

## Summary of Minutes of the 6th Meeting of the Study Group on the Accounting System in the Telecommunications Service

1. Date: 10:00 to 12:00, Wednesday, May 16, 2007

2. Location: Special Conference Room 3, 9th floor, Central Joint Government Building 2

### 3. Attendees

(1) Members (Entered in alphabetical order of last names, with honorifics omitted)

Hiroshi Obata, Hiromasa Sekiguchi (Deputy Chairperson), Norio Tezuka,  
Mikio Tokai (Chairperson), Junichiro Tsuruta

(2) Observers (Entered in alphabetical order of entity names)

Chubu Telecommunications Co., Ltd.; 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; Telecom Service Association

(3) Ministry of Internal Affairs and Communications

Sakurai, Director-General of the Telecommunications Business Department; Taniwaki, Director of the Telecommunications Policy Division; Ninomiya, Senior Planning Officer of the Tariff Division; Katagiri, Assistant Director of the Tariff Division; Imura, Assistant Director of the Tariff Division

### 4. Agenda

(1) Written opinions submitted by relevant observer companies

(2) Consolidation of major points at issue

(3) Others

### 5. Outline of proceedings

[Written opinions submitted by relevant observer companies]

- The Secretariat made presentations of written opinions of relevant companies based on Documents 1 to 4.

[Consolidation of major points at issue]

< 4. Proper method of treating depreciation expenses >

- The Secretariat explained the subject major point at issue based on Document 6.
- Major discussions were as given below:

(Member)

Although telecommunications service falls under the categories of equipment industry and facilities

industry, depreciation expenses have an important meaning.

(Member)

Service life should be discussed by ascertaining the meaning of the term “economic service life.”

(Chubu Telecommunications Co., Ltd.).

Does the current discussion concern the method of calculating costs for cases where calculation of interconnection charges is done for NTT East Japan and NTT West Japan, or does it strictly concern the proper definition of service life in terms of accounting?

(Member)

The current discussion concerns the proper definition of service life in terms of accounting, but interconnection charges are calculated using actual data based on service life. It is therefore impossible to consider it by completely separating these two matters.

(Chubu Telecommunications Co., Ltd.).

If economic service life is longer than the present legal service life, and if NTT East Japan and NTT West Japan calculate interconnection charges on the basis of the above-mentioned economic service life, then facilities competitor carriers cannot help following in the two companies’ footsteps in terms of interconnection charges. Therefore, the fear of such carriers’ investment incentives being reduced will exist. If economic service life is to be adopted, it is necessary to consider technical innovation, cancellation of contracts, and the risk of irrecoverable investment due to impediments and transfer.

(SoftBank Telecom Corporation)

It is also necessary to consider it by including the effects of market extension due to the reduction of market prices.

(Member)

If the actual conditions of enterprises are to be reflected to a further extent, it is better to switch from legal service life to economic service life. If Chubu Telecommunications Co., Ltd. alone sticks to legal service life while all other relevant companies adopt economic service life, I presume that a relatively high burden of depreciation expense will be incurred, resulting in charges remaining high. It seems to me that if economic service life is calculated by reflecting the actual condition of Chubu Telecommunications Co., Ltd. in the charge strategy, then no great confusion will occur.

(Chubu Telecommunications Co., Ltd.).

In the current market, the interconnection charges set by NTT East Japan and NTT West Japan constitute substantial market prices. The concepts of service life adopted by NTT East Japan and NTT West Japan are therefore important. What follows is a policy argument-oriented statement as seen from the viewpoint of facilities competition. In the case of FTTH, for example, networks have to be developed from now on. I feel that, under such circumstances, a business model where investment is recovered over a very long period of time brings new entrants into very difficult conditions.

(Mr. Masuno)

If a decision is made to introduce economic service life, then the pertinent enterprise’s decision on

investment is certain to be affected. It is necessary to conduct studies as to what effects will be caused if economic service life is introduced.

(NTT East Japan)

If “economic service life” refers to “service life in which actual usage conditions are reflected,” then we believe that this type of economic service life should naturally be adopted in present enterprise accounting as well, and that the adoption of this “economic service life” is nothing more than the practice of more appropriately complying with principles. On the other hand, service life that is currently adopted with respect to LRIC is a type of service life that may be realized by the most efficient carriers. We therefore feel resistance to this type of service life being called “economic service life.”

We wish to request that a definite decision be made as to which of the following courses will be taken: Actual service life will be calculated and applied by each individual company; or the Ministry of Internal Affairs and Communications will uniformly decide service life and have it applied, either by NTT East Japan and NTT West Japan or by companies other than these two NTT companies. If each individual company is to perform calculation, we feel that it is difficult to calculate numerical values that are appropriate as actual service life at this time. On the other hand, if the Ministry of Internal Affairs and Communications is to uniformly decide service life, we feel that it will turn out that companies other than NTT East Japan and NTT West Japan will also apply such service life. If economic service life is decided by reflecting actual usage conditions, then such service life is based on primary accounting principles, and therefore it is not appropriate to handle this type of service life differently in interconnection accounting and in business accounting.

