



# **Amendments to the Telecommunications (Disclosure) Regulations 1990**

Communications Networks Policy Group

August 1999

## **Contents**

Questions and Answers.....	1
Summary of Changes to Telecommunications Information Disclosure Regime.....	5

## Questions and Answers

### What Is the Overall Objective of the Amendments to the Telecommunications (Disclosure) Regulations 1990?

The objective of the amendments is to facilitate the ongoing development of competition in the telecommunications market by disclosing financial and price information about Telecom's local loop and telecommunications services that critically rely on access to Telecom's local loop.

### What Are the Key Components of the Existing Telecommunications Information Disclosure Regime?

The key components are the requirements that Telecom publish:

- Twice yearly financial statements for its subsidiary Telecom New Zealand Limited<sup>1</sup>.
- The price, terms and conditions of prescribed services<sup>2</sup> including discounts in excess of 10%.
- The full text of any interconnect agreements excluding information about the physical location of links between the networks.

### What Are the Main Information Disclosure Changes and What Do They Seek to Achieve?

They are to:

- Require Telecom to publish twice yearly, separate financial statements for its "local loop" and "other telecommunications services" businesses, prepared on the basis of the avoidable cost allocation methodology and complying with generally accepted accounting practice;

This requirement will provide information about the cost of core parts of Telecom's local loop. Such information is of use to Telecom's competitors in negotiating interconnection prices for access to the local loop, and in the monitoring and enforcement of competition concerns.

- Require Telecom to disclose any losses it incurs in complying with the Kiwi Share obligations (KSOs), the way it recovers any KSO losses, and calculate KSO costs

---

<sup>1</sup> Telecom Corporation of New Zealand Limited is the holding company. Telecom New Zealand Limited provides: local, national and international and Internet services; operates and manages the Telecom cellular network; and provides cellular mobile telephone, dispatch radio and paging services.

<sup>2</sup> In general prescribed services are Telecom telecommunications services that are reliant on access to the Telecom local loop for their viability.

in accord with a specified set of principles;

Telecom has said that it incurs losses in complying with the KSOs. The price of interconnection includes a contribution to KSO losses and this requirement will provide relevant information to parties negotiating interconnection with Telecom.

- Add Telecom's 0800 service to the list of prescribed services requiring price and discount disclosure, and delete international calls from the list.

This change will put 0800 services on the same footing as national calls which are already a prescribed service (0800 is effectively a national call where the called party pays. International services are now competitively provided, so continued disclosure is no longer necessary. A proposal in the discussion paper to delete leased services from prescribed services has not been proceeded with on the basis that submissions suggested the market was not fully competitive.

## **Why Is It Necessary to Require Telecom to Disclose More Financial Information?**

The current financial statements disclosed by Telecom are primarily used by the share market. In particular Telecom's current financial disclosures do not provide any information about:

- the cost of Telecom's local loop operation which is the critical facility with which Telecom's competitors must interconnect and therefore require information about to ensure pricing of interconnection reflects Telecom's costs. Under current financial reporting requirements all of Telecom's activities (contestable and non-contestable) are bundled together into one set of accounts; and
- the cost of the Kiwi Share obligations, which form part of interconnection pricing.

## **How Will the Disclosure by Telecom of Financial and Price Information Facilitate the Ongoing Development of Competition in the Telecommunications Market?**

The disclosures will:

- provide relevant information to all interested parties and analysts;
- facilitate the negotiation and resolution of network interconnection agreements between Telecom and its competitors. (The Clear-Telecom interconnect agreement expires 1 January 2001. Most other agreements are based on this agreement);
- assist enforcement of the Commerce Act by facilitating public monitoring of Telecom's actions where competition concerns arise.

## **Why Are These Requirements Being Introduced at This Time?**

The initial focus of telecommunications information disclosure has been to provide information on the price of prescribed services and about interconnection agreements. Substantial progress has been made in the development of effective competition in telecommunications markets. These proposals will facilitate the further development of competition by making detailed local loop cost information, including Kiwi Share obligations costs, publicly available.

## **Telecom Submitted That It Already Has to Prepare Several Sets of Accounts, Including for the US Market in Compliance with the New US GAAP SFAS 131 Reporting Requirement. Why Isn't This Information Good Enough?**

The purpose of SFAS 131 is to provide information for capital markets (i.e. to allow industry analysts and shareholders to monitor a publicly listed company's performance). SFAS 131 requires disclosure of the accounts management uses to run the business. This is quite different from a set of accounts for regulatory purposes (which aim to facilitate competition and prevent abuse of market power).

