IGNACIO REDONDO ANDREU, Board Secretary for the *Comisión del Mercado de las Telecomunicaciones* [Spanish Telecommunications Market Commission], by means of those capacities bestowed on him by article 40 of the Telecommunication Market Commission Regulations (approved by Spanish Royal Decree 1994/1996 on 6 September),

CERTIFIES

That during Board Meeting No. 18/10 of the *Comisión del Mercado de las Telecomunicaciones*, held on 10 June 2010, the following was adopted:

AGREEMENT

Approving the

Resolution on the updating of principles, criteria and conditions for the development of the cost accounting system (dossier AEM 2010/270).

I FACTUAL BACKGROUND

FIRST.- In its meeting on 15 July 1999, the Board of the *Comisión del Mercado de las Telecomunicaciones* (hereafter, CMT) approved the principles, criteria and conditions for developing the cost accounting system (hereafter CAS) for Telefónica Spain, S.A.U.

SECOND.-By its Resolution on 15 June 2000, the Board of the CMT approved the cost accounting system proposed by Telefónica Spain, S.A.U. (hereafter, TESAU) according to the principles mentioned above. Since that time, the CMT has been approving the resolutions to verify each financial year's accounting system results on a yearly basis.

THIRD.- On 27 July 2000, the Board of the CMT handed down a Resolution stating that the principles, criteria and conditions approved by the Resolution of 15 July 1999 would apply to those operators currently identified as dominant, or those which could be declared so in the future, and obliged to use a cost accounting system.

FOURTH.- By its Resolution on 20 December 2001, the Board of the CMT approved the cost accounting system proposed for Telefónica Móviles de España (hereafter, TESAU), according to the principles mentioned above, for immediate implementation and application. Following that resolution, the CMT has been approving the resolutions to verify each financial year's accounting system results on a yearly basis.

FIFTH.- By the Resolution of 8 May 2002, the Board of the CMT approved TESAU's proposed modifications to its cost accounting in order to reflect the offer of capacity interconnection.

SIXTH.- By its Resolution on 16 May 2002, the Board of the CMT approved the cost accounting system proposed for Vodafone Spain, S.A. (hereafter, Vodafone), according to the principles mentioned above, for immediate implementation and application. Since then, the CMT has been approving the resolutions to verify each financial year's accounting system results on a yearly basis.

SEVENTH.- By its Resolution of 27 June 2002, the Board of the CMT approved TESAU's proposed modifications to its cost accounting in order to reflect the offer of connection capacity.

EIGHTH.- By its Resolution of 24 April 2003, the Board of the CMT approved the Motion for Reversal which TESAU filed against the Resolution of 13 February 2003 regarding the cost accounting results presented by that operator for the 2001 financial year.

NINTH.- By its Resolution on 14 December 2004, the Board of the CMT approved the cost accounting system proposed by France Telecom Spain, (hereafter, Orange) according to the principles mentioned above, for immediate implementation and application. Since then, the CMT has been approving the resolutions to verify each financial year's accounting system results on a yearly basis.

TENTH.- On 25 May 2006, the Board of the CMT approved the Resolution on the principles, criteria and conditions for developing the incremental cost standard in TESAU's cost accounting system.

ELEVENTH.- On 1 June 2006, the Board of the CMT approved the Resolution on the accounting format and method to be used by Abertis Telecom, S.A.U. (hereafter, Abertis) in its cost accounting system.

TWELFTH.- On 14 June 2007, the Board of the CMT approved the Resolution on the national cost accounting system for Abertis. Since then, the CMT has been approving the resolutions to verify each financial year's accounting system results on a yearly basis.

THIRTEENTH.- By its Resolution on 13 December 2007, the Board of the CMT approved the adaptation of TESAU's accounting system according to the new regulatory framework.

FOURTEENTH.- By its Resolution on 13 December 2007, the Board of the CMT approved the adaptation of all mobile operators' accounting systems according to the new regulatory framework.

FIFTEENTH.- On 19 June 2008, the CMT approved the Resolutions to homogenise the TME, Vodafone and Orange cost accounting systems and adapt them to the new regulatory framework.

SIXTEENTH.- On 3 July 2008, the Board of the CMT resolved to verify the proposal to adapt TESAU's cost accounting system to the new regulatory framework.

SEVENTEENTH.- On 23 February 2010, the Commission's Service Report on revising the Resolution of 15 July 1999 on the principles, criteria and conditions for developing the cost accounting system was submitted for public consultation. That consultation was announced in the *BOE* [Official Spanish Gazette] on 3 March 2010.

EIGHTEENTH.- On 23 March 2010, the CMT's Register recorded receipt of a letter by TESAU containing a list of allegations against the abovementioned report.

NINETEENTH.- On 23 March 2010, the CMT's Register received a letter from TESAU containing a list of allegations against the abovementioned report.

TWENTIETH.- On 26 March 2010, the CMT's Register received a letter from Orange containing a list of allegations against the abovementioned report.

TWENTY-FIRST.- On 26 March 2010, the CMT's Register received a letter from Abertis containing an allegation statement against the abovementioned report.

TWENTY-SECOND.- On 30 March 2010, the CMT's Register received a letter from Orange containing an allegation statement against the abovementioned report.

II LEGAL BASIS

FIRST.- Ability to regulate competition

The presence of regulatory cost accounting models in the e-communications sector has to do with imposing obligations on operators declared to have significant market power. These obligations may include price control, cost accounting or accounting separation obligations. These obligations originated with Community regulations that were subsequently transposed into Spanish legislation.

Currently implemented European legislation, which gave rise to the Resolution of principles and criteria of 15 July 1999, is framed by Directives 90/388/EEC, 95/62/EC, 97/33/EC and 98/10/EC as stated in that Resolution.

In March 2002, a new package of Community directives regarding telecommunications was passed. These directives designed a new regime to be applied to markets of reference and operators with significant market power. This law states that the National Regulatory Authorities must periodically define and analyse the different markets in the electronic communications sector in order to determine if those markets are developing within a context of effective competition. If this is not the case, they must impose such specific obligations as are necessary.

This package of directives was modified by another known as the 2009 Telecoms Package [1] whose cost accounting method was a continuation of that described in previous directives. The most relevant dispositions are the Access Directive, the Framework Directive, the Recommendation on account separation and cost accounting systems and the Recommendation on fixed and mobile termination rates, which will be analysed below.

Article 8.2 of the Access Directive of 2002, modified by the Telecoms Package of 2009, states:

[1] Directive 2002/19/EC of the European Parliament and of the Council of 7 March 2002, regarding access to electronic communications networks and associated facilities, modified by Directive 2009/140/EC of the European Parliament and of the Council of 25 November 2009.

"Where an operator is designated as having significant market power on a specific market as a result of a market analysis carried out in accordance with Article 16 of Directive 2002/21/EC (Framework Directive), national regulatory authorities shall impose the obligations set out in Articles 9 to 13 of this Directive as appropriate."

Article 11 defines account separation as one of these obligations:

"1. A national regulatory authority may, in accordance with the provisions of Article 8, impose obligations for accounting separation in relation to specified activities related to interconnection and/or access.

In particular, a national regulatory authority may require a vertically integrated company to make transparent its wholesale prices and its internal transfer charges inter alia to ensure compliance where there is a requirement for non-discrimination under Article 10 or, where necessary, to prevent unfair cross-subsidy. National regulatory authorities may specify the format and accounting methodology to be used."

And Article 13 defines the obligations of price control and cost accounting:

"1. A national regulatory authority may, in accordance with the provisions of Article 8, impose obligations relating to cost recovery and price controls, including obligations for cost orientation of prices and obligations concerning cost accounting systems, for the provision of specific types of interconnection and/or access, […]

For the purpose of calculating the cost of efficient provision of services, national regulatory authorities may use cost accounting methods independent of those used by the undertaking. [...]

4. National regulatory authorities shall ensure that, where implementation of a cost accounting system is mandated in order to support price controls, a description of the cost accounting system is made publicly available, showing at least the main categories under which costs are grouped and the rules used for the allocation of costs. Compliance with the cost accounting system shall be verified by a qualified independent body. A statement concerning compliance shall be published annually."

Article 5 of the Framework Directive of 2002, modified by the Telecoms Package of 2009[2] states:

"1. Member States shall ensure that electronic communications networks and services provide all the information, including financial information, necessary

[2] Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services, modified by Regulation (EC) Nº 717/2007 of the European Parliament and of the Council of 27 June 2007, Regulation (EC) Nº 544/2009 of the European Parliament and of the Council of 18 June 2009 and by Directive 2009/140/CE of the European Parliament and of the Council of 25 November 2009.

for national regulatory authorities to ensure conformity with the provisions of, or decisions made in accordance with, this Directive and the Specific Directives. [...] Companies with significant market power on wholesale markets may also be required to submit accounting data on the retail markets that are associated with those wholesale markets.

Furthermore, the Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications (2005/698/EC) indicates in its recommendations 1, 2, 3 and 4:

"The purpose of imposing an obligation to implement a cost accounting system is to ensure that fair, objective and transparent criteria are followed by notified operators in allocating their costs to services in situations where they are subject to obligations for price controls or cost-oriented prices.

The purpose of imposing an obligation regarding accounting separation is to provide a higher level of detail of information than that derived from the statutory financial statements of the notified operator, to reflect as closely as possible the performance of parts of the notified operator's business as if they had operated as separate businesses, and in the case of vertically integrated undertakings, to prevent discrimination in favour of their own activities and to prevent unfair cross-subsidy.

2) It is recommended that national regulatory authorities require from the notified operators the disaggregation of their operating costs, capital employed and revenues to the level required to be consistent with the principles of proportionality, transparency and regulatory objectives mandated by national or Community law.

It is recommended that the allocation of costs, capital employed and revenue be undertaken in accordance with the principle of cost causation (such as activity-based costing, 'ABC').

The cost accounting and accounting separation systems of the notified operators need to be capable of reporting regulatory financial information to demonstrate full compliance with regulatory obligations. It is recommended that this capability be measured against the qualitative criteria of relevance, reliability, comparability and materiality.

It is recommended that national regulatory authorities satisfy themselves as to the adequacy and effectiveness of the cost accounting and accounting separation systems; such systems may be subject to public consultation.

3). It is recommended that a national regulatory authority, when assessing the features and specification of the cost accounting system, reviews the capability of the notified operator's cost accounting system to analyse and present cost data in a way that supports regulatory objectives. In particular, the cost accounting system of the notified operator should be capable of differentiating between direct costs and indirect costs. […]

For consistency and data integrity, it is recommended that the financial reports of the regulatory accounts be consolidated into a profit and loss statement and a statement of capital employed for the undertaking as a whole. A reconciliation of the separate regulatory accounts to the statutory accounts of the operator is also required. These statements should be subject to an independent audit opinion or a national regulatory authority compliance audit (subject to the availability of suitably qualified staff).”

