

PACIFIC INTERNET'S COMMENTS ON ACCOUNTING SEPARATION GUIDELINES



General Comments

1. Pacific Internet is pleased to respond and provide comments to the Info-communications Development Authority of Singapore ("IDA")'s Draft Accounting Separation Guidelines (ASG). Pacific Internet maintains that:
 - 1.1 Accounting separation is a necessary and complementary tool for monitoring and regulating anti-competitive behavior of a dominant licensee;
 - 1.2 The simplified segment accounting as proposed does not contribute to monitoring cross-subsidisation or delimit anti-competitive behavior;
 - 1.3 IDA's research, trending and monitoring objectives should be proportionate to costs that will be sustained and continually incurred by licensees;
 - 1.4 Instead of simplified accounting measures, data required for trending, industry monitoring or research can be obtained by other more efficient and relevantly accurate means;
 - 1.5 Greater care and restraint should be exercised on the creation of statutory and regulatory obligations imposed on non-dominant licensees so as not to stifle market and increased undue costs and burdens on new entrants.

Specific Amendments

2. The following are Pacific Internet's broad suggestions that the following amendments to the proposal be enacted. (The detailed justifications of these amendments are located in the specific clauses inviting comment):
 - 2.1 Simplified accounting segmentation obligations should not be imposed automatically on all FBO licensees but instead should be directed at specific licensees identified by IDA through independent research to possess:-

- 2.1.1 the business attributes and resources that would allow the licensee to adopt anti-competitive behavior such as predatory pricing, price squeezes, cross-subsidisation, bundling. (This would result in substantial cost savings across the industry as well as provide a more targeted scope of accounting); and
 - 2.1.2 the degree of diversity and/or vertical integration of the licensee's business operations.
- 2.2 Historical Cost Accounting (HCA) is the preferred methodology and the decision to migrate to a Current Cost Accounting (CCA) methodology should be balanced with the costs involved and whether it meets the objectives of ASG;
- 2.3 The breakdown between narrowband and broadband access for non-dominant licensees offering both services does not serve the objectives of ASG;
- 2.4 An exemption from simplified accounting reporting can be made available for non-dominant licensees to apply for based on the lack of diversity and/or vertical integration in their business operations.

Response to requests for comments

(IDA Consultative Document paragraphs and questions boxed and in italics.)

Consultative Document Para 5.2

Comment is invited on the proposed two-level approach to accounting separation.

General Agreement with Detailed and Simplified Approach

It is agreed that the main objectives of ensuring compliance with cross-subsidisation provisions under the Code of Practice and the ensuring of similar and fair terms of pricing and services to non-related licensees will in part be achieved by the detailed accounting segments that IDA has proposed.

Any simplified segment account should not be ‘automatic’

We maintain however that simplified segment reporting should not be automatically imposed on all non-dominant licensees. This automatic burden places a tremendous automatic blanket of costs which, as shown, cannot be justified based on the following:-

Failure of Simplified Segment Reporting to meet anti-competitive behavior monitoring objective

Not all the parties that the simplified segment accounting are directed to are in the same market circumstances or influencing and/or controlling position as the dominant licensee. Anti-competition acts in the domestic environment must naturally flow from parties with the ability to enact such measures, and not all FBO licensees fall into this category. Parties who do not own infrastructure or have vertical integration, for example, are unlikely to be capable of predatory or anti-competitive acts. Any accounting segment measures directed at parties without this ability would not only have no positive use, but may possibly stifle their business expansion plans with increased danger of disclosed information (from which strategic company directions can be extracted), increased risk of information leakage, and increased operating and administrative costs.

Increased costs stifles competitiveness and contrary to general market that needs to be encouraged

In general, increased regulatory obligations will increase costs borne by licensees. To compete effectively in the telecommunications arena, it is paramount for licensees to reduce their operating costs. This is due mainly to the competition with already established global players with vast resources, and technological-based barriers to entry for new telecommunications players, as well as the low general profit margins. Wherever possible, new entrants should be encouraged to participate in the market by a regulation and obligation free market except for the purposes of monitoring anti-competitive behavior, which is irrelevant to a non-dominant licensee.

Consultative Document Para 5.3

Should accounting separation be based on “pure” HCA, a modified form of HCA, or CCA?

Should CCA be implemented now or later? If later, what would be an appropriate time of implementation?

As the main purpose for accounting separation is the monitoring of anti-competitive behavior, the corresponding accounting methodology used should be the one best able to meet this objective.

It is preferable that the chosen methodology be one that is harmonized across the board of licensees (dominant or non-dominant) in order for the regulator to have a consistent comparison. Further, it should contain a high level objectivity and certainty; a methodology that is too open to subjective speculation would be easy to manipulate, and such a methodology would not be able to capture determined attempts to elude or mask anti-competitive behavior.

For the purpose of monitoring anti-competitive behavior, it is our view that HCA is a more reliable method than CCA and we agree with the general reasoning as stated in the consultation document. It also submitted that the industry does not have the level of price fluctuation that would be ideal for a CCA system of record.

