manual on 18 December 2009; both documents are available to view on Telecom's website.<sup>2</sup>
6. The Commission is required to publish a summary and analysis of the disclosed information to promote greater understanding of Telecom's operations and behavior, and any changes to Telecom's operation and behaviour over time. The Commission's summary and analysis of Telecom's regulatory financial statements for the 2009 financial year is available on the Commission's website.<sup>3</sup>
7. On 14 April 2010, the Commission published a consultation document, which presented its proposed changes to the Requirements and a draft set of revised Requirements. All references to proposed changes in this document are referring to the proposed changes itemized in the consultation. Telecom and 2degrees both lodged submissions.
8. The above documents and other material relating to the Commission's consultation process can be found on the Commission's website.<sup>4</sup>

## 1.1 Regulatory Reporting Objectives

9. Part 2B of the Act mandates that the Commission require Telecom to disclose information "about the operation and behaviour of all or any of its network, wholesale or retail business activities as if those activities were operated as independent or unrelated

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<sup>1</sup> The Companion Paper which described the Commission's approach to Information Disclosure, including the reasons for various decisions, was published at the same time as the Requirements.

<sup>2</sup> <http://www.telecom.co.nz>

<sup>3</sup> <http://www.comcom.govt.nz/IndustryRegulation/Telecommunications/AccSepofTelecom/reportingrequirements.aspx>

<sup>4</sup> [www.comcom.govt.nz/IndustryRegulation/Telecommunications/AccSepofTelecom/documents.aspx](http://www.comcom.govt.nz/IndustryRegulation/Telecommunications/AccSepofTelecom/documents.aspx),  
[www.comcom.govt.nz/IndustryRegulation/Telecommunications/AccSepofTelecom/reportingrequirements.aspx](http://www.comcom.govt.nz/IndustryRegulation/Telecommunications/AccSepofTelecom/reportingrequirements.aspx)

companies”<sup>5</sup>. The Commission’s requirements must be reasonable having regard to the confidentiality of the information and the time required to prepare it.<sup>6</sup>

10. To monitor compliance with the Requirements, the Commission may also require Telecom to provide additional information.<sup>7</sup>
11. The Commission developed a phased approach to implementation of the Requirements. The Commission’s priorities in implementing the first stage of Telecom’s regulatory reporting in 2009 were to:
  - Disaggregate Telecom’s statutory financial statements into regulatory financial statements for the Services Groups.
  - Report the regulatory financial statements in current cost accounting (CCA) methodology along with historical cost accounting (HCA).
  - Identify key issues which require revision or clarity.
12. The Commission’s priorities for regulatory reporting for 2010 are to:
  - Commence the publication of product statements.
  - Introduce improvements to the attribution and the CCA asset valuation processes and methodologies.
13. The Commission’s priority for 2011 and future years is to improve the quality of product statements to be disclosed by Telecom.

## **1.2 Reasonableness of the Requirements**

14. In assessing the reasonableness<sup>8</sup> of the changes to the Requirements, the Commission considered:
  - Feedback from submissions on the draft changes to the Requirements;<sup>9</sup>
  - The usefulness of the information to parties interested in understanding the operations and behavior of Telecom;
  - The cost and time to Telecom of implementing the changes;
  - The reliability and timeliness of the information;
  - The materiality of the changes; and
  - The impact of the changes on the product statements for regulated products and services required to be published for the financial year ending 2010.
15. The final changes to the Requirements will improve the scope and quality of the regulatory financial information, while having regard to the impact on Telecom’s cost to implement the Requirements.

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<sup>5</sup> Telecommunications Act 2001, s69ZB.

<sup>6</sup> Ibid, s69Z.

<sup>7</sup> Ibid, s69ZF (1).

<sup>8</sup> Section 69Z of the Act states that the Commission’s requirements must be reasonable.

<sup>9</sup> The draft changes to the Requirements were dated 14 April 2010.

## 2. SUMMARY OF THE CHANGES TO THE REQUIREMENTS

16. The table below summarises the changes to the Requirements. It is included to provide an overview of the changes presented in the body of this document.

Issue	Change
<p><b>Regulatory Accounting Principles</b></p> <p>Absence of a unified set of regulatory accounting principles.</p>	<ul style="list-style-type: none"> <li>▪ Prescribing a full set of regulatory accounting principles to be included in Telecom’s regulatory reporting manual.</li> <li>▪ Requiring Telecom to apply these principles when preparing the regulatory financial statements.</li> </ul>
<p><b>Regulatory Financial Statements</b></p> <p>Areas have been identified where the regulatory financial statements could be improved.</p>	<ul style="list-style-type: none"> <li>▪ Improving the presentation of the regulatory financial statements by simplifying the content and format: <ul style="list-style-type: none"> <li>- Adding an Introduction, a Basis of Preparation and a Commentary to the Regulatory Financial Statements.</li> <li>- Summarising the Regulatory Statement of Financial Performance; Notes to the Regulatory Financial Statements to include the detail.</li> <li>- Refining the Product Statements to align with the Regulatory Statement of Financial Performance.</li> </ul> </li> </ul>
<p><b>Regulatory Audit Requirements</b></p> <p>The regulatory audit opinion is currently required to be in the form “<i>prepared in all material respects in accordance with these Requirements</i>”.</p> <p>The revenue audit materiality level is currently set at 1%.</p>	<ul style="list-style-type: none"> <li>▪ Changing the audit opinion to be “<i>as prepared in all material respects in accordance with the regulatory reporting manual</i>” to remove the need for the auditor to comment on compliance with the Requirements.</li> <li>▪ Increasing the revenue audit materiality level to 2% to reduce the regulatory audit workload whilst still providing an adequate level of assurance.</li> </ul>
<p><b>Change Management Process</b></p> <p>There is a need to understand the impact of changes to the regulatory financial statements.</p>	<ul style="list-style-type: none"> <li>▪ Requiring Telecom to have a documentation process to track the implementation of any changes.</li> <li>▪ Publicly disclose changes which have a material effect on the regulatory financial statements and help readers understand the effects of changes.</li> </ul>
<p><b>Regulatory Reporting Manual</b></p> <p>Telecom’s inclusion of background material in the manual was useful for readers, but was not formally required.</p>	<ul style="list-style-type: none"> <li>▪ Requiring Telecom to include an introduction, glossary of regulatory terms, and a technical dictionary in its regulatory reporting manual.</li> </ul>
<p><b>Publication Date</b></p> <p>Choice of publication dates for Telecom’s regulatory financial statements.</p>	<ul style="list-style-type: none"> <li>▪ Change publication of Telecom’s 2010 regulatory financial statements to 31 December 2010 from 1 December 2010 (as per the existing Requirements).</li> </ul>
<p><b>Product List</b></p> <p>Existing requirements call for a full scope introduction of product statements in 2010.</p>	<ul style="list-style-type: none"> <li>▪ Revising the list of products and services to be reported via Product Statements in 2010 and 2011 to reflect that 2010 is a transitional year for introducing product statements.</li> </ul>

<p><b>Asset Valuation</b></p> <p>Lack of reliability of current asset valuation methodologies.</p>	<ul style="list-style-type: none"> <li>▪ Requiring that fully depreciated assets be valued at zero.</li> <li>▪ Requiring the use of straight line depreciation.</li> <li>▪ Prescribing the CCA valuation methods to exclude any additional functionality associated with new assets and any excess capacity.</li> </ul>
<p><b>Attribution</b></p> <p>Lack of reliability of current attribution methods.</p>	<ul style="list-style-type: none"> <li>▪ Prescribing the record keeping process for internal transfer charges.</li> <li>▪ Revising the presentation and wording of the attribution approach.</li> </ul>
<p><b>Non-financial Data</b></p> <p>Lack of reliability of non-financial data used in preparing statements.</p>	<ul style="list-style-type: none"> <li>▪ Requiring that data used for certain product statements are derived from regularly updated operational systems, survey or sample.</li> </ul>

### **3. PURPOSE AND CONTEXT OF REQUIREMENTS**

17. Both submissions raised several points, which were not specific to the proposed changes, but rather related to broader issues such as the general purpose, costs, benefits and scope of accounting separation. In preparing this decision paper the Commission has had regard to all material issues raised in submissions.

#### **3.1 Ultrafast Broadband (UFB)**

##### *Submissions*

18. Telecom submitted that the government's Ultrafast Broadband (UFB) policy creates sufficient uncertainty to warrant delaying the requirement to develop product statements until after the UFB process has been decided.<sup>10</sup>
19. Telecom further submitted that if product statements are required in 2010 it will request that the statements are kept confidential until the UFB process has been decided.
20. Telecom advised that it considered that all Wholesale products were competitive in some level and it was likely to ask that the product statements for Wholesale services not be made public.

##### *Commission's View*

21. The Commission considers that progress with implementation of the Requirements should continue independent of the UFB process until the outcome of UFB and its effect on accounting separation is known.
22. As the tools for accounting separation are already in place, the Commission considers the publication of product statements for 2010 to be reasonable and does not impose a major burden on Telecom.
23. The Commission has a statutory obligation to meet the requirements of Part 2B of the Act. Telecom's wish to suspend the publication of product statements is inconsistent with that obligation.

#### **3.2 Purpose of Regulatory Financial Statements and Past Consultation**

##### *Submissions*

24. Telecom submitted that the consultation paper "had only touched very briefly on the purpose of accounting separation".<sup>11</sup>
25. 2degrees submitted that the Commission should document the purpose of accounting separation and identified a number of specific goals it considered accounting separation should achieve including several points related to promoting competitive behavior and efficient investment.<sup>12</sup>

##### *Commission's View*

26. Prior to releasing the first set of information disclosure requirements in March 2009, the Commission undertook a consultation process which included several opportunities for interested parties to submit on both the specific and the broader aspects of accounting

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<sup>10</sup> Telecom, *Submissions on Draft Telecom Accounting Separation Information Disclosure Requirements*, 28 April 2010, para 68

<sup>11</sup> Telecom, *Submissions on Draft Telecom Accounting Separation Information Disclosure Requirements*, 28 April 2010, para 8

<sup>12</sup> 2degrees, *Comments on the Accounting Separation Consultation Document*, April 2010, p.4

separation including its purpose. The Commission's 6 March 2009 consultation documents included discussion on the purpose of accounting separation.<sup>13,14</sup>

27. Part 2B of the Telecommunications Act mandates that the Commerce Commission require Telecom to disclose information 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 as if those activities were operated as independent or unrelated companies.
28. The purpose of Part 2B shares a fundamental element with that of Part 2 and Part 2A of the Act - that is, to "promote competition in telecommunications services within New Zealand."<sup>15</sup> In Part 2B, however, this purpose is to be achieved by ensuring that Telecom publicly discloses timely and reliable information concerning its operations and behaviour. The purpose of Part 2B is therefore about identifying the operations and behaviours that may impact competitive outcomes.

### 3.3 Wide Audience

#### *Submissions*

29. Telecom submitted that the Commission had not articulated why the regulatory financial statements would be useful to a wide audience.<sup>16</sup>
30. 2degrees questioned the usefulness of the regulatory financial statements and the size of its audience arguing:<sup>17</sup>

It appears that there are few users of the regulatory accounts other than the Commission and the financial analyst community ...

#### *Commission's View*

31. In establishing the original framework for regulatory information disclosure and the proposed changes, the Commission considered who the wide audience might be and how they may use the information.
32. The wide audience includes individuals and organisations with an interest in New Zealand's telecommunications market. This includes alternative operators, which provide telecommunications services in New Zealand, industry bodies, media groups, wholesale customers of Telecom, policy and regulatory bodies, industry specialists such as consultants, and financial organizations.
33. The Commission will consider publishing a simplified version of its Summary and Analysis for a less financially informed audience for Telecom's 2010 regulatory financial statements.