Lastly, the Commission Recommendation of 7 May 2009 on the regulatory treatment of fixed and mobile termination rates in the EU (2009/396/EC) establishes in its recommendations 1, 2, 3 and 4:

“When imposing price control and cost-accounting obligations […] on the markets for wholesale voice call termination on individual public telephone networks […] NRAs should set termination rates based on the costs incurred by an efficient operator […]

2 It is recommended that the evaluation of efficient costs is based on current cost and the use of a bottom-up modelling approach using long-run incremental costs (LRIC) as the relevant cost methodology.

3. NRAs may compare the results of the bottom-up modelling approach with those of a top-down model which uses audited data with a view to verifying and improving the robustness of the results and may make adjustments accordingly.

4. The cost model should be based on efficient technologies available in the time frame considered by the model. [...]”

In keeping with the European regulatory framework of 2002, Law 32/2003 of 3 November, *General de Telecomunicaciones* (the General Telecommunications Law, hereafter LGTel) was p. It established that, within markets of reference shown to lack an effective competitive environment, the CMT may impose, maintain or modify certain specific obligations for operators identified as having significant power in those markets.

Specifically, article 48.2 of the LGTel indicates that the purpose of the CMT:

”is to establish and oversee the specific obligations that operators in the market must comply with, foster competition in audiovisual services markets according to that stated in its regulatory statutes, resolve conflicts between operators and, where necessary, act as an arbiter for the disputes arising between them".

Article 48.3 establishes that the CMT will perform the following function, among others:

“g) Defining the relevant markets in order to establish specific obligations, according to that stated in chapter II of title II and in article 13 of this law.”

Article 13 of the LGTel establishes the obligations imposed on operators with significant market power, including the following:

“c) Accounting separation, with the specified format and methodology as applicable. [...]

e) Price control methods such as price orientation according to costs and cost accounting intended to avoid excessive prices or price compression at the expense of end-users."

The Regulation on electronic communications markets, network access and numbering passed by Spanish Royal Decree 2296/2004 of 10 December (hereafter, the Market Regulation) offers more details on the obligations the Commission may impose, price orientation according to costs and cost accounting. Article 11 states:

“3. When an operator is obliged to ensure that its prices follow the principle of cost-dependent orientation, the burden of proof that prices are determined by costs, including a reasonable rate of return on the investment, rests upon the operator.

In these cases, the Comisión del Mercado de las Telecomunicaciones will determine what cost accounting system is to be applied, and may specify the format and accounting method to be used.

4. For purposes of calculating the cost of efficient service provision, the Comisión del Mercado de las Telecomunicaciones may use accounting systems or methods different from those used by the operator. These shall allow the operator a reasonable rate of return on its investments, taking into account the risks involved. […]

5. When the Comisión del Mercado de las Telecomunicaciones determines that a certain cost accounting system is to be applied, the operator must arrange for a yearly audit, performed by a qualified, independent entity, to verify application of that system. The audit then must be presented to the Comisión del Mercado de las Telecomunicaciones before the 31 July of each year except in the case of the Commission’s performing the audit itself.

6. The Comisión del Mercado de las Telecomunicaciones will guarantee that operators under the obligation of setting cost-oriented prices make a description of their cost-accounting system available to the public. To this end, it will determine the manner, sources or means by which the information regarding this system and its implementation is to be made public. The information includes:

a) Description of the system indicating at the very least the main categories into which costs are classified and the criteria used to distribute them.

b) Report regarding the implementation of that system following every yearly audit.”

With respect to the accounting separation obligation, article 9 of the Regulation states:

"1. Operators declared as having significant power in a wholesale market may be subject to the obligation of accounting separation with regard to access and interconnection activities.

The Comisión del Mercado de las Telecomunicaciones will have the power to establish the scope and conditions of the accounting separation measures.

2. Furthermore, it may require vertically integrated operators to make transparent their wholesale prices and internal transfer charges with a view to ensuring compliance with the non-discrimination principle, or, where necessary, to prevent unfair cross-subsidy. To that end, the Comisión del Mercado de las Telecomunicaciones may specify the accounting format and methodology to be applied.

Without prejudice to the obligations to provide information resting upon electronic communications networks and services, and in order to facilitate checking up on the obligations of transparency and non-discrimination, the Comisión del Mercado de las Telecomunicaciones may require operators to provide accounting documents upon request, including information about income received from third parties for access and interconnection, according to that established by article 9 of Law 32/2003 of 3 November (the General Telecommunications Law). It may also make said information public, provided that this is conducive to obtaining an open, competitive market, in accordance with that established in Spanish and Community regulations regarding commercial and industrial secrecy."

Therefore, based on current European and Spanish legislation regarding applying cost accounting and accounting separation obligations, we understand that the CMT is empowered to do the following:

- Declare which operators are obliged to comply with such obligations.
- Establish the format and method for the cost accounting and accounting separation system used by operators under such obligations.
- Establish the scope of the accounting separation obligation. Specifically, this Commission can establish a scope which may vary from obtaining margins broken down by services and/or markets to implementing transfer pricing systems.
- Determine the accounting system and the accounting separation to be used by operators under these obligations.
- Establish accounting methods different from those proposed by the operator.
- Audit the results from the cost accounting and accounting separation system on a yearly basis.
- Publish a yearly declaration on operators' level of compliance with accounting principles.

SEGUNDO.- Purpose and result of the procedure

The purpose and result of this procedure is to revise and update the cost accounting system's principles, criteria and conditions approved by the Resolution of 15 July 1999 in order to adapt them to the following:

- European legislation of 2002 and its Spanish regulatory counterpart framed in the LGTel of 2003 and accompanying legislation, and the 2009 modifications.
- New Spanish regulations on accounting, particularly the new General Accounting Plan ratified by Royal Decree 1514/2007 of 16 November.
- Theoretical and policy development in the area of regulatory accounting.
- Spanish operators' experience in applying principles and presenting the results from the accounting system over the last nine years.
- Best practices in implementing cost accounting in European countries.

We should specify that the cost accounting system is applied in order to implement cost accounting and accounting separation obligations simultaneously.

III PROPOSED OBSERVATIONS AND MODIFICATIONS TO THE 1999 PRINCIPLES, CRITERIA AND CONDITIONS

III.1 OBSERVATIONS ON THE PRINCIPLES, CRITERIA AND CONDITIONS

The cost accounting system's principles, criteria and conditions approved by the Commission constitute the theoretical and methodological framework which operators use to elaborate their cost accounting and accounting separation systems. They also serve as a guide for the Commission's subsequent revision and approval of those systems. The CMT verifies that they are properly applied, whether directly or by using external auditors or consultants, and prepares a yearly statement on the degree of compliance.

The purpose of the principles, criteria and conditions, once they are employed in cost accounting systems, is to ensure that the Commission will be able to apply the obligations imposed on operators with significant market power. This refers mainly to price control, cost accounting and accounting separation. In addition, establishing the abovementioned principles and criteria guarantees that information obtained from approved accounting models will be useful for purposes of detecting and analysing anti-competitive practices, and particularly those having to do with margin squeezing and discriminatory practices.

Furthermore, the Commission understands that the cost accounting system principles, criteria and conditions must be the same for all operators identified as having significant market power and subject to that obligation, regardless of the market in which they operate.

The principles, criteria and conditions are classified as:

- Type of the cost system.

- General accounting principles.
- Valuation and temporal criteria.
- Minimum breakdown by activity cost centres.
- Cost categories.
- Attribution processes for assets, revenues and costs
- Development, verification and implementation of the cost system.

The cost system is of a multi-standard type, meaning that results may be presented as historical cost, current costs and incremental costs standards. The cost standards determine the valuation of assets, operating cost adjustments and the attribution of the cost of services depending on the efficiency of the operator and the technology in use. Accounting principles are the general norms for assigning costs and revenues, and they establish attribution criteria in an objective, transparent, non-discriminatory and proportional way.

The cost standards and accounting principles are the fundamental basis for the principles, criteria and conditions. Their purpose is to obtain objective and transparent costs and margins depending on the regulatory purpose. In this way, we obtain an operator's historical cost as a direct transposition from financial accounting, or the long run incremental cost of an efficient operator using the most advanced technology available, as well as its intermediate status reflected by current costs. In any case, the process is based on causal, objective and consistent attribution criteria and produces transparent, auditable results.

Valuation and temporal criteria are the result of the multi-standard nature of the cost accounting system, since they define, for each standard, the valuation criteria for assets, costs unrelated to electronic communications services and equity and non-equity capital costs.

Disaggregation by activity centres, cost categories and revenue and cost allocation phases is what mainly determines the structure of the accounting system, referring to the presentation, classification and organisation of the elements that make it up. Those elements establish the accounting system's formal criteria.

Lastly, development and verification of the accounting system indicates what activities are to be carried out by operators or by the CMT in the process of developing the accounting system and verifying results yearly.

In summary, the principles, criteria and conditions are applied to the accounting system which simultaneously meets all cost accounting and accounting separation obligations. This is done in order to obtain sufficient, adequate and transparent information permitting the Commission to check for compliance with the obligations previously established in the corresponding market analyses. In addition, accounting separation is applied within the scope currently required by the CMT, that is, for purposes of obtaining margins broken down by services and markets.

III.2 PROPOSED MODIFICATIONS TO THE RESOLUTION OF 15 JUNE 1999 IN THE PUBLIC CONSULTATION

As stated in the 17th item in the Factual Background section, the Commission submitted the modifications to update the Resolution on principles, criteria and conditions of 15 July 1999 for public consultation. Below, we show the changes proposed in the Public Consultation of 23 February 2010 listed according to the sections in the Appendix of principles, criteria and conditions for the current Resolution.

1 Definition of the nature of the cost system

The Resolution of 1999 establishes that operators should propose a multi-standard system in such a way that the costs of services in each accounting period are shown according to three standards:

> *"a) Fully Distributed Historical Costs: This cost standard is based on allocating all costs included in external financial accounting to the production of different goods or services, and also incorporates the cost of equity capital.*
>
> *"b) Fully Distributed Current Costs: This standard arises as a transition from the fully distributed historical costs standard to the long run incremental costs standard. Its practical application is as follows:*
>
> *1. Substituting the cost of investment in existing assets with the replacement cost, using the most advanced technology available and optimum dimensioning, and re-calculating costs derived from amortisation and paying off invested capital based on the new value of assets.*
>
> *2. Adjusting the operating costs according to efficiency criteria, excluding extraordinary costs.*
>
> *3. Establish the mechanisms for calculating the previous costs deriving from investments in re-evaluated assets in such away that they are attributed to the production process according to their contribution to it and according to the current market circumstances (value, time, efficiency) instead of the historical circumstances.*
>
> *c) Long Run Incremental Costs: This standard is based on the assignment of costs which an efficient operator should incur over the long term, using the most advanced technology with an architecture of similarly advanced resources and processes. The principles and criteria for developing this cost standard will be established in subsequent resolutions by the CMT within the time frame of six months after the date of this resolution so that they may be developed and implemented by the operator during the first quarter of 2001, using accounting data from the 2000 financial year."*

<u>Proposal of and reason for the modification made in the Public Consultation phase</u>

The Resolution defines the adjustments and modifications which must be applied to the financial accounting records of expenditures and revenues in order to find the cost and the margin for services according to current cost and incremental cost standards.

