

Summary of Minutes of the 3rd Meeting of the Study Group on the Accounting System in the Telecommunications Service

1. Date: Wednesday, February 21, 2007 from 10:00 am to 12:05 pm
2. Location: Conference Room 1, Ministry of Internal Affairs and Communications, 1st Floor, Low-rise Building, Central Joint Government Building 2
3. Attendees
 - (1) Members (In alphabetical order; honorifics omitted)
Hiromasa Sekiguchi (Deputy Chairperson), Seno Tezuka, Mikio Tokai (Chairperson), and Junichiro Tsuruta
 - (2) Observers (In alphabetical order)
Chubu Telecommunications Co., Inc.; eAccess Ltd.; KDDI Corporation; Nippon Telegraph and Telephone East Corporation; Nippon Telegraph and Telephone West Corporation; Nomura Securities Co., Ltd. (Masuno, Senior Researcher); SOFTBANK TELECOM Corporation; and Telecom Service Association
 - (3) Ministry of Internal Affairs and Communications
Taniwaki, Director of the Tariff Division; Ninomiya, Senior Planning Officer of the Tariff Division; Katagiri, Assistant Director of the Tariff Division; and Imura, Assistant Director of the Tariff Division
4. Agenda
 - (1) Presentations by observers
 - (2) Others
5. Outline of proceedings
 - Presentations by observers
Presentation by Nippon Telegraph and Telephone East Corporation and Nippon Telegraph and Telephone West Corporation
 - Nippon Telegraph and Telephone East Corporation and Nippon Telegraph and Telephone West Corporation argued in accordance with Document 1 that deregulation should be implemented in light of significant progress in competition in the telecommunications services, and that on the basis of the above, the accounting system should be simplified so as to include only indispensable items.
 - Major discussions were as below.

(Member)

The term “simplification” is used as a keyword in your request. What in particular do you ask to be simplified?

(NTT East Corporation and NTT West Corporation)

We established an interconnection accounting system and opened up some facilities. As a result, there are very few cases where current user charges are determined by the addition of certain amounts to costs. In many cases, current user charges are decided taking other companies’ charges into account. In this situation, we would like to request that restraints imposed on the setting of user charges in particular be simplified.

(Member)

You say that facility categories for use departments in interconnection accounting are unnecessary. However, in light of the stack tests currently under discussion by the Telecommunications Council and in view of the fact that business accounting is intended to contribute to the proper calculation of user charges, we think that such facility categories will continue to be necessary in the future. What is your opinion about this?

(NTT East Corporation and NTT West Corporation)

The purpose of interconnection accounting is to contribute to the proper calculation of user charges. From now on we will appropriately handle facility categories regarding facilities designated as Class 1. However, we would like to be given a free hand regarding user charges. In this sense, we think that facility categories for use departments are unnecessary.

(Member)

In one of the meetings of the Committee for Matters Such as Basic Charges held the year before last, discussions were held on the basis that traceability was necessary for costs pertaining to basic charges as well. Such being the case, I presume that facility categories for use departments will be necessary from now on as well.

(Member)

Facility categories used in interconnection accounting are different from those used for calculating network use charges. Why is this the case?

(NTT East Corporation and NTT West Corporation)

It may be that in the past, there was a one-to-one correspondence to some extent between facility categories in interconnection accounting and functional categories in interconnection charge calculation. At present, however, in some areas there is no such correspondence due to diversification of interconnection patterns, including unbundling of dark fibers, for example. We are concerned about which facility categories are appropriate.

(Member)

Are you considering about the modification of the current facility categories so that they are compatible with the diversification of interconnection patterns?

(NTT East Corporation and NTT West Corporation)

Of course we are considering it. In connection with this, we hope that restraints will be limited to the minimum necessary, for example by simplifying items that have become less important.

(Member)

You say that LRIC itself should be abolished, and that consequently it is essentially unnecessary to make comparisons between LRIC and actual costs. However, at present, interconnection charges are actually calculated on the basis of LRIC. Therefore, comparisons between LRIC and actual costs are important in the discussion of LRIC. Such being the case, LRIC cannot be said to be unnecessary. Is there any problem with the submission of comparative data?

(NTT East Corporation and NTT West Corporation)

It is difficult to make such comparisons for individual facilities, since there are differences between LRIC categories and actual facility categories. However, it is possible to make comparisons on an overall basis or in terms of individual functions.

(Member)

You explained that costs are reduced by outsourcing work to subsidiary companies. It would be appreciated if a quantitative explanation could be given.

(NTT East Corporation and NTT West Corporation)

No specific numbers are at hand. When the companies we outsource to were separated from the parent companies in 2002, employees aged 51 and over were transferred to the new companies. Their wages were cut by nearly 20 percent.

(Member)

It has been pointed out that there is a possibility of costs such operating and maintenance costs being mixed in with the costs of outsourcing work to subsidiary companies. What is actually the case?

(NTT East Corporation and NTT West Corporation)

It is true that there is only one final contract for each project outsourced, but the operating costs and maintenance costs are appropriately recorded, and it is never the case that such costs are mixed in with the outsourcing costs.

