



eircom

HISTORICAL COST SEPARATED ACCOUNTS

FOR THE YEAR ENDED

31 MARCH 2004

**ACCOUNTING
DOCUMENTS**

***eircom* Historical Cost**

Separated Accounts

Accounting Documents – 31st August 2004

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Introduction

eircom is required, under Condition 15 of the General Telecommunications Licence, dated 1st December 1998 granted by the Office of the Director of Telecommunications (“ComReg”) to *eircom* to maintain accounting records in a form which enables the activities of any business unit specified in any direction given by the Director of Telecommunications Regulation (“the Director”) to be separately identifiable, and which the Director considers to be sufficient to show and explain the transactions of each of these business units.

Directive 97/33/EC of the European Parliament, as enacted into Irish law by Statutory Instrument No. 15 of 1998, establishes the legal and regulatory framework for the interconnection of telecommunication networks within the EU, including a requirement for accounting separation. The transposition of the new EU Regulatory Framework into Irish Law now means that the governing legislation requiring separated accounts has changed. From the 25th July 2003 these requirements on electronic communications network providers are now imposed under Regulation 24 of S.I. No. 307 2003 and Regulation 12 of S.I. No.305 of 2003.

The detailed framework and financial statement disclosure has been set out in ComReg Decision Notices D5/99 & D10/99 ‘Accounting Separation and Publication of Financial Information for Telecommunication Operators’, dated May 1999 & August 1999 respectively, and D8/99 ‘Costing methodologies for use in Accounting Separation’, dated July 1999, D9/00; D10/00 ‘Accounting Separation and Publication of Financial Information for Telecommunication Operators’, dated August 2000 and September 2000 respectively, and D7/01 Accounting Separation and Publication of Financial Information for Telecommunication Operators’, dated April 2001 (“the Decision Notices”), D12/01 ‘Revision of Timetable for Publication of Separated Accounts and Financial Information by *eircom*’, dated August 2001 and D3/03 ‘Review of Price Cap on Certain Communication Services’ dated February 2003.

Financial Statements have to be prepared for the following Businesses and, where applicable, Activities within the Businesses:-

Business	Activities
Local Access Network	n/a
Core Network	n/a
Retail	Access Local Calls National Calls International Calls Calls to Mobile Directory Enquiry Leased Lines Public Payphones Calls to Internet Internet Services Supply Supplemental Services Remaining Activities
Other Business	Apparatus Supply Indigo Subsidiary Activities Other Remaining Activities

The full definition of the Businesses and Activities are set out on pages 4 to 7.

The Financial Statements are prepared in accordance with the Accounting Documents which set out the framework under which the statements are to be prepared.

The Accounting Documents are made up of the following:-

1. Regulatory Accounting Principles - which lay out the general rules by which the Financial Statements should be prepared, for example that all balances should be attributed with reference to cost causality.
2. Attribution Methods - which explain how revenue, costs including transfer charges, assets and liabilities are attributed to the Businesses and Network Elements and Activities within those Businesses, following the Regulatory Accounting Principles, on a fully allocated basis.
3. Transfer Charges – which explain how charges are raised from the Core Network and Local Access Network Businesses to the Retail Business for its use of the respective networks.
4. Accounting Policies - which detail the accounting policies adopted in preparing the underlying financial information.

This introduction does not form part of the Accounting Documents.

***eircom* Accounting records**

eircom is a unitary business having one network with support functions. It consists of a number of customer facing divisions and divisions responsible for providing customers with telephony services, maintaining the core switching and transmission networks, and providing and maintaining customer connections to this network. A number of additional services are supplied by subsidiary companies which maintain separate accounting records.

eircom records its transactions in the accounting records in accordance with statutory and legal requirements and generally accepted accounting principles. Within these records detailed data is maintained in respect of the manner in which the transactions have arisen. Assets, liabilities income and costs are recorded by type.

For those cost types that are of a "direct" nature, such as provision and installation, there is also a system for booking time and items, such as stores, to a range of sub-accounts, known as "appropriation codes". These appropriation codes describe the type of equipment being maintained, installed or more generally supported, in further detail. It is therefore possible, for example, to identify separately the pay costs and related stores costs incurred in the maintenance of exchanges.

For those cost types of an indirect nature costs are booked to 'non-appropriated codes' on a cost centre basis. These costs are mapped to one of forty-six expenditure headings (refer to section 3.5.1). These expenditure headings are allocated into seven business processes, six support processes and one strategic process.

Basis of Preparation of Financial Statements

The structure of the Businesses required under the Decision Notices (i.e. Local Access Network, Core Network, Retail and Other Business) does not correspond to the way in which the company is organised and hence the way the statutory accounting records are structured. The Financial Statements are therefore produced by overlaying the requirements of the Decision Notices on the statutory accounting record structure of *eircom*.

As required by the Decision Notices, wherever possible, revenue, costs, assets and liabilities are directly associated with a Business, Activity or Network element using information recorded within *eircom*'s accounting records and are directly attributed to that item. Where no such direct attribution is possible the revenue, costs, assets and liabilities are apportioned between two or more Activities, Network Elements or Businesses on a basis that reflects the causality of the revenue, cost, asset or liability. Residual costs for which no direct or indirect method of apportionment can be identified are allocated using an equal proportionate mark-up method. Details of this process are given on page 13 in the Attribution Methods section within these Accounting Documents.

Definitions of the Businesses**Local Access Network**

The Local Access Network provides connections to the Core Network both internally and externally. The accounts for the Local Access Network Business includes the costs and capital employed associated with providing and maintaining these connections. For Accounting Separation, the Local Access Network Business includes all the customer-dedicated components of the network including, for example, the line cards and ports located at concentrators and/or exchanges. In respect of DSL, the Local Access Network Business includes all relevant equipment between the MDF and the ISP point of presence. The Core Network Business includes all other network components. Customer line rental is a service provided by the Retail Business. The revenue from line rental and connections provided to end users is therefore recorded in the Retail Business. The cost of providing customer lines is recorded against the Local Access Network Business and a transfer charge of costs to the Retail Business is levied in order to match revenues with their associated costs. Costs charged to the Retail Business are based on the fully allocated costs of Local Access Network Elements including a cost of capital, set at 11.5% as directed by ComReg.

Core Network

The Core Network Business provides a range of interconnection services internally and externally in order to allow the customer of one operator to communicate with customers of the same or another operator, or to access services provided by another operator. These services include the switching and conveyance of calls. The revenues of the Core Network Business will derive from the sale of interconnection services to the Retail Business of *eircom* and to other operators.

The Core Network also includes payments to other operators, dedicated transmission and capacity for leased lines and the provision of directory enquiry services. Costs charged to the Retail Business are based on the fully allocated costs of the Core Network including a cost of capital, set at 11.5% as directed by ComReg.