The modification proposals are based on the following analysis: historical cost accounting, under certain circumstances, does not offer satisfactory results for making regulatory decisions, since the asset value might not reflect the true costs for an operator with an efficient, modern network. To solve these problems, the National Regulatory Authority (NRA), in accordance with the Commission Recommendation of 19 September 2005 on cost accounting and accounting separation, may require operators to show current cost accounting.

Current cost standard allows us to evaluate the costs which an efficient operator using the latest available technology would incur in a competitive market. As the Recommendation on accounting separation and cost accounting states in Point 3:

> *"Evaluation of network assets at forward-looking or current value of an efficient operator, that is, estimating the costs faced by equivalent operators if the market were vigorously competitive, is a key element of the 'current cost accounting' (CCA) methodology. This requires that the depreciation charges included in the operating costs be calculated on the basis of current valuations of modern equivalent assets. Consequently, reporting on the capital employed also needs to be on a current cost basis. Other cost adjustments may be required to reflect the current purchase cost of an asset and its operating cost base. Evaluation of network assets at forward-looking or current value may be complemented by the use of a cost accounting methodology such as long run incremental costs (LRIC), where appropriate."*

This means that current costs have the following fundamental characteristics:

- They reflect the cost of an efficient operator's assets.
- They are forward-looking in nature, since they measure the evolution of asset prices, That is, assets are revalued to their current price in order to reflect their value to the business.
- They incorporate technological changes to the assets in such a way that improvements in efficiency and productivity of those technologies are reflected in the costs.
- They guarantee the company's long-term viability, since costs show the assets' replacement value.

Current cost accounting allows us to orient regulated prices according to efficient fixed asset costs that favour competitiveness and long-term investment in the market. Specifically, current cost accounting has the following advantages when compared to historical cost accounting:

- Assets are valued at their current value and not at their acquisition value which may be old or out of date and not reflect the efficient cost of providing services.
- Depreciation and capital costs are based on the updated value of fixed assets.
- The profit and loss statement reflects the true margin for services since it compares current revenues with the updated asset costs, and not with costs based on older acquisition values.
- The existence of holding gains and losses is registered and may be taken into account if applicable.

Revaluing an asset is based, in theory, on the valuation of the asset itself at its current price (replacement value) or on the valuation of a modern asset with equivalent features and services (modern equivalent asset or MEA) if the original asset's technology is obsolete. The MEA allows the accounting process to reflect the cost of an efficient network with the most advanced technology available, as indicated in the European Commission's Recommendations.

Lastly, we should mention that long run incremental cost accounting would also be based on valuating assets at current costs, but it would use long run incremental cost methodology (LRIC). For current cost and incremental cost standards, a top-down approach based on the operator's financial accounting is used. However, compared with current cost accounting, incremental cost standard achieves maximum cost efficiency because that standard is based on attributing costs which an efficient operator, using the most advanced technology and similarly advanced process architecture, should incur over the long term.

Because of the above, and in order to define current cost standard, we propose the following modifications to its three areas for practical application:

1. Asset revaluation.

In this section, we propose a modification to the wording to indicate that existing assets are to be substituted by revalued assets, without going into detail about the revaluation process. It may be based on replacement cost or on another type of updated cost, as explained further in the section titled Valuation and Temporal Criteria.

2. Efficiency adjustments and extraordinary costs.

This point is confusing since it does not clearly establish whether efficiency adjustments are to be made, or if only extraordinary costs are to be eliminated. We propose a modification to the wording to clear up this point by indicating that only extraordinary costs are to be eliminated, because applying additional efficiency adjustments in a top down model is complex. It could even distort the relationship between the operator's financial accounting and the regulatory costs model, and this relationship is one of the current regulatory model's strongest and most important points. For this reason, we feel that models prepared with a bottom-up approach are more suitable for establishing efficiency adjustments in network topology and in operating costs.

In addition, we propose a modification to the term "extraordinary costs", since according to the new Spanish General Accounting Plan of 2007[3] "extraordinary costs" has been eliminated as an expense category in favour of listing very specific, atypical events (natural disasters, expropriations, etc.). The costs to be eliminated are those which are not directly related to the operator's main activity in electronic communications.

3. Calculating costs and attributing them to the productive process according to what they contribute to it.

This third point regarding current costs may lead to confusion. In fact, it was eliminated by the Commission in the description of this standard in the Resolution on principles, criteria and conditions of incremental costs of 25 May 2006 and included within the incremental cost standard, and not the current cost standard.

We therefore propose that this point be eliminated since it refers to adjustments and modifications pertaining to incremental cost accounting and not to the current cost standard.

[3] Approved by Royal Decree 1514/2007 of 16 November.

Lastly, the CMT approved the abovementioned Resolution on the principles, criteria and conditions for developing the incremental cost standard. We propose inserting a reference to that Resolution and eliminating the following paragraph, since it is out of date and irrelevant:

> *"The principles and criteria for developing this cost standard will be established in subsequent resolutions by the CMT within the time frame of six months after the date of this resolution so that they may be developed and implemented by the operator during the first quarter of 2001, using accounting data from the 2000 financial year."*

The section on the nature of the accounting system which addresses the current and incremental cost standards will therefore be worded as follows:

> *"2. Fully distributed current costs: This standard arises as a transition from the fully distributed historical costs standard to the long run incremental costs standard. Its practical application is as follows:*
>
> *2.1. Substituting the cost of investment in existing assets with the revalued cost and recalculating costs derived from depreciation and paying off invested capital using the new value for assets.*
>
> *2.2. Eliminating costs unrelated to providing electronic communications services.*
>
> *3. Long run incremental costs: This standard is based on the assignment of costs which an efficient operator should incur over the long term, using the most advanced technology with an architecture of similarly advanced resources and processes. The development of this standard was approved by the Resolution of 25 May 2006 on the principles, criteria and conditions for the development of the incremental cost standard for the cost accounting system used by Telefónica de España, S.A.U."*

2 General accounting principles

Section 2 in the Resolution of 1999 establishes the following accounting principles:

Accounting principles
1. Causality
2. Objectivity
3.Transparency
4. Auditability
5. Consistency
6. Disaggregation
7. Neutrality
8. Sufficiency
9. No compensation

10. Reconciliation

Table 1 General accounting principles defined in the Resolution of 1999

Proposal of and reason for the modification made in the Public Consultation phase

According to the guidelines in the Common Position on accounting separation and cost accounting systems issued by the European Regulators Group (ERG),[4] regulatory accounting information should be prepared in accordance with a set of principles, policies and procedures. Regarding regulatory accounting principles, it states that they establish the basic doctrines that must be applied when preparing accounting information, and which must include, as a minimum, the following principles:

- Cost causality
- Objectivity
- Transparency
- Coherence (or consistency)

Therefore, the accounting principles approved by the CMT cover the basic principles established in the ERG Common Position and include another six principles:

- Auditability
- Disaggregability
- Neutrality
- Sufficiency
- No compensation
- Reconciliation

It should also be stated that most of the European regulatory authorities apply the basic principles recommended in the ERG Common Position.

Below, we offer an individual analysis of principles according to their definitions in the Resolution of 1999 and list the modifications for updating them:

1. Causality

Original wording:

> *"All attributions of costs and revenues to each activity or service must be carried out through the inducers/conductors of those costs and revenues, that is, by means of the objective parameters for the variables generating them and upon which the costs are distributed. These parameters will hereafter be known as "generators". Likewise, the operator's fixed assets, and where applicable, circulating assets, must be assigned to the "activity centres" so that the costs arising from investment in those assets will be managed with causality criteria toward forming the cost of different services."*

[4] Guidelines for implementing the Commission Recommendation C (2005) 3480 on Accounting Separation & Cost Accounting Systems under the regulatory framework for electronic communications.

We propose adding the following: Where it reads "All attributions of costs and revenues to each activity or service […] it should be modified to read "All attributions of costs and revenues to each activity, asset item or service […]."

2. Objectivity

Original wording:

> *"Generators of costs or revenues must be objective and quantifiable using sufficiently reliable statistical or census/sample based computations. These will be directly or indirectly related to the services produced, and information procedures and its determinations must form part of the Cost System; this in turn must be approved by the CMT before the operator implements it. As an exception, costs recognised as being difficult to identify using measurable, objective generators must be attributed using objective distribution criteria that have been previously established. Furthermore, in the event that some costs cannot be directly attributed to a service, objective criteria will be established for distributing them within the set of activities to which they are assigned."*

It is thought to be fitting to add a reference to the use of generally accepted statistical techniques in the event that objective data is lacking, as operators do in practice.

We propose modifying the wording at the beginning as follows:

> *"Generators of costs or revenues must be objective, reliable and quantifiable using census data, or statistical/sample-based computations. These will be either directly or indirectly related to the services produced and to information procedures. The way they are determined must form a part of the cost system which must be approved by the CMT before the operator implements it. Cost generators based on sample data must be founded on generally accepted statistical techniques. Costs which, as an exception, are recognised as being difficult to identify using measurable, objective generators, must be attributed using previously established objective distribution criteria.Furthermore, in the event that some costs cannot be directly assigned to a service, objective criteria will be established for distributing them within the set of activities to which they are assigned."*

3. Transparency

Original wording:

> *"The cost attributed to each activity or service in the end must be able to be broken down according to the different types of costs, as described throughout this resolution. In particular, costs arising from investment in assets allocated to productive processes, including provisions for depreciating investment, must be identified separately from the rest of the operating costs in the process, such as preservation, maintenance or use of the allocated asset."*

This principle has two parts which are analysed in detail:

1. Breakdown of the cost of activities or services into several costs according to type:

> *"The cost attributed to each activity or service in the end must be able to be broken down according to the different types of costs, as described throughout this resolution."*

The cost of the services is broken down in the operators' accounting system depending on the activity cost centres which incur costs.

However, the Resolution requires costs to be broken down "according to the different types", and, according to section 6 of the same document, costs by type are the ones appearing in Phase 1, that is, the reflected costs and fixed asset costs. All operators' accounting systems include the first type of cost breakdown, whereas the second is presented by only one operator in a specific report which other operators do not issue.

2. Separation of fixed asset costs:

> *"In particular, costs arising from investment in assets allocated to productive processes, including provisions for amortising investment, must be identified separately from the rest of the operating costs in the process, such as preservation, maintenance or use of the allocated asset."*

The operators' accounting system distinguishes between calculated and operating costs for an asset, and between depreciation and capital costs. We consider this redundant, since breaking down costs entails breaking down the costs for fixed assets.

In conclusion, this principle is found to be valid, but we propose simplifying its wording so that instead of explicitly mentioning breaking down costs by cost type, it refers to a breakdown according to the components that make up each cost in an activity, service or asset item, since the current degree of transparency in accounting systems is thought to be sufficient.