### 3.4 Cost of Preparing Regulatory Financial Statements

#### *Submissions*

34. Telecom submitted that the cost of preparing the regulatory financial statements is \$17 million and that the overall cost and time required to implement the changes is unreasonable.

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<sup>13</sup> Commerce Commission, *Draft Companion Paper on the Accounting Separation of Telecom*, 6 March 2009 pages 8, 11-15

<sup>14</sup> The Commission's final paper *Companion Paper on the Accounting Separation of Telecom*, 15 March 2009 also included discussion on the purpose of accounting separation.

<sup>15</sup> See sections 18(1) and 69A(a) of the Act.

<sup>16</sup> Telecom, *Submissions on Draft Telecom Accounting Separation Information Disclosure Requirements*, 28 April 2010, para 22-27

<sup>17</sup> 2degrees, *Comments on the Accounting Separation Consultation Document*, April 2010, p.3

35. Telecom also submitted that some changes should not be implemented as these changes are not material, are costly to implement and that there should be a preference given to methodologies which reduce compliance costs such as using methodologies already in use.<sup>18</sup>

#### *Commission's View*

36. In preparing both the 2009 Requirements and the 2010 changes to the Requirements, the Commission considered the cost-benefit trade-off. Several of the changes, such as the changes to the audit requirements and deferral of some product statements will reduce Telecom's compliance costs and therefore the effort required to prepare the regulatory financial statements.
37. In order to produce regulatory financial statements, which are reliable and useful to a wide audience, it will be necessary for Telecom to incur some costs in its preparation, such as verifying the reliability of key input data and assumptions behind the asset valuation and attribution models.
38. The Commission also notes that this cost benefit debate has been conducted in many countries where regulatory financial statements are mandated and the benefits from reliable information are considered to be significant, lending further support to the position adopted by the Commission.
39. Telecom has not provided any reasonable support of its \$17 million cost estimate. The Commission previously noted that much of the costs associated with accounting separation were incidental to the costs of implementing operational separation and necessary internal management reporting improvements.

### **3.5 Timing and Delivery Risk**

#### *Submissions*

40. Telecom submitted that the nature and the number of changes proposed by the Commission will impact the time, the cost and the delivery risk of the regulatory financial statements.
41. Telecom submitted that it will be unable to deliver reliable and accurate regulatory financial statements if it is required to make all the proposed changes. Telecom requested further dialogue with the Commission to prioritise the changes.

#### *Commission's View*

42. The Commission has been mindful of the impact on the cost to Telecom and the time necessary to deliver on the changes and has, in consultation with Telecom, moved the publication date from 1 December 2010 to 31 December 2010 in acknowledgement of the time and effort required to implement the changes.
43. The Commission considers that the changes are reasonable having regard to the purpose set out in section 69Y and can be implemented by 31 December 2010.

### **3.6 Relationship to Operation Separation**

#### *Submissions*

44. Telecom submitted that the Commission needs to consider the extent to which the changes to the Requirements align with Telecom's operational separation requirements. Telecom cited the internal trading regime as an example of the leverage used from operational separation to regulatory financial statements.

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<sup>18</sup> Telecom, *Submissions on Draft Telecom Accounting Separation Information Disclosure Requirements*, 28 April 2010, para 29

#### *Commission's View*

45. The requirements of s69ZB (3) of the Act concerning consistency with the separation plan were factored into the Requirements and is one of the many factors considered by the Commission in preparing the changes. The Commission has previously commented on Telecom's internal trading arrangements and especially noted the specific requirement for greater transparency around the internal transfers. This view is reflected in the proposed changes to the Requirements' in section 4.9.2 Transfer Charges.

### **3.7 Disclosure of Information Relating to Mobile Services and Other Service Providers**

#### *Submissions*

46. 2degrees submitted that all operators with significant market power should be required to disclose regulatory accounting information. 2degrees considered that this should include the backhaul operators Kordia and Vector, and the mobile operator Vodafone.
47. 2degrees also submitted that there should be increased disclosure of mobile information.

#### *Commission's View*

48. The Commission has had regard to 2degrees submitting that information disclosure should be expanded to include all operators with significant market power. The Commission considers this is beyond the scope of this consultation under s69ZB of the Act in relation to Telecom's accounting separation information, but will consider whether to require information disclosure by other access providers under section 69ZC of the Act.
49. The immediate priority for regulatory reporting includes the commencement of product statements in the area of regulated products. The Commission will consider the necessity to require information on mobile services at a later date.

## 4. CHANGES TO THE REQUIREMENTS

### 4.1 Regulatory Accounting Principles

#### *Issue and Reasoning*

50. Regulatory accounting principles are overarching guidelines for preparing regulatory financial statements. Such standards provide guidance as to the methodologies and policies to apply in the absence of specific instructions or requirements.
51. The Commission has identified several principles and guidelines in past papers.<sup>19</sup> Combining these principles into a set of overarching regulatory accounting principles will improve the reliability of the regulatory financial statements, and permit a greater understanding of Telecom's operation and behaviour of its network and activities. In addition, the prescription of regulatory accounting principles will align the regulatory financial statements closer to the purposes set out in the Act.
52. In developing integrated regulatory accounting principles, the Commission considered international best practice, the purpose and context of the New Zealand regulatory reporting regime, and the need to align terminology with overseas usage where appropriate.
53. Currently, where the regulatory accounting principles do not apply, Telecom must apply New Zealand Generally Accepted Accounting Practice (**NZ GAAP**) as per the Requirements. NZ GAAP prescribes principles applicable to statutory financial reporting which are not sufficient for regulatory reporting purposes. NZ GAAP is intended to meet the purposes of statutory reporting, and therefore does not always align with the purposes set out in the Act for accounting separation. Customised regulatory accounting principles, however, can be designed to assist in ensuring that information prepared using the regulatory accounting principles aligns with the purposes of the Act.

#### *Proposed Changes*

54. The Commission proposed that Telecom must:
  - Include the regulatory accounting principles in its regulatory reporting manual; and
  - Apply the regulatory accounting principles when preparing its regulatory financial statements and its regulatory reporting manual.
55. The proposed regulatory accounting principles, as noted in the Commission's Draft Decision, were:
  - (a) *Definition.* Where any word or expression used in Telecom's regulatory reporting manual is defined in the Requirements, that word or expression must be given the same meaning.
  - (b) *Use of NZ GAAP.* Except where the Requirements otherwise provide, all statements and manuals and other information must be prepared and published in accordance with NZ GAAP.
  - (c) *Transparency.* Telecom's regulatory reporting manual must disclose information regarding the regulatory accounting processes and methodologies used to prepare the regulatory financial statements with sufficient detail and clarity such that an informed reader can easily:

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<sup>19</sup> For example, the Requirements paper prescribed principles for the attribution methodology and defined many regulatory terms. The Companion Paper discussed the use of NZ GAAP in regulatory reporting and the importance of consistency (para 243).

- Gain a comprehensive understanding of the overall structure of Telecom’s financial and information systems from which regulatory data are derived.
  - Gain a detailed understanding of all the information, methodologies and driver data applied in the preparation of the regulatory accounting data.
  - Make a judgment as to the reasonableness of the information and attribution and valuation methodologies used to prepare the information and any changes to them.
- (d) *Causality*. Telecom must attribute all revenue (including transfer charges), expenses (including transfer charges), assets and short-term liabilities based on the activities, which caused the revenues to be earned, expenses to be incurred, assets to be used or short-term liabilities to be incurred.
- (e) *Objectivity*. Telecom must apply regulatory accounting processes and procedures which are objectively justifiable and reasonable. Consistent with the transparency principle, these processes and procedures, and any changes to them, will be documented with sufficient detail and clarity such that an informed reader can easily make a judgment as to their reasonableness.
- (f) *Consistency*. Telecom must treat similar types of revenue, expenses, assets and short-term liabilities in a consistent manner from year to year. Telecom must fully disclose details of any changes, and the impact of the changes, to the regulatory accounting principles, attribution methods or asset valuation methods, or any other change which has a material effect on the consistent treatment of revenue, expenses, assets and short-term liabilities in the regulatory financial statements.
56. Any express obligations in the Requirements override anything to the contrary in the regulatory accounting principles.

#### *Submissions*

57. Telecom did not specifically submit on the proposal that the Commission should prescribe a set of regulatory accounting principles to be included in Telecom’s regulatory reporting manual and applied in the regulatory financial statement process.
58. However, Telecom did disagree with the Commission’s proposal on the specific regulatory accounting principle “Use of NZ GAAP”.<sup>20</sup>
59. The Commission proposed that Telecom should prepare and publish all reports in accordance with NZ GAAP except where the Requirements provide. Telecom proposed retaining the current provisions which allow for NZ GAAP to be superseded by both the Requirements and Telecom’s regulatory reporting manual. Telecom argued that this would allow “burdensome or inappropriate disclosure requirements mandated by NZ GAAP” to be excluded from the regulatory financial statements.
60. 2degrees did not comment on any of the regulatory accounting principles proposed by the Commission, but proposed an alternative approach to regulatory accounting principles where key areas should be highlighted including mobile bottleneck access services, but not where there is a fully competitive market.

#### *Response to Submissions*

61. Telecom’s proposal would effectively allow Telecom to determine material aspects of the regulatory accounting polices and hence has the risk that Telecom could introduce changes to the methodologies and/or introduce new or alternative regulatory accounting practices which differ from the Commission’s intent. Such changes could potentially reduce the transparency, comparability or usefulness of the regulatory financial statements. A past example of this risk, from the 2009 regulatory financial statements, is

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<sup>20</sup> Telecom, *Submissions on Draft Telecom Accounting Separation Information Disclosure Requirements*, 28 April 2010, para 82

where Telecom assigned a positive CCA asset valuation to many fully depreciated fixed assets even though such as policy was neither consistent with NZ GAAP, nor prescribed (or intended) by the Commission.

62. The Commission's proposed principle "Use of NZ GAAP" already allows for Telecom to deviate from NZ GAAP when it is necessary to fulfil an express term of the Requirements.
63. Should compliance with NZ GAAP prove burdensome or create inappropriate disclosure requirements, the exemption provision of the Requirements provides a means for Telecom to propose a pragmatic solution.
64. The Commission considers that the prescribed regulatory accounting principles are reasonable having regard to the purpose set out in section 69Y of the Act and are aligned with international best practice. The selection of future product statements is expected to concentrate on key regulated bottleneck services.
65. The underlying aim of the regulatory accounting principles is to provide Telecom with guidelines for the preparation of the regulatory financial statements and regulatory reporting manual, thereby allowing readers to make a judgement as to their reasonableness, objectivity and transparency.

#### *Commission's Decision*

66. After considering the submissions received and part 2B of the Act, the Commission has decided to implement the changes as proposed with the following amendment:
  - The definition for *Use of NZ GAAP* is expanded to include reference to the NZ Framework as defined in section 2 of the Requirements.

## **4.2 Revisions to Regulatory Financial Statements**

#### *Issue and Reasoning*

67. The Act authorises the Commission, in making requirements under Part 2B, to "prescribe the manner in which information must be disclosed"<sup>21</sup>. The Commission considers that the revisions set out below will improve the presentation of the regulatory financial statements, in that the content will be communicated with greater clarity to interested parties. These revisions still permit comparability of Telecom's published information from 2009.
68. The Commission expects the *Commentary to the Regulatory Financial Statements* to explain material changes affecting the regulatory financial statements so as to keep a reader suitably informed.

#### *Proposed Changes*

69. The Commission proposed to improve the regulatory financial statements by simplifying the content and format by:
  - Adding an *Introduction* to describe key regulatory background information.
  - Adding a *Basis of Preparation* to outline key components in preparing the regulatory financial statements.
  - Requiring Telecom to include a *Commentary to the Regulatory Financial Statements* to explain and quantify material changes which effect the regulatory financial statements.