Retail

The Retail business includes all those Activities involving the selling of telephony services to end-users, including line rental, leased lines, calls, payphones and the provision of directory information. The accounts for the Retail Business include the costs, revenues and capital employed associated with the provision of these services to end-users. The costs allocated to the Retail Business include the transfer charges related to the use of network resources or services provided by Local Access Network Business and the Core Network Business, and the marketing and billing costs associated with the provision of end-user services.

The disaggregated activities within the Retail Business are as follows:-

1. Access

The business relating to the supply of customer line connections and rental (PSTN, ISDN and DSL) and its associated costs.

2. Local Calls

Local (inland calls, including calls to Northern Ireland, charged at local rates, excluding calls to internet using geographic numbers) dialled calls originating from any telephone exchange line, including a public telephone exchange line.

3. National Calls

National (inland calls, including calls to Northern Ireland, charged at national or regional call rates, excluding calls to internet using geographic numbers) dialled calls originating from any telephone exchange line, including a public telephone exchange line.

4. International Calls

International dialled calls (excluding calls to Northern Ireland) originating from any telephone exchange line, including a public telephone exchange line. (Also includes international inpayments and callnet).

5. Calls to Mobile

Calls to National Mobile telephones originating on any telephone exchange line, including a public telephone exchange line

6. Directory Enquiry

Calls to Directory Enquiry Services originating from any telephone exchange line, including a public telephone exchange line, whereby a telephone caller may be advised of telephone numbers of persons identified by the telephone caller.

7. Leased Lines

Business of connection, rental, maintenance, and change of national and international leased lines which provide for transparent transmission capacity between network termination points and which do not include connection to the PSTN network.

8. Public Payphones

Local, national, international dialled calls and calls to mobile, originating from public payphones, using cash, phone cards or credit cards.

9. Calls to Internet

Calls to non-geographic (1891,1892 and equivalent numbers as and when brought into service) and geographic numbered internet service providers, originating from any ordinary exchange lines, excluding public telephone exchange lines and excluding periodic subscription charges.

10. Internet Services Supply

The business relating to the supply of internet services.

11. Supplemental Services

The business relating to the supply of certain advanced data services. Examples of these services are data networks, broadcast and visual services.

12. Remaining Activities

All other telecommunications services that are within the Retail Business. This will include operator assistance, freephone, premium rate services, managed answering services, fixed SMS and VPN/IVPN.

Other Business

eircom provides a wide range of other services including the rental, repair and maintenance of customer equipment. For the purposes of Accounting Separation, the costs, revenues and capital employed associated with these activities will be separately identified.

The disaggregated activities within Other Business are as follows:-

1. Apparatus Supply

The business relating to the rental, maintenance and sale of customer premises equipment in the Republic of Ireland.

2. Indigo

The business relating to the provision of internet services by Indigo.

3. Other Subsidiaries

Activities of *eircom*'s subsidiaries other than Indigo.

4. Other Remaining Activities

All other remaining activities such as repayment works, IT Services and consultancy services.

1. Regulatory Accounting Principles

The following Regulatory Accounting Principles are applied in the production of the Historical Cost Financial Statements, in the application of the Attribution Methods, the Transfer Charging system, and the Accounting Policies.

- **Priority:** within the Regulatory Accounting Principles, insofar as there is conflict between the requirements of any or all of these Principles, the Principles are to be applied in the same order of priority in which they appear in this document.
- **Definition:** Any word or expression used in the Accounting Documents shall, unless the context otherwise requires, have the same meaning as it has in the Licence.
- **Causality:** Revenue (including transfer charges), costs (including transfer charges), assets and liabilities shall be attributed to cost components, services and businesses or disaggregated businesses in accordance with the activities which cause the revenues to be earned or costs to be incurred or the assets to be acquired or liabilities to be incurred.
- **Objectivity:** The attribution shall be objective and not intended to benefit the SMP operator or any other operator, product, service, component, business or disaggregated business.
- **Consistency:** There shall be consistency of treatment from year to year. Where there are material changes to the Regulatory Accounting Principles, the Attribution Methods, or the Accounting Policies that have a material effect on the information reported in the Financial Statements of the Businesses, the parts of the previous year's Financial Statements affected by the changes shall be restated.
- **Transparency:** The Attribution Methods used should be transparent. Costs and revenues, which are allocated to Businesses or activities, shall be separately distinguished from those that are apportioned.

2. Businesses

In accordance with the Decision Notices, Financial Statements are produced for the following Businesses and, where applicable, Activities within those Businesses:

Business	Activities
Local Access Network	n/a
Core Network	n/a
Retail	Access Local Calls National Calls International Calls Calls to Mobile Directory Enquiry Leased Lines Public Payphones Calls to Internet Internet Services Supply Supplemental Services Remaining Activities
Other Business	Apparatus Supply Indigo Subsidiary Activities Other Remaining Activities

3. Attribution Methods

3.1 Introduction

This document describes the Attribution Methodologies used to allocate fully *eircom*'s revenue, costs, assets and liabilities to its Businesses and, where applicable, their disaggregated Activities and gives an explanation of the different methods used for attributing revenue, costs and capital employed. Cost types and the processes involved in their allocation or apportionment are described, showing how costs are treated from their initial appearance in *eircom*'s accounting records to their ultimate attribution to Businesses, Activities or Network Elements. It explains both the system used to produce the Financial Statements and the methodologies employed in that system.

The purpose of Accounting Separation is to provide an analysis of information derived from financial records to reflect as closely as possible the performance of parts of a business as if they were operating as separate businesses. It is necessary for competing operators to have confidence that *eircom* is not unduly discriminating between its own Retail Activities and competing operators or between one competitor and another when providing similar services.

The aim of Accounting Separation is to assist in ensuring that charges are cost-based, transparent and non-discriminatory. This in turn promotes a competitive environment in a number of ways, including:-

- a) the publication of accounts that are transparent and allow other operators to understand how *eircom*'s revenues relate to costs
- b) the Financial Statements data demonstrates that wholesale products and services are treated fairly and equitably regardless of the purchaser of those products and services.
- c) the publication of detailed cost statements showing the average cost build of products and services provided by an SMP operator will increase and raise the confidence of competitors that there are no anti competitive cross subsidisation.

The fundamental feature of this approach to attribution is the principle of causality. Each item of income, cost and capital employed recorded in the *eircom* group accounts is attributed to the Activities and Network Elements which make up the separate Businesses defined under Accounting Separation.

Attribution Methodologies will be regularly reviewed and enhancements introduced to reflect, for example, changing technologies while the apportionment bases, which are the practical application of these methods to actual values, will be updated at least annually.

3.2 Businesses

Under Accounting Separation, Financial Statements are produced that show *eircom's* revenue, costs and capital employed attributed between the following Businesses:

Local Access Network Business

The Local Access Network Business provides the Retail Business with links between *eircom's* customers and the core network. The Local Access Network Business receives revenue from the *eircom* Retail Business in the form of a transfer charge equal to its costs plus a return on capital employed equivalent to that charged by the Core Network Business.

