



2.5.2007

UNOFFICIAL TRANSLATION

GENERAL GUIDELINES ON ACCOUNTING SEPARATION



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1. PROVISIONS IN THE COMMUNICATIONS MARKET ACT CONCERNING SEPARATION OF ACTIVITIES

According to section 86 of the Communications Market Act (CMA) (393/2003), if, under the CMA or in a SMP (significant market power) decision of the Finnish Communications Regulatory Authority (FICORA), a cost-orientation or non-discriminatory obligation has been imposed on a telecommunications operator, it has an obligation to prove that the price charged for its product or service is cost-oriented and non-discriminatory. The provisions have implemented Article 13(3) of the Access Directive (2002/19/EC). FICORA can assess the cost-orientation of pricing independently, but is not bound to the pricing calculation principles used by the telecom operator.

Pursuant to section 89 of the CMA, the Finnish Communications Regulatory Authority may impose an obligation on an operator with significant market power to separate in its accounts the functions that concern leasing out of access rights and interconnection from the other service provision activities of the telecommunications operator, where necessary in order to monitor pricing in regard to leasing out of access rights and interconnection. In its SMP decision, the Finnish Communications Regulatory Authority shall itemize the information to be clarified by means of the accounting separation procedures and the main features of the procedures. The provisions have implemented Article 11(1) of the Access Directive (2002/19/EC).

Under the CMA, the need for imposing an accounting separation obligation will be assessed from operator to operator e.g. on the basis of the competitive situation. The accounting separation obligation must be reasonable in view of the size and type of operation of the telecommunications operator and be targeted at such operators that have influence on relevant geographical markets.

For example, it is stated in the explanatory memorandum to the law that "Accounting separation increases the transparency of activities and prevents cross-subsidy between various activities of the operator". The profitability and capital structure of the activity to be separated can be interpreted, as primary means, with the help of accounting separation calculations. According to the explanatory memorandum, the calculations cannot, as such, be used for the purpose of monitoring reasonable pricing.

According to the explanatory memorandum to section 89 of the Act, FICORA will give guidance, when necessary, on accounting separation and general guidance on accounting separation procedures. This memorandum concerning accounting separation procedures is the first general guidance given under this section of the Act.

Provisions on the supervision of the accounting separation obligation are provided for in section 89 of the Communications Market Act. Accounting separation calculations in accordance with section 89(3) must be submitted to FICORA. An accounting separation calculation is, as referred to in the explanatory memorandum to the law



(HE 112/2002), a public document referred to in section 7 of the Act on the Openness of Government Activities (621/1999). According to the explanatory memorandum of section 89 of the Communications Market Act, the public nature of accounting separation calculations increases the transparency of operations and general supervision of operations. The provisions on secret official documents are provided separately in section 24 of the Act on the Openness of Government Activities and on the right to access information in an official document are laid down in section 3 of the same Act.

According to section 89(4) of the Communications Market Act, the auditors of the telecommunications operator shall inspect the accounting separation calculations and give a separate opinion on them to the telecommunications operator at the time of the audit. According to section 112 of the Act, a telecommunications operator has an obligation to submit the auditors' report to FICORA.

2. BUSINESS ACTIVITIES TO BE SEPARATED IN THE ACCOUNTING SEPARATION CALCULATIONS

Accounting separation calculations must produce sufficiently detailed information to support FICORA in its supervision duty. The separated calculations can then, for example, be used for the purpose of interpreting the profitability of separated activities and the formation of the capital structure. The calculations must be of such quality that it is, on the basis of them, possible to assess the transparency of the company's activities and the potential cross-subsidy between the various functions of the operator. It is recommended that the accounting separation principles and allocation methods remain as stable as possible so that the consecutive financial periods under review can be compared. Informative accounting separation calculations also affect how the business activities are steered and how the activities are weighed in the firm that draws them up, in which case the firms can use the calculations as a tool.

