

## Summary of Minutes of the 7th Meeting of the Study Group on the Accounting System in the Telecommunications Service

1. Date and time: 16:30 to 18:30, Thursday, June 28, 2007
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 (Entered in alphabetical order of last names, with honorifics omitted)  
Hiroshi Obata, Hiromasa Sekiguchi (Deputy Chairperson), Norio Tezuka, Mikio Tokai (Chairperson), Junichiro Tsuruta
  - (2) 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; Iimura, Assistant Director of the Tariff Division
4. Agenda
  - (1) Main Points of the Draft Report
  - (2) Others
5. Outline of proceedings

### [Main Points of the Draft Report]

#### <Chapters 1 to 4>

- The Secretariat explained Chapters 1 to 4 of Main Points of the Draft Report on the basis of Document 1.
- Major discussions were as given below:

#### (Member)

Chapters 1 to 4 concern the issue of deciding the structures of telecommunication service accounting and interconnection accounting. That discussions should be held within the overall framework of the Company Law or of accounting practices and accounting standards that are generally regarded as fair and reasonable is understood. However, it is not easy to reexamine those portions of accounting that have developed into unique accounting practices ever since Nippon Telegraph and Telephone Public Corporation was privatized. My understanding is that discussions are being held this time as a general review.

#### (Member)

Telecommunications service is now in a period of transition. Therefore, the intent is to make a somewhat piecemeal approach in which correction is first made to portions that are not compatible with the actual conditions. This approach is satisfactory in terms of the basic viewpoint. It seems to me that the overall tone up to Chapter 4 is fairly directive in nature.

(Member)

In regard to the relationship between B-FLET'S service and Hikari Telephone service that is premised on the conclusion of a contract for B-FLET'S service, a proposal is made in Main Points of the Draft Report to the effect that a category pertaining to B-FLET'S service should be newly established as a type of designated service that does not fall under the category of specific service. On the other hand, Hikari Telephone service falls under a category of service that does not come under the category of designated service. Therefore, Hikari Telephone service concurrently falls into two categories.

As discussed in the Study Group on Future Images of Universal Service Fund system, there is a possibility that, in the process of the changeover from PSTNs to Everything Over IP telephone networks, the time will come when B-FLET'S service will be regarded as universal service as in the case of PSTNs. Besides, there are instances where administrative agencies independently provide Hikari Telephone service in high-cost areas. If Hikari Telephone service is not premised on the conclusion of a contract for B-FLET'S service, there is a possibility that the cost allocation between B-FLET'S service and Hikari Telephone service will undergo changes. A future possibility will therefore exist that either of the following items will be discussed: whether it is appropriate to think that no particularly improper internal mutual assistance will exist if all types of service other than designated service are in the black; or whether it is appropriate to pass judgment on the sole basis of the independent income and expenditure of Hikari Telephone service.

(Secretariat)

There is a matter of whether Hikari Telephone service falls under the category of universal service and a matter of whether Hikari Telephone service comes under the category of designated telecommunications service. In regard, the purposes and criteria for controlling differ depending on category. From now on, discussions may be held on the treatment of Hikari Telephone service in relation to NGNs. As far as profit and loss portfolios are concerned, studies will be conducted as to whether Hikari Telephone service falls under the category of designated service. If affirmative, then profit and loss will be determined as necessary.

(Member)

At present, fees for B-FLET'S service are distinct from fees for Hikari Telephone service. In this regard, I presume that fiber-optic networks are shared by those two service entities. Is the relationship between fees and costs rationalized?

(Secretariat)

We were given the explanation that the costs corresponding to user fees for Hikari Telephone service are that portion of expenses which is added on to the expenses for B-FLET'S service.

Namely, the above-mentioned costs consist of the costs for equipment such as routers and servers related to Hikari Telephone service.

(Member)

Isn't there any problem with the allocation of such costs? For example, if it can be said that maintenance costs for fiber-optic networks are used to earn profits for the Hikari Telephone service entity, and if, from now on, such costs are to be allocated accordingly, then isn't there a possibility that services in categories other than designated categories will go into the red?

(Member)

In the case of profit and loss portfolios by service type, profit and loss can be properly calculated only if incomes and costs appropriately correspond to respective service categories. For example, if fiber-optic networks are shared by multiple service entities, then the pertinent costs should be allocated properly.

