



COMMERCE COMMISSION

## CONSULTATION DOCUMENT

### ACCOUNTING SEPARATION

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

**Date:** 14 April 2010

**File:** 967965v14

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

*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 proposed 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 Commission proposes various changes 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 proposed 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> explaining the reasoning and final decisions of the Commission in relation to the Requirements.
5. The Commission stated in its Companion Paper to the Requirements 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. 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

8. 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 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>

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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)

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

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

9. To monitor compliance with the Requirements, the Commission may also require Telecom to provide additional information.<sup>7</sup> The Commission may require the compliance information to be audited and/or verified by statutory declaration.<sup>8</sup>
10. The Commission developed a phased approach to implementation of the Requirements. The Requirements reflect this transitional process.
11. For 2009, the Commission's priorities in implementing the first stage of Telecom's regulatory reporting 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 and expand the number of product statements to be disclosed by Telecom.

## **1.2 Reasonableness of the Requirements**

14. In assessing the reasonableness<sup>9</sup> of the changes to the Requirements, the Commission considered:
  - 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 proposed changes 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.

## **1.3 Submissions on Proposed Changes**

16. The Commission is seeking submissions on the proposed changes presented in the draft decision paper by 5 p.m. on Wednesday, 28 April 2010.
17. Feedback should be sent either by email to [AccSepProject@comcom.govt.nz](mailto:AccSepProject@comcom.govt.nz) or in writing to:

Accounting Separation Project Team  
Commerce Commission, Level 6  
44-52 The Terrace  
PO Box 2351  
Wellington

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

<sup>8</sup> Ibid, sZF(3).

<sup>9</sup> Section 69Z of the Act states that the Commission's requirements must be reasonable.

## 2. SUMMARY OF THE CHANGES TO THE REQUIREMENTS

18. The table below summarises the Commission’s proposed changes to the Requirements. It is included to provide an overview of the proposed changes presented in the body of this document.

Issue	Proposed 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>Experience from 2009, identified areas 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>Establish a closer alignment of publication dates for Telecom’s regulatory financial statements and the Commission’s summary and analysis.</p>	<ul style="list-style-type: none"> <li>▪ Deferring the publication of the 2010 regulatory financial statements to 31 March 2011 to align with the publication of the Commission’s summary and analysis.</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. REGULATORY ACCOUNTING PRINCIPLES

#### *Issue and Reasoning*

19. 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.
20. The Commission has identified several principles and guidelines in past papers.<sup>10</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.
21. In addition, the prescription of regulatory accounting principles will align the regulatory financial statements closer to the purposes set out in the Act.
22. In developing integrated regulatory accounting principles, the Commission considered international best practice, the purposes and context of the New Zealand regulatory reporting regime, and the need to align terminology with overseas usage when appropriate.
23. New Zealand Generally Accepted Accounting Practice (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 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. Currently, where the regulatory accounting principles do not apply, Telecom must apply NZ GAAP as per the Requirements.

#### *Proposed Change*

24. The Commission proposes 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.
25. The proposed regulatory accounting principles are:
  - (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:
    - 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.

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<sup>10</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).

- 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.
27. Any express obligations in the Requirements override anything to the contrary in the regulatory accounting principles.

## 4. REVISIONS TO REGULATORY FINANCIAL STATEMENTS

28. The Commission’s review of Telecom’s regulatory financial statements identified a number of ways in which the presentation could be improved. The proposed changes include improving the presentation and format of the existing regulatory financial statements, revising the regulatory audit requirements, introducing a formal documentation process to manage and track changes to the Requirements, and changing the timing of the publication date of the regulatory financial statements.

### 4.1 Regulatory Financial Statements

#### *Issue and Reasoning*

29. The Act authorises the Commission, in making requirements under Part 2B, to “prescribe the manner in which information must be disclosed”<sup>11</sup>. The Commission considers that the following revisions will improve the presentation of the regulatory financial statements, in that the content is communicated with greater clarity to interested parties. These revisions still permit comparability of Telecom’s published information from 2009.
30. 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 Change*

31. The Commission proposes 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.
  - 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.
32. The revised format of the regulatory financial statements is shown in Appendix B.