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<sup>21</sup> Act, s69ZD(1)(a).

- Summarising the revenue and expenditure information in the *Regulatory Statement of Financial Performance*. Additional detail is to be provided in the Notes to the Financial Statements.
- Revising the product statements templates to align with the Regulatory Statement of Financial Performance.

70. The revised format of the regulatory financial statements is shown in Appendix B.

*Submissions*

71. Telecom endorsed the proposed changes to the regulatory financial statement templates.
72. 2degrees was concerned about including reports analysing mobile capital expenditure including a breakdown showing handset subsidies, backhaul and retail store investments.<sup>22</sup>

*Response to Submissions*

73. The Commission considers that the proposed changes to the regulatory financial statements are reasonable and will reduce the time and effort required by Telecom to prepare the relevant reports.

*Commission's Decision*

74. After considering the submissions received and Part 2B of the Act, the Commission has decided to implement the changes as proposed.
75. As noted in section 3.7 of this document, the Commission will consider if it would be beneficial in the future to require information on mobile services for future Requirements.

**4.3 Regulatory Audit**

4.3.1 Audit Opinion

*Issue and Reasoning*

76. Under the 2009 Requirements, Telecom was required to engage an independent regulatory auditor to provide an audit opinion as to whether the regulatory financial statements were “*prepared in all material respects in accordance with these Requirements*”.
77. The regulatory auditor is not required to form an audit opinion on the regulatory reporting manual, regulatory methodologies, or the compliance monitoring information. The role of the regulatory auditor is to assess and verify whether the regulatory financial statements have been prepared in accordance with Telecom’s regulatory reporting manual. In fulfilling this role, it is not necessary or appropriate for the regulatory auditor to form an opinion on Telecom’s compliance with the Requirements.
78. Revising the regulatory audit opinion to be expressed in terms of whether the regulatory financial statements have been prepared in accordance with the regulatory reporting manual instead of the Requirements will remove the obligation on the regulatory auditor to form an opinion in relation to Telecom’s general compliance with the Requirements, which is assessed by the Commission.

*Proposed Changes*

79. The Commission proposed that the regulatory audit opinion report whether the regulatory financial statements have been prepared in accordance with the regulatory reporting manual (instead of the Requirements).

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<sup>22</sup> 2degrees, *Comments on the Accounting Separation Consultation Document*, April 2010, p.6

### *Submissions*

80. Telecom endorsed the Commission's proposed changes regarding the scope of the audit opinion and noted that the change could deliver cost efficiencies.<sup>23</sup>
81. 2degrees submitted that it is important to have accurate cost details and considered that audits will help achieve this. 2degrees also submitted that the audit obligations should not be unreasonable on Telecom as high audit costs would flow through to wholesale prices.<sup>24</sup>

### *Response to Submissions*

82. The Commission considers that this proposal will reduce compliance costs while still providing a satisfactory level of scope for the regulatory audit. This outcome is reasonable having regard to the purpose set out in section 69Y

### *Commission's Decision*

83. After considering the submissions received and part 2B of the Act, the Commission has decided to implement the changes as proposed.

### 4.3.2 Audit Materiality

#### *Issue and Reasoning*

84. The 2009 Requirements required the regulatory auditor to form the audit opinion based on prescribed materiality levels.
85. The materiality level represents a trade-off between a satisfactory level of audit assurance and the cost of the regulatory audit to Telecom. Setting the materiality level too low introduces the risk that the regulatory auditor will not be able to complete some parts of the audit to the standard required for an unqualified audit opinion.
86. The regulatory audit for 2009 was performed to a materiality level of 1% of revenue for each Services Group's Regulatory Statement of Financial Performance and the consolidated Regulatory Statement of Financial Performance.
87. Experience gained from the 2009 audit indicates that for 2010 a satisfactory level of audit assurance could be achieved with a higher materiality level, and that this revision would not materially change the financial information reported in the regulatory financial statements. Moving to a 2% materiality level would reduce the regulatory audit workload, whilst still providing an adequate level of assurance. This change will assist to reduce the costs to Telecom of complying with the Commission's regulatory audit requirements.
88. The Commission does not propose any changes to the materiality levels for the other regulatory financial statements.<sup>25</sup>

#### *Proposed Changes*

89. The Commission proposed that the materiality level for the regulatory audit of the Statement of Financial Performance prepared at the Services Group level is set at 2% of each Services Group's revenue (instead of 1%).

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<sup>23</sup> Telecom, *Submissions on Draft Telecom Accounting Separation Information Disclosure Requirements*, 28 April 2010, para 76

<sup>24</sup> 2degrees, *Comments on the Accounting Separation Consultation Document*, April 2010, p.6

<sup>25</sup> These levels are set at 1% of total asset value for all regulatory statements of mean capital employed and 1% of total fixed asset value for all regulatory statements of fixed asset movements.

### *Submissions*

90. Telecom endorsed the Commission's proposed changes regarding the audit materiality level and noted that the change could deliver cost efficiencies without reducing the robustness or utility of the regulatory financial statements.<sup>26</sup>
91. 2degrees submitted that the audit obligations should not be unreasonable on Telecom as high audit costs would flow through to wholesale prices.

### *Response to Submissions*

92. The Commission considers that the proposed change to the audit materiality level will reduce compliance costs while still achieving a satisfactory level of audit assurance.

### *Commission's Decision*

93. After considering the submissions received, and Part 2B of the Act, the Commission has decided to implement the changes as proposed.

## **4.4 Change Management Process & Disclosure of Significant Changes**

### *Issue and Reasoning*

94. The regulatory reporting requirements for 2010 will require Telecom to implement a number of changes. In addition to the changes to the Requirements, changes may also result from other factors such as changes in accounting standards (NZ GAAP), changes in market conditions, or factors internal to Telecom. The Commission considers that a well documented change management process is needed in order to record these changes, to ensure that readers are aware of the impact of the changes on the regulatory financial statements, and to provide a means of tracking the changes for review by Telecom, the Commission and the auditor.
95. It is appropriate after the first year of accounting separation implementation for Telecom to document its implementation of the changes to the Requirements and any other changes impacting Telecom's regulatory reporting manual or published regulatory financial statements. A formal change management process typically includes documented procedures for managing the changes, and a central register to record and track implementation.
96. It is also beneficial that Telecom discloses in its regulatory financial statements details of any material changes and their effect in order that readers are aware of, and understand, the impact of the changes.<sup>27</sup>
97. Management of changes should improve the reliability of Telecom's regulatory financial statements as well as ensure that the processes used to prepare the regulatory financial information are verifiable.

### *Proposed Changes*

98. The Commission proposed that Telecom must:
  - Implement a documentation process, including specific written procedures and a register of changes<sup>28</sup> for recording and managing changes to the processes and methodologies covered by the regulatory reporting manual; and

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<sup>26</sup> Telecom, *Submissions on Draft Telecom Accounting Separation Information Disclosure Requirements*, 28 April 2010, para 77

<sup>27</sup> Statutory financial statements include a similar commentary where firms are required to disclose information regarding extraordinary and abnormal items.

<sup>28</sup> The register of changes will be reviewed by the commission under its compliance monitoring powers.

- Publicly disclose any changes which have a material effect on the information reported in the regulatory financial statements in the Commentary to the Regulatory Financial Statements, and describe the impact of those changes on the published information.

#### *Submissions*

99. Telecom did not specifically submit on the proposed inclusion of a change management process in the Requirements or the need to disclose significant changes.
100. 2degrees submitted that the Commission should be more prescriptive on change management. 2degrees' concern was primarily about the reduced visibility of independent business units (e.g. mobile).

#### *Response to Submissions*

101. The Commission considers that the introduction of a formal change management process and disclosure of changes is reasonable given the impact changes, including those initiated by Telecom or external factors (e.g. changes to NZ GAAP or market conditions) may have on the regulatory financial statements. These changes should improve the reliability and usefulness of the regulatory financial statements.

#### *Commission's Decision*

102. After considering the submissions received and Part 2B of the Act, the Commission has decided to implement the changes as proposed.

## **4.5 Regulatory Reporting Manual**

#### *Issue and Reasoning*

103. When preparing its regulatory reporting manual, Telecom prepared an introduction<sup>29</sup> which included a glossary (description of terms used)<sup>30</sup>, and a separate technical dictionary (Telecom dictionary). These sections were in addition to the content which the Commission had specified.
104. The Commission considers that the introduction and definition sections are informative and useful to readers, as they explain key concepts and help readers understand many of the specialist terms used in the telecommunications industry, and that it would be useful to incorporate these into the Requirements.

#### *Proposed Changes*

105. The Commission proposed that Telecom must include in its published regulatory reporting manual:
  - An *introduction* which explains the background to regulatory information disclosure and the regulatory reporting manual.
  - A *glossary of regulatory terms* which corresponds to the definitions found in the Requirements.
  - A *technical dictionary* which defines economic, accounting and network terms that are not explained in the above referenced glossary of regulatory terms.

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<sup>29</sup> There is overseas precedent for such introductions or prefaces (eg, UK and Ireland).

<sup>30</sup> The Introduction covers the background to the contributing manuals, the processes and the regulatory principles which Telecom adopted when preparing the regulatory financial statements, the relationship of the regulatory accounts to both the statutory accounts and operational separation, and descriptions of the Services Groups.

### *Submissions*

106. Telecom did not specifically submit on the proposed changes regarding the minimum content of the regulatory reporting manual. However, Telecom did make a general comment that the proposed changes resulted in:<sup>31</sup>
- Extensive expansion and reworking of the regulatory reporting manual that is already in excess of 300 pages long
107. 2degrees submitted that the regulatory reporting manual was too long and needed to be simplified.<sup>32</sup>

### *Response to Submissions*

108. Telecom's submission was not clear if its general comment on the expansion of the manual was intended to apply to this proposal or to other proposals which relate to specific applications of the methodologies.
109. The Commission considers that page count, alone, is not an indication of the burden of preparing a document. The regulatory reporting manual assists with achieving the purpose set out in section 69Y.
110. The need for the manual to prescribe the procedure to a level of detail sufficient for the auditor to form his or her opinion necessitates that the manual is written to enable audit testing of all processes and procedures. The level of detail required is consistent with international practice.
111. Given accounting separation is still in the transitional phase, it is reasonable to expect that changes will be made to the manual in 2010, such as adding text relating to the introduction of product statements and especially to meet the transparency and objectivity principles.

### *Commission's Decision*

112. After considering the submissions received and Part 2B of the Act, the Commission has decided to implement the changes as proposed.

## **4.6 Publication Date**

### *Issue*

113. The Act requires the Commission to ensure that timely and reliable information is provided by Telecom when publishing its regulatory financial statements.<sup>33</sup> The Act also requires that the Commission publish a summary and analysis of Telecom's disclosed regulatory financial statements.<sup>34</sup>

### *Proposed Changes*

114. The Commission proposed that Telecom's 2010 regulatory financial statements be completed and provided to the Commission only by 31 December 2010, and published by 31 March 2011 to align with publication of the Commission's summary and analysis.

### *Submissions*

115. Telecom noted that delaying the publication of the regulatory financial statements until 31 March 2011 may pose a problem under its continuous disclosure obligations (as defined in the NZX Listing Rules). Telecom advises that it is likely that the disclosure

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<sup>31</sup> Telecom, *Submissions on Draft Telecom Accounting Separation Information Disclosure Requirements*, 28 April 2010, para 36

<sup>32</sup> 2degrees, *Comments on the Accounting Separation Consultation Document*, April 2010, p.7

<sup>33</sup> Section 69Y of the Act.