Core Network Business

The Core Network Business sells a range of network services to meet the differing needs both of other operators and the Retail Business. The price of each network service is based on the fully allocated historical cost of the Network Elements, including a determined return on capital, used to provide the service.

Retail Business

The Retail Business is made up of a number of activities as follows:

- a) Access
- b) Local Calls
- c) National Calls
- d) International Calls
- e) Calls to Mobile
- f) Directory Enquiry
- g) Leased Lines
- h) Public Payphones
- i) Calls to Internet
- j) Internet Services Supply
- k) Supplemental Services
- l) Remaining Activities

Other Business

The Other Business is made up of a number of activities as follows:

- a) Apparatus Supply
- b) Indigo
- c) Other Subsidiaries
- d) Other Remaining Activities

3.3 Attribution Methodologies

3.3.1 Overview

eircom's approach to attribution is to identify income and costs which can be directly attributed to Businesses, Activities or Network Elements. For all remaining items *eircom* identifies the appropriate driver for each item, and, as far as possible, uses objective operational and/or financial data relevant to that driver to generate apportionment bases.

This approach to the process of attribution of financial information to Businesses, Activities and Network Elements can be summarised as follows:

- review each balance,
- establish the cost driver, i.e. the process that caused the cost to be incurred or the revenue to be earned,
- use the driver to allocate or apportion the balance to Retail Activities, the Local Access Network Business or, to the Core Network,
- allocate revenue to Retail Activities, or to the Core Network Business.

The general methods for revenue and cost attribution in Accounting Separation are set out below. The attribution of mean capital employed, which follows the same principles, is also described briefly below.

3.3.2 Revenue

Revenue is recorded in the accounting records in such a manner that it is usually possible to allocate it directly to Retail Activities, to the Local Access Network Business or to the Core Network Business.

3.3.3 Costs

Costs are drawn from the accounting records. The methodologies applied to the costs, which vary according to the nature of the costs and the way in which they are recorded, are set out below.

3.3.3.1 Direct and directly attributable costs

Certain costs can be allocated to specific Businesses, Activities or Network Elements and, therefore, do not require apportionment. These costs include most of the costs directly related to customer-facing activities, such as maintenance of customer premises equipment. They also include directly appropriated and plant costs which relate solely to individual Elements of the network. Some of these specific costs can be directly allocated to Network Elements, such as International Transmission or Directory Enquiry.

3.3.3.2 Indirectly attributable costs

Other costs cannot be directly associated with particular Businesses, Activities or Network Elements, and require indirect apportionment. These costs include general costs of *eircom*'s business units which service various Businesses, Activities and Network Elements, which are recorded on a cost centre basis using the Activity Based Costing process outlined in section 3.5 below, where a specific apportionment base can be identified and measured.

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The above cost type will also include other costs, such as the costs of transmission equipment, which are used to provide a number of network services. These costs are grouped and then apportioned to Network Elements using network statistics, surveys or other methods of analyses (see section 3.7).

3.3.3 Unattributable Costs

As stated above *eircom* utilises, wherever possible, objective data relating to cost drivers. There is, however, some expenditure for which no specific apportionment bases can be readily derived. These costs mainly represent central corporate overheads, such as the costs of central accounting functions. These costs are apportioned to Businesses, Activities and Network Elements using the equal proportionate mark-ups method i.e. any individual Business will receive a proportionate allocation of unattributable costs equal to its proportionate allocation of attributable costs.

3.3.4 Mean Capital Employed

Mean capital employed is defined by *eircom* as the mean of total assets, less current liabilities, less finance lease liabilities and provisions (other than those for deferred taxation), excluding corporate taxes and dividends payable and the short term element of long term liabilities (other than those for finance leases). The mean is calculated from the start and end values for the period. The apportionment of capital employed follows a similar approach to that used for operating costs.

Fixed assets are recorded by capital appropriation codes and can be segmented into three categories:

- 1) those assets that can be directly allocated to Businesses, Activities or Network Elements, e.g. satellite earth stations, which are directly attributable to the International Transmission Network Element;
- 2) assets relating to a group of Businesses, Activities and Network Elements which are apportioned on the basis of cost drivers, e.g. exchange line termination equipment asset classes, which provide both concentrating and switching functions and are thus apportioned both to the Local Access Network Business and various switching Network Elements;
- 3) assets of a general nature supporting, for example, general mainframe computers or motor transport, where an appropriate apportionment base, derived from the attribution of the operating costs of that element, is applied.

For current assets and liabilities, those Elements that can be directly attributed to Businesses, Activities and Network Elements (specific debtors and creditors, stocks and provisions) are directly allocated; for the remainder appropriate apportionment bases are derived for each element. For instance, trade debtors are attributed on the basis of an analysis of the related revenue.

Cash balances are attributed to Businesses, Activities and Network Elements on the basis of an analysis of operating and capital expenditure in the period.

Provisions are either allocated specifically to Businesses, Activities and Network Elements or are apportioned using a basis appropriate to the particular provision.

3.3.5 Non-Financial Data

Wherever costs cannot be directly allocated to Activities and appropriation codes, or when appropriation codes do not map exactly to Network Elements, an apportionment is required. Depending on the cost involved the appropriate basis of apportionment may be of a non-financial nature. In these instances the relevant data may be extracted from non-financial data sources, such as operational systems recording core transmission and usage, or may be collected through activity analysis.

By way of example, the apportionment to Activities and appropriation codes of the pay costs that relate to a cost centre identified by the Accounting Separation process may be apportioned on the basis of a survey of the time spent by the staff whose pay is being apportioned. Such surveys will typically involve analyses of the tasks undertaken by staff and the percentage of time spent on those tasks. These tasks will then be linked to Activities. These surveys are re-performed annually and in some instances more frequently.

3.3.6 Sampling

A number of the bases used to apportion costs and capital employed to Businesses, Activities and Network Elements are constructed using sample data. Sample data has been used to allocate certain indirect costs, which have no comprehensive allocation base, to products and services. The use of sample data has been kept to a minimum. Where sample data has been used in an apportionment base, this has been disclosed in this document where the impact is significant. For instance the allocation of duct costs is based upon physical examination of a sample of duct routes and Network Element route factors are based upon call volume data drawn from a number of sample representative periods in the financial year.

Where sample data has been used the sample has been constructed so as to meet the following principles;

- it is unbiased/objective;
- the sample size has been assessed to be statistically significant;
- it is representative of the entire population;
- it is not skewed by seasonal or other factors;
- it is based on either generally accepted statistical techniques or other methods designed to deliver an equivalent result; and
- it will be updated annually.

3.3.7 Summary

Revenue, costs and capital employed are attributed, by allocation and apportionment, either directly to Businesses, Activities or Network Elements; or via a series of steps of indirect allocation through analysis of appropriation codes or the Activity Based Costing process; or through the apportionment of unattributable overheads.

eircom's approach to attribution is to identify the appropriate cost drivers for each revenue, cost or capital employed type and, as far as possible, to use objective operational and/or financial data relevant to that cost driver to generate apportionment bases. Sample data has been used where appropriate and samples have been constructed on generally accepted statistical principles.