In particular, it is important to have a robust methodology for allocation of costs between activities. Particular problems with SFAS 131 are:

- Local loop reporting;

SFAS 131 would not require separate reporting of Telecom's local loop. In fact, SFAS 131 allows a business to bundle its activities in any way it wants as long as it is consistent with its internal reporting structure.

- Accounting methods;

It is essential to have a robust methodology for allocation of common costs between activities. SFAS 131 allows flexibility in the choice of allocation methodology.

- Disclosure requirements;

For information disclosure to be useful for regulatory purposes, detailed line item disclosure is required. SFAS 131 does not do this.

## **Why Should Telecom Be Required to Disclose Accounts For the Local Loop If Any Natural Monopoly Is Being Eroded?**

The telecommunications market in New Zealand is increasingly competitive. However, Telecom still faces relatively limited competition in the core local loop area of its operations. Other telecommunication service providers still have to interconnect with Telecom's local loop in order to be able to operate in New Zealand. Financial

statements disclosing the costs of the local loop will assist in negotiating interconnection agreements.

## **Are the Costs of Information Disclosure Reasonable?**

The total New Zealand telecommunications services market revenue is of the order of \$4,000 million annually, most of which is either competitive or is potentially competitive. Information disclosure provides information which will assist in the negotiation of interconnection agreements, and thus contribute to competitive entry, service provision and lower interconnection pricing, which will in turn lead to retail price reductions. In this context the Government considers the benefits that will flow from the additional information disclosure requirements outweigh the costs.

## **Are There Any Redundant Information Disclosure Requirements in the Current Regime?**

Yes. With the development of extensive competition in international call services in New Zealand it is no longer necessary to disclose the price (including discounts) of international calls and this service will be deleted from the prescribed services list.

## **What Have Changes Been Made from the Discussion Paper Proposals?**

Following consideration of submissions some relatively minor changes have been made to the proposals in the discussion paper. These are:

- Only requiring annual (and not also half-yearly) financial statements to be audited;
- Allowing Telecom to provide improved information for international benchmarking on a voluntary basis, rather than through regulation. Telecom has voluntarily agreed to work with the Ministry of Commerce to put in place suitable arrangements that will support the Organisation for Economic Co-operation and Developments (OECD's) tariff basket comparisons methods;
- Requiring Telecom to publish prescribed services information, KSO losses and costs, and its financial statements (in addition to interconnection agreements) on an Internet web site; and
- Not removing leased services from the list of prescribed services.

## **How Many Submissions Were Made on the Information Disclosure Regime?**

Twelve submissions were received from Telecom, Clear, Vodafone, Global One, Newcall Communications, Teamtalk, New Zealand Business Roundtable, TUANZ, Consumers Institute, Institute of Chartered Accountants (ICA), Coural and the Electricity Supply Association. Most supported the need for an information disclosure regime to apply to Telecom and broadly supported the key changes recommended in the discussion paper. The particular changes made from the discussion paper proposals

(as outlined in the Minister's press release) have been made following consideration of the submissions.

## **Summary of Changes to Telecommunications Information Disclosure Regime**

### **Separate Financial Statements**

- i. remove the requirement to disclose twice yearly financial statements relating to Telecom New Zealand Ltd;
- ii. require Telecom to publish twice yearly, within three months of the end of the financial year, and within three months of the end of the first half of the financial year separate financial statements for its 'local loop' and 'other telecommunications services' businesses, and reconciling with the accounts of Telecom Corporation of New Zealand;
- iii. require Telecom to prepare the financial statements on the basis of the avoidable cost allocation methodology and to comply with generally accepted accounting practice (except that there shall be no requirement to publish comparative data for the previous financial year in the first year that the regulations apply), with the separate businesses to be regarded as independent and unrelated companies;
- iv. require the financial statements to include the following specified performance measures; accounting return on total assets (pre-tax), accounting return on equity (post-tax) and accounting rate of profit (post-tax);
- v. require Telecom to have audited the end of year financial statements;
- vi. define the 'local loop' as the provision, support and maintenance, including as relevant the necessary billing, sales, marketing, fault reporting and repair etc, of the following telecommunications services:
  - telecommunications circuits, including telephone access circuits, between customers premises and the Telecom network;
  - telecommunications switching between local telephone exchanges in the same local calling area including transmission between exchanges;
  - telecommunications switching between local telephone exchanges and the long distance calls network access point in the local calling area;
  - telecommunications value added services which are either primarily supported by local telephone exchanges or are provided as an integral component of telephone service, and for which there are no widely available competitive alternatives, including directories.
- vii. require Telecom to disclose the full methodology used for preparing the financial statements (including any models used, all significant assumptions and estimates

underlying the calculations, and the nature of, reasons for and financial impact of any changes in methodology);