(Member)

Personally, I believe that an essentially reasonable course of action should be that relevant companies would calculate and apply economic service life with respect to their assets, not that the Ministry of Internal Affairs and Communications will establish legal service life. In this connection, my understanding is that carriers owning bottleneck facilities are subject to control and that whether such carriers are given a free hand should be discussed on a separate basis. I think that each company need not make different use of Tax Law-based service life and economic service life depending on internal departments, and that it is OK to use a single type of service life throughout the company.

(KDDI)

Actual past usage conditions, current usage conditions, and prospects for future usage should be considered in regard to economic service life. It is a matter of course that economic service life is not physical life. Business managers estimate service life by considering business risks including economic and functional changes, technical innovation, and environmental changes. We feel that even in the case of the same facility, economic service life differs depending on marketing strategies of relevant companies. As regards financial accounting, speaking in generalities, decisions are made by relevant companies by considering such points. In this regard, NTT East Japan and NTT West Japan are dominant carriers owning bottleneck facilities, and therefore we cannot help referring to

the grounds for interconnection charge costs. In the first place, the definition of service life should be decided based on the actual economic conditions in the FTTH market as seen by NTT East Japan and NTT West Japan.

(Telecom Service Association)

Arguments differ depending on whether facilities are those such as telephone networks for which actual values have already been determined or those for which investment is required and which involve high risks. New investment involves high risks, and it is therefore necessary to develop a setup whereby pertinent returns are considered and overall investment incentives are causes to act.

(Member)

It is easy to use the term economic service life to reorganize the outlook on service life in future telecommunications service accounting. However, it is meaningless to use this abstract term unless the implication of the term and a specific calculation method are known. There are accounting systems having different purposes, as well as various ways of thinking. It is therefore necessary to further work out arguments by rearranging such matters.

(Member)

The issue of service life is nothing more than a matter of estimation and presumption. It is satisfactory if a point of consensus is reached within the framework of telecommunications service as to where such presumption is to be finalized. I feel that the service life to be set by each company will be based on such service life as will be judged as appropriate in terms of audits. It is necessary to verify how inconsistent this service life is from the type of service life that we have been discussing.

#### < 5. Clarification of transactions with subsidiary companies commissioned with work >

- The Secretariat explained the subject major point at issue based on Document 6.
- Major discussions were as given below:

(KDDI)

Transactions among NTT group companies are thought to account for a high percentage of interconnection charge costs and are expected to increase from now on. What our company considers a very big problem is the fact that almost no information is available on such transactions. One suggestion is to establish an accounting system on a consolidated basis. Such a system exceeds the scope of institutional consolidated account settlement in that, for example, transactions with sister companies are included within the framework of the system. However, this accounting system is very meaningful for wiping out the area where transactions with group companies are nontransparent.

Moreover, even if consolidated accounting is introduced, there are limits in that no information is available on the efficiency of the subsidiary companies and that accounting consolidation with related companies can be carried out only by the equity method. Based on the above, another

suggestion is that items related to interconnection charge costs should be selected from transactions in the NTT group and should be verified. This is feasible, since there is a precedent involving OFWAT in the United Kingdom.

It is conceivable that the content of transactions to be disclosed will be extracted from databases for in-house collective decision-making systems. Such transactions should be limited to those that affect the calculation of interconnection charges. Pertinent information consists of detailed data, and it should therefore be submitted to third party organizations. As regards judgment on the propriety, there is an issue as to how data for market prices that are subject to comparison is to be collected. Be the matter as it may, we believe that mere submission of data is a very effective practice.

(Member)

The figure 1% is shown for illustrative purposes in regard to transactions to be disclosed. Based on this number, I feel that the amount of information to be extracted will not differ much from the amount voluntarily presented so far by NTT East Japan and NTT West Japan on transactions with subsidiary companies. On the assumption that the currently disclosed data are insufficient, if the standard value is reduced by 10%, then how effective do you think it is?

(KDDI)

We do not take all costs into account, but focus on interconnection charges. We assume that transactions exceeding 1% of calculated interconnection charge costs for individual functions are subject to disclosure.

(Member)

The term “Subitems ‘a’ and ‘b’ of Item 3 on Page 34” is mentioned. If information in subitem “a” is to be presented, then I feel that it is not significantly necessary to perform disclosure under the system for disclosure of transactions among related parties. I would like to ask for your opinion on this point. Moreover, if information in subitem “a” is to be presented in detail to a company commissioned with work, then it is probably inappropriate to disclose such information. In this sense, I feel that a choice should be made between the following two alternatives: Information will be disclosed with restrictions imposed and will be left to the discretion of the market; or detailed data will be presented to administrative agencies or third party organizations and it will be left to them to perform analysis. Which choice do you believe is more effective?

(SoftBank Telecom Corporation)

The number of target companies should be increased. We would like to have information that is as detailed as possible. At the present time, we cannot make an assertion on which is better as regards balancing with respect to disclosure.

