



**Telecom New Zealand Limited**

**Submission in respect of the**

**Commerce Commission's - Draft of Telecom  
Accounting Separation Information Disclosure  
Requirements for Financial Years ending 2009 and  
2010**

**Public Version**

**13 March 2009**

## **SUBMISSIONS ON THE DRAFT INFORMATION DISCLOSURE REQUIREMENTS**

- 1 The Commission's Draft of the Telecom Accounting Separation Information Disclosure Requirements for Financial Years ending 2009 (FY 09) and 2010 (FY 10) (the **Draft Requirements**) is a significant advancement, in terms of real workability, accuracy and certainty, from the requirements that were set out in the Commerce Commission's Draft Notification of Information Disclosure Requirements on Telecom New Zealand under Part 2B of the Telecommunications Act (**Draft Notification**). Telecom comments on these Draft Requirements below.

### **Costs**

- 2 Importantly, the Draft Requirements address some of the key cost concerns that were identified in our previous submissions. In particular we note that the Commission has:
  - (a) Confirmed that Telecom can use its Activities Based Management (**ABM**) system;
  - (b) Reconsidered the scope of the audit requirements that were set out in the Draft Notification; and
  - (c) Adopted more realistic and achievable timeframes for delivery of the Regulatory Financial Statements and Compliance Monitoring Reports.
- 3 Telecom is encouraged that the Commission is proposing to reach a position that addresses some of the very real cost concerns that were raised in our last submission and in the PricewaterhouseCoopers report.

### **Operational Separation**

- 4 The Commission acknowledges through its Draft Requirements and in the Draft Companion Paper on the Accounting Separation of Telecom Corporation of New Zealand Limited (the **Companion Paper**) that it is required to consider what is reasonable to meet the purposes of the Act taking into account the time any requirement will take (and implicitly the costs of a requirement).<sup>1</sup> While the current requirements are certainly more reasonable, Telecom remains of the view that the significant amount of organisational and industry structure change already delivered by Telecom's Operational Separation in setting the accounting separation requirements has not been fully appreciated. Telecom's still considers that the pre-existence of operational separation represents an

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<sup>1</sup> On page 8 of the Draft Companion Paper on the Accounting Separation of Telecom Corporation of New Zealand Limited the Commission identifies the two relevant sections from the Telecommunications Act 2001 and in particular the purpose set out in section 69Y and the *reasonableness* requirement set out in section 69Z.

opportunity for the accounting separation regime to be more targeted than is currently proposed simplifying the burdens of regulation while still achieving the objectives.

### ***Achievability of the proposed timeframes***

- 5 While the timeframes for the delivery of the regulatory accounts for both FY 09 and FY 10 are more reasonable, and more appropriately reflect the significant amount of work required to deliver them, the timeframes are only achievable if a number of interim milestones, set out in Appendix A, are met by both Telecom and the Commission. It is imperative for the success of this process that Telecom and the Commission achieve an agreed and certain view of the content and form of the manuals and methodologies that will underpin the regulatory financial statements and compliance monitoring reports, early in the process. Failure to achieve this agreement, or further unpredicted changes to the final requirements set out in this paper may have a material effect on the achievability of the timeframes.
- 6 In particular, as set out below, the timeframes could become unrealistic if:
- (a) the list of product statements are altered in a manner which requires additional platforms or systems to be incorporated into the product level reporting; or
  - (b) the network component/network activity statements that are required prove to be inconsistent with the approach Telecom is taking to the design of its regulatory reporting capability; or
  - (c) new data sets are required.

Telecom anticipates these risks can be managed through continued dialogue with the Commission.

### ***Manuals***

- 7 Sign off by the Commission of the Manuals is necessary to provide the certainty Telecom requires as it develops its systems and processes. The Draft Requirements and Draft Companion Paper are silent on the process for settling these manuals. As part of its accounting separation delivery project plan Telecom has detailed some timeframes for finalising the manuals. Our plan is attached at appendix A with the requisite Commission input that we seek highlighted in blue and Telecom's delivery dates highlighted in red.
- 8 Telecom wants to ensure that the methodology it is following reflects the requirements of the Commission – this provides important certainty to Telecom, and ensures a shared understanding so that the Commission receives accounting separation outputs that are fit for purpose.