Apportionment bases will be updated at least annually and methodologies regularly reviewed with enhancements introduced to reflect, for example, changing technologies.

3.4 Revenue

3.4.1 Overview

Turnover, which excludes value added tax and other sales tax, is made up of the value of services provided and equipment sales. Typically turnover can be analysed by Activity directly from the accounting records. The turnover arises from calls, line rentals, connection charges, equipment sales and other activities.

3.4.2 Local Access Network Business

The revenue arising from the provision of services to the Retail Business is calculated within the Transfer Charge element of the Accounting Separation system, rather than in *eircom's* main accounting systems, on the basis of the recorded operating costs and return on mean capital employed of the Local Access Network Business.

3.4.3 Core Network Business

Revenue arises from provision of network services to other operators and to the Retail Business. Revenues from other operators in respect of calls originating in their networks and terminating on, or in transit through, the core network are separately identified in the accounting records and directly allocated to the Business.

The revenue arising from the provision of services to the Retail Business is calculated within the Transfer Charge element of the Accounting Separation system, rather than in *eircom's* main accounting systems, on the basis of recorded volumes of usage.

3.4.4 Retail Business

3.4.4.1 Retail Access

Retail access revenue, which is separately identifiable from the accounting records, is in respect of connection and rental income related to the provision of narrowband and DSL lines to retail customers.

3.4.4.2 Calls

Call revenue relates to customers' calls that are accounted for on an accruals basis. *eircom's* billing system facilitates the identification of volumes and durations of all calls by type. This system is used to identify the revenue by call types including local, national, international, calls to internet, directory enquiry and calls to mobile in the accounting records. Therefore this revenue can be allocated directly to the relevant Retail Activities.

3.4.4.3 Public payphones

Public payphone revenue arises from the collection of cash from payphones and the sale of callcards. These can both be identified directly from the accounting records.

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3.4.4.4 Leased Lines

Rental and connection charges for leased lines can be separately identified in the accounting records and the revenue can therefore be directly allocated to the relevant activity.

3.4.4.5 Internet Services Supply, Supplemental Services and Retail Remaining

Rental, connection, calls and other charges for all of the above categories can be separately identified in the accounting records and the revenue can therefore be directly allocated to the relevant activity.

3.4.5 Other Business

3.4.5.1 Apparatus Supply

Apparatus supply revenue relates to the rental, sale, maintenance and connection of telephone apparatus within the Republic of Ireland, each of which are separately identified in the accounting records and directly allocated to this activity.

3.4.5.2 Subsidiary Activities (including Indigo)

Each subsidiary maintains its own accounting records. Revenue relating to subsidiary activities can thus be separately identified and directly allocated to this activity.

3.4.5.3 Other Remaining Activities

Remaining Activities revenue relates to the supply of non-telephony activities. Examples of these services are repayment works order revenue earned in relation to work undertaken repairing plant damaged by third parties. The revenue can be identified directly from the accounting records and allocated directly to this activity.

3.5 Costs

As noted earlier, non-appropriated costs are apportioned using an Activity Based Costing methodology. This consists of a two stage process comprising apportionment of non-appropriated costs to defined Activity Based Costing activities and a mapping of these activities to Businesses, Activities and Network Elements as defined by Accounting Separation.

3.5.1 Apportionment to Activity Based Costing activities

The non-appropriated cost information is held by cost centre and cost type. The cost types are compiled from general ledger account codes from the accounting records. The cost types are mapped to approximately 46 expenditure headings also known as Summary Resource Types ("SRT"), each SRT being an amalgamation of like cost types which have the same cost driver e.g. the pay costs SRT is made up of basic pay, bonuses, payroll subsistence, employers' PRSI, pension and contract staff costs. The cost driver for these costs is time spent.

The cost centres are amalgamated into approximately 130 nodes. These nodes consist of cost centres that are ultimately under the responsibility of one person. It is the responsibility of each Node manager to produce an allocation of the costs within the Node to activities defined in a compiled Activity Dictionary. This is performed by identifying a cost driver for each SRT and apportioning the cost to the defined activities using the defined driver volumes.

The Activity Dictionary consists of approximately 700 Activities which are aggregated into the main processes within *eircom*. The core dictionary defines seven business processes, six support processes, and a strategic process, "Manage the Business".

Each process is broken into a 3 level hierarchy:

- level 1 - the process itself
- level 2 - the sub processes
- level 3 - the activity dimension

The sub-processes assist in defining the activity costs more accurately, as they ensure that all aspects of the activities are combined to result in the complete cost of the particular activity.

Costs are allocated against the activity dimension. The cost of a process or sub-process is identified by aggregating the costs against the activity dimensions of which they are composed.

3.5.1.1 Business processes

Business processes are defined as the collection of activities arising from the development, supply and management of products and services supplied to *eircom*'s customers. The seven business processes are:

1. Product management - activities involved in developing and delivering a fully managed set of products and services to customers.

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2. Marketing & Sales - this involves the sales and marketing of all *eircom* products and group company products.
3. Provisioning - this covers all aspects of the supply of *eircom* products and services to the customer.
4. Billing - this covers all aspects of call measurement, customer billing and cash collection.
5. Repair - this covers the resolution of service difficulties reported by the customer and covers the full range of products of the company.
6. Operator services - this provides operator assisted services to customers.
7. Manage the Network – this covers all activities involved in managing the Core and Access Networks.

3.5.1.2 Support processes

Support processes support the business processes i.e. they provide services across all customer-related activities. The six support processes are:

1. People - this involves all aspects of the HR function.
2. Finance - this process involves all activities within the Finance function.
3. IT Support - this process includes all activities within the IT function, including system design, implementation and support.
4. Corporate Communications - this process involves strategic policy development and branding.
5. Corporate Services - this process involves various activities, including security and risk management, regulatory management, and strategic business planning.
6. Procurement – this process involves acquisition, management and maintenance of physical resources to be used by the company's activities.

3.5.1.3 Manage the Business process

The ‘Manage the Business’ process involves planning, organising, controlling and leading the company. The process involves the development of corporate strategy, development of the management system, and implementation of corporate strategy.

This is a strategic process and is thus distinct from the business and support processes.

3.5.2 Mapping of Activity Based Costing activities to Businesses / Activities / Network Elements

A further apportionment process is required to produce final allocations as the Activity Based Costing activities do not always directly map to the Businesses, Activities and Network Elements defined under Accounting Separation.