<sup>34</sup> Section 69ZG of the Act

rules would require it to disclose to the market at the same time it discloses to the Commission to avoid any asymmetry of information in the market (i.e. product statements considered material information thereby requiring immediate market disclosure).

116. Telecom considered that a 31 December deadline will be challenging and that to comply, proposed the following milestones for the Commission:
- The Commission publishes changes to the requirements by 31 March each year.
  - Confirmation of compliance monitoring requirements by 31 March each year.
  - Additional prescriptive guidance on material key methodologies by 31 May each year.
  - Commission commences its annual review from 1 January of the following year.
117. 2degrees submitted that the publication date was not as important as the simplicity.

#### *Response to Submissions*

118. Delaying the publication of the 2010 regulatory financial statements by 30 days will result in a latest publication date of 31 December which is the same timing as for 2009 and the same date Telecom used in their proposed milestones.
119. Publication of the regulatory financial statements by 31 December will provide the information to the wide audience in a timely manner as required by the Act, and addresses questions relating to Telecom's continuous disclosure obligations.

#### *Commission Decision*

120. Having considered industry submission, and Part 2B of the Act, the Commission has decided that Telecom should publish regulatory financial statements by 31 December for 2010. The Commission will review the publication date for 2011 in next year's review of the Requirements.
121. In relation to Telecom's milestones, the Commission will consider the operational milestones proposed by Telecom when finalizing timelines for future years.

## **4.7 Product Statement Reporting**

#### *Issue and Reasoning*

122. The 2010 Requirements identified a list of products and services that Telecom would be required to publish for the 2010 financial year. The Commission has reconsidered this list, and proposes the following reprioritization of the preparation of product statements.
123. The Commission still considers product statements are a critical component of regulatory financial reporting, as they are essential to understanding the operation and behaviour of Telecom's various business activities, and products and services. Accordingly, the Commission has selected the product statements it considers to be most important, having regard to the purpose set out in section 69Y.
124. The implementation of product statements can be difficult and complex, and therefore the reliability and usefulness of product statements may be compromised if introduced too quickly or without specificity. When formulating the product and services list (refer Appendix A), the Commission considered that an abridged product and services list for 2010 would be reasonable bearing in mind the time and cost to Telecom required to complete the product statements. An abridged list would still enable timely and reliable information to be provided to the marketplace in accordance with section 69Y of the Act.

### *Proposed Changes*

125. The Commission proposed adding the following new product statements in 2010 and 2011, in addition to those included in the list published in March 2009<sup>35</sup>:
- Sub-loop Extension Service (SLES)
  - 2Mbs Backhaul
  - UCLL MPF Transfer (individual and bulk).
126. In addition, the Commission proposed that Telecom should no longer be required to publish the following product statements in 2010, but must publish the following products statements in 2011:
- Interconnection with Telecom's fixed PSTN
  - IP interconnection
  - FTTP services
  - Sub-loop MPF Service monthly charges
  - Sub-loop MPF New Connection Charges
  - Sub-loop backhaul
  - Sub-loop Co-location power rental
  - Co-location floor space
  - 16A-48V DC Power Capacity
  - Co-location New Exchange
  - Co-location New Row
  - UCLL Backhaul Service New Connection
  - Enhanced UBA without POTS
  - Access Seeker Handover Connection Monthly Rental Charge.
127. The Commission also proposes some minor changes to the product statements, including:
- Reporting of internal transfer charges related to the product statements;
  - Reporting of network and non-network expenses; and
  - CCA adjustments.
128. The proposed list of product statements for 2010 and future years (2011 column) was attached in Appendix A of the Draft Decision.

### *Submissions*

129. Telecom submitted that no product statements should be published until the UFB process is settled.
130. Telecom requested, if there are to be product statements in 2010, that the products identified below are withdrawn:
- Broadband resale
  - Sub-loop co-location rack space rental
  - 2 Mbs backhaul
  - Sub-loop extension service
  - UBA backhaul.

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<sup>35</sup> Appendix F of the Requirements as issued on 25 March 2009

131. Telecom requested where a product's revenue is less than 2% of the total revenue of its services group that a product statement not be required.
132. 2degrees proposed greater disclosure of the mobile business in general.

*Response to Submissions*

133. The Commission is mindful that 2010 is the first year for publication of product statements. The Commission proposes to limit the scope of the products for publication so as to not place an unreasonable burden on Telecom, which allows it to concentrate on delivering reliable product statements for a limited number of products.
134. The Commission considers that removing the product statement for broadband resale (known as broadband wholesale - UBS and resale in Appendix A) is appropriate considering it is a legacy product and Telecom will not be offering it to any new customers from August 2010.
135. The Commission considers that deferring product statements for sub-loop extension service and sub-loop co-location rack space rental until 2011 would reduce the effort required by Telecom relative to the limited benefit these product statements would otherwise provide in 2010.
136. The Commission considers it is important to have disclosure of the listed products even if the product's revenue is less than 2% of its services group's revenue. This enables comparability over years for products which have changing volumes (e.g. the migration from UBS to UBA)<sup>36</sup>. Even where products have low revenue, the product statements are important for wholesale customers and may represent a significant proportion of the overall expenditure related to the provision of telecommunications services to end-customers. In addition, a low volume may indicate areas, which justify public disclosure for competitive reasons or potential release from disclosure and/or other regulatory obligations.
137. For those product statements which Telecom considers to be confidential and commercially sensitive, Telecom can follow the process as per the publication of confidential information clause of the Requirements whereby the Commission may exempt confidential information for publication if disclosure of that information is not reasonable.
138. As explained in section 3.7, the Commission does not consider that it is necessary for Telecom to prepare product statements for mobile related services at this stage.

*Commission's Decision*

139. After considering submissions received and having regard to the purpose set out in section 69Y (and more broadly Part 2B of the Act), the Commission has decided to implement the changes as proposed with the following modifications:
  - Product statements for the Sub-loop Extension Service and the Sub-loop Co-location Rack Space Rental will be deferred until 2011.
  - Product statement for broadband resale (known as broadband wholesale UBS and resale in Appendix A) will be removed completely.

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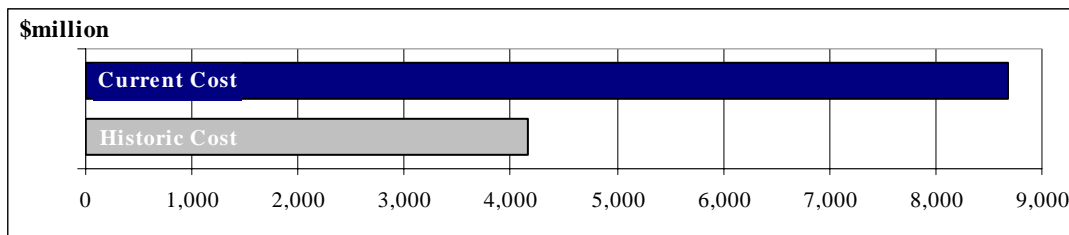
<sup>36</sup> As time series analysis includes comparisons of values other than revenue, there is benefit in including information which can not be immediately approximated (e.g. unit costs and margins) in the time series analysis even when revenue is below 2%. Such analysis could potential identify issues which require further consideration (e.g. if there is a mismatch between reported volumes and reported revenues).

## 4.8. Asset Valuation Methodology

### Issues and Reasoning

140. When consulting with stakeholders on the 2009 Requirements, the Commission's initial position was to use valuation methodologies based on historical cost accounting (HCA) in the first year of regulatory reporting, as it would be easier for Telecom to implement. However, Telecom subsequently proposed the use of current cost accounting (CCA).
141. HCA is the conventional accounting method, where fixed assets are valued at the cost recorded at the time of their purchase and subsequently depreciated. In contrast, CCA methodologies prescribe the valuation of fixed assets at current cost with the appropriate level of depreciation.
142. CCA concepts may, for example, be used in instances where costs are decreasing due to rapid technological change, the supply of services is subject to new competitive entry, and where there are considerable price changes over time. It can also be used where suitable records of historical valuations are not available<sup>37</sup>.
143. In the 2009 regulatory financial statements published by Telecom, the HCA valuation is \$4.2 billion, compared to the CCA valuation of \$8.7 billion<sup>38</sup>, resulting in a 107% uplift<sup>39</sup> of \$4.6 billion.

### Comparison of asset valuation methodologies (HCA vs. CCA)



144. This valuation uplift is significantly higher than is found where overseas telecommunication companies have applied CCA; for example the equivalent uplift of BT in the UK is approximately 10%.<sup>40</sup>
145. The auditor noted in their report, the inherent uncertainty in the completeness and accuracy of the network data used by Telecom in the preparation of the CCA valuations. The appropriateness of the uplift may also in part be determined by a further review of some of that network (non financial) data as proposed in the Requirements.
146. The majority of the uplift is in the Access Services Group's passive network, which contains trenches with ducts, trenches without ducts, ducts, copper cables, copper joints, fibre cables and fibre joints. The passive network is an essential input to deliver all fixed line based services (such as voice and broadband services) to customers, while Telecom Retail and other wholesale customers can use parts of the passive network (such as UCLL) as an input to provide their services. Therefore, failure to make adjustments for

<sup>37</sup> Additional information on HCA and CCA can be found on pages 22-26 of the Commission's *Companion Paper* which can be found at <http://www.comcom.govt.nz/IndustryRegulation/Telecommunications/AccSepofTelecom/ContentFiles/Documents/Final%20Companion%20Paper%20issued%20March%202009.pdf>

<sup>38</sup> This figure excludes the Other Services Group.

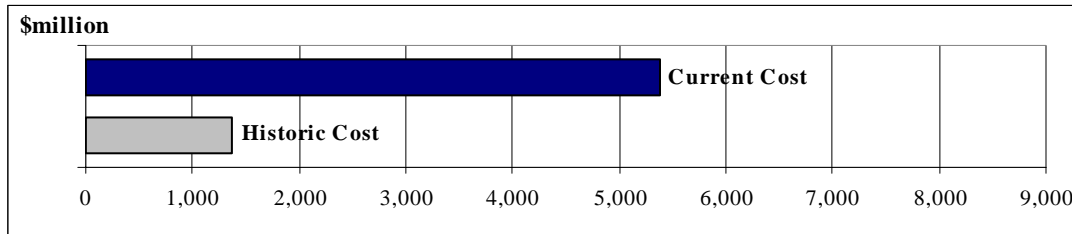
<sup>39</sup> The valuation uplift is the increase in the asset valuation base over HCA resulting from the application of CCA valuation methodologies.

<sup>40</sup> BT reported a CCA adjustment in the 2008 MCE (Mean Capital Employed) reconciliation statement of \$1.6b compared with BT's HCA fixed asset (property, plant and equipment) total in their annual report of \$15.3b

excess capacity and additional functionality results in a distorted picture of the CCA valuation, and may substantially undermine the reliability of Product Statements derived using CCA methodologies.

147. The absolute size of the value uplift of the passive network elements can be seen in the following illustration.

**Impact of Asset Valuation Methodology on Value of Passive Network**



148. Increasing the value of the underlying assets relevant for the provision of telecommunications services to customers will have a significant impact on the reported regulatory cost at both Services Group and product level.

4.8.1 Size of the Uplift

*Submissions*

149. Telecom’s submission assumed that that the proposed changes to the requirements are targeted at reducing the CCA valuation uplift. Telecom stated that their approach is consistent with international best practices and, therefore, the uplift is appropriate.

*Response to Submissions*

150. Information indicates that the size of the 107% uplift in the HCA to CCA valuation is relatively high compared to the experience of other telecommunication companies who publish current cost financial statements. However, the Commission notes that any comparison with other jurisdictions is indicative only.
151. The appropriateness of the HCA to CCA valuation uplift in a NZ context will be satisfied with the review of additional functionality and excess capacity for consistency with international best practice.
152. Additional transparency of the contributing inputs behind the reported uplift would help readers assess the reasonableness of the uplift. The Commission considers that for the purposes of preparing CCA asset valuations that HCA should be used as the default except where specific conditions apply as detailed in section 4.8.4 Valuation Methods.

