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Secondary Legislation Report

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0 EXECUTIVE SUMMARY

We have found no provision in the Turkish legal texts that diverges from the EU legal framework. If anything, the main difference with some Member States of the EU (but not with all) is in the level of detail of the legal texts. In the EU approach this level of detail is decided on the national level as long as the minimum requirements of the EU framework are met, which is the case in Turkey. In that sense, there is no legal divergence.

However, we recommend that ICTA increases the level of detail of the Board Decision in order to enhance the regulatory compliance process, and to add provisions on the auditing process, on publication of documents and on compliance statements. In this Report we present a proposal for this. In this proposal, we have taken into account the recommendations made in the Gap Analysis report.

1 INTRODUCTION

A consortium of Regulaid BV and Incyte Consulting Ltd has been assigned to implement the project "Technical Assistance for Achieving the Harmony with EU Regarding the Implementation of Accounting Separation, Cost Accounting and WACC (Weighted Average Cost of Capital)" (contract number DOGER/TWACC/TR2013/0740.10-2/SER/029).

The Turkish regulatory authority, ICTA, has been applying a system of accounting separation and WACC calculation for a number of years already. There are legal provisions in the Electronic Communication's Law and bylaws, and these have been detailed out in guidelines in Board Decision 2013/DK-ETD/557. In this project, the objective is to harmonize the legal framework and practice in Turkey with regard to accounting separation, cost accounting and WACC, benefiting from other national regulatory authorities' experience in the field and to contribute to achieving the information society and the provision of electronic communications services to consumers at affordable prices by improving ICTA's capacities and skills to analyse thoroughly the accounting separation reports of obliged operators and to calculate the WACC for each obliged operator..

The project aims to achieve this by (1) providing ICTA with state of the art secondary legislation aligning the regulatory framework with EU best practice and strengthening its legal position when applying it; (2) providing ICTA with thorough expertise in applying the framework and analysing the regulatory accounting reports submitted by operators; and (3) providing ICTA with the tools and know-how to calculate the WACC when relevant.

This is done through 4 results:

Result 1 - A report identifying the deviations, if any, of the current Turkish regulatory regime on accounting separation and WACC calculation from relevant EU regulations and member state practices – the Gap Analysis Report.

Result 2 - Secondary legislation proposal report on accounting separation, cost accounting and WACC calculation, fully in line with current relevant EU regulations.

Result 3 - Improvement of relevant ICTA staff's capacity and knowledge regarding the evaluations of accounting separation reports and WACC calculations through Workshops and Study visits.

Result 4 - A model to calculate WACC ratio for each obliged operator taking the different circumstances of each operator and sector/market specific conditions into account, and a training on how to use the model.

This report is Result 2, the Secondary Legislation Report.

2 METHODOLOGY

2.1 Terms of reference and working method

The Terms of Reference of our assignment require that depending on the consequences from the Gap Analysis Report and the exchange of information in the workshops, the Contractor shall prepare 'a secondary legislation report in order to revise the current legislation/regime on accounting separation and WACC calculation'. 'The proposal, inspired by Member States' best practices, shall be fully in line with corresponding EU regulations.'

In addition, the Contractor 'shall prepare public consultation documents (both in English and Turkish) regarding the draft proposal in order to take the opinions of relevant parties within the coordination of ICTA.

In accordance with the Work program of our project, the Secondary Legislation Report was prepared on the basis of a Working Document which was discussed with ICTA previously. This Working Document was discussed in a meeting with ICTA experts to ensure a shared understanding of the intended results, including the way secondary legislation would fit into the legal system in Turkey and the preferences of ICTA with regard to the type of regulation. Also, the discussions in the Workshops on Accounting Separation and on WACC calculation were taken into account.

2.2 Turkish legal framework taken into account

The following laws and regulations have been analysed to verify their conformity with EU legal provisions on accounting separation and WACC calculation:

- Electronic Communications Law – Law No. 5809 of November 5, 2008.
- By-Law on Access and Interconnection, published in Official Gazette No. 27343 on September 8, 2009.
- By-Law on the Principles and Procedures Concerning the designation of the Undertakings with Significant Market Power in the Electronic Communications sector and the remedies to be imposed on those undertakings, published in Official Gazette No. No. 27336 on September 1, 2009.
- Board Decision adopting the Principles and Procedures on Accounting Separation and Cost Accounting, 2013/DK-ETD/557 of October 21, 2013.
- Law No. 2813 on Institutional arrangements (Law About Establishment of ICTA, Official Gazette No. 18011, April 7, 1983).
- By-Law No. 5783 on Internal organisation decision (ICTA organizational By-Law, Official Gazette No. 27958, June 8, 2011)

Article 6-(1) of the Electronic Communications Law – Law No. 5809 (hereinafter, “the Law”) empowers ICTA, inter alia, to make regulations to create and protect competition, to take measures stipulated by the legislation and to determine criteria and implementation procedures and principles regarding tariffs to be imposed on operators within the scope of, among others, access, to conduct market analysis.

Article 7-(3) of the Law empowers ICTA to identify the operators with significant market power in the relevant markets and to impose obligations on SMP operators in order to ensure and promote effective competition. It is worth noting, that this provision specifically allows the regulator to differentiate the obligations to be imposed on the different operators with SMP. Hence, the regulator can act discretionally when deciding what obligations are imposed on what SMP operators, while respecting the regulatory principles and objectives that govern the regulator’s actions.

Article 21-(1) of the Law specifically deals with accounting separation and cost accounting. It empowers ICTA to impose accounting separation on SMP operators. It provides for the obliged operators to keep separate accounts for their fields of activities and business units within the scope of procedures and principles prescribed by ICTA. Further, section (2) provides for the possibility of ICTA to audit the accounts of the operators or have agencies to audit them or to oblige SMP operators to have their accounts audited by independent auditors. Any expenses derived from the auditing of the SMP operators are to be assumed by those obliged operators. Finally, section (3) establishes the possibility that ICTA may impose on SMP operators to publish documents and information prepared within the scope of the accounting separation and cost accounting obligations.

The provisions of Article 21 of the Law are detailed in the Article 13 of the By-Law on Access and Interconnection, which states that the operators shall submit to ICTA the reports they have prepared within the framework of the account separation and cost accounting obligation, within the format, scope and timeframe described by ICTA. Further, it states that ICTA may impose on the operators the obligation to publish documents and information that they have prepared within the scope of accounting separation and cost accounting obligations. Only in case ICTA considers it necessary, it may publish, on its own initiative, such documents and information. The scope of the documents and information to be published would be determined by ICTA.

Article 13 establishes that ICTA may audit the accounts of the operators or have agencies audit them by granting the authority to do so. Alternatively, ICTA may also impose the obligation of operators to have their accounts audited by an independent third party.

On the basis of the legal provisions referred to above, ICTA adopted a Board decision in 2013 (2013/DK-ETD/557 of October 21, 2013) establishing the procedures and principles on account separation and cost accounting.

2.3 EU Legal Framework taken into account

The following components of the EU framework were taken into account:

- Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services, as amended by Directive 2009/140/EC ("Framework Directive")
- Directive 2002/19/EC on access to and interconnection of, electronic communications networks and associated facilities, as amended by Directive 2009/140/EC ("Access Directive")
- European Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications (2005/698/EC)
- European Commission Recommendation of 20 September 2010 on regulated access to Next Generation Access Networks (NGA) (2010/572/EU)
- European Commission Recommendation of 11.9.2013 on consistent non-discrimination obligations and costing methodologies to promote competition and enhance the broadband investment environment

EU Regulatory Authorities are entitled to designate operators with significant market power and impose on them regulatory remedies. According to EU rules, regulators are to respect and abide by certain principles when deciding what regulatory remedies are to be imposed on those operators having SMP.

Specifically, the Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services, as amended by Directive 2009/140/EC ("Framework Directive"), establishes that:

- (1) regulatory intervention shall be reduced to the least intrusive measure that will effectively remedy the market failure identified
- (2) that all measures taken by the regulatory authorities in performing their tasks must be proportionate to the policy objectives to be achieved.