This apportionment can take any of the following forms:

- an activity may be wholly attributable to a Business, Activity or Network element regardless of the node in which the costs reside, e.g. costs within the DQ11818 International activity will be pointed to the International Directory Enquiries network element regardless of the node in which the cost resides;
- some activities may be attributed to different Businesses, Activities or Network Elements depending upon the node in which the cost falls, e.g. accommodation management activity is attributed in different proportions to Businesses, Activities or Network Elements depending on the nature of the node in which the activity has been identified;
- some activities may not be wholly attributable to a single Business, Activity or Network element. In this case an appropriate apportionment base has been created to apportion the costs within the Activity Based Costing activity to Businesses, Activities and Network Elements. For example the activities under the billing process have been apportioned to Activities and Network Elements by identifying the cost driver relevant to each activity.

3.6 Mean Capital Employed

3.6.1 Overview

The definition of mean capital employed for Accounting Separation purposes is contained in section 3.3.4. The apportionment of mean capital employed follows a similarly detailed and careful approach to that for operating costs. For some items, such as trade debtors, turnover is the appropriate driver rather than costs. Where reference is made to processes described elsewhere, full details of these processes are not repeated here.

For example, reference may be made to apportionment on the basis of "total pay". This is used wherever pay is the causal driver, e.g. for payroll creditors. Thus, the attribution of payroll creditors will follow the same procedure as the corresponding pay costs. The record of pay costs attributed to Businesses, Activities and Network Elements in the cost attribution process is used to attribute related creditors in such a way as to reflect fully the complexities of the analysis of those pay costs.

3.6.2 Tangible fixed assets

Some network equipment assets can be allocated directly to Businesses or Network Elements on the basis of the asset class recorded in the general ledger, or apportioned to Businesses or Network Elements on the basis of network studies. These include the following categories of plant:

- Local Access lines cable
- Exchange equipment
- Transmission cable
- Duct.

Motor vehicles, computers, land and buildings are apportioned across Businesses, Activities and Network Elements using bases which replicate the total apportionment to services of the costs of the operations supported by the assets concerned. The fixed assets of specialist operating units are directly allocated to the appropriate Business, Network Element or Activity by virtue of the operations undertaken by those specialist units. Where direct allocation is not possible each unit will apportion the relevant assets between activities using an appropriate cost driver specifically selected to reflect the operations concerned.

3.6.3 Stocks

Stock is directly allocated to the activity or business to which it relates.

3.6.4 Debtors

Debtors are analysed by type and sub-analysed where appropriate (e.g. by billing system) from information in the accounting records. At this stage, the appropriate apportionment bases (e.g., relevant turnover) are then applied. Debtors includes the following categories:

Accounting Documents

Attribution Methods

- Trade debtors are directly allocated to Businesses, Activities and Network Elements on the basis of relevant turnover.
- Wholesale debtors and creditors are attributed to the core network within the Outpayments Network Elements.
- Accrued income is directly allocated to Businesses, Activities and Network Elements on the basis of relevant turnover.
- Other debtors and prepayments are apportioned to Businesses, Activities and Network Elements using bases appropriate to the particular debtor type.

3.6.5 Cash at bank and in hand

Cash balances are apportioned on the basis of operating and capital expenditure in the period.

3.6.6 Loans and other borrowings falling due within one year

This category includes bank overdrafts and short term loans, which are apportioned on the basis of operating and capital expenditure in the period.

3.6.7 Other creditors

Creditors are analysed by type from the general ledger codes and the appropriate apportionment bases then applied in the following categories:

- Trade creditors are apportioned to Businesses, Activities and Network Elements on the basis of operating expenditure excluding pay and international outpayments.
- Capital creditors are apportioned to Businesses, Activities and Network Elements on the basis of capital expenditure in the period.
- Payroll creditors are apportioned to Businesses, Activities and Network Elements on the same basis as total pay.
- VAT balances are segmented into specific balances and a residual general balance. The specific balances are allocated to the activity to which they relate. The residual balance is further segmented into VAT output tax payable and VAT input tax receivable balances. VAT payable is apportioned to Businesses, Activities and Network Elements on the basis of external turnover. VAT receivable is apportioned on the basis of total external costs (excluding pay).
- Other creditors are apportioned to Businesses, Activities and Network Elements using bases appropriate to the particular creditor type.

3.6.8 Provisions

Provisions are either allocated directly to Businesses, Network Elements or Activities or are apportioned using a base appropriate to the particular charge.

3.7 Apportionment of appropriated Network costs

3.7.1 Overview

The process to apportion appropriated network costs to Network Elements where they relate to the Core Network Business and to the Local Access Network Business is based upon a series of network studies, which make use of relevant engineering data, operational systems and/or sample data.

Taken together, Network Elements make up all the costs and capital employed of the separated Core Network Business.

3.7.2 Exchange equipment

The main cost drivers for exchange equipment are connections, call attempts and call durations. Exchange equipment costs are allocated to the appropriate drivers on the basis of an in-depth engineering study undertaken, together with the equipment suppliers, to analyse the functionality of this equipment.

In certain cases e.g. Line Cards, ComReg has directed *eircom* to make certain adjustments to the manufacturers studies. *eircom* have been directed to treat line cards as 100% line sensitive.

The apportionment approach identifies the allocation of total exchange costs between the Local Access Network Business and Core Network Business. The specific equipment affected by this study is exchange line terminations, trunk terminations, core hardware, operating software and application software.

Exchange expenditure is assigned to the main cost drivers, as follows:

- Connections – costs that are associated with equipment that has the function of providing access to the network;
- Call set-up - costs that are associated with equipment that has the function of establishing and clearing an end to end network path (call set-up).
- Call duration - Costs associated with equipment that has the function of holding the network path open for the duration that a link is made across the network (call duration).

3.7.3 Transmission

The ‘transmission network’ provides the following type of links;

- links between customer connections and exchange locations;
- links between RSU locations and exchange locations (primary, secondary and tertiary);
- links between exchange locations.

Accounting Documents

Attribution Methods

These paths are recorded in the Fixed Asset Register as cable and associated equipment. The network is used both to carry calls on paths dedicated to PSTN, and to provide dedicated paths for other services, such as leased lines. Most routes would have some level of sharing between PSTN and other services.

The process for apportioning transmission equipment costs takes into account, and costs individually, each of the main building blocks (cable, line equipment and multiplexors), by the various technology types of the equipment, to reflect the different cost drivers of the specific transmission requirements of particular activities. The main cost drivers are weighted transmission length and the type of transmission path, with weighting factors applied to reflect the transmission capacity utilised.

Costs are segregated into those driven by the number of links (e.g. multiplexing equipment) and those driven by the total weighted length of the link (e.g. cable) on the basis of the equipment type.

3.7.4 Underground Access cables

The underground copper cables provide physical connectivity between the exchange and the cabinet and from the cabinet to the last distribution point. These cables are recorded in the fixed asset register as underground copper cables. The cables are used to carry local access services such as PSTN, ISDN and DSL as well as services such as private circuits that require dedicated paths. The main cost driver is the number of cable pairs.