- 9 Telecom is developing three levels of manuals which incorporate different levels of detail:
  - (a) The level one manual details the Commission’s accounting separation Requirements and broad methodological principles. It will be completed once the Commission’s Requirements have been issued;
  - (b) The level two manuals will provide more detail around the specific methodologies to be followed. There are three level two manuals: accounting policies, attribution methodologies and asset valuation. The level of detail that is to be included in the manuals can be seen through an example from the asset valuation manual. The asset valuation manual proposes that copper pipes be valued as length of the pipe multiplied by the current purchase price of the pipe; and
  - (c) The level three manuals, which provide the asset valuation information and attribution information, will have the greatest level of detail and will therefore necessarily contain confidential information. For the copper pipes example it will detail how the length is to be measured and where the price is sourced from. Because of the confidential nature of this information it is not expected that these manuals will be publicly available.
  
- 10 The production of the manuals in stages will enable Telecom to have clarity and certainty that it is following Commission approved methodologies and procedures. For the proposed reporting dates to be achievable it is essential that Telecom gets the necessary engagement and approvals from the Commission in the timeframes set out in Appendix A.

***Further changes will affect Telecom’s ability to meet the proposed timeframes***

- 11 To ensure the Commission’s accounting separation requirements are delivered on time Telecom has been building systems capability for some time, and is having to make critical design decisions that will determine what is deliverable for at least FY 09 and FY 10.
  
- 12 In the course of this, Telecom has had to make certain working assumptions, for example in regard to what product statements will be required, and what network components will be included in any compliance monitoring requests. These are an important aspect of the attribution methodology.
  
- 13 These decisions have had to be made without feedback from the Commission. Any significant refinement to these will have timing implications.
  
- 14 We also note that the Commission may issue further requirements around compliance monitoring reports in due course. We have assumed that the compliance monitoring reports are intended simply to reflect the workings

Telecom will have to do to populate the regulatory financial statements, and will not require Telecom to prepare whole new data sets. Similarly, if this proves not to be the case then there will be obvious implications for the timing of the delivery of these.

### **Materiality**

- 15 International guidance indicates that a materiality of between 1% and 5% of total assets or total revenue is a suitable range. The materiality of 1% that has been adopted for the statements of service performance and mean capital employed is very conservative. Telecom considers that this level of materiality adds unnecessary costs and adds additional delivery risk with respect to the Commission's timeframes. Telecom suggests that the Commission adopts materiality of 5% in the transitional year and 3% for subsequent years. These levels will provide an appropriate level of assurance without adding significant time and cost to the requirements.
- 16 The materiality requirement for the product statements is 1%. Again, this seems overly conservative when you consider the total assets and total revenue for each product statement and we again consider that the materiality levels in paragraph 15 would be more appropriate.

### **PSTN Interconnection**

- 17 Telecom maintains that the Commission should not require a product statement for PSTN interconnection. As noted in our previous submission, PSTN interconnection is a legacy product with a commercially agreed price. Despite all interconnected parties having had the option for some time now of applying to the Commission for a STD in relation to this service, no party has considered this necessary. This suggests the commercial arrangements in place are effective and efficient.
- 18 Telecom's view remains that there is no need for a product statement (noting that if such a need became apparent, it would be open to the Commission to require this at that time). This is a particular area where there is scope for a more targeted approach to regulation.
- 19 The policy rationale for requiring this statement is particularly important because it is the only product in the Commission's list that uses the voice platform. It will therefore require a considerable amount of work. In particular Telecom will need to develop cost drivers and detailed network switching asset attribution methodologies.
- 20 As also previously noted, if a product statement were to be required from Telecom, it would seem appropriate to request similar disclosures from access providers of the designated access service of interconnection with fixed PSTN other than Telecom's.

### **IP Interconnection**

- 21 Again, Telecom considers that it is premature to require this product statement because there is the potential for there to be only small quantities of IP interconnection in the FY 09 or FY 10 financial years. It is also uncertain whether, and if so in what respect, Telecom might have any market power in respect of IP Interconnection. IP interconnection is an extremely broad term, which could be interpreted as including such arrangements as existing internet peering, future VoIP interconnection, the connectivity elements of IP Interconnection currently captured as a Relevant service in Telecom's Operational Separation Undertakings, or all service-level interconnection of IP-capable services. Further guidance is required as to the focus of IP interconnection in the Commission's accounting separation requirements.