That is, regulatory remedies are only to supplement the deficiencies in the normal functioning of the relevant market, they are to be imposed only when necessary, they should be the minimum needed to achieve the objectives and they should be proportionate to the detected deficiency. There is also a requirement for regulatory measures to be technologically neutral.

The Framework Directive also aims at achieving a high degree of transparency in the implementation of the regulatory authorities' decisions, as a mechanism to improve the proper compliance with regulatory obligations, principles and objectives. A higher degree of transparency also increases the level of predictability and certainty, which improves the regulatory climate. For example, Article 6 contains the obligation for the NRAs to give interested parties the opportunity to comment when they intend to take measures in the implementation of the provisions of the Framework Directive or the specific Directives.

With regard to accounting separation and cost accounting, the Directive 2002/19/EC on access to and interconnection of, electronic communications networks and associated facilities, as amended by Directive 2009/140/EC ("Access Directive"), establishes that:

1. NRAs 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 for the allocation of costs.
2. compliance with the cost accounting system must be verified by a qualified independent body.
3. a statement concerning compliance shall be published annually.

For the implementation and the details of specific requirements on accounting separation and cost accounting, the EU also used non-legally binding measures, although deviation from them needs to be justified. 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 that:

"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 control 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. (Underline ours)

(...)

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.

(...)

(3) It is recommended that a national regulatory authority, when assessing the features and specification of the cost accounting system, reviews the capability of 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 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 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...

The European Regulators Group ("ERG") adopted a Common Position with guidelines for implementing the Commission Recommendation mentioned above, in which they insisted in the basic doctrines that must be applied when preparing accounting information and which must include, at a minimum the principles of cost causality, objectivity, transparency and consistency (coherence).

3 INPUTS FOR THE DRAFTING OF A NEW BOARD DECISION

3.1 No legal divergence found

We have found no provision in the Turkish legal texts that diverges from the EU legal framework. Therefore, there are no reasons of harmonization that require a redrafting of the Secondary legislation.

3.2 Improvements to strengthen the compliance process

In the discussions with ICTA, it became apparent that ICTA is planning to strengthen its capacity and process for reviewing the results of cost accounting regulations. As a consequence, we have looked at the existing Turkish secondary legislation not only from the point of view of legal harmonization, but also with regard to the question if improvements could be made with a view to the enhancement of the process of implementation and compliance oversight that is at the centre of our project.

Within the European Union legal framework on accounting separation and WACC calculation, Member States are free to determine to what level of detail they define and publish the principles that must be taken into account in implementation and compliance. We have selected three examples of different approaches (Spain, France and Romania) which were used to discuss with ICTA, which approach would be the most beneficial to the regulatory compliance process that ICTA envisages to implement. In the paragraph 3.2.1 this will be explained in detail.

In addition, the detailed rules and guidelines can be used to provide clear instructions to an external auditor as argued in the Gap Analysis report. Again, this is a choice that the EU legal framework leaves to individual Member States so it is not mandatory to use an external auditor, but it is beneficial to the compliance process and most Member states do. (see paragraph 3.2.2)

Also, we make recommendations to strengthen the compliance process by introducing an obligation for ICTA to make transparent the compliance by publishing the operators' reports (except parts that it agrees to consider as confidential) (see paragraph 3.2.3) and conclude the oversight process by issuing a clear statement of compliance for each obliged operator (see paragraph 3.2.4)

Finally, we have also taken into account the other recommendations of the Gap Analysis Report (see paragraph 3.2.5).

3.2.1 Increased level of detail beneficial to ICTA's compliance process

If anything, the main difference with some Member States of the EU (but not with all) is in the level of detail of the legal texts. In the EU approach this level of detail is decided on the national level as long as the minimum requirements of the EU framework are met, which is the case in Turkey. In that sense, there is no legal divergence. However, we recommend that ICTA increases the level of detail of the Board Decision in order to enhance the regulatory compliance process.

Within the European Union legal framework, Member States are free to determine if and to what level of detail they define and publish the principles that must be taken into account in implementation and compliance on accounting separation and WACC calculation.

Considering the regulatory requirements for intervention and their national circumstances, European Regulatory Authorities have adopted different measures of different level of detail when deciding on guidelines for regulatory accounting models, accounting separation and WACC determination mechanisms.

In all cases, regulators act on the basis of legally determined competencies, principles and objectives respecting the provisions of the EU and their national laws. And all regulators follow the provisions of the EU Recommendations mentioned above.

The Turkish legal and regulatory framework is relatively brief in explaining the principles to be applied by the operators and, in compliance oversight, by ICTA itself. This has a significant impact on the compliance process. When the imposed guidelines are limited to broadly defined principles, the operators have a relatively wide discretion in their interpretation and implementation. This means that many choices made in the implementation may differ from the choices made by other operators, and from the preferences that ICTA may have. If these choices are not made in advance and imposed on the operators, the process of compliance oversight is likely to be much more difficult for ICTA. The assessment of the regulatory accounting reports submitted by the operators, and the underlying regulatory accounts and models, will depend much more on the expertise, capacity and time investment of the ICTA staff. When encountering choices made by the operators that ICTA would prefer to have made differently, it will be much more difficult to address this and consistently apply the same choices for all the operators concerned. The operators will be reluctant to make changes to the reports retroactively and when these changes are not made, the results will be less useful to ICTA. Also, when using an external auditor for the cost accounting reports and underlying systems (as is recommended by the Gap Analysis Report), this external auditor will be better equipped when provided with detailed instructions.

The strengthening of the compliance process by ICTA is best served with a more detailed guideline. This detailed guideline can be used first by the operators when setting up the accounts, secondly by the external auditor in auditing the results and underlying systems, and finally by ICTA itself when making decisions on any divergences found.

To determine which level of detail would be appropriate, we have selected three typical examples from the EU Member States with three different approaches.

On the one hand, in some countries, such as Spain, the regulator has opted for a high-level set of principles, criteria of allocation of costs and models that serve as the basis for the further verification of the obliged operators' accounting. On the other hand, in other countries, such as France, the guidelines of the regulator are very extensive, as they include a long set of examples and a level of detail in the type of network element, accompanying the principles and criteria to be applied. A good example of the middle ground is Romania, where the regulator has decided to establish principles and criteria that, although of high level, also provide a greater degree of detail, without going to the specifics and length of the French solution.

Description of the Spanish model

The Board of the Spanish regulator, CNMC (previously, the CMT) adopted in 1999 the Principles, criteria and conditions for the development of the cost accounting system, which were updated in 2010.

On the basis of the principles adopted, in June 2000, the CNMC (then, CMT) approved the cost accounting system proposed by Telefónica Spain. Since then, the regulator has been approving the resolutions to verify each financial year's accounting system results on a yearly basis. In July 2000, the CNMC adopted a resolution according to which those principles would be applicable to all notified operators.

The Principles adopted by the regulator include seven main sections with general instructions and definitions, which serve as a guidance to the notified operators when they prepare their accounting models to be approved by the regulator:

1. nature of the cost system – the cost system proposed by the operator must be multi-standard.
2. general accounting principles - causality, objectivity, transparency, auditability, consistency, no compensation.
3. valuation and temporal criteria (criteria for valuing assets, evaluation criteria for costs unrelated to providing services, evaluation criteria for equity and non-equity capital costs).
4. minimum disaggregation by activity centres (network component activity centres inserted in productive network processes, other activity centres directly allocable to services, other activity centres not directly allocable to services).
5. cost categories which must be explicit in the cost system (to separate "reflected" costs in financial accounting and "calculated" costs based on its records, to separate costs which are "attributable" and "non-attributable", to determine the "direct and indirect costs" attributable to different "activity cost centres."
6. assignment process for assets, revenues and costs - the costs system must include the concrete definition of the corresponding account groups and an accounting process to precisely establish the phase – (1) reconciliation with financial accounting, determining reflected and calculated costs, determining reflected revenues, (2) allocating costs to "activity centres", (3) allocating costs to "services" and (4) assigning costs and revenues to the margins account.

7. development, verification and implementation of the cost system.

The burden of proof, by Regulation, resides with the notified operator. When an operator is obliged to apply cost oriented prices, the burden of proof that prices are determined by cost, including a reasonable rate of return on its investment, rests upon the operator.