Pursuant to the CMA, an obligation to separate in its accounts the functions that concern leasing out of access rights and interconnection from the other service provision activities of the telecommunications operator can be imposed on an operator, if FICORA's assessment so requires. The main products with regard to the relinquishment of access rights are: goods and services provided for other operators in accordance with the Communications Market Act, i.e. a local loop or part of it, local loop throughput capacity, local loop transmission capacity and equipment facilities, fixed connections and the leasing out of the terrestrial mass communications network and capacity in a terrestrial mass communications network. The main products of interconnection are interconnection services provided for other operators in accordance with the Communications Market Act, e.g. call origination and termination, transit traffic, and products that enable the interconnection of telecommunications networks and are usually used only once, such as interconnection circuit link and channel signalling interface. Other activities are requested as a separate calculation. Thus, all separated activities form their separate income and expenses accounts and the balance sheet's liabilities as they are stated in the firm's actual financial statement. The operator that has an obligation to separate its accounts must describe the



interfaces of separated activities in its accounting separation principles, and the main products included in each activity.

The information that results from the accounting separation procedures and the required separation method is determined in the SMP decisions issued to operators with an accounting separation obligation. Therefore, the general guidelines on accounting separation mainly aim at completing the detailed accounting separation obligations imposed in SMP decisions.

3. THE STRUCTURE OF ACCOUNTING SEPARATION CALCULATIONS

An accounting separation calculation in accordance with the Communications Market Act is a public document. It is the responsibility of SMP operators with an accounting separation obligation to draft it. The accounting separation calculations must consist of the profit and loss accounts of the activities to be separated, the balance sheets' liabilities, the background clarifications necessary for their preparation and principles for separation.

The structure of the profit and loss accounts and the balance sheets must correspond to the form chosen to be used in the company's actual financial statement. In FICORA's view, the profit and loss account model chosen by the operator must indicate the information itemized in annex 1. Depreciations are to be given in the calculations as planned depreciations at book value. The use of assets at book values clarifies the connection between the accounting separation calculations and the actual financial statement when the calculations are inspected. And, the structure of the separated balance sheets must be itemized to the same detail as the company's actual financial statement. However, in such way that the balance sheets' liabilities details are sufficient for the calculation of separated accounts. All separated financial statement details are requested to be reported at book values.

Since the accounting separation calculation is a summary of significantly large income and cost items at business activity-specific level, background calculations affecting these calculations should be attached to the accounting separation calculations. The background calculations consist of the detailed content and pricing method of internal transfer prices and allocation calculations per type of income or expense that are in the background of external and internal items. Internal income and costs both are reported as a separate item in its own right for each activity. Internal items rectify the company's actual financial statement by indicating the allocated use of the company's internal services between activities to be separated.

In its accounting separation principles, the company describes, phase-by-phase, the actual process how the background calculations lead to final separated calculations. The principles include the interfaces of the activities to be separated in the company i.e. which wholesale products are included in each activity. The accounting separation principles should be sufficiently detailed so that the auditors inspecting the accounting separation calculations as well as the supervising authority get a clear picture of the accounting separation procedures applied by the operator. Thus, FICORA and the auditor who audits the calculations can follow the principles and are able to find out



how the figures in the accounting separation calculations are connected to the details in the actual financial statement. The accounting separation calculations, background calculations and the principles for separation form an entity, which can be analysed and compared with the company's actual financial statement. The company's actual financial statement must be attached to the accounting separation calculations.

The separated profit and loss accounts, balance sheets and principles for separation must be submitted to FICORA within a month from the adoption of the financial statements of the company in question.

4. DETAILS TO BE INCLUDED IN THE ACCOUNTING SEPARATION CALCULATIONS

The Communications Market Act requires that the accounting separation is included in the bookkeeping accounts. Companies should be able to access accounting separation calculations in the bookkeeping accounts in real time by following certain principles and procedures. The companies must themselves decide how accounting separation calculations are implemented in the accounts. FICORA will not provide guidelines for that. It is, however, possible to enter into the bookkeeping system, by using a calculation identifier, information on how the entry to be posted allocates to the activities to be separated. E.g. this concerns direct costs and income. Allocation drivers necessary for the division of common entries can be included in the background information of bookkeeping accounts which will enable the entries to be automatically posted to the account and allocated to the separated activities. For example, internal entries and maybe even corporate-level general entries can be calculated afterwards. But, the amount of calculations to be done afterwards and thus the work necessary for accounting separation calculations can be minimised to a great extent.