We therefore propose the following wording:

> *"Transparency*
>
> *It must be possible to break down the cost attributed to each activity, asset item or service according to the different cost components that make it up".*

4. Auditability

Original wording:

> *"The Cost Accounting System will establish the proper relationship with the operator's external financial accounting records and with the operating and statistical systems upon which "generators" of costs and revenues attributed to services are based. This is intended to facilitate full auditability of the cost accounting system."*

No modifications are proposed for this principle.

5. Consistency

Original wording:

"The accounting principles, together with the proposed valuation, temporal and allocation criteria which comply with that stated in this resolution, must be maintained from year to year. In the event of changes in criteria which would significantly affect the presented information, following authorisation from the Comisión del Mercado de las Telecomunicaciones, then both the previous and amended criteria will have to be applied simultaneously during one financial year in order to show the resulting differences in the calculations of final costs."

The definition of this principle requires operators to meet three obligations:

- Maintain the valuation, temporal and allocation criteria applied from one financial year to the next.
- Request authorisation from the CMT prior to modifying the criteria.
- Present the account system results after applying both new and old criteria for the same financial year when a change in criteria will have a significant effect.
- In practice, this authorisation has been shifting toward the annual resolutions for account verification in light of the results from completed audits. This has shown itself as a more efficient mechanism for guaranteeing compliance with the principle of consistency.

We believe that the expression "significant effect" is imprecise. In order to avoid it, we propose modifying the wording of this principle so that it clearly indicates when a change is relevant, and when, therefore, two sets of criteria must be used.

In summary, we propose modifying this principle in the following ways:

- Immaterial changes will not require the use of two sets of criteria.
- A numerical threshold must be established for determining when an effect is significant.
- The requirement for prior authorisation will be suppressed as being impractical for both operators and the Commission.

Based on the study of the incidents detected during accounting system revisions in recent financial years, we propose applying a relevance criterion of 2% of the costs of regulated services. However, this relevance criterion will not apply to identifying incidents during the annual verification of results, where the CMT may establish the materiality criteria it deems necessary in order to ensure the reliability of the accounts that are presented.

The proposed wording is as follows:

"Consistency

"The accounting principles, together with the proposed valuation, temporal and allocation criteria, must be maintained from year to year. When introducing changes in criteria that are not required by the CMT and which will have an effect of more than 2% on the cost or revenue for any of the regulated services, then both the old criteria and the updated criteria must be applied simultaneously during one financial year. This will show the resulting differences in the measurement of costs, revenues and margins."

6. Disaggregability

Original wording:

> *"Regardless of the number and magnitude of attributions in the Cost Accounting, the total costs attributed to services must pass by an intermediate stage of distribution called "activity cost centres". The way these centres are detailed and broken down must be justified with technical studies showing the current functioning and anticipated future functioning of each of them. This principle will be applied without prejudice to the principles of transparency and sufficient information."*

We feel that this principle is not general enough to be classified as such. It is also redundant, since the Resolution of 1999 and its current version indicate in section 6:

> *"Phase 2) Allocating costs to activity centres: during this second phase, the total reflected and calculated costs must be allocated to "activity centres" in order to provide a "matrix view" relating all results from Phase 1.a to the "activity centres" defined within the System."*

Furthermore, the "*way these centres are detailed and broken down*" justified with technical studies is also considered to be outdated for the following reasons:

- Mobile operators cannot define their activity cost centres independently; they were established by means of a CMT Resolution.
- TESAU and Abertis have already defined their activity centres and all financial years in the result verification process have been revised.

For other operators which will be obliged to present cost accounting in the future, their accounting model will be reviewed and, if suitable, approved by the CMT. All elements within the system may be subject to evaluation, and not just the activity cost centres.

We feel that this principle should be eliminated since it is redundant and does not provide a basic standard or action policy for elaborating operators' accounting systems.

7. Neutrality

Original wording:

> *"Internal cost transfers, especially those leading to form the costs of interconnection services provided to other operators and self-consumption in the productive process of the operator, its subsidiaries and dependent companies, must be performed homogeneously and valued at the internal transfer charges corresponding to the applicable cost standard. Margins obtained through third-party and intragroup sales must be denoted differently in separate accounts."*

Transfer charges or internal cost transfers are related to cost accounting and accounting separation obligations. These obligations may only be imposed by a NRA by means of the process described in the Framework Directive on the definition and analysis of markets and imposing obligations on operators with significant market power.

In reference to the price control and cost accounting obligations, article 13 in the Access Directive states, as indicated in the Legal Basis section:

> *"A national regulatory authority may,[…] impose obligations relating to cost recovery and price controls, including obligations for cost orientation of prices and obligations concerning cost accounting systems, for the provision of specific types of interconnection and/or access, in situations where a market analysis indicates that a lack of effective competition means that the operator concerned might sustain prices at an excessively high level, or apply a price squeeze, to the detriment of end-users."*

Furthermore, the Recommendation on accounting separation and cost accounting states in consideration 2:

> *"Operators designated as having significant market power (SMP) on a relevant market […] may be subject, inter alia, to obligations concerning the preparation of separated accounts and/or implementation of a cost accounting system. The purpose of imposing such obligations is to make transactions between operators more transparent and/or to determine the actual cost of services provided. Furthermore, accounting separation and the implementation of cost accounting systems may be used by national regulatory authorities to complement the application of other regulatory measures (e.g. transparency, non discrimination, cost orientation) on notified operators."*

More specifically, point 1 states:

> *"The purpose of imposing an obligation to implement a cost accounting system is to ensure that fair, objective and transparent criteria are followed by notified operators in allocating their costs to services in situations where they are subject to obligations for price controls or cost-oriented prices.*
>
> *The purpose of imposing an obligation regarding accounting separation is to provide a higher level of detail of information than that derived from the statutory financial statements of the notified operator, to reflect as closely as possible the performance of parts of the notified operator's business as if they had operated as separate businesses, and in the case of vertically integrated undertakings, to prevent discrimination in favour of their own activities and to prevent unfair cross-subsidy."*

The accounting separation obligation is widely used to control and avoid discriminatory practices, especially price-related ones, on the part of vertically integrated operators. Accounting separation assumes the operator to be present in different markets (wholesale or retail markets, markets outside of the telecommunications sector) and aims to make margins and operator resources visible in each of the operator's markets.

A transfer charge is the criterion by which internal transactions between two segments in the same company are valued. In this way, output produced by the operator in one segment becomes input for another segment or market. This raises the problem of determining which criterion should be used to evaluate the input of the receiving service. That value is the transfer charge.

Implementation of transfer charges should be considered as neither mandatory nor inherent to the accounting separation system, since article 11 of the Access Directive simply indicates that implementation of a transfer charge system may be implemented in addition to the accounting separation system:

> *"In particular, a national regulatory authority may require a vertically integrated company to make transparent its wholesale prices and its internal transfer charges inter alia to ensure compliance where there is a requirement for non-discrimination under Article 10 or, where necessary, to prevent unfair cross-subsidy. National regulatory authorities may specify the format and accounting methodology to be used."*

In turn, the Recommendation on accounting separation and cost accounting systems leaves the NRA with the possibility of requiring, in addition to accounting separation, a profit and loss statement for pertinent markets and services with transfer charges:

> *"It is recommended that notified operators required to report accounting separation provide a profit and loss statement and statement of capital employed for each of the regulatory reporting entities (based on the relevant markets and services). Transfer charges or purchases between markets and services need to be clearly identified in sufficient detail to justify compliance with non-discrimination obligations."*

Therefore, Community regulations consider transfer charge systems to be an additional element and not an obligation under accounting separation. In order to implement this system, the NRAs may specify the format and specific methodology which they consider suitable. Spanish operators under obligations have implemented a cost accounting and accounting separation system, but not a transfer charge system.

In summary, this principle will be eliminated according to the conclusions reached because transfer charges should not be addressed in a generic Resolution on the common principles, applying equally to all operators under obligations, for the cost accounting and accounting separation model.

Should a transfer charge system be required, it will be necessary, given the specific, detailed information which the regulator must gather from operators, for the CMT to develop an *ad hoc* Resolution establishing the criteria to be followed in order to develop such a model.

8. Sufficiency

Original wording:

> *"The Cost Accounting System must make it possible to obtain the information needed to form separate statements for accounts being published, whether directly or through the external financial accounting records, and any other information which the operator is obliged to provide under current legislation and European Commission recommendations".*

This principle is found to be unnecessary, since it indicates that "The Cost Accounting System must make it possible to obtain […] the information needed to form separate statements for accounts to be published", but the results of the accounting system in its final phase, namely the margins for each service, represent precisely the separated statement of the accounts.

In other words, as stated before, the system defined by this Resolution is a cost accounting and accounting separation system, meaning that this principle is unnecessary and redundant.

Furthermore, this principle requires that the cost accounting system provide "...any other information which the operator is obliged to provide under current legislation and European Commission recommendations". This requirement is too generic and could lead to failure to comply, since the accounting system is oriented toward providing the cost, revenue and margin for services and markets, not toward providing “any other information which the operator is obliged to provide”.

We therefore propose that this principle be eliminated.

9. No compensation

Original wording:

> *“The processing of costs and revenues, both by cost accounting and external financial accounting, should keep the two concepts separate without any compensation between them. In particular, the income obtained by providing services should be valued at the operator's catalogue prices, with separate accounting for any incentives, discounts or commercial price reductions."*

We do not suggest any modifications to this principle except for eliminating the reference to external financial accounting, this being outside of the CMT’s regulatory scope.

10. Reconciliation

Original wording:

> *“For each cost standard, the operator must present the Comisión del Mercado de las Telecomunicaciones with its reconciliation with external financial accounting in which it indicates the amounts and the nature of the adjustments applied with what the regulator feels to be a sufficient level of breakdown."*

This principle does not indicate a basic and general rule applied in the accounting system, but rather an information requirement. We therefore propose eliminating this principle and moving the information requirement to the section indicating the phases which must have accounting separation: Section 6, Process for allocating assets, revenues and costs. It specifically points to this requirement in Phase 1, during which the costs and revenues reflected in the financial accounting are obtained. Below, we present the summary of the proposed modifications to principles:

Accounting principle	Modification
1. Causality	No relevant modifications
2. Objectivity	No relevant modifications
3.Transparency	Simplification
4. Auditability	No modifications

5. Consistency	Simplification
6. Disaggregation	Delete
7. Neutrality	Delete
8. Sufficiency	Delete
9. No compensation	No relevant modifications
10. Reconciliation	Delete

Table 2. Modifications to Accounting Principles in the 1999 Resolution

3 Valuation and temporal criteria

This section lists the valuation and temporal criteria, which are the fundamental elements for determining adjustments to be made to different cost standards. Adjustments to be applied to the current cost standard are of particular importance; incremental cost adjustments will be addressed in their own Resolution.