The CNMC annually audits the results from the cost accounting and accounting separation systems and publishes a statement on the operators' level of compliance with the accounting principles.

Description of the French model

In 2006, the French regulator, ARCEP (previously, ART), adopted the Decision 06-1007, in which it specifies the obligation of France Telecom to implement a cost accounting system and cost orientation. This decision deals with the specific obligation to be imposed on France Telecom (FT) as a notified operator in the relevant markets of access and interconnection, including the obligation as the universal service provider.

This decision, which also mentions previous accounting-related obligations imposed on FT adopted in 2005 (that have a three-year validity) is a result of multilateral discussions with operators in order to adopt coherent and harmonised cost accounting obligations imposed in different relevant markets. This decision has taken into account, not only national binding provisions (law, regulations) but also EU Recommendation mentioned above and ERG documents on this subject matter.

The decision contains the principles that are referred to with regard to the Spanish model. However, because of the difference in the approach, the Decision in the French case results into a more detailed document, as it has as the initial basis the specific model already implemented by FT in the early stages of the liberalisation process.

Description of the Romanian model

In 2003, the Romanian Authority (ANRC) adopted a decision approving the regulation for the accounting separation and cost accounting system of the notified operator, Romtelecom.

The approach implemented by the Romanian regulator works on the basis of a decision adopted for the notified operator, like in the French case. However, it has produced a more reduced document, with sections with definitions and interpretations that would serve in general, in which it maintains a balance between the general principles and guidance provided for by the Spanish regulator and the too detailed version of the French decision.

The Romanian decision contains the following schedule:

1. General provisions
2. Definitions
3. Accounting principle applicable to the separated financial statements – regulatory accounting principles
4. Level of detail for accounting separation – core network, access network, retail and

other businesses

5. Format of the separated financial statements
6. Audit of the separated financial statements
7. Transfer charging principles
8. Methodology for the allocation of costs, revenues and capital employed within the separate accounting – description of the operator's costing system, principles for the allocation of costs, revenues and capital employed, cost categories, operating costs allocation, revenues allocation, allocation of the capital employed, consistency of treatment of working capital, asset lives and depreciation method, current cost accounting
9. Final provisions

The decision contains annexes that specify (1) the synthesis of the information to be presented by the Operator within the separated financial statements and the costing methodology, (2) reporting formats of the separated financial statements, (3) the format of the statement of average costs of core network elements, (4) statement of costs of services format, (5) structure of transfer charges between core network and retail business, (6) the syntheses of the transfer charges, (7) cost allocation process, (8) methods for the allocation of operating costs, (9) methods for revenue allocation, (10) methods for the allocation of capital employed.

The advantages and disadvantages of the level of detail of the guidance document can be described in terms of transparency/predictability in the preparation process and in terms of the burden of proof in the compliance process. In both respects, an optimum should be achieved.

With regard to the transparency parameter, in all cases the legislation obliges the regulators to act in a transparent and predictable manner. However, in practice, when implementing regulation on cost accounting, it is recommended to find the right balance between detail and generality. If a regulator adopts a document that is too general in scope, much of the decision making is left to the process of implementation and compliance oversight. The NRA could face difficulties when implementing its guidelines to specific cases, as the operators could argue that there is not enough predictability. However, on the other hand, too much detail could reduce the clarity of the instructions, and easily lead to too much reporting and detailed information from the operator, damaging the degree of transparency desirable for the regulator, the auditor and third parties.

With regard to the burden of proof, although this initially resides with the notified operator, when it comes to the compliance phase the less detailed the imposed guidelines are, the more the burden of proof is on the regulator. This could constitute such a challenge for the regulator that the process of compliance oversight is thwarted. On the other side, when the level of detail of guidelines adopted by the regulator becomes too detailed and dense, this may lead to never ending discussions with the notified operators when having to approve their accounts. A balance must be struck.

In Spain the regulator adopted in the very early stages of liberalisation high-level guidance to the market as to what would be the principles and criteria that it would apply when

implementing the obligation of cost accounting and accounting separation. On this basis, the only notified operator at the time, had to propose a detailed cost accounting system to be approved by the regulator.

In France, the regulator initially did not adopt a general guidance and it adopted its position on the definitions and determination of the model on a case-by-case basis (starting with FT), until it reached a more general approach that would be applicable to all operators in a general manner. This led to the extensive detail in the French guidance document.

Romania, as one of the Member States that more recently joined the EU, was able to employ the benefits of a later liberalisation, by introducing the best of both approaches. In the same decision the Romanian NRA introduced (i) the general guidance, with reference to definitions, criteria and parameters and (ii) detailed information for the exercise to be carried out by the notified operator.

This is why the Romanian model appears as a better equilibrium for the benefit of the regulator. In terms of the parameters used, the Romanian model strikes the best balance for both aspects:

	Limited level of detail e.g. Spain	Middle ground models e.g. Romania	Extensive level of detail e.g. France
Predictability/Transparency	0	+	-
Compliance/Burden of proof	-	+	0

For this reason the Romanian example was selected as the preferred approach as the starting point for drafting a new version of the ICTA Board decision.

We discussed with ICTA whether the added level of detail should remain to have a legally binding nature as the current Board Decision, or should be presented as 'soft law' i.e. a set of non-binding additional guidelines that the operators should follow in principle, but from which they could divert subject to justifications given in their reports. This would determine the degree of modifications necessary within the legal framework currently in place in Turkey. ICTA indicated to have a preference for making the additional details legally binding, to which we agree.

On the basis of the existing legislation, it is for the Board of ICTA to adopt the Principles and Procedures on accounting separation and cost accounting and the WACC determination model. It is not possible to delegate this power to the Chairman or to the Services. For this to be possible, legal modifications would have to be introduced in the By-Law of institutional arrangements. Therefore, the redrafted guidelines would have to be an adapted version of the Board Decision.

3.2.2 Make use of an external auditor as a rule

The Gap Analysis report recommends that ICTA should use an external auditor to audit the accounting separation reports, the underlying models and their methodology. “The auditor can be the same as the one who audits the statutory financial accounts or different from the statutory auditor. The preferred option is a regulatory auditor different from the statutory auditor. The basic reason is that when the regulatory auditor is different from the statutory auditor, the auditor is perceived more independent from the operator and the audit results are considered to be more reliable by other market players. In most EU member states the regulatory auditor is different from the statutory auditor. Therefore we recommend that ICTA hires an independent auditor to audit the separated accounts of the operators and this auditor should be different from the statutory auditors.”

This is a choice that the EU legal framework leaves to individual Member States so it is not mandatory to use an external auditor, but it is beneficial to the compliance process and most Member states do. The expertise and capacity of an external operator will be stronger than those of the NRA, and the NRA reserves its position on any issues until after they have been reported by the auditor. The costs of the auditing can be charged to the operators through the regulatory fees.

For these reasons, we have inserted the hiring of an external auditor in the draft Board Decision.

3.2.3 Publication of documents as a rule, unless confidential

Although ICTA has the power to publish documents and information prepared by obliged operators within the scope of accounting separation and cost accounting obligations, it does not make use of this power. EU Member States have different policies according to their legal and regulatory traditions. The EU legal framework urges to apply a high degree of transparency, but it does not specifically require the publication of certain documents. We recommend that the new Board Decision takes a clear position in this, and for this reason we have inserted an obligation to publish the information submitted to ICTA unless ICTA specifically agrees to consider parts of the information confidential.

3.2.4 Statement of compliance

ICTA does not issue a final decision on whether the reports submitted by an operator are found to be compliant or not. The EU legal framework does require this to happen. The fact that it is not an obligation mentioned in the Turkish legal framework is not in conflict with the EU legal framework as long as the compliance statement is made in practice. However, this has not been the case in recent years. Now that ICTA plans to strengthen the process of compliance oversight, we suggest that it would be useful to insert in the Board Decision a rule that the compliance process ends with a clear statement of compliance from ICTA.