### 4.2 Regulatory Audit

#### 4.2.1 Audit Opinion

#### *Issue and Reasoning*

33. Under the Requirements, Telecom must 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*”.
34. 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

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<sup>11</sup> Act, s69ZD(1)(a).

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.

35. 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 for the regulatory auditor to form an opinion in relation to Telecom's general compliance with the Requirements, which is assessed by the Commission.

#### *Proposed Change*

36. The Commission proposes 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).

### 4.2.2 Audit Materiality

#### *Issue and Reasoning*

37. The Requirements require the regulatory auditor to form the audit opinion based on prescribed materiality levels.
38. 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.
39. 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.
40. Experience gained from the audit indicates that for 2010 a satisfactory level of audit assurance could be achieved with a higher materiality level, and that this revision would be unlikely to 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.
41. The Commission does not propose any changes to the materiality levels for the other regulatory financial statements.<sup>12</sup>

#### *Proposed Change*

42. The Commission proposes 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%).

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

#### *Issue and Reasoning*

43. 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,

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<sup>12</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.

ensure that readers are aware of the impact of the changes on the regulatory financial statements, and provide a means of tracking the changes for review by Telecom, the Commission and the auditor.

44. It is important that Telecom 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.
45. It is also important that Telecom discloses details of any changes and their effect in order that readers are aware of and understand the impact of the changes.<sup>13</sup>
46. 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. The Commission considers that the cost and time to implement this documentation process is reasonable, given the material impact changes to the Requirements, methodologies, or processes may have on the regulatory financial statements.

#### *Proposed Change*

47. The Commission proposes that Telecom must:
  - Implement a documentation process, including specific written procedures and a register of changes for recording and managing changes to the processes and methodologies covered by the regulatory reporting manual; and
  - 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 describing the impact of those changes on the published information.

## **4.4 Regulatory Reporting Manual**

#### *Issue and Reasoning*

48. When preparing its regulatory reporting manual, Telecom prepared an introduction<sup>14</sup> which included a glossary (description of terms used)<sup>15</sup>, and a separate technical dictionary (Telecom dictionary). These sections were in addition to the content which the Commission had specified.
49. 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 Change*

50. The Commission proposes 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.

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<sup>13</sup> Statutory financial statements include a similar commentary where firms are required to disclose information regarding extraordinary and abnormal items.

<sup>14</sup> There is overseas precedent for such introductions or prefaces (eg, UK and Ireland).

<sup>15</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.

- 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 glossary of regulatory terms.

## 4.5 Publication Date

### *Issue and Reasoning*

51. The Act requires the Commission to ensure that timely and reliable information is provided by Telecom when publishing its regulatory financial statements.<sup>16</sup> The Act also requires that the Commission publish a summary and analysis of Telecom's disclosed regulatory financial statements.
52. Under the current Requirements, the Commission cannot commence its review until publication and, as a result, a noticeable lag between the release of the regulatory financial statements and the subsequent release of the Commission's Summary and Analysis is inevitable.
53. The Commission considers that the contemporaneous publication of its Summary and Analysis with Telecom's regulatory financial statements will promote a greater understanding of Telecom's operations and behaviour, and allow interested parties to better assess the reliability of the information. The Commission considers the additional delay is offset by the increased reliability of the information, and its increased usefulness when considered alongside the Commission's summary and analysis.
54. The Commission expects Telecom to provide it with final audited regulatory financial statements for each financial year by 31 December. The Commission will then review and test Telecom's regulatory financial statements, particularly the product statements, and prepare its Summary and Analysis before publication of the regulatory financial statements.

### *Proposed Change*

55. The Commission proposes that the regulatory financial statements be completed by 31 December, and published by the following 31 March.

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<sup>16</sup> Section 69Y of the Act.

## 5. PRODUCT STATEMENT REPORTING

### *Issue and Reasoning*

56. The 2009/2010 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.
57. 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.
58. 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 broadly. 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.
59. The Commission has considered the time and cost which Telecom will require to prepare the product and services information, and considers the revised Product Statements list reasonable.