Differential valuation criteria are as follows:

1. Asset valuation.

On this topic, the Resolution states:

> *"a) The "assets allocated" to activity centres will be valued:*
>
> *- To determine the "historical cost" standard […].*
>
> *- To determine the "current costs" standard. Here, the gross attributed value will be that resulting from valuing assets at the "market price" of substitute goods with the most advanced technology and equal production capacity, even if the latter offer additional benefits having to do with production. Certain "allocatable assets" may be excluded from the process of re-evaluating their "current costs", accepting their "historical costs" as a substitute for the former when the assets' replacement is not feasible. In this case, the CMT will offer a justified resolution regarding their exclusion.*
>
> *- "Market price" is understood to be the mean acquisition price for the operator in the past two financial years if that operator acquired goods of that type and technology. If this is not the case, the operator will request tenders from at least three well-known manufacturers, if possible, and use the mean tender price as a reference for the new value."*

Proposal of and reason for the modification made in the Public Consultation phase

This point on the market price should be more flexible and include more revaluation methods, such as indexation, which may be applied by operators. We therefore propose adding the following phrase to the last paragraph:

> *"In addition, the current market price of an asset may be obtained by applying price indexes which faithfully reflect the evolution of that asset's price."*

2. Contingencies and extraordinary charges.

On this topic, the Resolution states:

“b) Charges to the financial year’s results due to extraordinary contingencies and risks will be attributed using causality criteria, depending on the function of the corresponding asset, and they will be valued as costs in the following manner:

- To determine "historical costs", using the value attributed to the allocated funds in the external financial accounting for that year.

- Keeping in mind the extraordinary nature of said charges, they will not be considered when determining the "current cost" standard.”

<u>Proposal of and reason for the modification made in the Public Consultation phase</u>

This topic is related to the modification proposed for adjustment to the current costs standard indicated in point 1 of this section. Here, the reference to extraordinary costs was replaced with a reference to costs not related to services. In addition, we feel that the wording of the first sentence, *"b) Charges to the financial year's results due to […]”*, is confusing and recommend simplifying it.

We therefore propose the following wording for this point:

“b) Costs which are not related to providing services will be attributed in the following way:

- According to the attributed value in the external financial accounting for that year, when determining "historical costs".

- Keeping in mind the nature of costs which are not necessary for providing services, they will not be considered when determining the “current cost” standard.”

3. Equity and non-equity capital costs.

On this topic, the Resolution states:

“c) Financial charges from non-equity capital, and costs of equity capital, will be valued as follows:

- To determine the “historical cost” […].

- To determine “current costs”, they will be calculated proportionally to the “net current value” of assets allocated with an "annual fee” estimated according to the mean weighted cost of the capital employed.

Before beginning each financial year, the operator will inform the CMT of the “annual fee” it proposes to apply in order to determine the “current cost” standard for that coming year, and justify the amount. The CMT will issue a *resolution regarding its application or modification, justified in terms of the cost of money on the market and the enterprise's risk rate.*

As an exception to that stated in the previous paragraph, the operator with the obligation of accounting separation for 1999 must, before 31 December 1999, inform the CMT of the annual rate it proposes to apply for that financial year in the "current costs" version and obtain the regulator's approval."

Proposal of and reason for the modification made in the Public Consultation phase

On this point, we do not propose any modifications except for eliminating the last paragraph, which is outdated.

4 Minimum disaggregation by activity cost centres

This section shows how activity centres are classified into three large groups:

- Activity centres of network components (ACNC).
- Activity centres directly attributable to services (ACDAS)
- Activity cost centres not directly attributable to services (ACNDAS).

We find the following subdivision within the ACNCs:

"Activity cost centres of network components" must be divided into four subgroups, according to their network functions: access, switching, conveyance and value-added functions. In addition, they must be subdivided by their respective methods for performing their functions, according to the technology they incorporate and their hierarchical level in networks".

Proposal of and reason for the modification made in the Public Consultation phase

This network centre outline is valid for telecommunications operators (TESAU, TME, Vodafone and Orange), but it is not applicable to the audiovisual sector (Abertis).

We therefore propose modifying this paragraph and substituting it with:

"Activity cost centres of network components" must be grouped according to their network functions. For telephone operators, these groups will be access, switching, conveyance and added-value functions, and for audiovisual operators, they will be co-location, interconnection and others. In addition, they must be subdivided by their respective methods for performing their functions, according to the technology they incorporate and their hierarchical level in networks".

5 Cost categories which must be explicit in the cost system

This section indicates different cost classifications. One refers to the relationship of causality with the services provided by the operator:

"As a result, and to obtain a proper cost distribution, each item within the system must be classifiable, regardless of other classification criteria which the operator under obligations may adopt, in one of the following categories

established according to the relationship of causality with the services provided by the operator:

- Direct identification costs: [...]

- Directly attributable costs: [...]

- Indirectly attributable costs: [...]

- Non-attributable costs: [...].”

This classification does not take shape in accounting systems with these names. In the case of fixed and mobile operators, the following names appear instead:

- Calculated costs.
- Activity-based costs:
    - Costs by activity.
    - Costs of attributable sales.
    - Costs of non-attributable sales.

Nevertheless, no modifications to this point are proposed since classifying costs within these categories is not a requirement. Rather, *"each item… must be classifiable"* in one of the listed categories.

6 Attribution processes for assets, revenues and costs

This section defines the phases of the accounting process, although there is the possibility of the operator breaking them down into as many sub-phases as finds to be convenient:

- Phase 1.a) Determining reflected and calculated costs.
- Phase 1.b) Determining reflected revenues.
- Phase 2) Attributing costs to “activity centres”.
- Phase 3) Attributing costs to “services”.
- Phase 4) Attributing costs and revenues to the margins account.

Proposal of and reason for the modification made in the Public Consultation phase

We propose adding Phase 1.c elaborating the reconciliation between financial accounting and the CAS to this point. In this way, this requirement changes places in the Resolution, coming from the No Compensation principle to fall under this section:

“For each cost standard, the operator must provide the CMT with its reconciliation with external financial accounting in which it indicates the amounts and the nature of the adjustments applied with what the regulator feels to be sufficient itemisation."

Two other modifications are also proposed:

- Phase 1.b states that “Revenues generated by financial investments in other activities, such as shareholding in subsidiaries and associated companies, will be allocated to “other activities not related with the telecommunications sector in Spain”. We feel that it is appropriate to replace this account with one called Not Attributable to the Main Activity (NAMA), as this account exists in the CAS for all operators with obligations.
- In Phase 3, it states that “Costs from network component activity centres will be attributed according to the volume of activity performed by each centre and the degree of use which each service makes of them as listed in the routing factor table". This attribution criterion is valid for the telephony sector (TESAU, TME, VFE and Orange), but not for the audiovisual sector (Abertis).

We therefore propose the following wording:

> *“Costs to telephony operators from network component activity centres will be attributed according to the volume of activity performed by each centre and the degree of use which each service makes of them as listed in the routing factor table. For audiovisual operators, costs will be attributed according to their contribution to the total cost of each service”.*

7 Development, verification and implementation of the cost system

This section states:

> *“The Comisión del Mercado de las Telecomunicaciones has the task of preparing a yearly statement on each operator's compliance with cost criteria and proposing modifications of a mandatory nature to Cost Systems as appropriate.*
>
> *The necessary information which the operator must provide in order for the Comisión del Mercado de las Telecomunicaciones to fulfil its function will be explained in detail, indicating both content and format, in the section on developing the cost system, in accordance with that established by sector legislation.*
>
> *In order to meet these objectives, the Comisión del Mercado de las Telecomunicaciones will be able to rely on cooperation from the auditor contracted by the operator to review the cost accounting and, should specific questions arise, receive help from other auditors or external consultants contracted and overseen by the Commission itself.*
>
> *During the process of the operator’s developing and implementing the Cost Accounting and Accounting Separation System, it may send queries to the CMT should there be any doubts about applying the principles, criteria and standards. These queries may be issued with a view to gaining the CMT's approval or input on the progress of the tasks to develop the Cost System proposal.*
>
> *The Comisión del Mercado de las Telecomunicaciones will publish, or make available to all concerned parties, those queries which it considers to hold*

general relevance or interest along with the solutions it suggests in order to serve as a reference and complement current legislation."

Proposal of and reason for the modification made in the Public Consultation phase

We believe it would be appropriate to expand the references to the account verification process in this section. It will be stated that the operator should present the accounting system's yearly results, duly verified by an auditor assigned a list of established processes to ensure that the yearly accounting results reflect a true image of the operations according to the principles, criteria and conditions. In addition, the auditing firm in charge of reviewing cost accounting must have the technical capacity sufficient in order to complete the assignments.

The current financial year's accounts will be presented along with those from the previous financial year modified according to the adjustments specified by the CMT in the previous year's revision. We therefore propose including an initial paragraph which reads as follows:

"Operators must present the CMT with their cost accounting system for each financial year along with the accounts for the previous year modified according to the adjustments specified by the CMT in the previous revision.

The cost accounting system must be accompanied by a report, drawn up by an auditor with sufficient technical qualifications, expressing whether or not the accounts represent a faithful view of the results for the period according to the principles, criteria and conditions established by the Comisión del Mercado de las Telecomunicaciones. The same report will list and measure any incidents and failures to comply which the auditor detects.

The CMT will issue a yearly statement on the operator's compliance with the accounting principles, standards and criteria in its cost accounting system."

The last two paragraphs have been eliminated because they were outdated.

8 Activities (services) subject to mandatory segregation

This section states:

"In its framework for the Cost Accounting system, the operator will propose subdividing the groups of activities referred to in article 15.3 of the Interconnection Regulation into as many subgroups as would correspond to the significant types of services they provide in each case. The CMT may expand the proposed subclassification if it finds the operator's model to be insufficient."

Proposal of and reason for the modification made in the Public Consultation phase

The regulation referred to in the Resolution has been revoked, and the proposed classification of services has been taken over by the CMT itself. The CMT established which services must be disaggregated by audiovisual and telephone operators in the following resolutions:

- Resolution of 1 June 2006 on the accounting format and method to be applied by Abertis.

- Resolution of 13 December 2007 on adapting mobile network operators' cost accounting systems to fit the new regulatory framework.
- Resolution of 13 December 2007 on adapting TESAU's cost accounting system to fit the new regulatory framework.

We therefore propose that this section be eliminated. In the event that an operator should be obliged to use cost accounting, the Resolution imposing that obligation will be able to:

- Refer to the resolutions stated above to indicate the list of services to be included in the cost system.
- Refer to a later resolution on the format and method for the cost accounting system which establishes, inter alia, the services subject to disaggregation.
- Expressly indicate services to be incorporated into the accounting system.

9 Minimum format requirements for presenting the proposed cost accounting system for the CMT's approval

This section describes the content of the accounting system model which operators must submit for the CMT's approval before it may be implemented.

Proposal of and reason for the modification made in the Public Consultation phase

We propose that this section be eliminated since, at this time, all operators have presented their accounting models and have had them approved by the CMT. In the event of an additional operator being obliged to implement cost accounting, it would be more practical to indicate the requirements for presenting the model in the resolution establishing the obligation, or in a subsequent resolution addressing format and method.

On the other hand, the reference to group 9 in the Spanish General Accounting Plan is out of date, since that group in the new General Accounting Plan covers revenues attributed directly to the net worth and does not address cost accounting.