3.2.5 Other recommendations of the Gap Analysis Report taken into account

The proposed Board Decision was drafted taking into account the recommendations from the Gap Analysis Report which was produced in parallel to this report. Including the mentioned recommendation to make use of an external auditor, these were the following:

1. *The principles of cost causality, objectivity, transparency and consistency should be included and defined in the Turkish regulatory regime.*

Most regulators in EU member states describe the principles which should be used when creating the regulatory accounting. The common principles are cost causality, objectivity, transparency and consistency. Some countries add few other principles based on their own preferences, but these have no significant impact. In the Turkish instructions the principles are included but not described, so that operators have no exact guidelines when creating the regulatory accounting models and reports. A description of the regulatory accounting principles should be added so that operators cannot interpret them freely. It is advised to include only the four basic principles (cost causality, objectivity, transparency and consistency) that are common to almost all EU member states. The principle of consistency should be accompanied by the obligation to restate previous year results reflecting any changes in the cost model (as it is in the EU member states).

2. *Instructions for creating LRIC models should be included.*

All countries prepare accounting separation reports based on top-down FAC CCA model results. Most countries prepare in addition also accounting separation reports based on top-down FAC HCA model results (8 countries out of 10). Half of the countries prepare also accounting separation reports based on top-down LRIC model results. Currently LRIC methodology is not used for creating accounting separation reports in Turkey. However we recommend to include also the instructions for creating LRIC models in the accounting separation guidelines for the case, that ICTA would decide in future to request also the accounting separation reports created based on LRIC methodology.

3. *Input values for the preparation of separated accounts should come from national statutory financial accounting.*

The regulatory separated accounts can be created based on input values coming from national statutory accounting or from IFRS. Both options are used across EU member states. We think that the input values entered into the regulatory costing models should be based on the national statutory financial accounting which is the primary accounting system. The advantage of this approach is that the source data in the financial books of the operators are kept in accordance with the national statutory financial accounting rules and as such they can be used directly as input into the regulatory costing models without any adjustments.

4. *The description of the cost allocation should include more details about the allocation of common costs and conversion of different traffic types (voice, sms, data) into common unit.*

In the meeting with the Turkish operators which was held on 11th of September 2017 in ICTA's premises Vodafone specifically asked for detailed instructions how to allocate common costs and how to convert different traffic types (voice, sms, data) into common unit. Because the accounting separation guidelines include description of examples of allocation of different types of costs, we recommend to describe there also the allocation of common costs and the conversion of voice traffic, sms and data traffic into common unit.

5. *Asset revaluation methodology should be described.*

The ICTA Board Decision number 2013/DK-ETD/557A states that current costs should be used when creating the regulatory costing models and the accounting separation reports, but it does not define the asset revaluation methodology (absolute valuation, revaluation using MEA, indexation). In order to make sure that all operators use the same and the correct methodology, the asset revaluation methodology should be described in the accounting separation guidelines.

6. *Pre-tax WACC should be used to calculate the cost of capital.*

Cost of capital should be calculated by multiplying the mean capital employed by WACC. In all EU member states the pre-tax WACC is used. The reason is that taxes in general are excluded from regulatory accounting because prices and resulting revenues from regulated services are also before tax. Therefore we recommend to use the pre-tax WACC formula in the Board Decision.

7. *Cost of debt can include also commissions and other fees directly related to the debt (for example commissions and fees paid when issuing bonds).*

In the meeting with the Turkish operators which was held on 11th of September 2017 in ICTA's premises Türk Telekom asked for costs other than interest such as commission and insurance premiums to be included in cost of debt calculation.

The cost of debt can be calculated as risk free return plus debt premium or as the actual cost of debt paid by the operators. If the debt premium approach is used a sector-specific premium may be calculated from a peer group of operators in Europe. If the actual cost of debt paid by the operators is used, then the cost of debt may include in addition to the interest paid also the commissions and other fees directly related to the debt (for example commissions and fees paid when issuing bonds).

8. *Statements of mean capital employed for services and markets, reconciliation between separated accounts and statutory financial accounting and statement of unit transfer prices should be added to the list of reports.*

The lists of accounting separation reports are quite different between the EU member states. However there are some basic reports which are required in all member states. These basic reports are Profit and loss statements for markets and services, Statements of mean capital employed for markets and services, Reconciliation statements with statutory financial accounting, Statement of unit transfer prices, Network element costs and their allocation to services. Most countries then add some country specific reports.

The ICTA Board Decision number 2013/DK-ETD/557A includes the following reports:

- Direct / Indirect Operating Costs – this report shows the direct costs allocated to services and costs of network elements and their allocation to services.
- Capital employed – this report shows the capital employed in network elements and its allocation to services.
- Transfer charges between services
- Transfer charges between markets
- Profit and loss statement for each service
- Profit and loss statement for each market.

This means that from the basic reports used in EU member states ICTA Board Decision number 2013/DK-ETD/557 does not cover the Statements of mean capital employed for markets and services, Reconciliation statements with statutory financial accounting, Statement of unit transfer prices. These reports should be therefore added to the list of the required reports.

9. ICTA should hire an auditor to perform the audit of the separated accounts.

The accounting separation reports, the underlying models and their methodology are usually audited by external auditors, to ensure regulatory compliance. The auditor can be hired directly by the regulator or by the operator (if this is the case, then the selection of the auditor should be subject to the approval by the regulator). In most EU member states the auditor is hired directly by the regulator.

The auditor can be the same as the one who audits the statutory financial accounts or different from the statutory auditor. The preferred option is a regulatory auditor different from the statutory auditor. The basic reason is that when the regulatory auditor is different from the statutory auditor it is perceived as more independent. Furthermore having two different auditors creates a double check and the audit results are considered to be more reliable by other market players. In most EU member states the regulatory auditor is different from the statutory auditor. Therefore we recommend that ICTA hires an independent auditor to audit the separated accounts of the operators and this auditor should be different from the statutory auditors.

In the light of findings mentioned before in this study, a proposal for a draft Principles and Procedures is presented in the Annex.

4 CONCLUSION AND PROPOSAL

After an analysis of the Turkish legal framework on accounting separation and cost accounting, and after having confronted it with the European legal framework and best practice, we conclude that we have found no provision in the Turkish legal texts that diverges from the EU legal framework. If anything, the main difference with some Member States of the EU (but not with all) is in the level of detail of the legal texts. In the EU approach this level of detail is decided on the national level as long as the minimum requirements of the EU framework are met, which is the case in Turkey. In that sense, there is no legal divergence.

However, we recommend that, for reasons of enhancing the process of implementation and compliance oversight in the area of accounting separation and WACC calculation, a revision is made of the existing Board Decision adopting the Principles and Procedures on Accounting Separation and Cost Accounting, 2013/DK-ETD/557 of October 21, 2013 by updating it and adding more detail in the definitions and principles and allocation drivers, as well as with regard to the auditing process, the publication of documents and the issuing of compliance statements.

In our opinion, the Romanian example should serve as a good basis for the redrafting as it provides a balanced approach for predictability, transparency, durability in time and practical allocation of burden of proof on the notified operators in the compliance process

Based on this example, and taking into account the recommendations of this report and the Gap Analysis Report, we have drafted a new version of the Board Decision as presented in Annex 1.

In Annex 2, we have included the text of a short Consultation Document that could be used by ICTA if it organises a public consultation on the proposed regulation.

ANNEXES

Annex 1: Draft text for new Board Decision

INFORMATION AND COMMUNICATION TECHNOLOGIES AUTHORITY

DRAFT BOARD DECISION

As a result of the market analysis conducted by the Authority, the operators who are determined to have Significant Market Power in the relevant market(s) can be subject to account separation and cost accounting obligations as well as some other obligations. The obliged operators are required to comply with the obligations imposed by the Authority, and to submit the accounting separation reports to the Authority in accordance with the principles and procedures approved by the Authority.

And in this context, considering Article 21 of the Electronic Communication Law No. 5809 published in the Official Gazette No. 27050 dated 10/11/2008 and Article 13 of the Access and Interconnection Regulation published in the Official Gazette No. 27343 dated 08/09/2009, and other relevant legislation, the Board adopted Board Decision 2013/557 dated 21/10/2013, in which it was decided to:

- Approve the Procedures and Principles of Account Separation and Cost Accounting and their accompanying annexes,
- Issue notifications of that Decision to Avea İletişim Hizmetleri AŞ., Turkcell İletişim Hizmetleri AŞ, Türk Telekomünikasyon AŞ and Vodafone Telekomünikasyon AŞ, which were subject to the Board of Directors' decision on imposing obligations on accounting separation and cost accounting.