(Member)

I presume that this will be the greatest problem for several years to come. In the case of current controlling, there is a wall between designated service and undesignated service. Therefore, there is no choice but to rationalize the situation in this way. Now let us direct our attention to the facilities called fiber-optic networks. From now on, the service types that coexist by surmounting walls will increase, and bundled services will emerge. This is really one of the tasks accompanying the changeover to IP telephones. The awareness that the accounting system should be one that is capable of dealing with this task has been shared in this Study Group. In this regard, at present, we should not contemplate developing a method whereby income and expenditure are disclosed in domains for which no controlling is carried out. Instead, studies should be made from the point of view of vitalizing markets. Anyhow, my understanding is that an important future problem has arisen.

(Member)

At the beginning of Document 1, problems with an appropriate accounting system are raised, and then a specific viewpoint is described. Does this mean that studies will be conducted this time by focusing on this viewpoint as a first step? That is, aren't there any other tasks to be studied?

(Member)

Personally, I feel that there are other problems. In this connection, I presume that there are now orders of priority regarding matters to be accomplished when the situation is recognized. The final Chapter 8 states that a review should be conducted in three years, and that the environment will change by that time. The purport is that during the review to be conducted this time, important points should be made compatible without fail.

(Secretariat)

Not all of the problems with the accounting system are covered by Main Points of the Draft Report. In this regard, the points that should be reviewed in terms of the purport of the accounting system on the changeover from PSTNs to IP networks were categorized, and they are as shown in Main

Points of the Draft Report. If opinions on the need to address any other tasks are offered, for example, on inviting public comment, then studies will be conducted accordingly.

<Chapters 5 to 8>

- The Secretariat explained Chapters 5 to 8 of Main Points of the Draft Report on the basis of Document 1.
- Major discussions were as given below:

(Member)

Page 26 says that applicable entities to which work is to be commissioned are not in “direct” capital relationship with NTT East Japan or NTT West Japan. Speaking in terms of accounting, there are cases where indirect ownership leads to domination. Is it that in the case of indirect ownership, pertinent entities are no longer applicable?

(Member)

In a narrow sense, direct ownership refers to a case where NTT East Japan or NTT West Japan makes direct investment, and indirect ownership refers to a case where the pertinent entity is owned via a subsidiary company. If this situation comes under a concept similar to the one in the case of substantial domination in consolidated accounting, I presume that it is not necessary to use the term “direct,” and that it is sufficient to use the term “capital relationship”.

(Secretariat)

We are resigned to having to accept sub-subsidiary companies as applicable entities. However, we think that we cannot help eliminating sister companies to some extent. We would like to review the indicated wording.

(Member)

The term “direct” may possibly be interpreted differently by different readers. Therefore, if the intent is to eliminate sister companies, it is better to delete this term and state the purport in a supplement.

(Member)

Page 25 says, “As regards this point, competitor carriers point out that most probably the incentive to reduce work commissioning expenses will not act easily on NTT East Japan or NTT West Japan.” To begin with, does the incentive to reduce expenses act when no work is commissioned? Is it that whether the incentive to reduce expenses acts on NTT East Japan or NTT West Japan should be raised as an issue only when work is to be commissioned?

(Secretariat)

Competitor carriers argue as follows: In cases where work is commissioned, and even where the subsidiary companies commissioned with such work improve efficiency, it is possible to maintain interconnection charge costs if commissioning expenses, as they are, are treated as costs; and therefore, the incentive to reduce commissioning expenses in keeping with subsidiary companies’ improvement in efficiency presumably does not act on NTT East Japan or NTT West Japan.

(Member)

Does that mean that even if commissioned subsidiary companies carry out work at costs lower than commissioning expenses, the resulting effects will not be reflected in commissioning expenses or interconnection charge costs of NTT East Japan or NTT West Japan?

(Secretariat)

In reality, outsiders are kept from knowing how much improvement is made in efficiency by commissioned subsidiary companies. We can only make a guess. In this connection, it seems that subsidiary companies earned certain amounts of profits, because several years ago, subsidiary companies paid special dividends to NTT East Japan and NTT West Japan. We do not know if such continues to be the case at present. In any case, knowledge of such information is kept from outsiders. Therefore, we suggest that this point be clarified.