IV RESPONSE TO THE ALLEGATIONS RAISED IN THE PUBLIC CONSULTATION

This section responds to the statements made by operators regarding the Public Consultation carried out in February 2010. The responses[5] appear according to the sections given in the Appendix of principles, criteria and conditions in this Resolution.

1. Regarding accounting separation, transfer charges and the principle of non-discrimination

TME and TESAU allege that the current CA systems allow for obtaining the revenues, costs and margins for those segments in which operators are active, and that neutrality in determining wholesale and retail costs is guaranteed by the use of the same drivers in network component activity cost centres. The implementation of common drivers involves

[5] TESAU and TME presented the same allegations against the report which was submitted for Public Consultation.

attributing the same unit costs to all services with a high degree of traceability between the network component and the service.

Implementing a transfer charge model would be a drastic structural modification to the actual system and lead to significant resource consumption without there being any improvements in the model's traceability. In addition, operators state that, as written in the service report, transfer charges *"do not have to be different from costs as long as the unit costs of the input and output can be identified".*

Furthermore, TME and TESAU point out the following with regard to non-discrimination, which, according to the service report, is guaranteed not only when:

> *"1) The operator presents an accounting breakdown for the wholesale service provided to third parties and wholesale self-consumption for each wholesale service.*
>
> *2) Wholesale services attribute costs to retail services."*

If this is not the case, discriminatory treatment and cross-subsidy are also avoided when common distribution drivers for network components are applied to wholesale and retail services, as this guarantees that the same costs are attributed to both self-consumption and wholesale services.

Orange considers that compliance with the non-discrimination requirement is especially relevant in vertically integrated fixed telephone companies, and for that reason it proposes the implementation of a transfer charge system for the fixed telephone markets.

In this respect, Orange believes that although *ex ante* analysis of TESAU's offers and promotions is a means of preventing discriminatory practices, it cannot replace the need for establishing transfer charges in regulated accounting. This is because accounting offers an overall view of all offers arising in a year, compared to the customer-by-customer analysis as we see with *ex ante*.

Another benefit of transfer charges will be that incumbent operators will not appropriate the improved margins created by lower costs resulting from the time gap between when regulated prices are set according to verified cost accounting and the accounting's year of reference.

Response by the Commission

Transfer charges are the prices at which internal movements or transfers between the operator's wholesale and retail divisions are valued. Valuing internal transfers (according to cost, regulated price or other sum) is different from calculating the cost of wholesale and retail services. Calculating the cost is based on the principles of causality and objectivity, and for this reason the same drivers are applied. However, verifying non-discrimination through transfers is based on breaking down the retail service according to its corresponding wholesale service or services.

Therefore, calculating the cost of wholesale and retail services based on the same drivers does not necessarily lead to the same results as we obtain when transfer charges are applied to self-consumed wholesale services used to provide retail services.

The implementation of a system of transfer prices is a tool which legislation has granted to this Commission, but we must keep in mind that, as stated in article 9 of the Market

Regulation, the scope and conditions of accounting separation are determined by the Commission itself, and that scope may or may not include an internal transfer charge system. At present, given the amount of information found in current cost models, the Commission feels it is not necessary to include transfer charges in the accounting separation system. Were it to impose this obligation in the future, it would be necessary to adopt an *ad hoc* Resolution explaining the format and specific method.

2. Regarding the nature of the cost accounting system applied by the CMT

According to Vodafone, the nature of the cost accounting system must reflect the particularities of the incumbent fixed telephone operator's asset of access to the copper pair network, which is a matter of extreme importance for alternative operators.

Applying current and incremental cost standards while considering asset revaluing and an efficient network reflects the cost of a theoretical network which has nothing to do with the true situation. This network cost calculation methodology is appropriate for a trunk network, but not for an access network in which the basic costs are civil works, conduits and cables. This is the case because civil works do not lead to the technological evolution of the equipment as it does in a trunk network. Rather, the techniques used to build the network are essentially the same as those used when it was first made, except that the cost of labour is much higher. Furthermore, calculating the cost of such assets is made even more complicated by the difficulty in determining their useful life, given that these assets are not replaced.

Because of the above, Vodafone proposes a different model from that of current and incremental cost standards for fixed access. This model takes into account the fact that the assets are not always replaced, in addition to the cost associated with maintaining the infrastructure in optimal conditions (renewal accounting). In this way, an entrant would deploy new network infrastructure if its cost was lower than the cost of depreciation and maintaining the incumbent's current network.

In conclusion, Vodafone proposes that:

- The multi-standard CAS should be of a flexible nature, so that standards adapted to each type of activity may be applied in order to determine costs in the most efficient way possible.
- Specific treatment should be introduced for the cost of the fixed access network, taking into account the non-replacement of the assets and valuing the cost of maintenance in optimal service conditions (renewal accounting).

Response by the Commission

Vodafone’s proposal is already covered by TESAU's incremental cost standard. This regulation establishes different treatment for assets having to do with access to the fixed network and all other network assets. Specifically, the Third Point in the Resolution of 25 May 2006 states that:

> *“In order to determine network access costs, Telefónica de España, S.A.U. must consider that applying the depreciation system with a constant financial annuity must guarantee economic continuity. In particular, the depreciation system may only be applied to that part of the access network corresponding to new investment. The linear depreciation system must be applied for assets that are not completely depreciated”.*

In addition, attributing the cost of fully depreciated access elements is not permitted even if they are in use, unlike that established for the rest of the network.

Therefore, the Commission already ensures that TESAU's fixed access network is treated differently from the rest of the network with regard to incremental cost standards. This is based on the concept of "economic continuity".

3. Regarding the revaluation of assets in the current cost standard

Orange has some reservations regarding revaluing TESAU's civil works (conduits and channels) using indices above the consumer price index[6], and indicates that other regulators have established limits for revaluing these assets, such as the CPI or the CPI plus a certain percentage.

Secondly, with respect to calculating the universal service deficit, Orange feels it is not logical to apply revaluation indices which result in current costs that are higher than the historical ones; this would mean compensating the lender for a higher amount than the deficit incurred.

Furthermore, Abertis states that with a current cost standard, assets will be valued at market price, understanding that to mean:

> *"the mean price of acquisition by the operator in the past two financial years, if that operator acquired goods of that type and technology. If this is not the case, the operator will request tenders from at least three well-known manufacturers, if possible, and use the mean tender price as a reference for the new value."*

Abertis proposes specifying, in a more concise way, whether it is necessary to have three providers or manufacturers per asset for the first option (mean acquisition price) as required in the yearly resolutions to verify its accounting system results. It also proposes specifying what to do when not all of the information needed in order to revalue assets according to the indicated requirements is not available for a yearly period.

Response by the Commission

With regard to revaluing TESAU's network and calculating the cost of universal service, the Commission refers to that already indicated in the Resolutions to review results of TESAU's cost accounting and the revaluation methods applied by the operator in each financial year, as well as the Resolutions for estimating the net cost of that operator's universal service for each financial year.

Furthermore, the CMT feels that Abertis' stipulation regarding market price at current costs is correct, and will modify the wording for this point to include the following in the paragraph pointed out by Abertis:

> *"In the event that the type of asset so requires, acquisitions in the last two financial years must be made from at least three different providers. If this is not the case, the operator will call for tenders from other providers until it has at least three samples from different providers per asset, referring to acquisitions and estimates, and it will use the mean price as the new reference value."*

[6] Consumer price index (CPI).

We should make it clear that, in this situation, new estimates are added to the completed acquisitions in order to calculate the mean price. The Commission will determine what specific assets will be subject to this requirement in its specific resolutions on each operator's CAS.

Lastly, situations in which not all information necessary for revaluing assets is available within a yearly period should be guarded against and avoided by the operator. If the operator does not have acquisitions, it should request the corresponding tenders from providers.

4. exclusion of costs unrelated to providing electronic communication services in current cost standard

TME and TESAU feel that the new wording in this section is too general and should be clarified. Furthermore, according to Abertis, the new General Accounting Plan indicates that extraordinary costs are those relating to natural disasters, expropriations, etc. It therefore proposes that costs of disposal of assets and other asset value losses (provisions, deterioration, etc.) be considered as costs attributable to services in the CAS.

Response by the Commission

The Commission understands "costs unrelated to providing electronic communications services" to be those costs which do not form part of the production process for those services and which, therefore, cannot be attributed to that process either directly or indirectly.

As an example, without providing an exhaustive list, costs unrelated to providing services may include:

- Extraordinary costs due to natural disasters, damages from lawsuits, accidents, etc.
- Losses of fixed assets due to disposal or deterioration.
- Costs of activities and business unrelated to mobile telephony, such as TETRA, fixed telephony, trunking, etc.
- Costs of restructuring, early retirement, redundancies, etc.
- Legal obligations and mandatory provisions unrelated to services, such as contributions to the national fund for universal service, the yearly contribution toward financing RTVE Corporation,[7] dismantlement costs, etc.
- Costs deriving from mergers and acquisitions, such as taxes on operations and depreciation of goodwill, financial costs of financing operations, etc.
- Other costs resulting from the investment process, such as underrated investments, disinvestments, dismantled non-depreciated facilities, recovered materials, etc.
- Activities performed abroad.

[7] Ratified by Spanish Law 8/2009, of 28 August, on financing the *Corporación de Radio y Televisión Española* [Spanish Radio and Television Corporation].

5. Regarding the objectivity principle

Abertis feels that the Commission should specify what is meant by the expression "generally accepted statistical techniques". The Commission believes that generally accepted statistical techniques are those commonly used in accounting and finance.

6. Regarding the transparency principle

On this subject, Orange proposes clarifying how to handle government-awarded subsidies and low interest loans and the universal service deficit financed through the national fund for universal service.

Orange believes that subsidies and government aid should be identified within each kind of fixed asset so that the final cost does not increase based on the cost of investments for which the operator did not pay. Orange lists the plan to substitute TRAC and the PETA plans within Plan Avanza as examples.

With respect to the universal service deficit, Orange proposes that the part paid for by the national universal service fund be eliminated from the incumbent operator's access costs, since if this is not the case, this operator is recognised as incurring a cost which is paid for out of the fund.

Response by the Commission

The Commission wishes to make it clear that subsidies and government aid are already covered in the accounting system in a transparent manner. They appear in the appropriate income sections for all operators receiving them. Furthermore, the CMT emphasises that the cost accounting system is intended to show the revenues, costs and margin for services regardless of whether they are funded with operators' own resources, outside financing or public funds. In any case, dealing with government aid, incentives or subsidies which operators may have received and which have to do with setting wholesale prices is not the purpose of this procedure.

With respect to the universal service deficit, the financing which an operator under obligations receives from other operators stems from this Commission's decision that the cost incurred by TESAU as an operator with the obligation to provide universal service constitutes an unjustified burden. The contributions which TESAU receives from the National Universal Service Fund are net of subsidies, according to the terms of article 49 of the Universal Service Regulation. The amount that the operator would have had to pay in order to provide the service is compensated by the costs which that operator has already incurred while providing the service. Therefore, this contribution should not be eliminated from the costs corresponding to the operator providing the service. Furthermore, we must highlight that revenues from providing universal service are identified in the operator's accounting system in a transparent manner, and that this procedure does not address their treatment with regard to setting wholesale prices.