### *Proposed Changes*

60. The Commission proposes adding the following new product statements in 2010 and 2011, in addition to those included in the list published in March 2009<sup>17</sup> (refer Appendix A, left-most column headed year 2010):
  - Sub-loop extension service (SLES)
  - 2Mbs Backhaul
  - UCLL MPF Transfer (individual and bulk).
61. In addition, the Commission proposes that Telecom is no longer required to publish the following product statements in 2010, but must publish these 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

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<sup>17</sup> Appendix F of the Requirements as issued on 25 March 2009

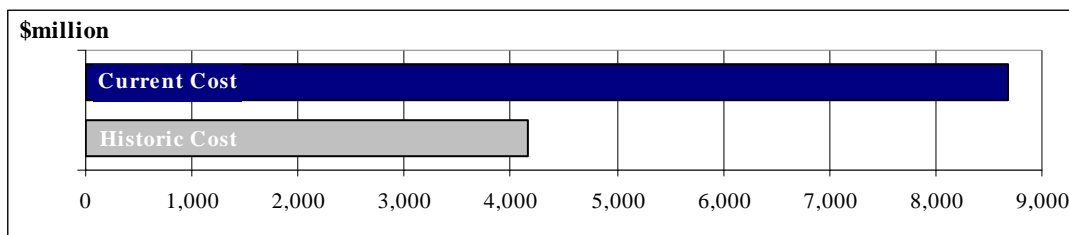
- Access Seeker Handover Connection Monthly Rental Charge.
62. The Commission also proposes some minor changes to the product statements, including:
- reporting of internal transfer charges related to the Product Statements;
  - reporting of network and non-network expenses; and
  - CCA adjustments.
63. The proposed list of product statements for 2010 and future years is attached in Appendix A, along with the list provided with the Requirements.

## 6. ASSET VALUATION METHODOLOGY

### Issues

64. When consulting with stakeholders on the 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).
65. 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.
66. 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>18</sup>.
67. 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, resulting in a 107% uplift<sup>19</sup> of \$4.6 billion.

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



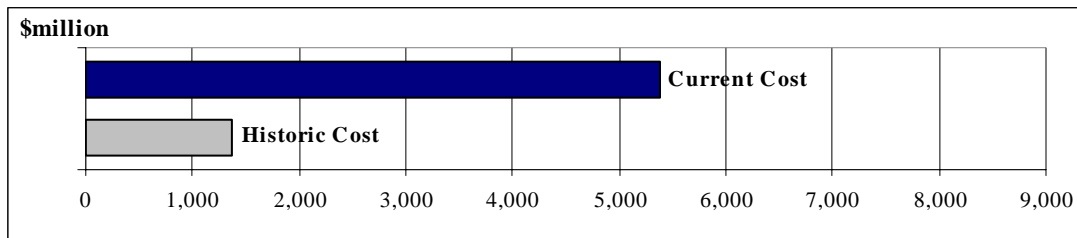
68. This valuation uplift is significantly higher than is found where overseas telecommunication companies have applied CCA; for example the equivalent uplift of BT in the UK is approximately 10%.<sup>20</sup>
69. The majority of the uplift is in the Access Services Group's passive network, which contains 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, 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 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.
70. The absolute size of the value uplift of the passive network elements can be seen in the following illustration.

<sup>18</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>19</sup> The valuation uplift is the increase in the asset valuation base over HCA resulting from the application of CCA valuation methodologies.

<sup>20</sup> BT reported a CCA adjustment in the 2008 MCE reconciliation statement of \$1.6b compared with BT's HCA fixed asset (property, plant and equipment) total in their annual report of \$15.3b

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



71. 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.

### 6.1 Straight-Line Depreciation

#### *Issue and Reasoning*

72. 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.
73. 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.
74. 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 Change to Requirements*

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

### 6.2 Fully Depreciated Assets

#### *Issue and Reasoning*

76. 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.
77. 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>21</sup> For CCA, a similar approach is found in the Independent Regulators Group<sup>22</sup> regarding current cost valuation in

<sup>21</sup> NZ GAAP recognizes 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).