(Member)

The explanation of the Secretariat is correct. On the other hand, Main Points of the Draft Report places somewhat too strong an emphasis on the effects of improvement in efficiency at commissioned subsidiary companies. Main Points of the Draft Report says, "Cost reduction effects are expected to be produced." This is a misleading expression, since it is unknown whether the results are positive or negative unless commissioned work is carried out. Readers can have an appropriate understanding if it is frankly stated that the status of improvement in efficiency at commissioned subsidiary companies is kept unknown to the outsiders.

(Member)

From the point of view of cost management, it may be that the costs called work-commissioning expenses are not appropriately understood. Instead, if costs are expressed in such a way as to properly show activities, it is possible to obtain information that is relatively easy for specialists to understand. I presume that this point is deliberately left fuzzy. In any case, my understanding is that it is not assumed that work commissioning is non-efficient. A study should be conducted on wording on the basis of the suggestion.

(Member)

There is a possibility that depreciation issue contained in Main Points of the Draft Report may affect audits. In terms of audits, the point is whether service life is reasonably estimated. Therefore, the direction of the Main Points of the Draft Report should be handled with careful attention to make rationality as objective as possible.

(Secretariat)

This is a very important point. We would like the Report to also contain the matters to keep in mind from the viewpoint of audits.

(Member)

By way of an important issue, it is necessary to conduct proper studies of compatibility with respect to the following items: Company Law, which exists within the overall framework and the external framework; accounting practices and accounting standards generally regarded as fair and reasonable. Unless this is done, problems will arise which cannot be solved by the Study Group

alone. This is an important issue to be clarified.

(Member)

The term “proper” costs is mentioned on page 23. I presume that this wording should be revised to read “proper costs”.

(Secretariat)

We would like to improve the indicated wording.

(Member)

There are the following three types of “economic service life”: economic service life referred to in general accounting standards; economic service life pertaining to LRIC; and economic service life to be used in this Report. To what extent can this issue be rationalized?

(Member)

It is a troublesome task to define economic service life on a generalized basis. The term “economic service life” is frequently used in accounting standards. However, this term is not clearly defined. I think that there is no problem with the very practice of using this term. However, there can be a variety of interpretations. Therefore, at least in this Report, the meaning should be restricted to a single sense.

(Member)

Page 24 says that it is appropriate to use economic service life pertaining to LRIC unless there is a rational reason for using another type of economic service life. Isn't it the case that hypothetical efficient carriers are assumed in the case of LRIC? Is it appropriate to use economic service life pertaining to LRIC when a comparison is made to the actual business environment of NTT?

(Secretariat)

LRIC costs are certainly based on costs for cases where the most effective equipment and technologies available at present are used and where networks are newly built. Service life used to calculate depreciation expenses is calculated as follows in the particular case of fiber-optic networks: based on service data collected from relevant carriers, average usable periods are calculated by assuming survival functions from Gompertz functions approximated to such data and from Weibull distributions. This approach, which is the result of many years of discussions participated in by relevant carriers as well, is considered to have a certain level of rationality. In Main Points of the Draft Report, economic service life is defined as “the average usable period subsequent to the initiation of the use of equipment, as estimated using past service data and the like.” The above-mentioned service life is considered to meet this definition. We therefore feel that it is appropriate to use the aforementioned definition unless there is a rational reason for using another type of economic service life.

(Member)

Legal service life is significantly shorter than economic service life pertaining to LRIC. Is it the case that a considerable amount of equipment exists whose legal service life is exceeded but which still continues to be used, and that the depreciation expenses for such equipment are not recorded in terms of interconnection accounting, resulting in such depreciation expenses failing to be

included in interconnection charge costs?

(Secretariat)

In interconnection accounting, no depreciation expense is created with respect to equipment whose legal service life is exceeded. To begin with, there is the issue of whether such legal service life is compatible with the realities. In this connection, it is pointed out that in the case of certain pieces of equipment, legal service life is not compatible with the realities. This fact is the motive for the current discussion.

(Member)

As is the case with the general accounting system, no depreciation expense is produced in regard to fully depreciated assets in interconnection accounting. However, in terms of pricing, many of the interconnection costs are calculated within the framework of LRIC in such a way that economic service life pertaining to LRIC is used. In this case, historical costs are irrelevant to begin with.

(Member)

However, if service life is set at a level shorter than legal service life, with respect to equipment for which interconnection charge costs are calculated by the actual cost method, then is it the case that depreciation expenses for fully depreciated equipment are set at rather low levels?