The process for apportioning the costs of access cables between the exchange side and the distribution side is based on a two stage engineering study. The first stage stratifies total access copper cables into two categories; exchange side and distribution side. The second stage apportions access copper cables to network elements on the basis of cable pairs length.

The apportionment is based on an examination of a representative sample of access copper cables records.

3.7.5 Duct

The duct network provides physical underground paths as listed in section 3.7.3 above. These path types are recorded in the Fixed Asset Register as underground civils and plant. The network is used both to carry local access services such as PSTN, ISDN and DSL as well as services such as private circuits that require dedicated paths. It is also used to carry core transmission links. The primary cost driver for duct is total duct kilometres.

The process for apportioning the costs of duct between the Local Access Network Business and the Core Network Business is based upon a three stage engineering study. The first stage stratifies total duct kilometres into three categories; Access only, Core only and shared duct. The second stage attributes the shared duct between Access and Core on the basis of the number of core/access cables in shared duct track. The final stage apportions Core and Access duct to Network Elements on the basis of duct usage.

The duct apportionment is based on a representative sample of duct routes and data maintained on the GIS database.

3.7.6 Overhead plant

The overhead network provides physical overhead paths as listed in section 3.7.3 above. These path types are recorded in the Fixed Asset Register as overhead poles and equipment. The network is used both to carry local access services such as PSTN, ISDN and DSL as well as services such as private circuits that require dedicated paths. It is also used to carry core transmission links. The primary cost driver for overhead plant is cable kilometres.

The process for apportioning the costs of overhead plant between the Local Access Network Business and the Core Network Business is based upon a three stage engineering study. The first stage stratifies total overhead kilometres into three categories; Access only, Core only and shared. The second stage attributes the shared element between Access and Core on the basis of the number of core and access cables on shared overhead routes. The final stage apportions Core and Access overhead plant to Network Elements on the basis of cable length.

The apportionment of overhead plant is based on a sample of overhead plant records taken from a representative sample of exchange areas.

3.7.7 Other appropriated costs

The fully allocated costs of most other appropriated network costs can be directly linked to Network Elements, with no further analysis.

In cases where apportionment of appropriated costs is required, appropriate bases are derived by reviewing the causal links of the appropriated costs. For example the apportionment of maintenance activities to Network Elements is based upon an analysis of time spent for a representative sample period.

3.8 Network transfer charges

3.8.1 Overview

The transfer charges of Network Elements from the Core Network Business to Retail Activities and charges to other operators are based on the unit costs of Network Elements. In addition the Retail Activities are charged the applicable rate of return on mean capital employed and the volume of segments used by the Retail Business and other operators respectively.

3.8.2 Creation of the Core Network Business account

The Network Business account is made up of interconnect revenues from other operators and the transfer charge income from the Retail Business and the cost and capital employed of all Core Network Elements.

3.8.3 Creation of the Local Access Network Business Account

The Local Access Network Business Account is made up of revenue on access services from other operators and the transfer charge income from the retail business and the cost and capital employed of all Local Access Network Elements.

3.8.4 Creation of the Retail Business account

The Retail Activities have now been attributed with all their income, costs and capital employed including transfer charges for their use of the Core Network and Local Access Network.

3.9 Regulatory decisions

eircom is required to ensure that the Accounting Documents (including this Attribution Methods document) are consistent with, and give effect to, a range of actions including directions, consents and determinations made by ComReg. This chapter summarises the key determinations relevant to the statements not outlined elsewhere in this document.

3.9.1 Relevant Costs

- Transfer charge Debtors and Creditors have been excluded from the statements and have not been included in the transfer charge from the Access or Core Network businesses to the Retail Businesses. ComReg have further determined that all working capital associated with interconnect traffic is attributed to services on a combined basis.
- Exceptional costs not related to Y2K or Euro transition attributable to the core network, have been deemed by ComReg to be non-relevant and are excluded from the separated accounts. The provisions relating to exceptional costs excluding Y2K and Euro transition attributable to the core network, contained in the Mean Capital Employed Statement, are also excluded from the separated accounts.
- ComReg have determined that for the purposes of calculating the net book value and the depreciation charge for the year to be used in the statements, the company must use the asset lives which were applicable to the 1997/98 Statutory Accounts, with the exception of land and buildings, poles and access network overhead cable.

3.9.2 Treatment of Line Card

Line cards in switching equipment are to be allocated 100% to access per D7/01.

3.9.3 Route Factors

Route factors have been calculated by *eircom* based on its network plan and actual traffic samples. Under D7/01 ComReg reserves the right to require amendments to these route factors where ComReg deems them not to represent 'efficient operator' route factors.

3.9.4 Recovery of Switching Costs

The allocations of core switching equipment cost between call set up and duration elements is currently the subject of negotiations between *eircom* and ComReg. The current allocations are based upon the allocations arising from a manufacturers study of cost components as amended by the imposition of an overriding pre-dominance principle namely that all components less than a certain % related to call set up are attributed solely to duration. The treatment is in compliance with current ComReg guidance. It is anticipated that future statements will reflect the outcome of the negotiations.

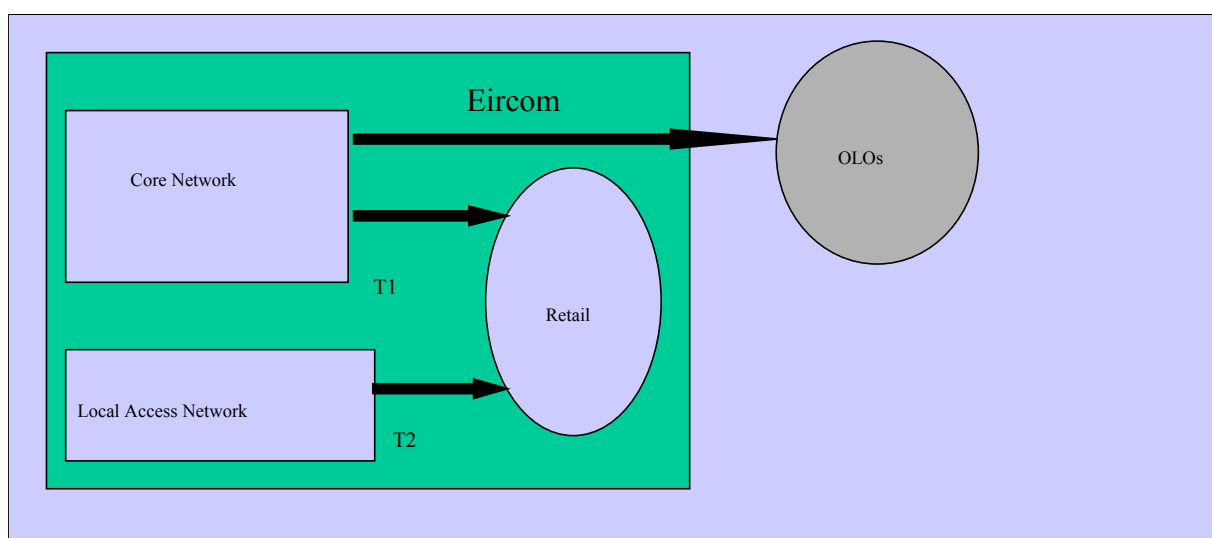
3.9.5 Cost Of Capital Employed (WACC)

ComReg has directed the cost of capital to be used in producing the 2004 statements is set at 11.5%.