As a result of the experience and in order to align Turkish regulatory practices to best international practices, the Board has decided to amend the Board Decision of 2013 with the objective of enhancing transparency and increasing the level of compliance with the adopted Principles and Guidelines.

PRINCIPLES AND PROCEDURES OF ACCOUNTING SEPARATION ANC COST ACCOUNTING

PART 1

General Provisions

Article 1: Objective

The purpose of these Procedures and Principles is to distinguish between accounts in order to ensure that operators determined as having significant market power in the electronic communications sector subject to account separation and cost accounting obligation are and that they have separate accounting accounts for the products or services they are obliged to offer under the relevant market cost accounting principles.

Article 2: Scope

These Procedures and Principles cover the procedures and principles to be applied in the fulfilment of obligations regarding accounting separation and cost accounting by operators determined to have significant market power in the relevant market.

Article 3: Legal Provisions

These Procedures and Principles have been prepared on the basis of the Electronic Communication Law No. 5809 and the Access and Interconnection Directive which was published in the Official Gazette dated 8 September 2009 and numbered 27343.

Article 4: Definitions

The Terms in this Procedures and Principles have the same meaning as in Electronic Communications Law No. 5809 and in the Regulation on Access and Interconnection and related regulations.

PART 2

Article 5: Regulatory accounting principles applicable to the Separated Financial Statements

5.1. When preparing the Separated Financial Statements, the following principles will apply:

a) cost causation, according to which revenues and costs, assets and liabilities will be allocated to cost components, network elements, businesses and services in accordance with the activities which cause the revenues to be earned, the costs to be incurred, the assets to be acquired or the liabilities to be incurred. The revenues and the costs include the transfer charges between the businesses;

b) objectivity, according to which the allocation of costs to businesses and services will be objective and will not be intended for the benefit of the operator or of a third party, product, service, network element or business;

c) consistency of treatment, according to which, where there are changes in the regulatory accounting principles, in the methodology of cost allocation or in the accounting policies, that have a material effect on the information included in the current Separated Financial Statements, the financial statements of the previous period will be restated, according to these changes. The effect of the above-mentioned changes upon the information included in the Separated Financial Statements is considered to be material if by non-presentation or faulty presentation of these changes the economic decisions of the users, based on the Separated Financial Statements, might be influenced;

d) transparency, according to which the principles, the accounting policies and the methodology for cost allocation will be transparent. Publication of the Separated Financial Statements and of the description of the costing system must ensure the observance of this principle;

5.2. Should a conflict appear between the principles stipulated at par. (1) these will be applied in the order of their enumeration.

Article 6: Level of detail for Accounting Separation

The Operator will prepare Separated Financial Statements for the following businesses:

a) Network – all network activities through which a range of telecommunication services is being provided internally (for the users of the operator) and externally (to other operators). These services include the connection to the network (access lines) and switching and transport of calls and data within the network or to/from networks of other operators. The accounts of the network business will include the costs, the revenues and the capital employed associated with the provision of these services. The revenues of the network business will derive from the sale of telecommunication services to the retail business as well as to other operators on the wholesale market. The costs of the provision on the retail market will be charged to the retail business (transfer charge). The revenues earned from the provision on the retail market will be allocated first to retail business and then through the transfer charge to the network business. The costs of the provision on the wholesale market will be charged directly to the other operators. The revenues earned from the provision on the wholesale market will be allocated directly to network business.

b) Retail – all the activities involving the provision of services to end users. The accounts of the retail business will include the costs, the revenues and the capital employed associated with the provision of these services to end users. The costs allocated to the retail business will include the transfer charges related to the use of network resources as well as the marketing and billing costs associated with the provision of services to end users. Since the provision of telecommunication services to end users is a service provided by the retail business, the revenues resulting from services provided to end users will be recorded in the accounts of the retail business. The part of the retail revenues corresponding to the use of the network resources will then be allocated to the network business through the transfer charge.

c) Other – all the activities not included in network and retail businesses. The accounts of other business will include the costs, the revenues and the capital employed associated with other activities not related to the provision of telecommunication networks or services.

Article 7: Format of the Separated Financial Statements

7.1. Preparation of Separated Financial Statements

7.1.1. The Separated Financial Statements will include the profit and loss statement and the statement of mean capital employed for each business as a total and for individual services provided by the business. The operator has to report individually all services provided on the specific relevant markets where the operator has been designated by ICTA, during the accounting year for which Separated Financial Statements are prepared, as having significant market power and for which the obligation for accounting separation was imposed. All other services may be reported under the heading „unregulated services“.

7.1.2. When preparing the Separated Financial Statements, the following conditions will be observed:

- a) The Separated Financial Statements will be based on a transparent cost apportionment methodology;
- b) The Separated Financial Statements will include the transfer charges between businesses for services provided internally by the operator. The Separated Financial Statements will separately disclose the equivalent transactions with other operators;
- c) The Separated Financial Statements will be prepared in accordance with the national accounting standards, insofar as they are relevant;
- d) The Separated Financial Statements will be prepared in accordance with the Regulatory Accounting Principles;
- e) Details of changes having significant impact on the Separated Financial Statements, as well as the effect of restating opening balances, will be disclosed;
- f) The Separated Financial Statements will be published on an annual basis and will include statements for the current year and for the previous year. In case of significant changes in the regulatory accounting principles, in the cost allocation methodologies or in the accounting policies that have a material effect on the current balances in the Separated Financial Statements, the closing balances of the previous year's Separated Accounts will be restated, according to the respective changes, in order to ensure the comparability of the Separate Accounts from one year to the other;
- g) The Separated Financial Statements will include all the costs incurred by the operator during the accounting year;
- h) The Separated Financial Statements will be prepared on historical and on current costs basis;
- i) The Separated Financial Statements will present fully allocated costs. Following the decision of ICTA, the Separated Financial Statements will be additionally drawn, upon the request of ICTA , based on long rung incremental costs including mark-up for common costs;

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j) The Separated Financial Statements will be pre-tax.

7.1.3. The format of the Separated Financial Statements is presented in Appendix 1, which forms an integral part of this regulation.

7.2. The Statement of Costs of Network Elements

7.2.1. The operator will elaborate, within the Separated Financial Statements, a statement of the costs of network elements. This statement will indicate the total cost and unit cost of each network element including the cost of capital. For line sensitive network elements the unit will be the access line. For traffic sensitive network elements the unit will be the common traffic unit for data and voice. The conversion of the common traffic unit into voice minutes and data Mbytes will be described in an explanatory note.

7.2.2. The statement under 7.2.1. will be elaborated on historical and current costs basis and will present fully allocated costs.

7.2.3. The format of the statement mentioned in 7.2.1. is shown in Appendix 2, which forms an integral part of this regulation.

7.2.4. The statement mentioned in 7.2.1. will be presented to ICTA. Publication is not necessary.

7.3. The Statement of Routing Factors and Network Unit Costs of Services

7.3.1. The operator will prepare a statement which will include the routing factors for each service and calculate the network unit costs of the services by multiplying the unit costs of the network elements from the statement under 7.2.1. by the routing factors. The statement will include also access network elements and access services. In such a case the routing factors will represent the access network element usage factors.

7.3.2. The statement under 7.3.1. will be elaborated on historical and current costs basis and will present fully allocated costs.

7.3.3. The format of the statement mentioned in 7.3.1. is shown in Appendix 3, which forms an integral part of this regulation.

7.3.4. The statement mentioned in 7.3.1. will be presented to ICTA. Publication is not necessary.

7.4. Explanatory information

The explanatory information to be published with the Separated Financial Statements is the following:

- a) A statement of accounting principles used when preparing the Separated Financial Statements;
- b) A complete definition of the businesses;

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c) A statement of the transfer charges which will show for each business and service the transfer charge received and the transfer charge paid calculated as the actual usage multiplied by the unit price;

d) The details of changes in accounting policies with material impact upon the Separated Financial Statements and upon comparative figures;

e) Reconciliations of the separated Profit and Loss and the Mean Capital Employed statements with the statutory Profit and Loss statement and balance sheet.

