Office of Utilities Regulation

Accounting Separation for Cable and Wireless Jamaica

Determination Notice

OFFICE OF UTILITIES REGULATION

March 29, 2006

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DOCUMENT TITLE: ACCOUNTING SEPARATION FOR CABLE AND WIRELESS JAMAICA: DETERMINATION NOTICE

1. PURPOSE OF DOCUMENT

This document provides the Office's Determination on Accounting Separation for Cable and Wireless Jamaica (C&WJ) and should be read in conjunction with the Office's Regulatory Accounting Guidelines for C&WJ.

RECORD OF REVISIONS

Revision Number	Description	Date

APPROVAL

This document is approved by the Office of Utilities Regulation and becomes effective on **April 1, 2006**.

On behalf of the Office:

………………………………..
J Paul Morgan
Director General

March 29, 2006
…………………………
Date

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INTRODUCTION

In the Supplementary Consultative Document on Accounting Separation for Cable and Wireless Jamaica dated June 30, 2005, the Office of Utilities Regulation (the OUR) proposed that Cable & Wireless Jamaica (C&WJ) will be required to submit Regulatory Accounts to the OUR as is necessary for dominant carriers or service providers under the Telecommunications Act 2000 (the Act). The Office also issued its Proposed Drafting Instructions for regulatory Accounting Rules).

Review of Comments and Decisions

This Determination Notice summarises the comments received and the Office's consideration of those comments.

Two responses were received following the invitation to respond and provide comments on those responses. The respondents were:

- Cable & Wireless Jamaica; and
- Digicel (Mossel) Jamaica

Additionally, reply comments were received from Reliant Enterprise Limited. The Office wishes to thank those who have responded to this invitation to comment for their contributions. These comments may be viewed at the OUR's website in full.

Guidelines for Accounting Separation for Cable and Wireless Jamaica

Along with this Determination Notice, the Office will publish Guidelines for Accounting Separation for Cable and Wireless Jamaica. These Guidelines should be read in conjunction with this Determination Notice.

CHAPTER 1: REGULATORY FRAMEWORK

1.0 The Telecommunications Act 2000 (The Act) is the primary legislation governing Jamaica's telecommunications sector. Under this Act the Office has been assigned certain regulatory duties. The broad objectives of this Act are:-

- to promote and protect the interests of the public;
- to promote universal access to telecommunications services for all persons in Jamaica, to the extent that it is reasonably practicable to provide such access;
- to facilitate competition in a manner consistent with Jamaica's international commitments in relation to the liberalization of telecommunications; and
- to encourage economically efficient investment in the sector.

1.1 It is a provision of the Act that the Office discharges its duties and responsibilities in a transparent and accountable manner. Amongst the duties and functions, the Office is to:-

- promote the interests of customers while having due regard to the interests of carriers and service providers ; and
- promote competition among carriers and service providers.

1.2 In order to satisfy the *any-to-any* connectivity principle of interconnection each public voice carrier is obligated to permit interconnection of its public voice network with the public voice network of any other carrier for the provision of voice services.[1] Two other general principles regarding the nature and purpose of interconnection by all public voice carriers are:-

a) *End-to-end Operability:* Interconnection should be across interfaces, of sufficient functionality to ensure that high quality services can be provided to consumers even where the call recipient and the calling customer are on different networks.

b) *Equal Responsibility: A*ll public voice carriers have equal responsibility to ensure that networks are interconnected and to do so as quickly as is reasonably practicable.

[1] Section 29(1), Telecommunications Act, 2000

1.3 Entrants have to pay a significant portion of their revenues in interconnection charges, making them vulnerable to abuse of dominance by the incumbent dominant carrier/service provider, C&WJ[2]. A dominant firm has the ability to distort competition in a relevant market. This is especially so in telecommunications, in which a dominant firm is typically both:-

- a supplier of critical inputs (interconnection and wholesale) to downstream service providers; and
- a competitor against these service providers in downstream retail markets.

1.4 For these reasons, the Act provides some general underlying principles regarding interconnection services supplied by dominant public voice carriers. These are listed below (Section 30):-

- terms and conditions of interconnection shall be
  - "on a non-discriminatory basis;
  - reasonable and transparent, including such terms and conditions as relate to technical specifications and the number of locations of points of interconnection; and
  - charges shall be cost oriented and be guided by certain cost causation principles (section 33);
- no unfair arrangements for cross-subsidies shall be made; and
- where technically and economically reasonable interconnection services shall be so diversified as to render it unnecessary for an interconnection seeker to pay unreasonably for network components or facilities it does not require."