4.8.2 Straight-Line Depreciation

*Issue and Reasoning*

153. Several different approaches can be used to calculate the depreciation expense of a fixed asset over its useful life. During the 2009 implementation of accounting separation, the Commission provided guidance to Telecom on the depreciation method for CCA regulatory financial statements. Telecom uses the straight-line depreciation method for its statutory financial statements, as it does when preparing the HCA regulatory financial statements.
154. In the Commission’s view, while straight-line depreciation method does not necessarily reflect economic depreciation, it is simple, cost-effective and transparent. In addition, it is consistent with Telecom’s HCA approach, and will therefore help readers better understand the relative performance of Telecom’s separated business activities, products and services.

155. The Commission considers that, over time, this position may need to be revisited. For example, the depreciation profile of assets valued under CCA may need to be adjusted given the possible impact at the product level.

#### *Proposed Changes*

156. The Commission proposed that Telecom be required to use the straight-line depreciation method for both HCA and CCA.

#### *Submissions*

157. Telecom submitted that a tilted annuity depreciation approach is more appropriate than the straight-line approach that the Commission proposes. Telecom based its arguments on the reasoning that tilted annuity reflects the actual assets in use and its expected future lives; that Telecom is unable to reliably model straight-line depreciation for the 1988 block of assets; and that the Independent Regulators Group (**IRG**) recommend economic depreciation as best practice in the EU. Telecom also maintained that straight-line depreciation will impact the reliability of the information.

#### *Response to Submission*

158. The Commission considers that straight-line depreciation should be used because:
- The IRG notes<sup>41</sup> that in a situation where the incumbent operator's asset base is being used for a CCA valuation that a straight line depreciation methodology may be appropriate.
  - The Commission considers that for the early years of accounting separation implementation that having regulatory financial statements prepared using the same depreciation profile as statutory accounts (HCA) will aid comparability between the two approaches.

#### *Commission's Decision*

159. After considering the submissions received and Part 2B of the Act, the Commission has decided to implement the changes as proposed.
160. The Commission will (if necessary) review its decision that straight-line depreciation must be used to prepare the regulatory accounts after the first year of product statements as appropriate.

### 4.8.3 Fully Depreciated Assets

#### *Issue and Reasoning*

161. In 2009, Telecom applied a fully depreciated asset approach. Under this approach, assets that had been fully depreciated under HCA were re-valued for the CCA asset valuation. This policy increased Telecom's CCA valuation by \$711 million. In the Commission's view, if translated into prices, this would result in a reported regulatory over-recovery of annualised costs.
162. Under NZ GAAP, fully depreciated assets which are still in use at balance date are required to be valued at zero under historical cost.<sup>42</sup> For CCA, a similar approach is

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<sup>41</sup> IRG, (05) 40 *Principles of Implementation and Best practice ... communication activities* - page 12 which is the document cited by Telecom in its submission

<sup>42</sup> NZ GAAP recognises current cost as a measurement basis. *New Zealand Equivalent to the IASB Framework for the Preparation and Presentation of Financial Statements*, Issued 2005 (January 2008 ed), para 100(c).

found in the IRG<sup>43</sup> regarding current cost valuation in regulatory reporting, as well as with the CCA methodologies that have been adopted for regulatory accounting in other jurisdictions, including the United Kingdom.

#### *Proposed Changes*

163. The Commission proposes that fully depreciated assets which are still in use at balance date should be valued at zero for CCA asset valuation purposes.

#### *Submissions*

164. Telecom submitted that it is common for firms to generate revenue from fixed assets that have nil book value.<sup>44</sup>
165. Telecom also submitted<sup>45</sup> that if the purpose of the Requirements is other than for pricing decisions then a fully depreciated asset policy may be appropriate.
166. Telecom maintained that its 2009 approach to asset valuation was consistent with an economic view of fixed assets and fixed asset lives.

#### *Response to Submissions*

167. The Commission referred to NZ GAAP and the IRG Guidelines on Best Practices<sup>46</sup> on the use of current cost methodologies in determining its policy position on fully depreciated assets. Both references recommend that fully depreciated assets be excluded from revaluation. The IRG notes that for regulatory cost accounting the depreciation approach has to be aligned to the accounting policies of the network operator (i.e. Telecom). The IRG considered that to allow such assets to be revalued would result in double cost recovery.<sup>47</sup> Double recovery would overstate the costs which Telecom actually incurs.

#### *Commission's Decision*

168. After considering the submissions received and Part 2B of the Act, the Commission has decided to implement the changes as proposed. These changes are aligned with both NZ GAAP and international best practice.

#### 4.8.4 Valuation Methods

##### *Issue and Reasoning*

169. The above section on asset valuation methodology and the Commission's earlier Companion Paper<sup>48</sup> and Requirements identify a range of methods and principles which Telecom should follow when valuing assets for regulatory financial reporting purposes.
170. One particularly important issue in preparing the CCA regulatory financial statement is the selection of the valuation basis to use when valuing each asset or group of assets. Although the Commission's view is that HCA should be the basis for valuing assets, the

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<sup>43</sup> IRG, *Summary of the public consultation on draft IRG Principles of Implementation and Best Practice regarding the use of current cost accounting methodologies as applied to electronic communication activities* 10.01.06

<sup>44</sup> Telecom, *Submissions on Draft Telecom Accounting Separation Information Disclosure Requirements*, 28 April 2010, para 51

<sup>45</sup> Telecom, *Submissions on Draft Telecom Accounting Separation Information Disclosure Requirements*, 28 April 2010, para 52

<sup>46</sup> IRG, (05) 40 *Principles of Implementation and Best practice ... communication activities*

<sup>47</sup> IRG, *Summary of the public consultation on draft IRG Principles of Implementation and Best Practice regarding the use of current cost accounting methodologies as applied to electronic communication activities* 10.01.06, pages 9-10.

<sup>48</sup> For example the Companion Paper addressed the relative pros and cons of CCA and HCA (para 87-94).

basis for revaluation under CCA depends on factors such as the asset's remaining life, the extent of technological change, the level of competition in the supply of services, and whether the regulated firm intends to replace the asset.

171. Integrating these methods into a combined set of valuation methods which are documented in the Requirements will provide greater clarity for both Telecom and stakeholders.

#### *Proposed Changes*

172. The Commission proposed that the Requirements explicitly state the asset valuation methods which Telecom must apply when preparing the regulatory financial statements.
173. In preparing valuations for the regulatory financial statements, Telecom must comply with the regulatory accounting principles, accepted international best practice for regulatory reporting, and the following valuation methods:
- For the purposes of preparing CCA asset valuations, Telecom must value fixed assets according to the following guidelines:
    - (a) *Historical cost* must be used as the default proxy for the current cost, and in particular where the fixed assets:
      - (i) Are fully depreciated;
      - (ii) Have a low net book value in comparison to the total value of the fixed assets;
      - (iii) Have a short remaining asset life;
      - (iv) Are a recent investment and there is minimal difference between the current gross replacement cost and the historical net book value; and
      - (v) Are not expected to be replaced.
    - (b) *Indexation*<sup>49</sup> must be used for fixed assets where there has been little technological change, and the capitalised costs would have to be incurred again if the fixed assets were replaced. The indices to be used should, where possible, be fixed asset specific. Where a suitable specific index is not available, then a more general index may be used.
    - (c) *Absolute valuation* must only be used where there is significant technological change, or where suitable records of historical valuations are not available. Where Modern Equivalent Asset (**MEA**) valuations are used to derive an absolute valuation, the choice of replacement or alternative fixed assets used for the valuation must be appropriate, and any and all potential valuation adjustments (eg, for productive capacity, operating cost savings and additional functionality) are to be made.

#### *Submission*

174. Telecom considered that its 2009 valuation methods were reliable, fit-for-purpose, and aligned with international best practices. Telecom stated that its asset valuation methods should not be changed. Telecom submitted that if the Commission wished Telecom to change its asset valuation methodologies from those which Telecom used in 2009<sup>50</sup>, then the Commission should prescribe the methodologies prior to the end of May 2010.
175. With respect to the valuation of trenches, Telecom interpreted indexation as the Commission's preferred asset valuation approach. Telecom argued that indexation is not feasible due to the fact that ducts and cables cannot be separated from trenches. Telecom

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<sup>49</sup> Indexation is the adjusting of a variable (e.g. a fixed asset's valuation) according to an index (e.g. the rate of price inflation for similar items).

<sup>50</sup> Telecom's valuations methods are documented in section 3 of Telecom's 2009 Regulatory Reporting Manual.

maintained that under indexation, it will not be able to deliver fit-for-purpose regulatory financial statements for 2010.<sup>51</sup>

176. Telecom noted three specific points as follows:

- Changes to a valuation approach should be applied at the fixed asset group level.
- Referencing clause 8.3 of the 2010 Requirements; change comparison of GRC to NBV to GRC to GBV<sup>52</sup>.
- Referencing clause 8.3 of the 2010 Requirements; remove the requirement that HCA is the default valuation proxy where fixed assets are not expected to be replaced.

#### *Response to Submissions*

177. The CCA valuation approach that Telecom adopted in 2009 resulted in significant, and unexpected, valuation uplift over HCA. The Commission was unable to assess whether Telecom's 2009 valuation methodologies were appropriate at a detailed level which prompted the Commission to provide guidelines for the valuation of fixed assets for CCA.<sup>53</sup> The Commission's guidelines describe the conditions under which each valuation approach is to be used but do not express a preference for a particular valuation methodology

178. In regard to Telecom's three specific points, the Commission provides the following decisions:

- It is unclear from Telecom's submission what asset group level that changes to valuation approach could be implemented. The Commission's decision is to require valuation changes at the lowest level of asset detail and still meet the requirements set out in clause 8.3 of the 2010 Requirements, especially to comply with the regulatory accounting principles.
- The draft valuation guidelines required Telecom to apply historical cost where assets were recently purchased and therefore the Gross Replacement Cost (GRC) is likely to be close to the Net Book Value (NBV). Therefore the appropriate relationship is GRC to NBV and therefore the requirements set out in clause 8.3 (a) (iv) of the 2010 Requirements remain as proposed.
- The draft valuation guidelines required Telecom to also apply historical cost to assets that have not been or are not replaced. As such the requirements set out in clause 8.3 (a) (v) of the 2010 Requirements remain as proposed but that the Commission will consider fixed assets that fall outside this category by exception.

#### *Commission's Decision*

179. After considering the submissions received and Part 2B of the Act, the Commission has decided to implement the changes as proposed with minor amendments to the indexation methodology and absolute valuation methodology guidelines.

#### 4.8.5 Valuation Adjustments

##### *Background*

180. Where Telecom used replacement assets to derive the CCA value, it did not make any efficiency adjustments when replacing an existing asset with a new one<sup>54</sup>. Examples

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<sup>51</sup> Telecom, *Submissions on Draft Telecom Accounting Separation Information Disclosure Requirements*, 28 April 2010, para 56(d)

<sup>52</sup> These terms are abbreviations of Gross Replacement Cost (GRC), Net Book Value (NBV), and Gross Book Value (GBV).

<sup>53</sup> Refer to paras 82 and 83 of the Commission's April 2010 Consultation Document

<sup>54</sup> The decision to replace assets is highly dependent on potential cost saving (economies of scale) and new/increased service potential (economies of scope).

where adjustments are to be expected include excess capacity in the existing network,<sup>55</sup> a higher level of functionality of the replacement assets (due to technological progress) or a longer useful lifetime of the underlying asset. Such adjustments have to be made where the valuation approach deviates from HCA, as asset valuations have a significant impact on the reported cost.