4. Transfer charges

4.1 Background and overview

Under Accounting Separation *eircom* prepares separate Financial Statements for its businesses: Core Network, Local Access Network, Retail and Other Business as disaggregated. *eircom* is required to prepare Financial Statements on an historical cost basis using Transfer Charges calculated in accordance with the principles outlined below.



4.2 Network charges

The Core Network Business sells a range of network services to meet the differing needs of other operators and the Retail Business respectively. The price of each service is based on the fully allocated cost of the Network Elements or parts thereof, including a return on capital, used to provide the service.

A Network Element is a unit of network plant or activity which can be separately costed but, in most cases, cannot be separately supplied, e.g. a primary to secondary link. All services sold by the Core Network Business, either to other operators or the Retail Business, are built up from combinations of one or more Network Elements.

4.3 Transfer charges from the Core Network Business

4.3.1 Principle

Transfer charges, and charges to other operators, are based on the product of unit costs and usage. *eircom* produces Financial Statements containing transfer charges based upon the calculated unit costs and usage for the year in question.

4.3.2 Volumes and usage data requirements

The system used to calculate the transfer charges and produce the Financial Statements contains non-financial data, including detailed analyses of service volumes and network usage data. The table below summarises the main classes of information.

Call conveyance and Network Element usage

- Call traffic by product/service (in minutes)
- Route factors by Network Element by product/service
- Network Element usage (in minutes/km minutes)

Ancillary services

- Various volume and usage information by product/service

4.3.3 Calculation of the Core Network Business transfer charges to the Retail Business

Calculated Network Element charges form the basis of both Network Businesses transfer charges to the Retail Business and charges to other operators. *eircom* Retail's route factors and volumes are applied to the calculated Network Element charges to derive its transfer charge. The route factors are calculated using four, two week samples of call data for all products and services.

Transfer charges are calculated in three stages:

- aggregation of unit Network Element charges into unit network service charges;
- application of time of day gradient to network service charges; and
- multiplication of unit network service charges and network service volumes.

The following is an example of the processes for conveyance charging.

Stage 1 Unit network service charge

	Network element 1	Network element 2	Network element n	Service specific	Overall cost
Unit cost	X	X	X		
Route factor	X	X	X		
Service charge	X	X	X	X	X

Stage 2 Time of day specific unit network service charge

Time of day specific unit network service charges are calculated by applying a time of day gradient to the average 24 hour network service charge calculated in stage 1 above. This stage is only appropriate to conveyance services.

The time of day gradients for ‘day’, ‘evening’ and ‘weekend’ charge periods are based on the retail tariffs as outlined in Decision 8.8.2 of Decision Notice D7/00.

Stage 3 Overall time of day specific unit network service charges

Overall service charges are calculated by applying time of day unit network service charges to service charge volumes by time of day.

The above example is specific to a conveyance service. The calculation for non-conveyance services operates in a similar manner.

4.4 Transfer charges from the Local Access Network Business

4.4.1 Principle

Transfer charges, and charges to other operators, are based on the product of unit costs and usage. *eircom* produces Financial Statements containing transfer charges based upon the calculated unit cost (including the applicable return on capital employed) and usage for the year in question.

4.4.2 Volumes and usage data requirements

The system used to calculate the transfer charges and produce the Financial Statements contains non-financial data, including detailed analyses of service volumes and network usage data. The table below summarises the main classes of information:-

Local Access Network Element Usage

- Volumes by product/services;
- Usage factor by local access network elements by product/service;
- Local Access Network Element Usage

Ancillary Services:-

- Various volumes and usage information by product/service.

4.4.3 Calculation of the Local Access Network Business transfer charges to the Retail Business

Calculated Network Element charges form the basis of the Local Access Network Business transfer charges to the Retail Business. *eircom* Retail's volumes are applied to the calculated Local Access Network Element charges to derive its transfer charge.

Transfer charges are calculated in two stages:

- aggregation of unit Network Element charges into unit network service charges;
- multiplication of unit network service charges and network service volumes.

4.5 Public Payphones

The network conveyance charges relating to calls made from payphones and access charges related to lines are initially charged to the Retail activity related to the type of call being made, e.g. Local, National etc. A further transfer charge is then levied from the relevant retail activity to the Public Payphone activity based upon a retail rate equivalent to that charged to other payphone operators.

4.6 Other intra-*eircom* transfer charges

eircom's Businesses sell services to each other. The basis on which charges are made from the Core Network Business and the Local Access Network Business to the Retail Business is set out above.

For all other inter-Business sales, the transfer charges are, as required by ComReg's Decision Notices, to ensure no preferential treatment is given to Businesses within *eircom*, set at a rate equivalent to the charge that would be levied if the product/service were sold externally rather than internally.

The costs of a Business will not ordinarily arise wholly within one operating division of *eircom*. For internal management purposes transfers of cost may take place. These costs are attributed to Businesses using the methodologies described in the Attribution Methods section of the Accounting Documents and do not constitute Transfer Charges as referred to in this section of the Accounting Documents.

4.7 Reporting of transfer charges

The Financial Statements record transfer charges as specified above as:

- revenue in the Core Network Business from *eircom* Retail Activities;
- revenue in the Local Access Network Business from Retail Activities
- Payphone Access Charge; and
- Operating costs in the Retail Activities.

At the time the Financial Statements are produced, the system produces detailed reports and analyses of all Transfer Charges between the separated Businesses, together with volumes purchased and totals due.

The Retail Business purchases from the Core Network Business and the Local Access Network Business are analysed in the general form described within the proforma Financial Statements as set out in the Decision Notices.

5. Historical Cost Accounting Policies

5.1 Basis of Accounting

The Financial Statements are prepared in accordance with the Accounting Documents in the order of priority:

- The Regulatory Accounting Principles
- The Attribution Methods
- The Transfer Charges
- The Accounting Policies

The Financial Statements are required to give primacy to Regulatory Decisions.

The Financial Statements are prepared in accordance with the historical cost convention modified by the valuation of land and buildings, excepting those held on a short leasehold basis.

5.2 Revenue Recognition

Turnover comprises the fair value of all services provided and equipment sold to third parties, exclusive of value added tax and after discounts. Turnover is recognised in the period earned by rendering of services or delivery of products. Turnover includes sales by Group undertakings including the Group's share of its associates' turnover but excludes all intercompany sales.

Turnover from calls is recognised at the time the call is made over the Group's networks. Turnover from rentals is recognised evenly over the period to which the charges relate. Turnover from installation and connection activities is recognised in the same period to as the related costs. Turnover from equipment sold to third parties is recognised at the point of sale. Turnover arising from the provision of other services, including maintenance contracts, is recognised over the term of the contract.