7. Regarding the consistency principle

All of the operators find that the 2% variation limit in the cost or revenue of regulated services is too restrictive and that it is accompanied by the obligation to present both sets of criteria in most cases. Abertis proposes raising the limit to 10%. TESAU and TME propose making it 5% and limiting the required information to an analysis of impact on service revenue, cost and margin in order to avoid the time-consuming task of processing the entire CAS every time there is a modification.

Furthermore, Abertis considers that the expression "*an effect of more than 2% on the cost or revenue of any of the regulated services"* is insufficient. It proposes adding express mention of the unit costs, since its accounting contains attribution criteria which only affect unit costs.

Response by the Commission

The Commission feels that carrying out cost accounting using both sets of criteria is the best way to guarantee proper calculation of the impact of changing the criteria. The 2% variation limit is thought to be reasonable, because if several changes in criteria occur, considerable variations in cost may arise without the operator having to provide two sets of results. This is because the individual changes would not lead to an impact of more than 5%, although their combined effect would.

The Commission believes that the suggestion of variation in the unit cost is appropriate.

8. Regarding the categories which must be explicit in the CAS

TME and TESAU proposed eliminating this section, or substituting the proposed categories with those currently used by operators:

- Calculated costs
- Activity-based costs
    - Costs by activity.
    - Costs of attributable sales.
    - Costs of non-attributable sales.

Response by the Commission

Section 5 of the Appendix lists cost categories, establishes which ones must be listed in the accounts (attributable/non-attributable cost, reflected/calculated cost, etc.) and classifies costs according to their causality with respect to services (directly identified, directly attributable, indirectly attributable and non-attributable costs). With respect to the latter, it is stated that each cost "*must be classifiable, regardless of other classification criteria which the operator under obligations may adopt, in one of the following categories established according to the relationship of causality with the services provided by the operator"*.

Therefore, the cost causality-based classification listed in the appendix does not entail a reorganization of the accounting plan. Simply speaking, costs "*must be classifiable*" within these categories and the classification currently used for operators is compatible because "*other classification criteria which the operator under obligations may adopt*" are permitted.

9. Regarding the processes for attributing assets, revenues and costs

With regard to the introduction of Phase 1.a in which creating the reconciliation between financial accounting and the CAS was proposed, Abertis considers that it is not necessary to compare the profit and loss account audited by external auditors and the costs listed in the CAS according to the breakdown shown in the annual report. This is because information provided in the profit and loss account, the reflected costs and revenues and in the activity-based costs is already sufficient for purposes of performing the necessary reconciliations and revisions between accounts.

Response by the Commission

The CMT believes it is necessary to perform reconciliation between financial accounting and the accounting system, since cost accounting should be based on reliable, verified input data, such as the operator's audited annual report.

Furthermore, we must point out that this phase of CAS has already been implemented by operators, since it was carried out to comply with the reconciliation principle. As indicated in the report submitted for public consultation, this principle has been eliminated and replaced with the following new phase in the CAS:

> *"This principle does indicate a requirement for information to be presented, rather than a basic and general rule applied to the accounting system. We therefore propose eliminating this principle and moving the information requirement to the section indicating the phases which the CAS must contain [...] We specifically propose listing this requirement in Phase 1, during which the costs and revenues reflected in the financial accounting are obtained.*

10. Regarding development, verification and implementation of the cost system.

TME and TESAU made the following statements about the obligation of presenting the CAS for each financial year along with the previous year's corrected accounts.

The limited amount of time between the approval of the Resolution on the modifications to be introduced in the CAS and the due date on 31 July of the year following the financial year in question may mean that the model will not include large-scale modifications, or that the accounts will not be presented with their corresponding audit report. Operators propose that the CMT's resolution regarding verifying the CAS should be approved before 31 December of the financial year in which the changes will be effective, that is, the following year.

In addition, one must take into account that presenting the previous financial year's CAS with the required modifications (along with the corresponding financial years CAS) requires twice the resources and related costs on the part of the operators, which become especially susceptible to passing the due dates.

TME and TESAU suggests that instead of turning in the previous year's CAS adapted according to the modification resolution, the operators should present a report or set of reports with the impact of those modifications. Furthermore, they propose that these reports be turned in when the auditor contracted by the CMT begins work, and not on 31 July.

Likewise, Abertis believes that auditing the CAS twice is unnecessary and constitutes doubling the operator's workload and costs.

Response by the Commission

On 31 July, operators must present cost accounting for the corresponding financial year and the previous year's report with the modifications required by the Commission. If this is not completed, the Commission will never be able to receive each financial year's corrected accounting information.

In addition, we must point out that presenting information for one period along with data from the previous period is common financial and accounting practice. Likewise, cost accounting presented for the previous financial year is for the CMT's internal use.

Lastly, we must stress that the Commission's review of the CAS is intended to revise, *inter alia*, specific aspects of particular importance and other aspects relevant to the Commission. It is therefore different from the revision ordered by the operator.

In light of the above, the Commission

HEREBY RESOLVES

FIRST.- To approve updates to the principles, criteria and conditions for developing the cost accounting system which are included in the attached appendix constituting an essential part of this Resolution, which replaces the Resolution of 15 July 1999.

SECOND.- To replace the principles, criteria and conditions for the fully distributed historical cost standards and fully distributed current cost standards listed in the Appendix to the Resolution of 25 May 2006 on the principles, criteria and conditions for the development of the incremental cost standard in the cost accounting system for Telefónica de España, S.A.U., with the updated principles, criteria and conditions included in the attached Appendix constituting an essential part of this report.

The present certificate is issued by authority of that stated in article 27.5 of Law 30/1992 of 26 November and article 23.2 of the Redrafted Text of the Interior Regulation Regime approved by resolution of the Board of the Commission on 20 December 2007 (published in the Spanish Official Journal on 31 January 2008) prior to approval of the minutes of the corresponding meeting.

Furthermore, the resolution to which the present certificate refers, and which puts an end to administrative avenues, may be contested by filing a motion for reversal before this Commission within one month from the day following its publication, or by filing a direct appeal against the administration in the *Sala de lo Contencioso Administrativa* of the Spanish National Court, within two months of the day after it was made public, as stated in article 48.17 of Law 32/2003 of 3 November (the General Telecommunications Law), additional disposition four, section 5, of Law 29/1998 of 13 July (Regulating the Jurisdiction of Appeals against Administrative Decisions) and article 116 of Law 30/1992 of 26 November (On the Legal Regime for Government Bodies and the Common Administrative Procedure), without prejudice to that stated in section 2 of article 58 of the same Law.

The present document bears the electronic signature of Secretary Ignacio Redondo Andreu, with the approval of the President, Reinaldo Rodríguez Illera.

APPENDIX

Principles, criteria and conditions for the development of the cost accounting system

1 Nature of the cost system

The cost system which the operator will propose must be multi-standard, meaning that for each accounting period, we can obtain the costs of services according to the following cost standards:

1. Fully distributed historical costs: This cost standard is based on attributing all costs included in financial accounting for the production of different goods or services, and also incorporates the "cost of paying off equity capital".
2. Fully distributed current costs: This standard arises as a transition between the fully distributed historical costs standard and the long-run incremental costs standard. Its practical application is as follows:
   - 2.1. Substituting the cost of investment in existing assets with the revalued cost, recalculating the costs derived from amortisation and paying off invested capital based on the new value of assets.
   - 2.2. Eliminating costs unrelated to providing electronic communications services.
3. Long-run incremental costs: This standard is based on the attribution of costs which an efficient operator should incur over the long term, using the most advanced technology and architecture with similarly advanced resources and processes. The development of this standard was approved by the Resolution of 25 May 2006 on the principles, criteria and conditions for developing the incremental cost standard for the cost accounting system used by Telefónica de España, S.A.U.

2 General accounting principles

The general principles which must be applied in order to create the cost system and attribute assets, revenue and costs to the services provided by the operator are as follows:

1. Causality

Attributing costs and revenues to each activity or service must be done through the inducers/conductors of those costs and revenues, that is, by means of the objective parameters of the variables generating them and over which the costs are distributed. These parameters will hereafter be known as "generators". Likewise, the operator's fixed assets, and where applicable, circulating assets, must be assigned to the "activity centres" so that the costs arising from investment in those assets will be managed with causality criteria in order to sum up the cost of services.

2. Objectivity.

Generators of costs or revenues must be objective, reliable and quantifiable using census data, or statistical/sample-based computations. These will be directly or indirectly related to the services produced and information procedures. The way they are determined must form a part of the cost system, which must be approved by the CMT before the operator implements it. Cost generators based on sample data must be founded on generally accepted statistical techniques. Costs which, as an exception, are recognised as being difficult to identify using measurable, objective generators, must be attributed using previously established and objective distribution criteria. Furthermore, in the event that some costs cannot be directly assigned to a service, objective criteria will be established for distributing them within the set of activities to which they are assigned.

3. Transparency

It must be possible to break down the cost attributed to each activity, asset item or service according to the different cost components that make it up.

4. Auditability

The Cost Accounting System will establish the proper relationship with the operator's external financial accounting records and with the operating and statistical systems upon which "generators" of costs and revenues attributed to services are based. This is intended to facilitate full auditability of the cost accounting system.

5. Consistency

Accounting principles, together with the proposed valuation, temporal and allocation criteria, must be maintained from year to year. When introducing changes in criteria which are not required by the CMT and will have an effect of more than 2% on the cost or revenue of any of the regulated services, then both the old criteria and the updated criteria must be applied simultaneously during one financial year. This will show the resulting differences in the measurement of costs, revenues and margins.

6. No compensation

When processing costs and revenues in cost accounting, both concepts should remain separated with no compensations between them. In particular, the income obtained by providing services should be valued at the operator's catalogue prices, with separate accounting for any incentives, discounts or commercial price reductions.

In addition to these principles, the cost accounting system developed by the operator must satisfy any accounting principles established by the General Accounting Plan which are not specifically mentioned.

3 Valuation and temporal criteria

The value of the balance sheet and profit and loss accounts are determined according to those accounting principles generally accepted in Spain, applying the appropriate adjustments according to the cost standard employed (fully distributed historical costs or fully distributed current costs).

In any case, regardless of the cost standard employed, the CMT may verify that:

1. The assets allocated to activity cost centres are in use and are properly inventoried. The external auditing firm working with the cost accounting must explicitly state its degree of confidence in the inventories employed.
2. Depreciation of fixed assets will be performed according to the appropriate procedures and economic useful lives proposed by the operator and, in accordance with normal practice in the sector worldwide, subsequently accepted by the CMT

without prejudice of the tables used for financial accounting. Rejection of the useful lives proposed by the operator must be explained.

3. Adjustments made in order to apply different standards must be properly registered by the operator and accompanied by written proof, including references to future plans, if applicable.