181. Where MEA technologies are taken into account, the Commission requires that corresponding adjustments are made in order to reflect the cost reducing effects resulting from replacing legacy assets.
182. The Commission considers that valuation adjustments are essential for implementing a CCA methodology for telecommunication purposes that provides a reliable and informative view.

#### 4.8.5a Excess Capacity

##### *Issue and Reasoning*

183. Excess capacity is defined by the IRG<sup>56</sup> as any capacity within the network that is neither in use nor required to provide appropriate levels of network resilience, and is not expected to be put into use within the foreseeable future, and excludes spare capacity.<sup>57</sup> Spare capacity, in contrast, is necessary to meet normal demands or to provide normal levels of network resilience to meet expected demands. For example, telecommunications equipment is subject to rapid technological progress, so the potential capacity of any replacement asset is typically increasing over time.
184. Excess capacity may have a significant impact on the CCA asset valuation. In addition, this impact will flow through to product statement expenses, thereby providing a distorted view of any reported average unit cost.<sup>58</sup>
185. Identification of excess capacity will give a more accurate picture of the efficiency of Telecom's network capacity and the costs associated with providing telecommunications services.
186. The Commission's view on excess capacity is consistent with international practice on regulatory reporting. The IRG have a number of Principles of Implementation and Best Practice in relation to accounting separation, which act as guidelines for European national regulators. In those guidelines, the IRG prescribes a number of situations under which valuation adjustments should be made.

##### *Proposed Changes*

187. The Commission proposed that Telecom's regulatory financial statements exclude from the CCA valuation any costs associated with excess capacity.

##### *Submissions*

188. Telecom contended that a preliminary review of operating cost adjustments where MEA are included has revealed little scope for material adjustments. In addition, Telecom's cost-benefit analysis of cost adjustments did not support this approach.
189. Telecom submitted that it has undertaken a review of all fixed assets to determine where excess capacity would exist and has made appropriate adjustments. Telecom argued that

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<sup>55</sup> Telecom made some capacity adjustments for buildings. Refer to para. 251 of Telecom's 2009 Regulatory Reporting Manual.

<sup>56</sup> IRG, *Summary of the public consultation on draft IRG Principles of Implementation and Best Practice regarding the use of current cost accounting methodologies as applied to electronic communication activities* 10.01.06, pages 9-10

<sup>57</sup> Spare capacity, on the other hand, is necessary to meet normal demands or to provide normal levels of network resilience to meet expected demands.

<sup>58</sup> Ofcom addressed similar issues in the UK.

the benefits of the exercise were minimal as the spare capacity value was small compared to the overall value of the fixed assets and that future work is unlikely to yield material results.<sup>59</sup>

#### *Response to Submissions*

190. By requiring Telecom to transparently disclose the findings of its review of adjustments for excess capacity, readers will be able to form a view as to whether the adjustments are objectivity justifiable. Based on these assessments, the Commission will determine what adjustments are appropriate taking into account the costs and benefits from the adjustments.

#### *Commission's Decision*

191. After considering the submissions received and Part 2B of the Act, the Commission has decided to exclude from the CCA valuation any costs associated with excess capacity.

#### 4.8.5b Additional Functionality

#### *Issue and Reasoning*

192. Additional functionality occurs where the replacement fixed asset, (used to derive a substitute value and cost for the actual fixed asset in place for which there is no historical information), has functionality in addition to that of the existing asset. This often occurs where an asset is subject to significant technological progress.
193. Adjusting for differences in functionality will remove the asset valuation premiums which are implicit in the price of modern assets, and which are not found in the fixed assets already in place. As with excess capacity, failure to take into account additional functionality (and different useful lifetimes of the modern assets) will have an impact on the CCA valuation and will flow through to product statement expenses, thereby increasing any reported average unit cost.<sup>60</sup> The IRG notes the potential for additional functionality when using a replacement asset and that the value of the asset must be adjusted to represent the actual functionality of the asset in use.<sup>61</sup>

#### *Proposed Changes*

194. The Commission proposes that Telecom's regulatory financial statements exclude from the CCA valuation any costs associated with additional functionality.

#### *Submission*

195. Telecom submitted that it has reviewed fixed assets and identified areas where it will assess whether functionality adjustments are required to be implemented.<sup>62</sup>

#### *Response to Submission*

196. Telecom submitted that it will disclose the findings of its review of adjustments explaining areas already reviewed and those that it intends to review for additional functionality. Based on these assessments, the Commission will determine what

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<sup>59</sup> Telecom, *Submissions on Draft Telecom Accounting Separation Information Disclosure Requirements*, 28 April 2010, para 60-62

<sup>60</sup> To the extent that an original HCA valuation is used but assets are added to the original HCA base, the costs of these new assets may also require some form of adjustment to account for any additional functionality.

<sup>61</sup> Summary of the public consultation on draft IRG Principles of Implementation and Best Practice regarding the use of current cost accounting methodologies as applied to electronic communication activities (2006).

<sup>62</sup> Telecom, *Submissions on Draft Telecom Accounting Separation Information Disclosure Requirements*, 28 April 2010, para 63-66

adjustments are appropriate taking into account the costs and benefits from the adjustments.

#### *Commission's Decision*

197. After considering the submissions received and Part 2B of the Act, the Commission has decided to implement the changes as proposed.

### **4.9 Attribution Methodology**

198. The Commission's review of Telecom's approach to attribution in 2009 identified two broad areas for improvement: the visibility and documentation of internal transfer charges, and better definition in the Requirements as to how Telecom must apply the attribution principles.

#### 4.9.1 Attribution Methods

##### *Issue and Reasoning*

199. The Commission proposes requiring that Telecom implement its attribution process in keeping with the regulatory accounting principles of causality, transparency and objectivity, to improve the reliability of the regulatory financial statements.
200. The Commission considers that prescribing some of the attribution methods to be used by Telecom when complying with the specific regulatory accounting principles will help ensure that Telecom's attribution process, and its application of the regulatory accounting principles, are more closely aligned to the purposes of Part 2B of the Act.

##### *Proposed Changes*

201. The Commission proposed that the attribution methods are included in the main body of the Requirements, and revised to align with other proposed changes.
202. In preparing the regulatory financial statements, the Commission proposed that Telecom would be required to implement the attribution methodologies in accordance with the regulatory accounting principles and the following attribution methods:
- In applying the regulatory accounting principles of causality, Telecom must:
    - (a) Ensure the attribution process is direct in its flows. This includes minimising the use of intermediate steps which either aggregate source data prior to attributing it, or result in source data being attributed or allocated multiple times, when a more direct relationship could be established.
    - (b) Ensure cost drivers have a demonstrable link to the items being attributed and allocated.
    - (c) When Telecom has a choice of activity drivers, choose the driver that has the most demonstrable link to the items being attributed or allocated compared to the alternatives, and document the reason for selecting the chosen activity driver.
  - In applying the regulatory accounting principle of transparency, Telecom must:
    - (a) Separately distinguish revenue, expenses, assets and short-term liabilities which are attributed<sup>63</sup> directly to a service, product, activity or Services Group from those which are allocated<sup>64</sup> indirectly.
    - (b) Document the overall structure of Telecom's financial and information systems from which the data used in the attribution process is sourced.

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<sup>63</sup> Attribution occurs where there is a direct causal relationship so therefore a specific cost will be directly charged to a cost unit.

<sup>64</sup> Allocation, in contrast, occurs where no direct causal relationship can be established, and as the cost cannot be attributed directly, it is split between two or more cost units.

- (c) Document the attribution process from source data through to the regulatory financial statements.
- In applying the regulatory accounting principle of objectivity, Telecom must:
  - (a) Document the attribution processes with sufficient detail and clarity such that an informed reader can easily make a judgment as to their reasonableness.

#### *Submissions*

- 203. Telecom reaffirmed the link between asset valuation and attribution by stating that the same volume information is crucial to implementation of both methodologies.<sup>65</sup>
- 204. Telecom confirmed the Commission's proposal to have an attribution process that is as direct as possible and advised that work is underway to implement this where appropriate with particular emphasis on product statements.
- 205. Telecom also advised that it will continue to use an allocation approach where costs are not directly related to products.

#### *Response to Submissions*

- 206. The Commission notes that Telecom supported the Commission's proposal to have an attribution process that is as direct as possible. The Commission considers that this approach will help ensure the reliability and integrity of the regulatory financial statements.

#### *Commission's Decision*

- 207. After considering the submissions received and Part 2B of the Act, the Commission has decided to implement the changes as proposed.

### 4.9.2 Transfer Charges

#### *Issue and Reasoning*

- 208. The Commission's review of Telecom's attribution process for the 2009 financial year enabled it to trace end-to-end attribution flows of revenue, expenses, assets and short-term liabilities, thereby ensuring that all costs were fully allocated. However, the Commission was unable to determine whether the 2009 process approach was appropriate and free of systematic bias and, therefore, this may result in less informative product statements in 2010.<sup>66</sup>
- 209. The value of Telecom's internal transfer charges<sup>67</sup> is significant at \$1.6 billion<sup>68</sup>, and has a direct and material effect on the reported financial performance of the Services Groups.
- 210. The Commission considers that detailed and documented information regarding Telecom's transfer charges is necessary in order to assess if the transfer charges satisfy the causality principle, a major indicator of reliability. As Telecom must already record and document transfer charges under the separation undertakings, the Commission considers this proposed change will not be unduly burdensome, costly, or time-

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<sup>65</sup> Telecom, *Submissions on Draft Telecom Accounting Separation Information Disclosure Requirements*, 28 April 2010, para 72-74

<sup>66</sup> An example of this approach is the allocation of Shared Services assets and expenses which see the Access Services Group (primarily consisting of Chorus) incur 4% of the total Technical and Shared Services (T&SS) expenses whilst 95% is spread across the Retail and Wholesale Services Group with the majority to Retail.

<sup>67</sup> A transfer charge is a documented arrangement in place for a Telecom Business Unit to supply another Business Unit with a particular service.

<sup>68</sup> Telecom reported internal revenue from internal transfer charges of \$1.6b which is 22% of their total revenues of \$7.1b across all Services Groups.

consuming, and is therefore reasonable having regard to the purpose set out in section 69Y of the Act.

211. Telecom's transfer charges include confidential information. Nevertheless the Commission anticipates requiring this information through compliance monitoring.
212. In regard to transfer charges, Telecom must:
  - (a) Where there is an arm's-length, documented arrangement in place for a Telecom Business Unit to supply another Business Unit with a particular service, record the price indicated in the arrangement –
    - (i) as internal revenue of the Services Group providing the service; and
    - (ii) as an expense of the Services Group receiving the service.
  - (b) Where there is no arm's-length, documented arrangement in place for a Telecom Business Unit to supply another Business Unit with a particular service, attribute the costs of providing such a service to the receiving Services Group.

#### *Proposed Changes*

213. The Commission proposed that Telecom must implement, maintain, and reconcile internal transaction records that document all transfer charges. The Commission also noted that these records must be kept up-to-date and be auditable.

#### *Submissions*

214. Telecom did not specifically submit on the Commission's proposed changes to transfer charges.

#### *Commission's Decision*

215. The Commission has decided that Telecom must implement, maintain, and reconcile internal transaction records that document all transfer charges. These records must be kept up-to-date and be auditable.