Billings for telephone services are made on a monthly or bi-monthly basis. Unbilled revenues from the billing cycle date to the end of each month are recognised as revenue during the month the service is provided.

Commissions paid to agents are recognised on an incurred basis.

The Group acts as principal in the vast majority of transactions with its customers. Where the Group sells services to customers as a network provider as opposed to service provider, the circumstances of these transactions are reviewed, and the Group believes that it carries all of the risks of the relationship and sale to the end customer and settlement with the service originator are separate and unrelated. Therefore, the Group considers itself the principal in these transactions and accounts for the settlement and revenue recognition as two distinct transactions.

5.3 Research & Development

Expenditure on research and development is written off as incurred.

5.4 Goodwill

Goodwill is capitalised and amortised over its expected useful life. Goodwill represents the excess of the consideration paid for the acquisition of shares in subsidiaries and associated undertakings over the fair value of their separable net assets. The useful lives of goodwill related to acquired businesses have been determined by reference to the periods over which the values of the underlying businesses are expected to exceed the values of their identifiable net assets and are presumed not to exceed 20 years. Prior to 3 April 1998, goodwill arising from acquisitions of subsidiaries and associated undertakings was eliminated against reserves.

Negative goodwill is written back to the consolidated profit and loss account over the estimated life of the underlying assets.

5.5 Foreign Currencies

Transactions designated in foreign currencies are translated into euro at the rate of exchange ruling at the transaction date. Assets and liabilities denominated in foreign currencies are translated at the rates ruling at the balance sheet date, or rates of exchange contracted for under various currency management instruments, with the resulting gain or loss being dealt with through the profit and loss account.

The financial statements of foreign subsidiaries are translated at year-end rates for the balance sheet and weighted average rates for the profit and loss account. Translation gains and losses arising are reported as a movement on reserves.

5.6 Financial Instruments

The Group enters into transactions in the normal course of business using a variety of financial instruments in order to hedge against exposures to fluctuating exchange and interest rates. Firmly committed transactions and the related receivable, and payable, may be hedged with forward exchange contracts.

Currency swap agreements and forward exchange contracts are used to cover the Group's foreign currency debt position. These are valued at year-end exchange rates and the resulting gains and losses are offset against gains and losses on the translation of the related debt. The interest element of the contracts is reflected in interest expense and similar charges.

Interest rate swap agreements are used to reduce the effect of interest rate fluctuations. Interest differentials, arising from these agreements, are accrued and reflected in interest expense and similar charges. Gains or losses arising from interest rate swaps which are terminated upon the repayment of the related debt are reflected in interest expense and similar charges. Interest rate swaps have only been terminated upon the early repayment of the related hedged debt. Any such gains and losses arising are reflected in interest expense and similar charges.

5.7 Tangible Fixed Assets

Tangible fixed assets are stated at historical cost, existing use basis or valuation less accumulated depreciation. Cost in the case of network plant comprises expenditure up to and including the last distribution point before customers' premises and includes contractors' charges, materials, direct labour, and related overheads incurred in the construction of tangible assets. Land and buildings, excepting those held on a short leasehold basis, are stated at a valuation, the basis of which is depreciated replacement cost or open market value as appropriate. Depreciated replacement cost is the gross replacement cost of fixed assets less depreciation based on that cost and on the age of the assets.

Depreciation is provided on tangible assets (excluding land) on a straight line basis so as to write off their historical cost or valuation over their estimated economic lives. Per the note on page 27 the estimated economic lives assigned to tangible assets are as directed by ComReg per D7/01 not the asset lives used to prepare the statutory accounts:

Asset Class	ComReg Directed Life
Buildings	40
Network Services	
<u>Transmission Equipment</u>	
Duct	20
Overhead Cable	10
Overhead Poles	15
Underground Cable	14
<u>Exchanges</u>	
Exchange line Terminations	8
Core Hardware	6
Others	4-9

Fully depreciated assets are retained in tangible fixed assets and depreciation accounts until they are removed from service. In the case of disposals, assets and related depreciation are removed from the accounts and the net amount, less proceeds from disposal, is charged or credited to the consolidated profit and loss account.

5.8 Impairment

The group undertakes a review for impairment of a fixed asset or goodwill if events or changes in circumstances indicate that the carrying amount of the fixed asset or goodwill may not be recoverable. To the extent that the carrying amount exceeds the recoverable amount, that is the higher of net realisable value and value in use, the fixed asset or goodwill is written down to its recoverable amount. The value in use of fixed assets is determined from estimated discounted future net cash flows.

5.9 Capital Grants

Non-repayable grants are accounted for as deferred income, which is amortised to the profit and loss account at the same rate as the related assets are depreciated.

5.10 Leased Assets

The capital cost of assets acquired under finance leases is included in tangible assets and written off over the shorter of the lease term or the estimated useful life of the asset. The outstanding capital element of the lease obligations is included in loans and other debt, while the interest is charged to the profit and loss account over the primary lease period.

Operating lease rentals are charged to the profit and loss account as incurred.

5.11 Stocks

Stocks comprise consumable items, which may be used in the construction or maintenance of plant and goods held for resale. Stocks are stated at the lower of cost and net realisable value. Cost includes invoice price, import duties and transportation costs. Where necessary provisions are made for damaged, deteriorated, obsolete and unusable items.

5.12 Debtors

Debtors are stated in the balance sheet at estimated net realisable value. Net realisable value is the invoiced amount less provisions for bad and doubtful debts. Provisions are made specifically against debtors where there is evidence of a dispute or an inability to pay. An additional provision is made based on an analysis of balances by age of debtor, payment history, previous losses experienced and general economic conditions.

5.13 Pension Costs

The pension entitlements of employees arising from their service with the Group, are secured by contributions from the Group and the employees to separately administered superannuation schemes. The contributions are based on the advice of a professionally qualified actuary and are included as staff costs in the profit and loss account.

Pension costs in respect of the Group's defined benefit schemes are charged in the profit and loss account on a basis which spreads the cost of pensions over the service lives of employees in the schemes.

Actuarial valuations are carried out triennially. Additional contributions are made to superannuation schemes in respect of employees who take early retirement. These contributions are based on the advice of a professionally qualified actuary.

The group also operates a defined contribution pension scheme and the profit and loss account is charged with the contributions payable by the group.

5.14 Provisions

A provision is defined as a liability of uncertain timing or amount. Provisions are recognised when the Group has a legal or constructive obligation as a result of past events and a reliable estimate of that obligation can be made.

5.15 Onerous Contracts

In accordance with the requirements of FRS 12 “Provisions, Contingent Liabilities and Contingent Assets”, provision is made against the net cash outflow expected to arise from contracts where the unavoidable costs under the contract exceed the economic benefit expected to be received under the contract.