Principles for calculations are e.g. general principles for calculations (such as the cost causality) and good accounting practice. When companies make calculations, they should e.g. apply the cost causality principle. The cost causality principle means the handling and allocation of income and cost items in such way that the variables are divided into activities to be separated according to the nature of the actual production process where the income and costs originally incur. Thus, an operator with an obligation to separate its accounts must determine itself the distribution principles for common costs and allocate the costs, on the basis of the cost causality, to correct activities to be separated. On the one hand, the cash flow should be allocated correctly and on the other hand, calculations must be simple and understandable so that the whole is manageable. It is recommended that good accounting practice be used so that the accounting separation calculations produce a reliable picture of the income and cost flows of various activities.

In accounting separation calculations, it is challenging to determine the company's general production operation and its sub-operations so that they belong to the correct activity to be separated in the accounting separation context. In the calculations, the profit and loss account and balance sheet items related to the same sub-operation must be handled consistently by allocating them to the same activity to be separated.



Direct costs are posted to a certain activity in order that there would be as little subsequent clarification and division afterwards as possible to be done and that the accounting separation as a whole is cost-efficient. The allocation of direct external and internal costs related to production activities should be based, whenever possible, directly on the duct volume or traffic volume or other technical reason in question. The internal costs of the company's individual activity must be indicated as corresponding income in another activity and the price to be applied must be in accordance with the company's external tariff information. Common and general costs must be allocated to activities to be separated on the basis of the cost driver and in accordance with the cost causality principle. Several cost drivers can be determined depending on the character of the cost to be divided. The basis of division may be e.g. personnel volume or working hours, device volume (cars, IT devices) or square metres.

This memorandum includes the main principles which are advisable to be taken into consideration in accounting separation calculations. FICORA will update the general guidelines also in the future on the basis of changes in legislation and the sector.



2.5.2007

ANNEX 1

PROFIT AND LOSS ACCOUNT MODEL BY TYPE OF EXPENSE

TURNOVER	0,00
Material and services	- 0,00
Personnel costs	- 0,00
Depreciation and reduction of value	- 0,00
Other income from business operations	0,00
Other expenses from business operations	- 0,00
PROFIT (-LOSS)	<u>0,00</u>
Financial income and expenses	+/- 0,00
PROFIT (LOSS) BEFORE EXTRAORDINARY ITEMS	<u>0,00</u>
Extraordinary items	+/- 0,00
PROFIT (LOSS) BEFORE APPROPRIATION AND TAXES	<u>0,00</u>
Appropriation	+/- 0,00
Direct tax	- 0,00
PROFIT (-LOSS) FOR THE FINANCIAL PERIOD	<u>0,00</u>

PROFIT AND LOSS ACCOUNT MODEL BY TYPE OF ACTIVITY

TURNOVER	0,00
Acquisition and production costs	- 0,00
Gross profit	<u>0,00</u>
Sales and marketing costs	- 0,00
Administrative costs	- 0,00
Other income from business operations	0,00
Other expenses from business operations	- 0,00
PROFIT (-LOSS)	<u>0,00</u>
Financial income and expenses	+/- 0,00
PROFIT (LOSS) BEFORE EXTRAORDINARY ITEMS	<u>0,00</u>
Extraordinary items	+/- 0,00
PROFIT (LOSS) BEFORE APPROPRIATION AND TAXES	<u>0,00</u>
Appropriation	+/- 0,00
Direct tax	- 0,00
PROFIT (-LOSS) FOR THE FINANCIAL PERIOD	<u>0,00</u>