7.5. Transparency

The documents and information prepared by obliged operators within the scope of the accounting separation and cost accounting obligations will be published. In principle, the Separated Financial Statements are considered not to be confidential and will be published. Financial information that ICTA, based upon justification provided by the operator, considers as being confidential will not be published.

7.5.1. The Separated Financial Statements are prepared for an accounting year and are published on an annual basis. The accounting year begins on 1 January and ends on 31 December.

7.5.2. The Separated Financial Statements will be published no later than six months after the end of the accounting year to which they relate.

Article 8: Audit of the Separated Financial Statements

8.1. The cost accounting system presented by the operators will be audited by an auditor selected and hired by the Authority. The auditor shall have sufficient technical qualifications and shall be different from statutory auditor of the operator. The auditor shall express whether or not the accounts represent a faithful view of the results for the period according to the principles, criteria and conditions adopted by the Authority and other relevant legislation and any arrangements made in relation to the subject matter by the Authority. The report shall list and measure the incidents and failures to comply that the auditor identifies.

Specifically, the auditor will verify whether:

a) The Separated Financial Statements reflect, in all material aspects, the information contained in the accounting documents and the relevant financial statements of the operator;

b) The Separated Financial Statements have been prepared in compliance with the provisions of this regulation;

c) The procedures for collection and processing of accounting information as well as the evaluation and allocation methodologies used for the preparation of the Separated Financial Statements are consistent with the methodology for the calculation and accounting separation of the costs, revenues and capital employed which accompanies the Separated Financial Statements;

8.1.1. The audit report will be addressed to ICTA.

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8.1.2. The audit report will accompany the Separated Financial Statements and will be published together with them.

8.2. Expenses related to the audits performed by the independent auditing institutions shall be covered by the operators concerned.

8.3. The independent auditors conduct audits and inspections in accordance with Decree Law No. 660 and related legislation.

8.4. The Authority, the auditors and the operators may request any kind of correction, amendment and clarification during the time of auditing.

8.5. Independent auditors are responsible for damages that may be incurred due to incorrect and misleading information and opinions in the reports prepared by them and are liable for any damages that may occur to third parties.

8.6. The Authority shall 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.

9. Transfer Charging Principles

9.1. The network business provides services to other operators and to the own retail business. A system of transfer charges will apply to services and products provided between the businesses.

9.2. The transfer charging principles to be observed during the preparation of the Separated Financial Statements are set out below:

a) The transfer charges (revenues and costs) will be allocated to cost components, services and businesses in accordance with the activities which caused the revenues to be earned, or costs to be incurred;

b) The allocation will be objective and not intended to benefit any business, service or cost component;

c) There will be consistency of treatment of transfer charges from year to year;

d) The transfer charging methods used will be transparent;

f) The transfer charges for network usage should be determined as the actual usage multiplied by the unit price for the use of network elements;

g) The tariffs for the internal use of the network will be equivalent with the tariffs charged for the equivalent services provided to other operators. According to the non-discrimination principle, the retail business will pay to network business the same charges as the ones applicable to other operators, as they are set out in RIO. If there is no equivalent service provided to other operators the transfer price will be set equal to the cost for the provision of the service including a reasonable return on capital.

10. Methodology for the allocation of costs, revenues and capital employed within the separate accounting

10.1. Description of the operator's costing system

10.1.1. The operator will prepare and submit to ICTA, along with the Separated Financial Statements, a methodology for the calculation and accounting separation of the costs, revenues and capital employed, hereinafter referred to as Methodology, which details the accounting separation system and the accounting principles and policies which form the basis of the Separated Financial Statements.

10.1.2. Within the Methodology, the description of the operator's accounting separation system will include the following:

- a) Methodology (fully allocated costs, incremental costs) and the cost base (historical cost, current costs) being used;
- b) A detailed description of the accounting principles and policies used within the accounting separation, including the regulatory accounting principles;
- c) The allocation methods used to identify the costs, revenues and capital employed of each service or network element;
- d) The description of the treatment applied to each category of cost, revenue or capital employed, including the presentation of the cost drivers used for this allocation;
- e) The description of the source data used for the cost drivers and the degree to which sample data has been used for allocation purposes;
- f) A detailed description of the transfer charging system which operates within the accounting separation;
- g) A description of the methodology and principles used for asset valuation on current costs basis and for preparing the Separated Financial Statements based on current costs. The methodology and principles used have to be described for each asset type.

10.1.3. The accounting principles and policies and the methodologies used for accounting separation and detailed in the Methodology will observe the provisions herein.

10.1.4. Following evaluation, ICTA may impose changes in the Methodology, indicating the Separated Financial Statements to be modified in order to reflect these changes.

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a) Services – this cost pool contains the costs which can be directly identified with the provision of a certain service. For these purposes, the term “services” refers to both end user services and intermediate services (network services);

b) Network elements – this cost pool contains the costs related to the various elements of transmission, switching, and other network plant and systems. This category includes the network element costs that cannot be directly allocated to the provision of a single service, as they are used for the provision of several services;

c) Functions related to provided services – this cost pool contains the costs of the provision of services to the users, such as billing, maintenance, or customer care;

d) Other functions – this cost pool contains costs which, although are not related to the provision of a particular service, represent a significant part in the operations of the company as a whole (e.g. planning, general and administrative costs etc.).

10.2.3. The allocation will be done through the following steps:

Step 1 – the allocation of Other functions costs across the other 3 categories: Services, Network elements, Related functions;

Step 2 – the allocation of Related functions costs to Services and Network elements;

Step 3 – the allocation of Network elements costs to Services.

10.2.4. Each allocation step may involve a number of intermediate steps, especially if primary information is collected and registered at an aggregated level.

10.2.5. Each cost component can be considered to belong to one of the following categories:

a) Direct costs – the costs that can be directly allocated to a certain product or service provided by the operator;

b) Indirectly attributable costs – the costs that can be related to the provision of a service or product on a non-arbitrary basis. These costs will be allocated to the relevant service or product using the appropriate cost driver;

c) Unattributable costs – the costs for which no direct or indirect method of allocation can be identified. It is therefore not possible to allocate these costs to a certain product or service on a non-arbitrary basis. These costs are likely to fall under the category of corporate overheads, being allocated to products or services by using the Equi Proportionate Mark-Up method (EPMU) or another method.

10.2.6. The Methodology will include a statement that will disclose the unattributable costs and present in detail their allocation methodology.

10.2.7. In order to decrease the proportion of unattributable costs, the operator will rigorously apply the cost causation principle so that at least 90% of the costs are allocated based on this principle.

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10.2.8. In order to allocate indirectly attributable costs to services the operator may use sampling techniques, as long as they are based on adequate statistic methodologies that do not induce significant errors.

10.2.9. The operator will observe the following principles governing the use of sample data for allocation purposes:

- a) The sample will be selected objectively;
- b) The size of the sample will be assessed in a statistical manner and will be statistically significant;
- c) The sample will be representative for of the entire selected population;
- d) The sample will not be distorted by seasonal or other temporary factors;
- e) The sample will be based on either generally accepted statistical techniques or other methods, approved by ICTA , which should result in the accurate allocation of revenues (including transfer charges), costs (including transfer charges), assets and liabilities;
- f) In case significant changes occur in one year compared to the other, the sample will be updated on an annual basis.

10.2.10. The operator will present, within the Methodology, a detailed statement of the used statistical sampling techniques used, indicating the degree to which sampling data has been used in the allocation process.

10.3. Revenue allocation

10.3.1. The operator has the obligation to develop, in compliance with the legal provisions and the provisions herein, an allocation methodology for revenues which will be included in the Methodology.

10.3.2. The methodology for the allocation of revenues will comply with the consistency principle and will result in the establishment of correspondence between revenues and their related costs.

10.3.3. The revenues resulted from the provision of products and services may be directly allocated to the products and services to which they relate, based on accounting records and on information in the billing system of the operator. In case direct allocation based on the above is not possible, revenues will be allocated based upon causation.