Historical Cost Accounting is preferred because it is:-

- objective with barriers to manipulation
- verifiable, e.g. can be reconciled to audited accounts
- more worldwide acceptable allows easier integration
- more comparable across companies for industry and cross industry comparison

As Historical Cost Accounting is EX-POST, the measure of past performance currently based on GAAP is a functional and more reliable measure methodology. A pure CCA approach would be impossible to implement over the time frame suggested for the industry and a combination of HCA and CCA regimes would lead to gross distortion of margins and financial ratios.

Briefly, the drawback of Current Cost Accounting are:-

- subjectivity and ease of manipulation
- non-verifiable
- non-worldwide worldwide
- administrative burden
- tedious data collection and increased costs

Consultative Document para 5.6

*The degree of disaggregation and segment definitions proposed for Simplified Segment Reporting;
The preferred method of cost allocation for Simplified Segment Reporting; and
The degree of prescription in the ASG that should be specified for cost allocation methodologies for Simplified Segment Reporting.*

Narrowband/Broadband segmentation not helpful for monitoring anti-competitive behavior

The segmentation of narrowband and broadband access would not be necessary as they are both utilities for internet usage and differ only in speed. The breakdown would result in high setup costs as well as routine operational costs for the engineering and accounting units, and may result in inefficiencies in operation, slowing/clogging of the Internet access to both segments of users. Any such cost allocation methodology would necessarily have to be speculative and arbitrary in nature for licensees in the business of sharing a common backbone between the two. The reliability of such information, especially when calculated by a range of licensees would fail to provide a reliable cross-reference of licensees in order to monitor predatory pricing.

A useful analogy would be that the splitting up of narrowband access and broadband access is akin to developing cost allocation methodologies for IDD 001, 019, and so forth. Such a breakdown would only serve to make the accounting process more complex and costly without the any identifiable positive industry data contribution.

Some licensees' network setup would be such that their Internet bandwidth is shared between narrowband and broadband users and there is no technical or network segregation of bandwidth just for narrowband or broadband users. As the amount of data traffic that transverses within such an unsegregated network's backbone in and out of the Internet is enormous, to separate this Internet traffic between narrowband and broadband users would require massive extraction and processing of data packets. This may in turn result in the slowing down the network performance of our backbone and reduce access speed.

Further, it fails to deliver the research data required which could otherwise be satisfied more efficiently and with greater relevance through a non-cost allocation data format

Consultative Document para 5.7

Should non-financial information be required as part of the standard reporting requirements?

Should the same level of non-financial reporting be required under both Simplified Segment Reporting and Detailed Segment Reporting?

Research objectives should be proportionate to costs incurred by businesses, especially where these costs as incurred as part of regulation and obligation

While IDA's goals of maintaining objective reference points for evaluating information as well as trending and other forms of research is a positive measure, these research goals should be proportionate to the cost, administration, organization of information and internal monitoring that the licensees will need to create and administrate to entertain these research data requirements.

Research data already being provided in sufficient detail and amounts

Currently, IDA requires FBOs to submit non-financial statistics such as subscriber base and QoS reports (this includes system accessibility, service activation, number of complaints) on a monthly and quarterly basis respectively. These non-financial data pools would satisfy the need for industry monitoring while sparing licensees the burden and costs of financial accounting segmentation. If the same data (e.g. subscriber statistics) is required again under accounting separation, this would clearly amount to duplication of work.

Obtaining research objectives through simplified segment reporting will incur unnecessary costs while instituting duplication of work

To avoid unnecessary duplication of work, operational statistics should still be submitted to IDA in the present form. We submit that accounting separation should be more "focused" on monitoring anti-competitive behavior and predatory pricing and that over-loading it with operational and technical details leads to excessive compliance costs with minimal tangible benefits.

Consultative Document para 7.2

Comment is invited on the proposed audit approach.

Definition of Independent Auditor

Section 8.2 (a) and (b) of the Draft Accounting Segmentation Guidelines detail that an auditor must be 'independent', as well as be a member of ICPAS. It is requested that the word 'independent' be clarified due to the growing amount of industry guidelines and increasing uncertainty in the determination of the level of 'independence', and the criterion thereon.

Independent Auditor for a Dominant Licensee

It is agreed with the proposal that the need for an independent auditor should remain for the dominant licensee due to the higher level of independent scrutiny required for detailed accounting. An independent auditor is primarily relevant especially for the purposes of monitoring anti-competitive behavior.

Auditing Simplified Segment Accounts

The same circumstances surrounding dominant licensees, detailed segment reporting and the objectives thereon are not present where simplified segment reporting and non-dominant licensees are concerned, as already previously shown in this paper. It is submitted that internal auditing measures be considered for non-dominant licensees as the general rule for simplified segment accounting as any such costs incurred from such additional reporting should be minimized.