### **4.10 Operational Data and Management Estimates**

#### *Issues and Reasoning*

216. Telecom's 2009 regulatory financial statements were prepared in part using data from operational systems. These systems were not developed for regulatory purposes, and have not previously been subject to external audit, and in some cases are not complete records and are inadequate for regulatory purposes.
217. Such shortcomings in the non-financial data may compromise the quality of the attribution and valuation of Telecom's fixed assets and related expenses, thereby impacting on the level of reported earnings in the Services Groups and the product statements to be published in 2010.
218. KPMG's regulatory auditor's report<sup>69</sup> included an explanatory paragraph which described the implication of the fundamental uncertainty in relation to network inventory data used by Telecom in the preparation of the CCA asset valuations and attribution to Services Groups:

It is uncertain as to whether the network inventory data is sufficiently reliable for the purposes of the preparation of the Regulatory Financial Statements ... any further physical verification of the network inventory data may result in material variance, either positive or negative, in the Regulatory Financial Statements.
219. Telecom has also made use of management estimates in its analysis of the activities which define how expenses and fixed assets are attributed to Services Groups.

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<sup>69</sup> KPMG's Auditor's Report is on page 7-8 of Telecom's published regulatory financial statements.

Estimations are not sufficiently reliable for regulatory reporting, especially at product level in 2010, and where the impact is material, the data will require further refinement.

220. The Commission considers that data used in Telecom's methodologies needs to be robust and current in order to prepare reliable regulatory financial statements. However, the Commission recognises that requiring Telecom to update all non-financial data sources to an appropriate standard would be a significant requirement. Accordingly, the Commission considers that there should be a focus on the integrity of non-financial data sources that impact on the most important product statements, which are to be provided for 2010.
221. Product statements report information at a more granular level, and hence the source data must be similarly detailed and reliable (that is, derived from verifiable sources). The Commission considers that this change is essential to ensure the impact of non-financial data on product statements is such that the reliability and usefulness of the reported product statements will not be compromised.

#### *Proposed Changes*

222. The Commission proposed that when applying the regulatory accounting principles, where material, Telecom must give priority to ensuring that the product statements listed below are prepared using data sourced from either:
- Operational systems which are regularly updated; or
  - A survey or sample, based on generally accepted statistical techniques (or similar methods), which is updated with a frequency proportionate to its importance and potential for material change.
223. The Commission proposed that this would apply to the following product statements in 2010:
- UCLL MPF service monthly charges;
  - UCLL MPF new connection;
  - UCLL Backhaul Service – 100Mbps by average distance group;
  - UCLL Backhaul Service – 1 Gbps by average distance group; and
  - Line Rental resale.
224. For 2011, the Commission proposed that this would apply to all product statements as listed in Appendix A.

#### *Submissions*

225. Telecom advised that the proposed change would require it to produce data by necessary means and that it could impact the results of the regulatory financial statements.
226. Telecom further advised that surveys and samples can be expensive and time consuming. Telecom submitted that this activity “*must be prioritised*”, may need to be undertaken over several years and should only occur if the benefits exceed the cost.<sup>70</sup>

#### *Response to Submission*

227. The Commission acknowledges that changes in non-financial data could impact the regulatory financial statements and, in particular, improve the quality and reliability of product statements.
228. The Commission will work with Telecom to identify and timetable, where deemed necessary, the appropriate surveys and samples while bearing in mind the costs and benefit to the regulatory financial statements. In doing so, the Commission will continue

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<sup>70</sup> Telecom, *Submissions on Draft Telecom Accounting Separation Information Disclosure Requirements*, 28 April 2010, para 75

to assess whether the benefit of the respective Requirements outweighs any additional costs.

*Commission's Decision*

229. After considering the submissions received and Part 2B of the Act, the Commission has decided to implement the changes as proposed.

**APPENDIX A – LIST OF SERVICES TO BE REPORTED ON BY PRODUCT STATEMENTS**

List of Products and Services (product statements are not required for those products listed, but not ticked)	Product statements in existing 2009/2010 Requirements	Product statements in the amended Requirements for 2009/2010	Product statements in the amended Requirements for 2010/2011
<b>Relevant Services with Current STDs</b>			
<b>Access Services</b>			
<b>UCLL</b>			
<b>Recurring charges</b>			
MPF Service Monthly Charge - urban	✓	✓	✓
MPF Service Monthly Charge - non-urban	✓	✓	✓
Tie Cable Service space rental charge			
<b>One off charges (Service Fulfillment/Assurance)</b>			
MPF New Connection - individual with site visit	✓	✓	✓
MPF New Connection - individual without site visit	✓	✓	✓
MPF New Connection - bulk without site visit	✓	✓	✓
MPF Transfer - individual		✓	✓
MPF Transfer - bulk		✓	✓
Other Service to MPF Transfer - individual			
Other Service to MPF Transfer - bulk			
<b>Sub-loop</b>			
<b>Recurring charges</b>			
Sub-loop MPF Service monthly charges - urban	✓		✓
Sub-loop MPF Service monthly charges - non-urban	✓		✓
Sub-loop Tie Cable Service Space Rental			
<b>One off charges (Service Fulfillment/Assurance)</b>			
Sub-loop MPF New Connection - Individual new connection with site visit	✓		✓
Sub-loop MPF New Connection - Individual new connection without site visit	✓		✓
Sub-loop MPF Transfer - Individual new connection without site visit			
<b>Sub-loop Co-location</b>			
<b>Recurring charges</b>			
Sub-loop Co-location rack space rental	✓		✓
Sub-loop Co-location power rental	✓		✓
Sub-loop Co-location cable space			
<b>Sub-loop backhaul</b>			
<b>Recurring charges</b>			
Sub-loop backhaul	✓		✓
Sub-loop backhaul connection space rental charge			
Sub-loop handover fibre space rental charge			
<b>One off charges</b>			
Sub-loop backhaul new connection charge			
<b>Co-location UCLL</b>			
<b>Recurring charges</b>			
Co-location floor space	✓		✓
16A-48V DC Power Capacity	✓		✓
<b>One off charges (Service Fulfillment/Assurance)</b>			
Co-location New Exchange	✓		✓
Co-location New Row	✓		✓
<b>UCLL backhaul</b>			
<b>Recurring charges</b>			
UCLL Backhaul Service – 100Mbps – Distance Group 1			
UCLL Backhaul Service – 100Mbps – Distance Group 2			
UCLL Backhaul Service – 100Mbps – Distance Group 3			
UCLL Backhaul Service – 100Mbps – Distance Group 4			
UCLL Backhaul Service – 100Mbps – Distance Group 5			
UCLL Backhaul Service – 100Mbps – Distance Group 6	✓	By average distance groups	✓
UCLL Backhaul Service – 1Gbps – Distance Group 1			
UCLL Backhaul Service – 1Gbps – Distance Group 2			
UCLL Backhaul Service – 1Gbps – Distance Group 3			
UCLL Backhaul Service – 1Gbps – Distance Group 4			
UCLL Backhaul Service – 1Gbps – Distance Group 5			
UCLL Backhaul Service – 1Gbps – Distance Group 6	✓	By average distance groups	✓
<b>One off charges (Service Fulfillment/Assurance)</b>			
UCLL Backhaul Service New Connection - Two Ends			✓
UCLL Backhaul Service New Connection - One End			✓
Backhaul Connection Installation			

List of Products and Services	Product statements in existing 2009/2010 Requirements	Product statements in the amended Requirements for 2009/2010	Product statements in the amended Requirements for 2010/2011
<b>Wholesale Services</b>			
<b>Unbundled bitstream</b>			
<b>Recurring charges</b>			
BASIC UBA with POTS	✓	✓	✓
BASIC UBA without POTS - urban	✓	✓	✓
BASIC UBA without POTS - non-urban	✓	✓	✓
Enhanced UBA without POTS	✓	✓	✓
Access Seeker Handover Connection Monthly Rental Charge - GigE capacity - Basic UBA Service only	✓	Average of the rental charges	✓
Access Seeker Handover Connection Monthly Rental Charge - GigE capacity - Enhanced UBA Service only	✓		✓
Access Seeker Handover Connection Monthly Rental Charge - STM1 capacity	✓	Average of the rental charges	✓
Access Seeker Handover Connection Monthly Rental Charge - STM4 capacity	✓		✓
<b>One off charges (Service Fulfillment/Assurance)</b>			
Basic and Enhanced UBA Services with/without POTS Connection & Wiring			
Basic and Enhanced UBA Services with/without POTS Modem installation			
Enhanced and Basic UBA/UBS Service Change Plan with/without POTS			
Transfer of (basic or enhanced) UBA Service from an Access Seeker to a (basic or enhanced) UBA Service with another Access Seeker			
<b>UBA Backhaul</b>			
<b>Recurring charges</b>			
UBA Backhaul Service - 50Mbps - Distance Group 1	✓	By average distance groups	✓
UBA Backhaul Service - 100Mbps - Distance Group 1	✓	By average distance groups	✓
UBA Backhaul Service - 200Mbps - Distance Group 1	✓	By average distance groups	✓
UBA Backhaul Service - 1Gbps - Distance Group 1	✓	By average distance groups	✓
UBA Backhaul Service - 50Mbps - Distance Group 2			
UBA Backhaul Service - 100Mbps - Distance Group 2			
UBA Backhaul Service - 200Mbps - Distance Group 2			
UBA Backhaul Service - 1Gbps - Distance Group 2			
UBA Backhaul Service - 50Mbps - Distance Group 3			
UBA Backhaul Service - 100Mbps - Distance Group 3			
UBA Backhaul Service - 200Mbps - Distance Group 3			
UBA Backhaul Service - 1Gbps - Distance Group 3			
UBA Backhaul Service - 50Mbps - Distance Group 4			
UBA Backhaul Service - 100Mbps - Distance Group 4			
UBA Backhaul Service - 200Mbps - Distance Group 4			
UBA Backhaul Service - 1Gbps - Distance Group 4			
UBA Backhaul Service - 50Mbps - Distance Group 5			
UBA Backhaul Service - 100Mbps - Distance Group 5			
UBA Backhaul Service - 200Mbps - Distance Group 5			
UBA Backhaul Service - 1Gbps - Distance Group 5			
UBA Backhaul Service - 50Mbps - Distance Group 6			
UBA Backhaul Service - 100Mbps - Distance Group 6			
UBA Backhaul Service - 200Mbps - Distance Group 6			
UBA Backhaul Service - 1Gbps - Distance Group 6			
Access Seekers Handover Connection Monthly Rental Charge - GigE capacity			
Handover Fibre Space Rental Charge			
<b>One off charges (Service Fulfillment/Assurance)</b>			
UBA Backhaul Service New Connection – Two Ends	✓	✓	✓
UBA Backhaul Service New Connection – One End	✓	✓	✓
Access Seeker Handover Connection Installation - GigE Capacity			
Handover Fibre Installation			
<b>Other Key Designated Services</b>			
Interconnection with fixed PSTN	✓		✓
IP Interconnection	✓		✓
Line rental resale	✓	✓	✓
Broadband wholesale (UBS & resale)	✓		✓
Other Resale			
<b>Other Services</b>			
FTTP Services	✓		✓
Sub-loop Extension Service (SLES)			✓
2Mbs Backhaul		✓	✓
<b>Specified Services</b>			
Mobile Co-location			
National Roaming			

## **APPENDIX B – SAMPLE REGULATORY FINANCIAL REPORT**

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Regulatory Product Statements for 2010 (as per Appendix A)

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## **Introduction**

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  - 2.1 Describes the financial reporting obligations as per the Requirements
  - 2.2 Defines the Services Groups
  - 2.3 Defines the expense line items

## **Certification for Published Information**

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We, [*insert full names*], directors of Telecom Corporation of New Zealand Limited, certify that, having made all reasonable enquiry, to the best of our knowledge and belief, the following attached audited information prepared for the purposes of fulfilling the requirements contained in the *Telecom Accounting Separation Information Disclosure Requirements for the Financial Year ended 2010* complies with those Requirements -

[*insert list of information to be certified*]

[*Signatures of 2 Directors*]

[*Date*]