### **Wholesale Accounts 2009**

- 22 Clause 5.2 of the Draft Requirements specifies that Telecom is to complete *closing Regulatory Statements of Fixed Assets for the FY 09 Financial year* for the:
- (a) Wholesale Services Group (Relevant Services); and
  - (b) Wholesale Services Group (Other Services).
- 23 While Telecom will be in a position to do this for FY 10 it is not feasible for FY 09. This is because the split between the two sets of Wholesale services are strongly reliant on the products that make up each service group and this product split is not going to be completed in FY 09. Requiring this in FY 10 is also consistent with the requirement that Telecom produces Separate Regulatory Statements of Financial Performance and Mean Capital Employed for FY 10, but not FY 09.

### **Retail Service Group**

- 24 The extent of the Gen-i activities that are to be included in the *Retail Service Group* is unclear. The definition of *Retail Service Group* states that it should include all activities and services provided under the Gen-i brand. The companion paper takes a different approach in that it states that Australian activities should be allocated to the 'other' service group. These requirements do not reconcile as Gen-i's Australian activities use the Gen-i brand.

### **Compliance Monitoring Requests**

- 25 Clause 16.4 (d) of the Draft Requirements refers to an audit opinion for Regulatory Statement of Asset Movement. This clause should be removed because the Regulatory Statement of Asset Movement is a compliance monitoring report and is therefore not subject to audit. In addition, the closing value of the assets for each service group will be covered in the audit of the

regulatory financial statements and therefore by default the movement will have been audited.

- 26 Clause 18.1 of the Draft Requirements requires a Regulatory Statement of Asset Movements and Detailed Regulatory Statement of Fixed Assets to be prepared for the Access, Wholesale and Retail Service groups. This is inconsistent with earlier requirement in clause 5 to only produce a statement of Assets for Chorus and Wholesale. It seems that the compliance monitoring requirements in relation to Retail should be removed.

### ***Principle of Causality***

- 27 At paragraph 80 of the Companion Paper the Commission suggests that the allocation of common costs will not be arbitrary as stated by Telecom. However, for that to be the case the Commission needs to provide guidance on which causal methodology it considers the most appropriate for the purposes of accounting separation. For example, Telecom has already supplied the Commission with five different ways of allocating trenching and duct costs. Each of these reflects the principle of causality but applies it in a different way. None is a better expression of the principle of causality than any of the others. Where there is a choice of causal methodologies, Telecom's expectation is that the Commission will provide its view of the appropriate one to use for accounting separation purposes, and provide it in time to enable it to be implemented.

### ***Audit Standard***

- 28 We note that paragraph 16.1 (a) refers to an audit opinion being prepared in accordance with the 'presented in all material respects in accordance with' standard. We note this is not a recognised standard and understand you to be meaning the 'properly prepared in all material respects in accordance with' standard.

### ***Chorus statement of assets***

- 29 Finally, we note there are some factual inaccuracies for correction in paragraph 117 of the Draft Companion Paper. In particular, clause 104 of the Undertakings required Chorus to produce a *historic cost* statement of assets. Telecom chose to prepare additional statements on an economic basis.

## Appendix A

## Methodology Finalisation Timetable

		week beginning												
		2 Mar	9 Mar	16 Mar	23 Mar	30 Mar	6 Apr	13 Apr	20 Apr	27 Apr	4 May	11 May	18 May	
Level One	Regulatory Accounting Principles <sup>a</sup>			✓		☑							x	☒
Level Two	Asset Valuation Methodologies													
	- methodological principles (chorus assets)	✓		☑									x	☒
	- methodological principles (all other assets)						✓		☑				x	☒
	Accounting policies	✓		☑									x	☒
Level Three	Attribution Methodologies													
	- methodological principles (P&L - exclu network related items)	✓			☑								x	☒
	- methodological principles (network related items P&L and BS)						✓			☑			x	☒
	- methodological principles (remaining MCE items)			✓			☑						x	☒
Level Three	Asset Valuation Detailed Information													
	- passive network	✓			☑								x	☒
	- ducts and manholes		✓			☑							x	☒
	- access derived systems				✓								x	☒
	- fibre						✓			☑			x	☒
	- other							✓			☑		x	☒
	Attribution Detailed Information													
	- P&L - excluding network related items			✓				☑					x	☒
	- network related items								✓			☑	x	☒
	- remaining MCE items <sup>b</sup>												x	☒

- ✓ Telecom to provide methodology documentation to Commission for discussion
- ☑ Commission to provide sign-off in principle of methodology to Telecom
- x Telecom to provide final methodology documentation to Commission
- ☒ Commission to provide formal sign-off of methodology to Telecom

<sup>a</sup> To be presented by Telecom to the Commission two weeks after publication of the Final Notification  
<sup>b</sup> Likely to not be available until after June