<sup>22</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 10.01.06

regulatory reporting, as well as with the CCA methodologies that have been adopted for regulatory accounting in other jurisdictions, including the United Kingdom.

*Proposed Change to Requirements*

78. 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.

### **6.3 Valuation Methods**

*Issue and Reasoning*

79. The above section on asset valuation and the Commission's earlier Companion Paper<sup>23</sup> and Requirements identify a range of methods and principles which Telecom should follow when valuing assets for regulatory financial reporting purposes.
80. 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 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.
81. 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 Change to Requirements*

82. The Commission proposes that the Requirements explicitly state the asset valuation methods which Telecom must apply when preparing the regulatory financial statements.
83. 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.
      - (v) Are not expected to be replaced.
    - (b) Where historical costs cannot be used, *Indexation* 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.

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<sup>23</sup> For example the Companion Paper addressed the relative pros and cons of CCA and HCA (para 87-94).

Where 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.

## 6.4 Valuation Adjustments

### *Background*

84. 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>24</sup>. Examples where adjustments are to be expected include excess capacity in the existing network,<sup>25</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 it has a significant impact on the reported cost.
85. Where MEA technologies are taken into account, the Commission would expect that corresponding efficiency adjustments are made in order to reflect the cost reducing effects resulting from replacing legacy assets.
86. The Commission considers that valuation adjustments are essential for implementing a CCA methodology for telecommunication purposes that provides a reliable and informative view.

### 6.4.1 Excess Capacity

#### *Issue and Reasoning*

87. Excess capacity is defined by the Independent Regulators Group (IRG) 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>26</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.
88. 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>27</sup>
89. 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.<sup>28</sup>
90. 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 to act as guidelines for European national regulators. In those guidelines, the IRG prescribes a number of situations under which valuation adjustments should be made.

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<sup>24</sup> The decision to replace assets is highly dependent on potential cost saving (economies of scale) and new/increased service potential (economies of scope).

<sup>25</sup> Telecom made some capacity adjustments for buildings.

<sup>26</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>27</sup> Ofcom addressed similar issues in the UK.

<sup>28</sup> In this regard, excess capacity adjustments could also be made to HCA valuations of the network.

*Proposed Changes*

91. The Commission proposes that Telecom’s regulatory financial statements exclude from the CCA valuation any costs associated with excess capacity.

6.4.2 Additional Functionality

*Issue and Reasoning*

92. 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 the asset is subject to significant technological progress.
93. 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 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>29</sup>
94. 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>30</sup>