## **Auditor's Report**

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## **Basis of Preparation**

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### 1. Introduction to the Basis of Preparation

1.1 Includes a brief description of accounting principles, accounting policies and methodologies applied in the preparation of the RFS. Additionally, it will address other issues including:

- 1.1.1 application of the management and accounting structure
- 1.1.2 material estimates and judgements made in relation to methodologies
- 1.1.3 review, update and improvement status of non financial data
- 1.1.4 known limitations in the preparation of the statements
- 1.1.5 variances in cost trends
- 1.1.6 changes in prior year comparatives

### 2. Other Aspects of Basis of Preparation

2.1 Describes other aspects of the basis of preparation including summary and explanation of:

- 2.1.1 material changes and quantifiable impact
- 2.1.2 CCA adjustments
- 2.1.3 material asset valuation movements

## **Commentary to the Regulatory Financial Statements**

1. Commentary on Statements of Financial Performance
2. Commentary on Statements of Mean Capital Employed
3. Commentary on Statements of Fixed Assets
4. Commentary on Product Statements

Statement of Financial Performance for HCA								
Year Ended 30 June 2010								
Million	Access Services Group	Wholesale Services Group		Retail Services Group	Other Services Group	Group Total Regulatory Accounts	Reconciliations	Group Total Statutory Accounts
		Relevant	Non-Relevant					
<b>Revenues</b>								
Internal revenues								
External revenues								
<b>Total revenue</b>								
<b>Expenses</b>								
Network expenses								
Internal network expenses								
External network expenses								
<b>Total network expenses</b>								
Non-network expenses								
Internal non-network expenses								
External non-network expenses								
<b>Total non-network expenses</b>								
Depreciation and amortisation								
<b>Total expenses</b>								
<b>Earnings before interest and taxation</b>								
<i>Earnings before interest and taxation %</i>								

Statement of Financial Performance for HCA							
Year Ended 30 June 2009							
Million	Access Services Group	Wholesale Services Group	Retail Services Group	Other Services Group	Group Total Regulatory Accounts	Reconciliations	Group Total Statutory Accounts
Internal revenues							
External revenues							
<b>Total revenue</b>							
<b>Expenses</b>							
Network expenses							
Internal network expenses							
External network expenses							
<b>Total network expenses</b>							
Non-network expenses							
Internal non-network expenses							
External non-network expenses							
<b>Total non-network expenses</b>							
Depreciation and amortisation							
<b>Total expenses</b>							
<b>Earnings before interest and taxation</b>							
<i>Earnings before interest and taxation %</i>							

Statement of Financial Performance for CCA								
Year Ended 30 June 2010								
Smillion	Access Services Group	Wholesale Services Group		Retail Services Group	Other Services Group	Group Total Regulatory Accounts	Reconciliations	Group Total Statutory Accounts
		Relevant	Non-Relevant					
<b>Revenues</b>								
Internal revenues								
External revenues								
<b>Total revenue</b>								
<b>Expenses</b>								
Network expenses								
Internal network expenses								
External network expenses								
<b>Total network expenses</b>								
Non-network expenses								
Internal non-network expenses								
External non-network expenses								
<b>Total non-network expenses</b>								
Depreciation and amortisation								
<b>Total expenses</b>								
<b>Earnings before interest and taxation</b>								
<i>Earnings before interest and taxation %</i>								

Statement of Financial Performance for CCA							
Year Ended 30 June 2009							
Smillion	Access Services Group	Wholesale Services Group	Retail Services Group	Other Services Group	Group Total Regulatory Accounts	Reconciliations	Group Total Statutory Accounts
Internal revenues							
External revenues							
<b>Total revenue</b>							
<b>Expenses</b>							
Network expenses							
Internal network expenses							
External network expenses							
<b>Total network expenses</b>							
Non-network expenses							
Internal non-network expenses							
External non-network expenses							
<b>Total non-network expenses</b>							
Depreciation and amortisation							
<b>Total expenses</b>							
<b>Earnings before interest and taxation</b>							
<i>Earnings before interest and taxation %</i>							

Statement of Mean Capital Employed for HCA As at 30 June 2010								
Smillion	Access Services Group	Wholesale Services Group		Retail Services Group	Other Services Group	Group Total Regulatory Accounts	Reconciliations	Group Total Statutory Accounts
		Relevant	Non-Relevant					
<b>Assets</b>								
Current assets								
Cash and short-term investments								
Receivables and prepayments								
Inventories								
<b>Total current assets</b>								
Non-current assets								
Fixed assets								
<b>Total non-current assets</b>								
<b>Total assets</b>								
<b>Liabilities</b>								
Short-term liabilities								
Accounts payable and accruals								
Short-term provisions								
Short-term derivatives								
<b>Total short-term liabilities</b>								
<b>Closing capital employed</b>								
<b>Mean capital employed</b>								
<b>Mean capital employed %</b>								

Statement of Mean Capital Employed for HCA As at 30 June 2009							
Smillion	Access Services Group	Wholesale Services Group	Retail Services Group	Other Services Group	Group Total Regulatory Accounts	Reconciliations	Group Total Statutory Accounts
Current assets							
Cash and short-term investments							
Receivables and prepayments							
Inventories							
<b>Total current assets</b>							
Non-current assets							
Fixed assets							
<b>Total non-current assets</b>							
<b>Total assets</b>							
<b>Liabilities</b>							
Short-term liabilities							
Accounts payable and accruals							
Short-term provisions							
Short-term derivatives							
<b>Total short-term liabilities</b>							
<b>Closing capital employed</b>							
<b>Mean capital employed</b>							
<b>Mean capital employed %</b>							

Statement of Mean Capital Employed for CCA								
As at 30 June 2010								
Smillion	Access Services Group	Wholesale Services Group		Retail Services Group	Other Services Group	Group Total Regulatory Accounts	Reconciliations	Group Total Statutory Accounts
		Relevant	Non-Relevant					
<b>Assets</b>								
Current assets								
Cash and short-term investments								
Receivables and prepayments								
Inventories								
<b>Total current assets</b>								
Non-current assets								
Fixed assets								
<b>Total non-current assets</b>								
<b>Total assets</b>								
<b>Liabilities</b>								
Short-term liabilities								
Accounts payable and accruals								
Short-term provisions								
Short-term derivatives								
<b>Total short-term liabilities</b>								
<b>Closing capital employed</b>								
<b>Mean capital employed</b>								
<b>Mean capital employed %</b>								

Statement of Mean Capital Employed for CCA							
As at 30 June 2009							
Smillion	Access Services Group	Wholesale Services Group	Retail Services Group	Other Services Group	Group Total Regulatory Accounts	Reconciliations	Group Total Statutory Accounts
Current assets							
Cash and short-term investments							
Receivables and prepayments							
Inventories							
<b>Total current assets</b>							
Non-current assets							
Fixed assets							
<b>Total non-current assets</b>							
<b>Total assets</b>							
<b>Liabilities</b>							
Short-term liabilities							
Accounts payable and accruals							
Short-term provisions							
Short-term derivatives							
<b>Total short-term liabilities</b>							
<b>Closing capital employed</b>							
<b>Mean capital employed</b>							
<b>Mean capital employed %</b>							

<b>Statement of Fixed Assets for HCA<sup>1</sup></b>			
<b>As at 30 June 2010</b>			
<b>\$million</b>	<b>Gross Book Value</b>	<b>Accumulated Depreciation</b>	<b>Net Book Value</b>
<b>Telecommunications plant and equipment</b>			
Passive network			
Active transmission			
Mobile			
Services			
Other			
<b>Buildings</b>			
<b>Land</b>			
<b>Software</b>			
<b>Other assets</b>			
<b>Total fixed assets</b>			

<b>Statement of Fixed Assets for HCA<sup>1</sup></b>			
<b>As at 30 June 2009</b>			
<b>\$million</b>	<b>Gross Book Value</b>	<b>Accumulated Depreciation</b>	<b>Net Book Value</b>
<b>Telecommunications plant and equipment</b>			
Passive network			
Active transmission			
Mobile			
Services			
Other			
<b>Buildings</b>			
<b>Land</b>			
<b>Software</b>			
<b>Other assets</b>			
<b>Total fixed assets</b>			

1 To be prepared for the Access Services Group, the Wholesale Services Group, and the Retail Services Group

<b>Statement of Fixed Assets for CCA<sup>1</sup></b>			
<b>As at 30 June 2010</b>			
<b>\$million</b>	<b>Gross Replacement Cost</b>	<b>Accumulated Depreciation</b>	<b>Net Replacement Cost</b>
<b>Telecommunications plant and equipment</b>			
Passive network			
Active transmission			
Mobile			
Services			
Other			
<b>Buildings</b>			
<b>Land</b>			
<b>Software</b>			
<b>Other assets</b>			
<b>Total fixed assets</b>			

<b>Statement of Fixed Assets for CCA<sup>1</sup></b>			
<b>As at 30 June 2009</b>			
<b>\$million</b>	<b>Gross Replacement Cost</b>	<b>Accumulated Depreciation</b>	<b>Net Replacement Cost</b>
<b>Telecommunications plant and equipment</b>			
Passive network			
Active transmission			
Mobile			
Services			
Other			
<b>Buildings</b>			
<b>Land</b>			
<b>Software</b>			
<b>Other assets</b>			
<b>Total fixed assets</b>			

1 To be prepared for the Access Services Group, the Wholesale Services Group, and the Retail Services Group

<b>Product Statement Summary</b>									
<b>Year Ended 30 June 2010</b>									
Products/ services	Product	Product	Product	Product	Product	Product	Product	Total of all Other Products	Total Services Group
<b>Revenues</b>									
Internal revenues									
External revenues									
<b>Total revenues</b>									
<b>Expenses</b>									
Network expenses									
Non-network expenses									
Depreciation and amortisation									
<b>Total expenses</b>									
CCA adjustments									
<b>Earnings before interest and tax</b>									
<b>Mean capital employed</b>									
<b>Non-financial</b> (identify unit of measure)									
Volumes - Internal									
Volumes - External									
Revenue per unit - Internal									
Revenue per unit - External									

<b>Product Statement</b>	
<b>Year Ended 30 June 2010</b>	
	Product
<b>Revenues</b>	
Internal revenues	
From Access	
From Wholesale	
From Retail	
From Other	
<b>Total internal revenues</b>	
<b>Total external revenues</b>	
<b>Total revenues</b>	
<b>Expenses</b>	
Network expenses	
Internal network expenses	
From Access	
From Wholesale	
From Retail	
From Other	
External network expenses	
<b>Total network expenses</b>	
Non-network expenses	
Internal non-network expenses	
From Access	
From Wholesale	
From Retail	
From Other	
External non-network expenses	
<b>Total non-network expenses</b>	
<b>Depreciation and amortisation</b>	
<b>Total expenses</b>	
<b>CCA adjustments</b>	
<b>Earnings before interest and tax</b>	
<b>Mean capital employed</b>	
<b>Non-financial</b> (identify unit of measure)	
Volumes - Internal	
Volumes - External	
Revenue per unit - Internal	
Revenue per unit - External	

## Notes to the Regulatory Financial Statements

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### 1. Statements of Financial Performance

#### 1.1 Services Group Internal Revenue Split

	Access Services Group	Wholesale Services Group	Retail Services Group	Other Services Group
- From Access				
- From Wholesale				
- From Retail				
- From Other				
Total				

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#### 1.2 Services Group Expenses Split<sup>1</sup>

	Internal Network	External Network	Internal Non- network	External Non- network
- Finance and billing				
- General management				
- General support				
- Marketing and sales				
- Network support				
- Other activity expenses				
- Human resources and administration				
- Planning and development				
- Provisioning and maintenance				
Total				

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<sup>1</sup> To be prepared for each Services Group.