1.5 To ensure that charges are truly cost oriented Section 30 of the Act makes it obligatory for each dominant public voice carrier to "…keep separate accounts in such form and containing such particulars as will enable the Office to assess whether that carrier provides interconnection services in accordance with the principles specified…" at paragraph 1.4. A more general provision is set out at section 4(5) which provides for the Office to "….make rules, subject to affirmative resolution, prescribing the system of regulatory accounts to be kept by a dominant carrier or service provider".

Role of Accounting Separation

1.6 Market distortion by a dominant firm may take various forms, including excessive charges for interconnect services, discrimination in pricing, unfair cross-subsidies, and predatory pricing. These practices are usually aimed

[2] See the Office's Decision "Dominant Public Voice Carriers, August 14, 2003".

at stifling competition and may even prevent market entry. Accounting Separation (AS) is a common tool used to address these anti-competitive concerns. Under this approach, the operator's activities are split for accounting purposes, into separate businesses or services. In other words accounting separation does not impose on the operator a set of rules about how its activities should be organized, but simply how accounting information is to be collected and reported. The transfer charges from one business to another can be explicitly identified, allowing non-discrimination to be enforced, and the profitability of particular businesses or services can be monitored, allowing cross-subsidies to be identified. Accounting separation would also ensure a systematic division of costs between retail and wholesale, thereby ensuring that the cost base for interconnection charges and charges for other services and products include only relevant costs.

1.7 Carriers/service providers have also found separated accounts to be useful because it provides the foundation for an integrated platform for internal product reporting requirements and pricing.

1.8 Accounting separation provides a useful technique for investigating allegations about anti-competitive behavior by dominant firms. The Office is also aware of the need for robust cost information for future price cap purposes as well as for setting or assessing interconnection charges.

1.9 The Office maintains the position that the preparation and publication of separated accounts that are transparent and audited are essential to the development of truly competitive markets for telecommunications services. Indeed, without such a tool the Office may not be able to discharge its duties and functions as provided for in the Act. In the March 2000 consultative document (Regulatory Accounts for a Dominant Carrier or Service Provider) the Office set out four regulatory objectives that separated accounts are intended to support:-

- ensuring non-discrimination,
- identifying unfair cross-subsidies,
- setting or assessing interconnection charges,
- retail price control.

1.10 It is important to establish not only that the transfer charges from one of the incumbent's businesses to another are calculated in a non-discriminatory manner, but also that these are treated by the dominant carrier/service provider as 'hard' charges and not simply paper accounting transactions. In other words, when the incumbent sets the prices for the retail business that purchases network services, it must treat the transfer charges as real costs that need to be recovered. Otherwise, a price squeeze may occur if the incumbent engages in discriminatory pricing behavior. The margin between the interconnection charges and the incumbent's retail price, against which the entrant is competing, may be insufficient to allow an efficient competitor to make a profit. This may constitute a distortion of competition.

1.11 A widely used technique to ensure that such price squeezes are not occurring is the 'imputation test'. The imputation test is conducted by comparing the retail price charged by the incumbent with the 'stack' of costs incurred to provide each service which is subject to competition. These costs comprise the transfer interconnection or wholesale charges for that service plus its retail costs (and any other relevant costs). The interconnection charges for the relevant service are calculated using the same charges as paid by interconnecting operators, and depend on the particular interconnection services that it uses as inputs.

1.12 If regulatory accounting requirements have not been set in advance, when a problem arises there is the risk that the Office would lack the necessary information to analyze the issue. Any cost information obtained would be on an ad hoc basis and could consequently lack robustness and credibility.

Regulatory Accounting Guidelines

1.13 Consistent with International best practice, the Office will be issuing Regulatory Accounting Guidelines for Accounting Separation. These guidelines will also reflect international best practice but, importantly, the Guidelines will also reflect the domestic conditions and the specific firm circumstances, in this instance, C&WJ.

Structure of this Document

1.14 The Office received two responses and a reply comment regarding its consultative document and notice of Proposed Rule Making (Accounting Separation for Cable and Wireless Jamaica and Proposed Drafting Instructions for regulatory Accounting Rules). This document will address the concerns raised by all three respondents. Chapter 2 will address the concerns raised by C&WJ, those raised by Digicel will be addressed in chapter 3 and Reliant's concerns will be addressed in chapter 4.