- viii. require Telecom to retain all data, including calculation models and associated documentation, for at least seven years.
- ix. require Telecom to disclose the following items (costs, revenues, assets and liabilities) in its financial statements:
  - all material transfer payments between the local loop and other telecommunications businesses, including:
    - i. a detailed description of the good or service provided;
    - ii. the price and quantity and/or frequency of each good or service provided (both the unit price and the total amount paid per year would be required);
    - iii. the terms of the payment for each good or service provided;
    - iv. the period during which the good or service was provided.
  - a range of specified items, including GAAP requirements;
  - those items which form the basis of the financial performance measures; and
  - all items that are of such a size, nature or incidence that their disclosure is necessary for an understanding of the business.

## **Kiwi Share Obligations**

- i. require Telecom to disclose:
  - any losses incurred in complying with the Kiwi Share obligations (KSOs), including details of: (i) the amount of the losses that are attributable to each component of the KSOs; and for each of these components, (ii) the amount of the losses that are attributable to individual customer groups;
  - the way it recovers the KSO losses, including: (i) the sources (internally and externally) that Telecom recovered these losses from; (ii) the amounts that Telecom recovered from each of these sources; (iii) and the components of any charges (internal or external) that Telecom uses to recover these losses from.
- ii. define the KSOs for costing purposes as covering all residential telephone lines, residential directory services, directory listings and emergency call centres supporting emergency telephone numbers;
- iii. require the calculation of KSO costs to be in accordance with the following principles:

- The cost of the KSOs is the unavoidable net losses incurred by an efficient operator in providing the KSO-mandated services to the customers or groups of customers required.
  - The net cost calculation must be based on objective, transparent, non-discriminatory and proportionate procedures and criteria.
  - The net cost calculation should identify the cost, less revenues and associated benefits of providing services covered by the Kiwi Share obligations, to a customer or group of customers.
  - When calculating net cost, a quantification of the intangible benefits of being New Zealand's only universal service provider, an implicit requirement of the KSOs, should be added on the benefit side;
  - The net costs of emergency services, directory services, directory listings and the provision of special equipment or services must be identified separately;
  - No account may be taken in calculating the net cost of Kiwi Share obligations of obligations which are outside its scope other than those specifically included.
- iv. require Telecom to publish an audited calculation of its KSO costs twice yearly in conjunction with the publication of its financial statements under the financial information disclosure regime;
  - v. require Telecom to disclose the full methodology used for calculating its KSO costs (including any models used);
  - vi. require Telecom to retain all data used to calculate KSO costs, including calculation models and associated documentation, for at least seven years;

## **Prescribed Services**

- i. add Telecom's 0800 service to, and delete international calls from, the list of prescribed services;

## **Interconnection Agreements**

- i. require Telecom to disclose along with interconnection agreements any operating agreements, side letters, and associated documentation which form a material part of such interconnection agreements;

## **Publication Requirements**

- i. remove the requirement to publish any changes to prescribed services tariffs quarterly and to make the information available at Auckland, Wellington, and Christchurch offices;

- ii. remove the requirement to publish prices and terms and conditions of supply at the end of September in each alternate year from 1990 on;
- iii. require disclosure of the standard prices and terms and conditions of supply for prescribed services information (including a list of current prescribed services) by way of Telecom's List of Charges, with publication of any changes within one month of any change, and the information to be available for public inspection at Telecom's Head Office, and by publication on an internet web site;
- iv. require disclosure of the principles or guidelines applied in determining whether or not to allow a discount, the maximum discount available to a customer, and in the case of discounts of 10 per cent or more, the principles or guidelines applied in allowing that discount, the actual discount allowed, and any variation of terms and conditions represented by the discount, to be available for inspection at Telecom's Head Office and by publication on an internet web site.
- v. require interconnection agreements and associated documentation to be published within 15 working days of completion and be available at Telecom's Head Office and on an Internet web site, and to remove the existing publication requirements;
- vi. require publication of Telecom's financial statements and KSO information on an internet web site;
- vii. require information provided on an internet web site to be maintained for three years.