(Secretariat)

We explained earlier that, at present, actual costs are lower than LRIC costs. The greatest reason is due to the difference in the method of calculating depreciation expenses. Since the beginning of 2000, NTT East Japan and NTT West Japan have been curbing investment in PSTNs. The service life of some of the equipment in use has been exceeded. As a result, in the case of such equipment, there are no depreciation expenses, and actual depreciation expenses therefore go down. On the other hand, in the case of LRIC, it is assumed that equipment will be newly built from now on, and in such cases, depreciation expenses will be calculated based on the economic service life mentioned on page 48 of the Document. We feel that LRIC costs differ from actual costs because of such a difference.

(Member)

A setup whereby LRIC costs can be compared to actual costs is going to be established in the accounting system. I therefore presume that instead of using the assertive expression “actual costs are lower than LRIC costs,” it should be stated that such an analysis came to be conducted.

(Member)

Fully depreciated assets coexist with assets acquired by new investment. An overall explanation may therefore be that LRIC costs are higher and actual costs are lower. However, the situation is expected to change depending on the age of equipment. I therefore presume that the method of explanation will also differ.

(Member)

In reality, fully depreciated assets coexist with undepreciated assets. If economic service life is adopted for certain pieces of equipment, then the depreciation expenses for items that have been

depreciated on the basis of economic service life will go down, while, on the other hand, items that have been depreciated as a result of performing depreciation on the basis of conventional shorter service life will also coexist. Are such periods reasonable when viewed on an overall basis?

(Member)

It seems to me that discussions to that extent are not covered by the scope of this Main Points of the Draft Report.

(Member)

According to Main Points of the Draft Report, the use of economic service life with respect to all assets will be regarded as the ideal, and then a choice will be made of applicable pieces of equipment by considering the depreciation amount and the undepreciated equipment ratio for the relevant single fiscal year. It seems to me that carrying out restoration of depreciation for fully depreciated equipment is not the intent.

(Member)

That will turn out to be a matter of whether profit and loss for past fiscal years should be changed. I presume that depreciation expense amounts should be adjusted in such a way that no retroactive action will be taken and that services life will be changed in the future as well.

(Member)

Besides, there may be the idea that only equipment acquired via new investment will be regarded as applicable.

(Member)

Will corrections be made from now on in regard to equipment whose legal service life is 13 years and for which seventh-year depreciation is performed at present?

(Member)

That point has not been worked out yet.

(Member)

When discussing such matters, it is important to pay attention to discussions being held in the Enterprise Accounting Standards Committee.

In the United States, if accounting policies are changed, it is a matter of course to restate past profits and losses. On the other hand, in Japan, this practice has so far not been authorized.

However, The Company Law contains a provision that approves restatement that is due to “any justifiable reason such as any change in accounting policies.” Therefore, in connection with the enforcement of the amended Company Law, discussions are presently being held on business-based operations for cases where accounting policies are changed.

In terms of accounting, it is so arranged that service life is a matter of estimation and does not concern accounting policies. However, depending on discussions in the Enterprise Accounting Standards Committee, there is a possibility of the conclusion being reached that restatement should be performed. In such a case, discussions will be held later as to whether restatement should be performed retroactively with respect to existing pieces of equipment or as to whether another choice is available so that restatement should be applied only to newly acquired pieces of

equipment.

If any conclusion is reached solely by the Study Group in regard to the application of service life and a different conclusion is drawn in the Enterprise Accounting Standards Committee afterward, then there is the possibility that the conclusion of this Study Group will not be approved in the world of financial accounting. It is therefore necessary to conduct studies by considering the outcome of discussions in the Enterprise Accounting Standards Committee.

(Member)

Page 25 says, “It seems that it is necessary to make arrangements so that the cost reduction effects due to improvement of work efficiency in subsidiary companies and the like can be appropriately reflected in the accounting of NTT East Japan and NTT West Japan.” The meaning of the term “accounting” in this context is a little unclear. Page 26 states, “Such effects will only be subjected to comparative verification.” The expression should be toned down somewhat and it should at least be stated, directive in nature, that such effects will not be reflected in fee calculation, business accounting, or texts of financial statements in interconnection accounting.

[Others]

- In the next meeting, only the members will discuss the Draft Report.

End