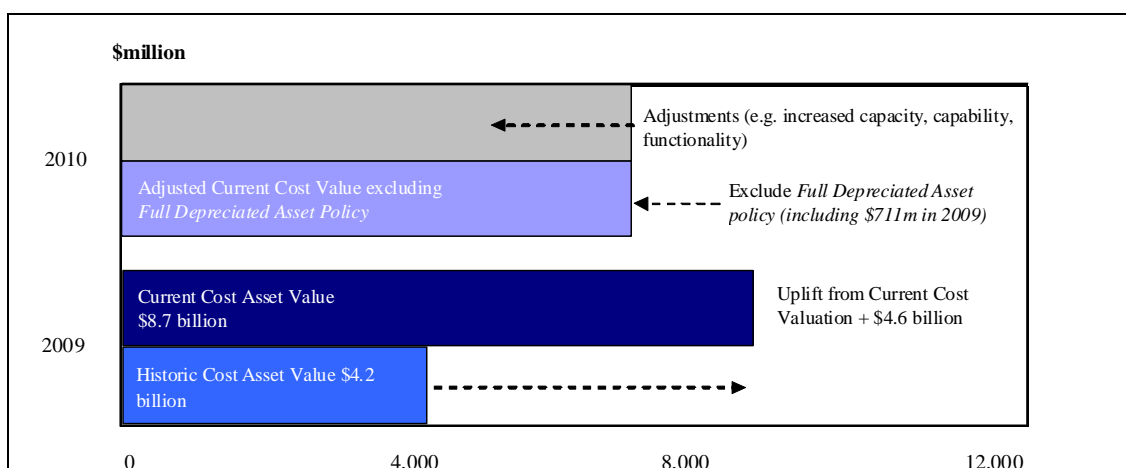
*Proposed Changes*

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

**6.5 Asset Valuation Summary**

96. The following illustration summarises the likely impact of the proposed changes to the Requirements on Telecom’s CCA valuation. The substantial uplift seen in 2009 will be reduced in 2010 with the removal of the fully depreciated asset policy (\$711m in 2009), and the Commission’s requirement that Telecom make valuation adjustments. The actual size of the CCA valuation reduction in 2010 is not yet known.

**Valuation Uplift and Recommended Changes to the Requirements**



<sup>29</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 and additional functionality.

<sup>30</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).

## 7. ATTRIBUTION METHODOLOGY

97. 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.

### 7.1 Attribution Methods

#### *Issue and Reasoning*

98. The Commission proposes requiring that Telecom implement its attribution process in keeping with the regulatory accounting principles of causality, transparency and objectivity, to improve reliability of the regulatory financial statements (see above).
99. 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*

100. The Commission proposes that the attribution methods are included in the main body of the Requirements, and revised to align with other proposed changes.
101. In preparing the regulatory financial statements, 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 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>31</sup> directly to a service, product, activity or Services Group from those which are allocated<sup>32</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.
    - (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.

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<sup>31</sup> Attribution occurs where there is a direct causal relationship so therefore a specific cost will be directly charged to a cost unit.

<sup>32</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.

## 7.2 Transfer Charges

### *Issue and Reasoning*

102. 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 are fully allocated. However, the Commission was unable to determine whether the 2009 process approach was appropriate and free of systematic bias; and therefore it may result in less informative product statements in 2010.<sup>33</sup>
103. The value of Telecom's internal transfer charges<sup>34</sup> is significant at \$1.6 billion<sup>35</sup>, and has a direct and material effect on the reported financial performance of the Services Groups.
104. 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-consuming, and is therefore reasonable.
105. Telecom's transfer charges include commercially sensitive information, and the Commission therefore anticipates requiring this information through compliance monitoring.
106. 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*

107. The Commission proposes 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.

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<sup>33</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>34</sup> A transfer charge is an arm's-length, documented arrangement in place for a Telecom Business Unit to supply another Business Unit with a particular service.

<sup>35</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.

## 8. OPERATIONAL DATA AND MANAGEMENT ESTIMATES

### *Issues and Reasoning*

108. The 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.
109. 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.
110. KPMG's regulatory auditor's report<sup>36</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.
111. 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. 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.
112. 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 recognizes 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.
113. 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).
114. 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*

115. The Commission proposes 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.
116. This proposal applies to the following product statements in 2010:
  - UCLL MPF service monthly charges
  - UCLL MPF new connection

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<sup>36</sup> KPMG's Auditor's Report is on page 7-8 of Telecom's published regulatory financial statements.

- UCLL Backhaul Service – 100Mbps by average distance group
- UCLL Backhaul Service – 1 Gbps by average distance group
- Line Rental resale
- Broadband resale.

117. For 2011, this proposal applies to all product statements as listed in Appendix A.

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

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>Relevant Services with Current STDs</b>			
<b><u>Access Services</u></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			
Access Seeker Handover Connection Monthly Rental Charge - GigE capacity - Enhanced UBA Service only	✓	Average of the rental charges	✓
Access Seeker Handover Connection Monthly Rental Charge - STM1 capacity			
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 resale	✓	✓	✓
Other Resale			
<b>Other Services</b>			
FOTP 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 Statements of Mean Capital Employed

Regulatory Statements of Fixed Assets

Regulatory Product Statements for 2010 (as per Appendix A)

Notes to the Regulatory Financial Statements

## **Introduction**

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1. Regulation in New Zealand
  - 1.1 Describes the regulatory framework in NZ
2. Regulatory Financial Reporting Obligations
  - 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								
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 CCA							
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 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</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</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>			

<b>Statement of Fixed Assets for CCA</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</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>			

<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.