10.4. Allocation of the capital employed and determination of cost of capital

10.4.1. In accordance with the legal framework and the provisions herein, the operator has the obligation to develop a methodology for allocation of capital employed which will be included in the Methodology.

10.4.2. The cost of capital will be applied to the value of capital employed in network elements and other assets, as well as to working capital (which represents the difference between the current assets and current liabilities) in order to determine a reasonable return to be included in the services

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and products charges. The average values of capital employed in the period will be used, and not their closing balances.

10.4.3. The pre-tax nominal cost of capital will be calculated based on weighted average cost of capital (WACC), which should be calculated using following formula:

$$\text{WACC nominal pre-tax} = D/(D+E)*R_d + E/(D+E)*R_e/(1-t)$$

Where:

R _d	cost of debt
R _e	cost of equity
D	total market value of debt
E	total market value of equity
t	corporate tax rate

10.4.4. The total market value of equity for operators whose stocks are traded in Istanbul Stock Exchange (BIST) should be calculated as the listed number of shares of the operator multiplied by the market value of the shares. If market values of equity are not available, then alternatives like benchmarking may be considered to obtain the required ratio of debt to equity.

10.4.5. If market values of debt are available then these should take precedence. If market values are not available, the total value of debt should be calculated as the long-term financial liabilities and other long-term liabilities included in the balance sheet of the entity.

10.4.6. The cost of debt can be calculated as risk free return plus debt premium or as the actual cost of debt paid by the operators. If the actual cost of debt paid by the operators is used, then the cost of debt may include in addition to the interest paid also the commissions and other fees directly related to the debt (for example commissions and fees paid when issuing bonds). Another option is to obtain the cost of debt from a peer group of operators.

10.4.7. The cost of equity should be calculated as follows:

$$R_e = R_f + B*(R_m - R_f)$$

where

R _f	risk free rate
B	beta coefficient
R _m	market return

10.4.8. The risk free rate shall be based on the return of long-term Turkish government bonds. If these are not available or are not considered fit-for-purpose, alternative approaches including benchmarking may be considered.

10.4.9. The beta coefficient for operators whose stocks are traded in Istanbul Stock Exchange (BIST) should be calculated as the correlation coefficient between the shares of the operator and the BIST 100 index. For other operators the beta coefficient of a similar company or the parent company

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should be used. The Authority may amend the method of determining the beta coefficient taking into account the country and market conditions.

10.4.10. The evaluations of national and international institutions and organizations and the data they used in their work will be taken into account for estimating the market return. If the beta coefficient was calculated as the correlation coefficient between the shares of the operator and the BIST 100 index, the market return should be the return of the BIST 100 index.

10.4.11. If deemed necessary, the Authority may consider different risk profiles for different products or services. As a result, different Weighted Average Cost of Capital values can be determined for different products or services.

10.4.12. If deemed necessary, the Authority may change assumptions about the variables used in the calculation of cost of capital.

10.4.13. The detailed description of WACC calculation will be included in the Methodology. WACC value determined by the operator, together with its calculation formula and values of the individual parameters used in the calculation, will be sent annually to ICTA for approval within 2 months from the end of the financial year.

10.5. Asset Lives and Depreciation Method

10.5.1. The lives of fixed assets will usually be the same as the ones used in the statutory annual financial statements.

10.5.2. The operator may change the asset lives, if they are not justified by the technical and economic conditions. Any deviation from the asset lives used in the statutory annual financial statements will be separately identified within the Methodology.

10.5.3. The operator will analyse the changes in asset lives. The analysis will consider the technical and economic reasons that determined the changes as well as the effect of these changes on the total costs of products and services provided, and will be presented as a separate note, annexed to the Separated Financial Statements.

10.5.4. The operator will present, within the Methodology, a breakdown of useful lives used for each category of fixed assets. If different useful lives are used within the same category of fixed assets, these asset lives will be distinctively underlined.

10.5.5. The Operator will present, within the Methodology, the description of the depreciation method used within the separated accounts.

10.6. Current cost accounting

10.6.1. The Separated Financial Statements based on current costs will be prepared using the concept of financial capital maintenance. The concept of financial capital maintenance considers that the shareholders' funds at the end of the period are maintained in real terms at the same level as at the beginning of the period. Within this concept, the profit is recognized only after the gains or

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losses derived from the valuation of assets at current costs are considered (changes in asset values can be generated either as the effect of inflation, or by technological progress and obsolescence).

10.6.2. The use of current costs implies the valuation of assets (and hence, of the depreciation) at their current market value, or in case of assets which can no longer be found on the market at the value of a Modern Equivalent Asset (alternative asset with the same capacity and functionality).

10.6.3. If the use of the method stated in 10.6.2 would be very difficult, the approximation of the gross replacement cost can be realized by indexation of the historical gross book values, but only if the differences between the values derived by this method and those derived using the method stated in 10.6.2 would be immaterial. The use of the indexation method has to be justified by the operator, within the Methodology, distinctively for each asset category.

10.6.4. The operator will include in the Methodology a detailed description of methods used for restating asset values on a current costs basis.

10.6.5. The asset value used in the current cost accounts will be the net replacement cost (NRC) which is gross replacement cost less accumulated current cost depreciation. Thus, for example, if a particular piece of equipment is five years old and has a useful life of 10 years, then, under straight-line depreciation, its net replacement cost will be half of its gross replacement cost.

10.6.6. Fully depreciated fixed assets will have a zero net replacement cost and their costs will not be accounted for within the current costs of services.

10.7. Long run incremental costs

10.7.1. Long Run – the time period in which the operator can realize capital investments or disinvestments in order to increase or decrease its productive capacities. In the Long Run, all inputs, hence all costs vary in response to a change in the volume or in the structure of production in response to the evolution of demand.

10.7.2. Increment – non-minimal and finite quantity of products or services provided by the operator.

10.7.3. Incremental Costs – costs caused by the supplementary provision of a defined increment of services, or the costs saved when the defined increment of services is no longer provided.

10.7.4. The first step in calculating the long run incremental costs is to group costs that have similar characteristics into homogenous cost categories. The homogenous cost categories should include only costs reflecting efficient operation. Therefore the total costs of homogenous cost categories should be adjusted for any inefficiencies stemming from excess capacity, inefficient operational processes and other excessive expenses.

10.7.5. The second step in calculating the long run incremental costs is deriving cost-volume relationship (CVR) for each of the homogenous cost categories. Cost-volume relationships show the way in which costs change in relation to a change in volumes of the services provided. CVRs shall be estimated either using technical-economic models, or simulations realized by engineering experts, or

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by the use of either regression analysis or through the analysis of the processes which are at the basis of various activities. The operator will include in the Methodology a detailed description of how CVRs have been derived, their shape, and their cost driver.

10.7.6. The third step in calculating the long run incremental costs is identifying the extent in which the services included in each increment use different homogenous cost categories.

10.7.7. The incremental costs are derived by adding or excluding an increment of services and by identifying the effect of these changes on the total costs of the homogenous cost category using the cost-volume relationship. The incremental costs should be allocated to the services within the increment using the appropriate cost driver.

10.7.8. The common costs are calculated as the total costs of the homogenous cost category minus the sum of the incremental costs of all increments. Common costs should be allocated to services as a mark-up on the incremental costs.

PART 4

Other Provisions

Article 11: Procedures and principles removed from the enforcement

The Procedures and Principles related to Account Separation and Cost Accounting, which were approved by the Board Decision dated 21.10.2013 numbered 2013/DK-ETD/557 are repealed.

Article 12: Entering into force

These Procedures and Principles shall enter into force on the date on which they are published and notified to the relevant operators.

Article 13: Transition Period

Operators shall submit to the Authority the revenue statements for the year and other related tables in accordance with the present procedures and principles before 31 March The Authority may give additional time to the operators when it deems it necessary.

Article 14: Execution

The provisions of these Procedures and Principles are executed by the President of the Information and Communication Technologies Authority.