Differential evaluation criteria for determining different cost standards to be explained within the single cost system are established as follows:

3.1 Criteria for valuing assets

The assets allocated to activity centres will be valued as follows:

1. In order to determine the historical costs standard using the gross acquisition or construction value verified through the accounting records for items, plus the value normalisations applied under and according to the laws authorising them. In the case of balancing accounts with opposite sign, it should be chacked that the amount accumulated as the “depreciation fund” is in proportion to the elapsed period of a component’s useful life; in no case may the fund’s value exceed the component's gross value.

2. When determining the “current cost” standard, the gross allocated value will be that resulting from valuing assets at the market price of substitute goods with the most advanced technology and equal production capacity, even if the latter offer additional benefits having to do with production. Certain “allocatable assets” may be excluded from the process of re-evaluating their "current costs", accepting their "historical cost" as a substitute for the former when revaluation is not feasible. In this case, the CMT will offer a justified resolution regarding its exclusion.

   "Market price" will be understood to mean the mean acquisition price for the operator in the past two financial years, if the operator has acquired assets of similar nature and with comparable technology. If this is not the case, the operator will request tenders from at least three well-known manufacturers, if possible, and use the mean tender price as a reference for the new value. In the event that the type of asset so requires, acquisitions in the last two financial years must be made from at least three different providers. If this is not the case, the operator will call for tenders from other providers until it has at least three samples from different providers per asset, referring to acquisitions and estimates, and it will use the mean price as the new reference value. In addition, the current market price of an asset may be obtained by applying price indexes which faithfully reflect the evolution of that asset’s price.

3.2 Evaluation criteria for costs unrelated to providing services

Costs which are not related to providing electronic communications services will be attributed in the following way:

1. According to the value attributed in external financial accounting for that year, when determining "historical costs".

2. Due to the nature of costs which are unnecessary for providing services, they will not be considered when determining the standard “current costs”.

3.3 Evaluation criteria for equity and non-equity capital costs

Financial charges from non-equity capital, and costs of equity capital, will be valued as follows:

1. "Historical costs" will be determined using the same criteria used in that year's financial accounting, adding "paying off equity capital" in proportion to the "next accounting value" of the attribute assets, as indicated in the following paragraph.
2. “Current costs” will be calculated proportionally to the “net current value” of assets allocated with an "annual fee” estimated according to the mean weighted cost of the capital calculated according to CMT-approved methodology.

Before beginning each financial year, the operator will inform the CMT of the “annual fee” it proposes to apply in order to determine the “current cost” standard for that coming year, and justify the amount. The CMT will issue a resolution regarding its application or modification, justified in terms of the cost of money on the market and the enterprise risk rate.

4 Minimum disaggregation by activity centres

"Activity centres" are different types of cost groups formed around plant components, auxiliary fixed assets and all groups of similar tasks carried out by the operator for the purpose of providing final services or providing support for them. Activity centres can be divided into three large groups:

- Network component activity centres inserted in productive network processes in order to develop the production phase of one or more services.
- Other activity centres directly allocatable to services.
- Other activity centres not directly allocatable to services.

“Network component activity centres” must be grouped according to their network functions. For telephone operators, these groups will be access, switching, conveyance and added-value functions, and for audiovisual operators, they will be co-location, interconnection and others. In addition, they must be subdivided according to their respective methods for performing their functions, according to the technology they incorporate and their hierarchical level in the networks. The costs of these centres will be directly attributable to services.

"Activity centres directly attributable to services" are groups of directly or indirectly identified costs attributable to those services, and for which more or less simple criteria are present to attribute them to services.

"Activity centres not directly attributable to services" are groups of non-attributable costs for which it is necessary to establish the most objective criteria possible for attributing them to services.

Activity centres are a phase in the process providing a regulator with relevant and highly useful information for achieving its goals.

Consequently, the breakdown of business activity which the cost system proposes in the form of "activity centres" must be accompanied by a pertinent technical study delimiting the "network components centres" according to their different, individually identifiable functions, and suggesting the most ideal measurements for each one in order to establish cost "generators". The technical study will also propose asset allocation criteria for each cost centre and a unit for measuring the production capacity which those assets and other allocatable resources provide to the corresponding centre.

5 Cost categories which must be explicit in the cost system

The cost system must show the categories into which costs are grouped and the rules used for distributing them in a transparent way, based on ABC system (activity-based costing), particularly those referring to equitable distribution of common and joint costs. To that effect, categories must be established for the following purposes:

- To separate "reflected" costs in financial accounting and "calculated" costs based on its records.
- To separate costs which are "attributable” and "non-attributable" to the standard in question.
- To determine the "direct" and "indirect" costs attributable to different "activity cost centres"; in turn these will be either directly attributable or not directly attributable to services.

Cost distribution must be carried out in such a way that costs are attributed to the services which cause them to be incurred. Cost amounts must be measured proportionally to the corresponding contribution to the product. For each “activity centre”, one or more representative, measurable “cost generators” will be established in order to identify the reasons why costs are incurred. If different reasons are present, the variables serving as units for distributing the cost will also be identified.

“As a result, with a view to producing a proper cost distribution, each concept within it must be classifiable, independently from other classification criteria which the operator under obligations may adopt, in one of the following categories established according to the causal relationship with the services provided by the operator:

- Direct identification costs: Costs that present a direct, immediate and exclusive relationship with a product or service and which are identified with that product or service in the operator’s accounting system. This is the most objective allocation method, and it should be applied whenever possible.
- Directly attributable costs: Costs with a direct, exclusive relationship with a product or service, but which are not directly identified with that service in the accounting system and therefore require an attribution process.
- Indirectly attributable costs: Those costs which do not have a direct relationship with products and services, but which may be attributed to them by their indirect connection with an "attributable activity centre". They will therefore be distributed similarly to the costs to which they are related, and through subsequent distributions of costs among services.
- Non-attributable costs: Those costs which do not have a direct relationship with products and services and which may only be attributed to them using arbitrary, although reasonable, criteria. Failing any other criterion, these costs must be distributed following the same proportions as for the abovementioned costs previously distributed to services,

respecting the quantitative attribution limit for the cost of regulated services as established in the description of phase 3 in the following chapter.

6 Assignment processes for assets, revenues and costs

The cost system must include the concrete definition of the corresponding account groups and an accounting process to precisely establish the following phases, divided in as many sub-phases as the operator considers convenient:

Phase 1.a) **Reconciliation with financial accounting**: For each cost standard, the operator must provide the CMT with its reconciliation with external financial accounting in which it indicates the amounts and the nature of the adjustments applied with what the regulator feels to be sufficient itemisation.

Phase 1.b) **Determining reflected and calculated costs**. Costs extracted from financial accounting will be reflected in accounts for "costs grouped by type" divided into two kinds, "reflected costs" from financial accounting and "calculated costs" according to the assets allocated to the productive process.

For accounts with costs grouped by type, the first group will contain the financial year's operating costs which originate in accounts in Group 6 in the General Accounting Plan and subject to the evaluation and temporal criteria established by this Resolution.

The second group, for accounts organised according to the type of asset creating them, will contain expenses related to provision for depreciation, financial charges, capital costs, etc. These will be attributable to the financial year's costs according to the value of the assets allocated to productive processes.

The differences between the value of items in Group 6 and that reflected in the corresponding account in the cost accounting, according to the standard employed, will be reflected in a single account for "costs not attributable to the standard", with different categories according to the type of difference.

Phase 1.c) **Determining reflected revenues.** Gross revenues for services valued at catalogue price will be established in the cost system's accounts, and any discounts, reductions and commercial offers, reflected in Group 7 of the financial accounting accounts, will be deducted as charges to those accounts.

Phase 1 must permit the elaboration of a valuation report on the costs and revenues broken down by type and attributed to the total business activity in the financial year according to each of the cost standards being determined, which is reconcilable with financial accounting.

The revenues will be allocated to services directly according to the accounting records and information from the invoice systems. For exceptional cases in which this is not possible, income must be allocated based on the causality principle.

Financial revenues must be attributed in the same way that their related investments are. Revenues generated by financial investments in other activities, such as shareholding in subsidiaries and associated companies will be allocated to activities which are “not allocatable to the main activity”.

Phase 2) **Allocating costs to “activity centres”:** During this second phase, the total reflected and calculated costs must be allocated to “activity centres” in order to provide a “matrix view” relating all results from Phase 1.b to the “activity centres” defined within the system."

Using the sub-phases in Phase 2) which are considered suitable, we can develop different steps to distribute costs among “activity centres[8]” other than the "activity centres" defined specifically by the system. In this way, using causal allocation processes, we achieve the matrix view referred to above.

Phase 3) **Allocating costs to “services”**. Costs assigned to each “activity centre” in the previous phase must be allocated to "services" in such a way that the results can be used to gain a "matrix view" aligning the "activity centres" with "services" to reflect each activity centre's attribution of costs to each service. Allocatable "activity centres" must have one or more "generator" variables which are linked to them and rigorously defined in the system as well as a method for distributing the total cost for the "activity centre" among the "services" according to what their activity contributes to the production of those services.

Costs to telephony operators from “network component activity centres” will be allocated according to the volume of activity performed by each centre and the degree of use which each service makes of them as listed in the routing factor table. For audiovisual operators, costs will be assigned according to their contribution to the total cost of each service.

For distributing the cost of "activity centres" identified as "non-allocatable", the system will establish the objective basis for distribution among "services", respecting the general principle that regulated services should not receive attributions from "non-attributable activity centres" in amounts greater than 10% of the rest of the costs allocatable to them.

Phase 4) **Assigning costs and revenues to the margins account:** Costs allocated to "services" in the previous phase must be fully reflected in the corresponding "margins account", and so should the net revenues established In Phase 1.c).

The result obtained through completing this phase will be the “profit and loss statement" for each of the fully distributed "historical" and "current” cost standards.

7 Development, verification and implementation of the cost system

Operators must present the CMT with the results of their cost accounting systems for each financial year along with the accounts for the previous year modified according to the adjustments specified by the CMT in the previous revision.

The cost accounting system must be accompanied by a report drawn up by an auditor with sufficient technical qualifications which expresses whether or not the accounts represent a faithful view of the results for the period according to the principles, criteria and conditions established by the *Comisión del Mercado de las Telecomunicaciones*. The same report will list and measure the incidents and failures to comply which the auditor detects.

The CMT will issue a yearly declaration on the operator's compliance with the accounting principles, criteria and conditions in its cost accounting system, and propose mandatory modifications to the cost accounting system as it sees fit.

[8] From a technical and accounting viewpoint, the "activity centres" referred to repeatedly in this document are "cost centres" in especially defined category which must cover the total costs attributable to the corresponding standard in a specific stage in the accounting process. There are no limits whatsoever on the use of other "cost centres" which were previously used to organize the process.

The content which the operator must provide and the formats required in order for the CMT to carry out its duties will be specified in the development of the cost system and the yearly verification of results.

In order to meet these objectives, the *Comisión del Mercado de las Telecomunicaciones* will be able to rely on cooperation from the auditor contracted by the operator to review the cost accounting and, in the event of specific questions, help from other auditors or external consultants contracted and paid by the Commission itself.