Presentation by KDDI Corporation

- KDDI Corporation argued in accordance with Document 2 that it was necessary to improve the transparency of accounting procedures, increase the transparency of transactions with related companies, coordinate interconnection accounting, interconnection charge calculation and accounting by service type, and to make it compulsory to review accounting systems.
- Major discussions were as below.

(Member)

The term “transparency” is used as a keyword in your request. What in particular do you ask to be made transparent?

(KDDI Corporation)

Transactions with related companies. We do not see the fact that related companies make profits through transactions with NTT East Corporation and NTT West Corporation as a problem.

However, with regard to areas pertaining to interconnection accounting, we hope that information will be disclosed so that prices contained in transactions with related companies can be compared with general market prices. It is necessary to set up a system where information is disclosed not to competing carriers but to neutral organizations and where such organizations can verify the contents of the information.

(Member)

The water utility industry in the United Kingdom is used as an example in relation to the disclosure of information about transactions with related companies. The scope and contents of the rules for the accounting system in this industry are significantly different from the current Rules for Telecommunications Business Accounting. What are you specifically requesting, in this context?

(KDDI Corporation)

We think that it is necessary to discuss not only the way transactions with companies that have a capital relationship are handled, but also how transactions with companies from which work has been previously commissioned are handled.

(Member)

You request that information centering on consolidated financial statements be disclosed. Does your request pertain to relevant information on management in general or on specific segments?

(KDDI Corporation)

We hear that in regulatory accounting for BT, there are consolidated financial statements regarding management in general, and that there are financial statements for a specific SMP market as one type of segment included in within them. We hope that our request will be understood in these terms.

(Member)

Will consolidated financial statements requested by your company be similar to those which are currently released by NTT Corporation (holding company) and which will be prepared with NTT East Corporation and NTT West Corporation as parent companies? Document 2 points out that it is problematic that information about NTT East Corporation and NTT West Corporation, which are subsidiaries of NTT Corporation (holding company) and so-called brother companies, goes missing. What does this mean?

(KDDI Corporation)

In consolidated accounting under the current institutional accounting system, so-called brother companies are not covered. In this sense, this consolidated accounting is not very meaningful. Discussions should be held on the assumption that consolidated accounting of the holding company will be subjected to segmentation in terms of interconnection accounting involving NTT East Corporation and NTT West Corporation or that transactions regarding interconnection accounting will be combined.

(Member)

If you are too particular about consolidated financial statements, I presume that issues will arise, for example, as to what the range of consolidation should be and whether full consolidation should

be carried out including assets. Thus I am afraid that the actual conditions will not be addressed, although the framework will be established. If the purpose is to ensure the transparency of transactions with related companies, it is conceivable, for example, that information will be disclosed in such a way as to be limited to commission expenses and to consolidate only the segment involving companies with which transactions are conducted.

(Member)

With regard to the differences between facility categories used in interconnection accounting and those used for calculating network use charges, your company explained that NTT East Corporation and NTT West Corporation disclosed information on how they correspond. What specifically are the unknown points regarding this?

(KDDI Corporation)

In the present circumstances, it is problematic that the process of calculating network use charges cannot be traced from interconnection accounting. We think that insufficient disclosure about how these categories correspond is one of the reasons.

Presentation by eAccess Ltd.

- eAccess Ltd. argued in accordance with Document 3 that it is necessary, for example, to establish the method of checking for internal mutual assistance, straighten out facility categories in interconnection accounting, improve the transparency of treatment procedures, ensure the compatibility between interconnection accounting and business accounting, and to increase the transparency of transactions with related companies.
- Major discussions were as below.

(Member)

The term “transparency” is used as a keyword in your request, as in the request of KDDI Corporation. Does your company want processes to be disclosed as well with regard to items for which results are disclosed?

(eAccess Ltd.)

That is correct. If no procedures are disclosed, it is impossible to verify the accuracy of results. For example, regarding allocation criteria, in the present circumstances we can only say that there is a possibility of impropriety.

(Member)

You also request more transparency for transactions involving related companies. With regard to carriers for which disclosure is requested, the scope of KDDI Corporation is a little wider. Your request could be interpreted as being limited to subsidiary companies and related companies. Is this interpretation correct?

(eAccess Ltd.)

We would like to request that important entities be focused upon, for example, starting with subsidiary companies and proceeding to closely related companies or to companies separated in the last several years due to reorganization.

(Member)

This question is directed to the Secretariat. What reports are made under the current system, with regard to transactions with related companies for which information disclosure is requested by KDDI Corporation and eAccess Ltd?

(Secretariat)

There is a document called the Telecommunications Business Operating Expense Portfolio, which is one of the attached portfolios under the category of financial statements under the Rules for Telecommunications Business Accounting. Thus it is possible to understand the amounts of total commission expenses for individual broad-expense categories, such as operating expenses and maintenance expenses. However, there is no information on either related individual companies or on individual detailed-expense categories.

(Member)

Suppose that information on transactions with related companies is disclosed. Do you have any benchmark for judging whether the contents of such information are accurate? If there is no such benchmark, it may be impossible to verify.