Appendix 1 – Format of the Separated Financial Statements

Profit and Loss Statement for Network Business

	Service 1	Service 2		Service N	Unregulated services	Total Network
Revenues						
External revenues from wholesale customers						
Transfer charges received from Retail business						
Transfer charges received from Other business						
Total revenues						
Costs						
Operating costs						
HCA Depreciation						
CCA Holding (gains)/losses and other adjustments						
CCA Supplementary depreciation						
Total Costs						
Profit						
Average capital employed						
Return on average capital employed (%)						

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Profit and Loss Statement for Retail Business

	Service 1	Service 2	Service N	Unregulated services	Total Retail
Revenues					
External revenues from retail customers					
Transfer charges received from Other business					
Total revenues					
Costs					
Operating costs					
HCA Depreciation					
CCA Holding (gains)/losses and other adjustments					
CCA Supplementary depreciation					
Transfer charges paid to Network business					
Transfer charges paid to Other business					
Total Costs					
Profit					
Average capital employed					
Return on average capital employed (%)					

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Profit and Loss Statement for Other Business

	Service 1	Service 2	Service N	Unregulated services	Total Retail
Revenues					
External revenues from other services					
Transfer charges received from Retail business					
Total revenues					
Costs					
Operating costs					
HCA Depreciation					
CCA Holding (gains)/losses and other adjustments					
CCA Supplementary depreciation					
Transfer charges paid to Network business					
Transfer charges paid to Retail business					
Total Costs					
Profit					
Average capital employed					
Return on average capital employed (%)					

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Statement of mean capital employed (the same statement format will be used for all businesses)

	Service 1	Service 2		Service N	Unregulated services	Total Network
Fixed assets						
Tangible fixed assets						
Intangible fixed assets						
Investments						
Total fixed assets						
Current assets						
Stocks						
Debtors						
Short term financial investments						
Cash						
Total current assets						
Current liabilities						
Mean Capital Employed (total assets minus current liabilities)						

Appendix 2 – Format of the Statement of Costs of Network Elements

	Network element 1	Network element 2	Network element N
Operating costs			
HCA Depreciation			
CCA Holding (gains)/losses and other adjustments			
CCA Supplementary depreciation			
Total costs			
Mean capital employed			
WACC (%)			
Cost of capital (Mean capital employed * WACC)			
Total costs including cost of capital			
Volume unit			
Total volume			
Unit cost			

Appendix 3 – Format of the Statement of Routing Factors and Network Unit Costs of Services

	Network element 1	Network element 2	Network element N
Unit cost			
Routing factors			
Service 1			
Service 2			
Service N			
Network unit costs of services			
Service 1 (unit cost * routing factor)			
Service 2 (unit cost * routing factor)			
Service N (unit cost * routing factor)			

Appendix 4 – Examples of the allocation of costs

Cost category	Cost type	Allocation method
Asset depreciation	Depreciation	Directly to individual network elements or other asset types.
Equipment installation, maintenance, repair	Payroll costs	Directly to the equipment where possible. Otherwise allocated between equipment based on the time spent on the installation, maintenance and repair work.
Equipment installation, maintenance, repair	External costs	Directly to the equipment where possible. Otherwise allocated between equipment based on the analysis of the invoices from the external suppliers.
Network planning and development	Payroll costs	Directly to the network element where possible. Otherwise allocated between network elements based on the time spent on the network planning and development work.
Network planning and development	External costs	Directly to the network element where possible. Otherwise allocated between network elements based on the analysis of the invoices from the external suppliers.
Network management costs	Payroll costs	Directly to the network element where possible. Otherwise allocated between network elements based on the time spent on the network management work.
Network management costs	External costs	Directly to the network element where possible. Otherwise allocated between network elements based on the analysis of the invoices from the external suppliers.
Marketing and sales costs	Payroll costs	Directly to services where possible. Otherwise allocated between services based on labour time.
Marketing and sales costs	Publicity, promotions, market research, distributors fees, other costs	Directly to services where possible. Otherwise, for those costs related to marketing or selling of multiple services, cost should be allocated to the related services on a reasonable basis (e.g. revenue, volume).
Billing and collection costs	Payroll costs	Directly to services where possible. Otherwise allocated between services based on labour time.
Billing and collection costs	Other billing costs	Directly to services where possible. Otherwise allocated based on usage (e.g. number of bills produced).
Customer care costs	Payroll costs	Directly to services where possible. Otherwise allocated between services based on labour time.
Payments to other operators	Out-payments for outgoing traffic	Directly to services.
HR costs	All	To the staff overseen by HR based on labour time.
IT costs	All	To the IT applications based on the share of IT costs used by individual applications. Costs allocated to applications can then be attributed to network elements, services supported by the applications.

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Cost category	Cost type	Allocation method
Building costs	All	To network elements and departments based on space occupied.
Accounting and finance costs	All	To services based on a reasonable basis (e.g. equi proportionate mark-up).
General administrative costs	All	To services based on a reasonable basis (e.g. equi proportionate mark-up).
Network elements costs	All	Directly to services where possible. Otherwise allocated between services based on usage (e.g. routing factors and volume of the services). Volume of the services has to be converted into common unit. In IP networks all traffic has the form of data traffic. Voice minutes should be converted into Mbytes using following calculation: $\text{number of voice minutes} * 60 * \text{voice channel size in kbps} / 8 / 1024$ SMS should be converted into Mbytes using following calculation: $\text{number of SMS} * \text{average size of SMS in bytes} / 1024 / 1024$

Annex 2: Draft Consultation Document

The Board of the Information and Communications technologies Authority ICTA announces a public consultation on the draft text of a new version of its Decision on Principles and Procedures of Accounting Separation and Cost Accounting.

The current version of the Decision was adopted on October 21, 2013 number 2013/DK-ETD/557.

The legal framework and regulatory practice with regard to accounting separation and WACC calculation was evaluated in a recent project by a team of international experts. Their mission was

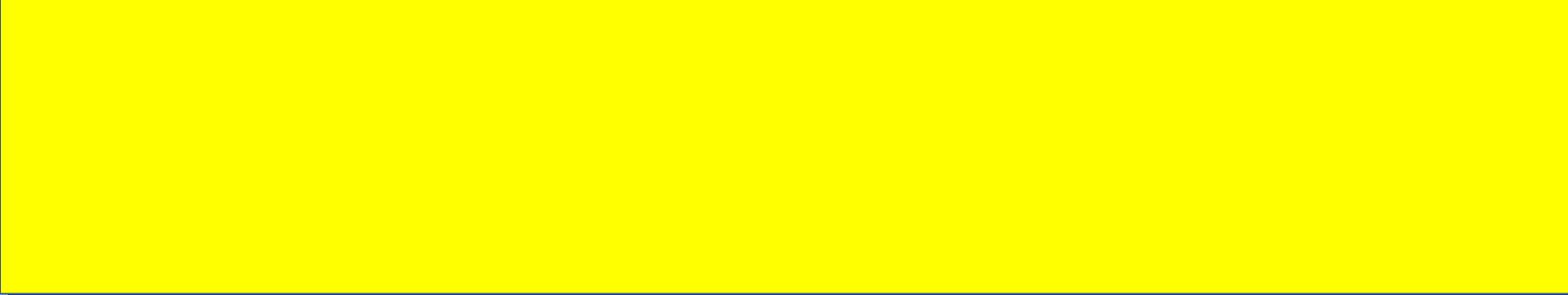
1. to identify any gaps between the Turkish legal and regulatory approach and international best practice as represented by the European Union legal framework and regulatory practice; and
2. based on their recommendations, to prepare a proposal in order to revise the current secondary legislation/regime on accounting separation and WACC fully in line with corresponding EU regulations.

The reports of the expert team can be found on ICTA's website as follows:

Although the main conclusion of the review was that no provision in the Turkish legal framework was found that diverges from the EU legal framework, the experts made recommendations to improve the existing regulations from the point of view of strengthening the implementation and compliance process. The level of detail in the Board Decision on Principles and Procedures needs to be enhanced while taking into account improvements recommended on the basis of benchmarking with relevant EU Member States.

Based on a draft presented by the experts, the board of ICTA has adopted the attached draft amended Decision. The Board calls upon stakeholders to send their comments on this draft text before (date.....) to the following address:.....

(Attached: draft Board Decision).



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