(NTT West Japan)

Both subitems “a” and “b” were mentioned, presumably in a bid to ask which should be chosen. In the case of either subitem “a” or “b,” demands are made for data that differ considerably from those in the actual conditions of business practices of the present group companies. We therefore believe that both subitems “a” and “b” are practically very difficult to implement. This is particularly so in

the case of interconnection accounting on a consolidated basis and implementation of operations in terms of small departments, as mentioned in the allocation method documents.

(NTT East Japan)

We conduct commissioning expense negotiations with subsidiary companies in a severe manner. In one year out of every two, subsidiary companies go into the red. Therefore, if accounting is consolidated, there is a possibility of interconnection costs going up. It is conceivable that there is an argument that accounting should be consolidated to increase transparency, but consolidated accounting systems are time-consuming and costly. We wonder if accounting consolidation ought to be accomplished at so much cost. Subsidiary companies were founded for streamlining purposes. Total costs, including those of such subsidiary companies, have been reduced via the effects of streamlining. We therefore presume that it suffices to look at actual results. We are aware that NTT East Japan and NTT West Japan are subject to special obligations. In the case of administrative departments, the realities are that facilities, particularly those related to IP telephones, are subject to competition. Besides, other companies are also taking measures such as commissioning work, including maintenance, to subsidiary entities. If we present cost data pertaining to such commissioned work, then this act will benefit other companies. We therefore wish to request that careful consideration be given to the handling of such data.

(eAccess Ltd.)

Costs of work such as collocation account for a large proportion in our business. We perform checks each year for rationalization and efficiency improvement regarding such costs. Work commissioning expenses are lumped together, and therefore it is difficult to take an itemized look at them. In regard to work commissioning expenses, we wish to request that at least the percentage of expenses for companies related to NTT East Japan and NTT West Japan and the corresponding percentage for the other companies be clearly shown, thereby developing an environment where our check work can be performed in a more intelligible way.

(SoftBank Telecom Corporation)

Competition was mentioned earlier. In the present circumstances where, for example, the shares of NTT East Japan and NTT West Japan have increased in regard to Hikari Telephone service, our understanding is that competition is not necessarily in progress. Costs that are collectively classified as work commissioning expenses account for an overwhelmingly high percentage of total costs. We presume that this fact impairs overall transparency. Furthermore, when subsidiary companies or affiliated companies of NTT East Japan or NTT West Japan are requested to perform work, it is difficult to conclude negotiations for items such as costs and work periods. We therefore feel that such subsidiary companies have problems not only with accounting aspects, but also with actual competitive aspects.

(Member)

The fact that work-commissioning expenses account for a high percentage of total costs in the case of NTT East Japan and NTT West Japan is actually shown as data. It therefore seems necessary to probe this matter somehow by means of the following: Documents will be prepared that will permit

the measurement of efficiency improvement effects for which it is difficult to perform measurement and judgment on the basis of general documents such as financial statements; or a study will be made of disclosure methods. We would like to promote discussions as to which techniques are feasible and which methods are capable of demonstrating effects.

< 6. Improvement of stack testing feasibility regarding accounting systems >

- The Secretariat explained the subject major point at issue based on Document 6.
- Major discussions were as given below:

(NTT East Japan)

As regards comparison between LRIC and actual costs, the final purpose is comparison of the costs of network functions in subitem “c.” In the last meeting, there was an argument that facility categories for interconnection accounting would also be based on network functions. Considering this argument, we presume that it is OK to prepare documents by centering on subitems “b” and “c.” As regards stack testing, within the framework of sales support, there are intermediation commissions, which are paid on a special arrangement basis with respect to expenses required for acquiring customers and which come under one of the breakdowns of operating expenses. In this connection, agency commissions and the like are typical examples of expenses required for acquiring customers.

< 7. Others >

- The Secretariat explained major points at issue based on Document 4.
- Major discussions were as given below:

(NTT East Japan)

As regards basic income and expenditure statements for telecommunications service, we presume that it is sufficient if the portions required for calculating LRIC costs are divided into the management category and the usage category, and that it is sufficient to divide only the content of operating expenses into the usage department category and the management department category.

< 8. Major points at issue as a whole >

- Major discussions were as given below:

(Chubu Telecommunications Co., Ltd.).

As regards service categories in profit and loss statements by service type, it is certain that types of telecommunications service other than designated ones are in a competitive market. In this regard, profits and losses should be disclosed in regard to the fields that are expected to grow from now on, such as Hikari Telephone service and IP telephone service.

(Member)

The trend of changeover to IP telephones should also be kept in mind. Nevertheless, it is also a fact that accounting should be based on current controls.

(KDDI)

There will be progress in the changeover to IP telephones, and we will enter the NGN era, then the relationship between facility categories and network functions will become complicated. Such being the case, in regard to facility categories in interconnection accounting, we feel uneasy about whether all items can be subjected to cost consolidation in the stage of interconnection charge calculation. It seems to us that interconnection charges should be calculated after facilities are categorized, with attention paid to functional aspects in the interconnection accounting stage where basic data are prepared. Unless the above is done, we presume that what is complicated now will become still more complicated.

[Others]

- In the next meeting, only the members will discuss the main points of the report.

End