(eAccess Ltd.)

This is a very complex issue. We presume that if unit prices for individual contracts are known, it will be possible to make comparisons with market prices.

(Member)

That information constitutes management information. Therefore, I presume that it is not appropriate to disclose such information. It may be necessary, for example, to conduct a study on the need to establish a system where, as was discussed in the case of LRIC, relevant companies conclude nondisclosure agreements to show data to one another.

(Member)

Regarding profit and loss portfolios by service type, you argue that income and expenditure for important service types should be restated on an individual basis. What important service types do you have in mind?

(eAccess Ltd.)

The service types we consider to be important are IP-based services, where competition should be encouraged from now on, such as B-FLET'S service and Hikari Telephone service.

Open discussion

- Following the presentations and respective question-and-answer sessions made by the four companies, open discussions were held. Observers who did not make presentations also participated.
- Major discussions were as below.

(Telecom Service Association)

eAccess Ltd. argued in its presentation that discussions should be held in which priority is given to problems arising in the period when conventional telephone networks and IP networks coexist. In this regard, it is necessary to hold discussions on a long-term basis, taking into account a future picture of the situation where the full changeover to IP networks has been completed.

(SOFTBANK TELECOM Corporation)

Document 1 of NTT East Corporation and NTT West Corporation argues that the accounting system should be simplified to include only the minimum items necessary. In our view, the minimum level necessary has not yet been reached. Moreover, NGNs should all be categorized as designated telecommunications facilities.

(NTT East Corporation and NTT West Corporation)

What we mean by arguing that the accounting system should be simplified to include only minimum items necessary is this: We will properly carry out interconnection accounting. Such being the case, we request that restraints on user charges be limited to the minimum necessary. We presume that both KDDI Corporation and SOFTBANK TELECOM Corporation are going to build NGNs. If both of them do that we presume that, unlike in the case of conventional telephone networks, the two companies' networks will be mutually interconnected. In that case, such NGNs will not fall into the category of bottleneck facilities. Consequently, we ask that restraints be relaxed.

(Chubu Telecommunications Co., Inc.)

In the case of electric utilities, logistics departments are subjected to sectional accounting. The resulting interconnection costs are the same for electric power company themselves as for outside carriers. User charges are set in such a way that relevant carriers' expenses, including electric power costs and operating costs, are added to these costs. In the case of the telecommunications industry as well, it is desirable that it be possible to check the relationship between user charges and interconnection charges, which together constitute the costs of such user charges.

(NTT East Corporation and NTT West Corporation)

There are great differences in market environments between the electric power industry and the telecommunications industry. Some aspects of fixed telephone services are similar to those of the electric power industry. In the case of broadband services, we presume that all companies are in the red when they start business. If user charges were set by adding certain amounts to interconnection costs and operating costs, it follows, to put it in extreme terms, that businesses with a deficit would not exist. In reality, the benefits of users and carriers are taken into account, and business is conducted on the basis that even if deficits are incurred at the beginning, costs are recovered on a long-term basis. Regarding user charges, it is up to the carriers whether or not to recover the portion of operating costs in particular, within the pertinent fiscal year. It is not necessary to check if user charges are set by adding certain amounts to interconnection costs.

(eAccess Ltd.)

Deficits in networks and those in operating costs should be considered separately. As regards networks, there is no problem with a model where prior investment is performed and deficits are incurred at the beginning. In the case of operating costs, if a carrier operates at such exorbitant costs that no other companies can follow in its footsteps, it will presumably cause a problem in terms of fair competition.

(NTT East Corporation and NTT West Corporation)

What are “exorbitant” operating costs? Criteria are unclear. The principle of competition comes into play in the case of agency commissions, which are often mentioned in this context. No agency will deal in our products unless we pay amounts commensurate with commissions paid by competing carriers. That is, if we reduce operating costs, we will be beaten in competition. In that sense, all carriers are in the same boat.

(eAccess Ltd.)

Document 1 of NTT East Corporation and NTT West Corporation says that most of the fiber-optic cable in which investments were made in 1985 has been reconditioned by now. When was this started? Will this be carried out from now on at a similar pace?

(NTT East Corporation and NTT West Corporation)

We verified on the basis of discussions about LRIC models. About 80 percent of such fiber-optic cable has been reconditioned over the last 20 years. We have not gone so far as to analyze the reasons, which include technical innovations in fiber-optic cable itself and network relocation due to impediments. In any case, such circumstances are considered to have led to the current results. We do not know what things will be like in the future.

(eAccess Ltd.)

What do you think of our request for accounting information to be disclosed in the form of electronic data?

(NTT East Corporation and NTT West Corporation)

We would like to answer that question at the next meeting or later.

(Member)

I would like to request NTT East Corporation and NTT West Corporation to hold in-house discussions about the following matters based on today’s discussions: the extent to which information can be disclosed from now on regarding allocation standards that are more detailed than the current level of disclosure regarding allocation processes; and the way that, as dominant companies, they should fulfill their responsibilities to carriers and users with regard to such level and extent.

End