1.15 This Determination Notice must be read in conjunction with the "Regulatory Guidelines for Cable and Wireless Jamaica".

CHAPTER 2: COMMENTS ON C&WJ'S RESPONSE TO THE CONSULTATIVE DOCUMENT ON ACCOUNTING SEPARATION FOR C&WJ AND NPRM

2.0 The Office will respond to each comment based on the questions they relate to or the segment of the Consultative document which it addresses. C&WJ's major areas of concern include the appropriate level of public disclosure, implementation of reporting requirements, appropriate documentation and the costs associated with Accounting Separation. The Office will address all these major issues.

Objectives of Separated Accounts

C&WJ's Current Interconnection Rates

2.1 C&WJ stated that "the OUR has on occasion exercised due diligence by examining C&WJ's cost model as it relates to relevant costs for interconnection and has subsequently approved the Reference Interconnect Offers (RIO). In C&WJ's view this process of examination already provides an adequate safeguard mechanism for setting and assessing interconnection charges. C&WJ recognizes the importance of having interconnection rates that fairly reflect the associated costs and the Company has consistently applied the prescribed regulatory and accounting principles to ensure that interconnect rates are cost-based. C&WJ has openly shared with the OUR the costing information and methodologies used in determining interconnect rates.

2.2 Only after examining and finding comfort in C&WJ accounting and costing information did the OUR approve these interconnect rates. Having examined this costing information the OUR should be aware that the publication of commercially sensitive information is not necessary in order to satisfy users of the separated accounts that interconnection rates have been calculated fairly. It is the duty of the auditor and regulator to examine the accounts to ensure that the rates properly reflect the relevant cost and to provide this assurance to the market."

2.3 The Office:

The Office wishes to note that services offered under the RIO do not encompass all services used in the provision of retail services. Therefore, it could not be reasonably argued that the review of the RIO provides an adequate safeguard mechanism.

Determination 1.0:

In relation to the publication of commercially sensitive information, the Office has no intention to publish commercially sensitive information. For the avoidance of doubt, consistent with the provisions of the Act, where any information is deemed confidential, it will be treated as such. The OUR will take into consideration, the public interest and C&WJ's need for confidentiality in the specification of the format and type of information to be published.

Cost of Accounting Separation

2.4 C&WJ indicated that, "…costs incurred by C&WJ for the implementation and annual submission of regulated accounts will be borne by wholesale and interconnected customers (). As per the *Telecommunications Act 2000, Part 2 Section 4-(2),* "*In making a decision in the exercise of its functions under this Act the Office shall observe reasonable standards of procedural fairness*". C&WJ notes that the OUR has not demonstrated that the cost to be borne by the telecommunication industry will be surpassed by the anticipated benefit from accounting separation. C&WJ believes that there needs to be this type of quantitative analysis before the implementation of a costly regulatory accounts system which is to be audited. C&WJ, and the telecommunication sector as a whole, needs the OUR to provide a detailed cost-benefit analysis showing the welfare loss that would be involved if a system of regulatory accounts was not developed.

2.5 …C&WJ agrees that the OUR needs to have sufficient accounting separation information available to ensure that a level playing field exists in the Jamaican (fixed) market. However, directions to produce information on areas of business where competitors are not reliant on wholesale inputs from C&WJ, or directions to publish excessive or confidential information regarding the operation of C&WJ individual services will cause C&WJ and the industry to incur significant cost and place C&WJ at a competitive disadvantage. C&WJ trust that this is not what the OUR is intending to do through this consultation."

2.6 **The Office:**

The Office is of the view that it is exceedingly difficult to conduct a cost benefit analysis of accounting separation on a priori basis. Assuming that there is wide-scale cross-subsidization and

discrimination, how would the Office determine how many operators would have been in business, the amount of products and service that would have been produced and the impact this would have had on prices?

Determination 1.1:

The Office maintains the view that one of the primary purposes of regulatory accounting separation and the attendant obligations is to discourage anti-competitive practices but acknowledges that the benefits are extremely difficult to quantify. Nonetheless, the Office identifies the following benefits of having an effective regulatory accounting separation regime:

- **non-dominant telecommunications carriers and service providers are assured that the Office has information to monitor and where necessary, enforce obligations such as non-discrimination;**
- **disputes and investigations will be resolved more timely, efficiently and based on more reliable information; and**
- **the competitive environment in telecommunications markets is protected and provides the expected benefits for the Jamaican economy.**

Level of Accounting Separation

In relation to Question 3.1, (Do you agree that for the purposes of regulatory accounts C&WJ should split its activities into four Main Business Activities, namely: Fixed Access, Fixed Network, Fixed Retail Services and Mobile Business. The definitions of each main business are set out in Annex I to this Document?), C&WJ had the following comments.

2.7 According to C&WJ, it "…recognizes that within the supplementary consultative document the OUR has requested Accounting Separation (A/S) information at a more aggregated level. While C&WJ is generally in agreement with the degree of dis-aggregation for the main business areas proposed, the Company believes that any reporting on the Mobile business should not go beyond that which is required of any other mobile operator in the market. C&WJ firmly believes that the publication of sensitive information on the “mobile business” will place C&WJ mobile operations at a competitive disadvantage unless a similar demand is made on all mobile operators.

2.8 …C&WJ notes that Mobile reporting has often been required during the implementation of A/S in other jurisdictions to which the OUR refers. It must be appreciated however that these markets exhibited very distinct characteristics from Jamaica i.e. the incumbent fixed operator was also dominant in the Mobile market. This is not the case in Jamaica.

2.9 …C&WJ acknowledge that a mobile ‘basket’ will be the reconciling difference between the regulatory and statutory accounting statements and would therefore require inclusion in the AS modelling process. However, C&WJ believes that this information should be outside the scope of any public reporting requirement.”

2.10 **The Office:**
As noted above, the Office has no intention to publish commercially sensitive information and will consult the C&WJ on the specific format and type of information to be published.

2.11 C&WJ indicated that it “…is also not clear on the Business definitions outlined by the OUR. Within the Fixed Access Business the OUR has stated that the Business will contain ‘all the revenues (installation, rental, relocation, reconnection, etc) from access, as well as the costs, assets and liabilities associated with supplying connections and maintenance of ordinary business and residential exchange lines, including the low user tariff or any special tariff plan, domestic and international toll free lines, foreign exchange lines, and direct inward dialing lines and other access line technologies such as Integrated Services Digital Network (ISDN)’. C&WJ believes that the revenue for this business should be derived from transfer charges made to the Retail arm of C&WJ and any charges made to other operators for the wholesale provision of access services. Put more simply, customer line connection and rental will be a service provided by the Retail Business. The revenue from line connection and rental provided to end-users will therefore be recorded against Retail. Thus, the cost of providing customer lines will initially be recorded against the Local Access Network Business and there will need to be a transfer of costs to Retail in order to match revenues with their associated costs. In this way the Fixed Access

Business (together with the Fixed Network Business) will return the appropriate Weighted Average Cost of Capital (WACC), adjusted for any ‘retail minus’ charging as appropriate.

2.12 *C&WJ believes that it may also be appropriate to have an additional Exchange Line Rental & Connection retail business to appropriately capture the Retail Access Business.* Exchange line rental and connection are products offered to customers as a retail product. The structure proposed by the OUR suggests that both wholesale and retail costs be lumped together into the Fixed Access Business. Within separated accounts the Access business typically represents wholesale and will return the allowed WACC. Blurring the divide of retail and wholesale will also have implications for the model build itself and any effort to reconcile it from an audit and internal compliance perspective.”

2.13 **The Office:**
The Office is in agreement with C&WJ on all the points raised above. The Office agrees that the revenue for the Fixed Access Business should be derived from transfer charges paid by the Retail arm of C&WJ and any charges made to other operators for the wholesale provision of access services. Additionally, the Office agrees that it is appropriate to further segment the fixed access business to separately account for retail and wholesale transactions (that is, to the extent that there are in fact wholesale transactions for access).

2.14 Specifically related to access, there are no regulations that are constraining prices below cost; therefore, as in any market for a product, the wholesale price should be less than the retail prices.

Determination 1.2:

C&WJ revenue for the Fixed Access Business should be derived from transfer charges paid by the Retail arm of C&WJ and any charges made to other operators for the wholesale provision of access services (that is, to the extent that there are in fact wholesale transactions for access). Additionally, it is appropriate to further segment the fixed access business to separately account for retail and wholesale transactions.

For the avoidance of doubt, all wholesale transactions must be reported separately from retail transactions, irrespective of the business area they are associated with.

Question 3.2: Should C&WJ be asked to disaggregate its Retail Services Business into the nine service categories listed …? Respondents should justify their response. The definitions of each disaggregated business area are set out in Annex II of this Document.

2.15 C&WJ stated that it "… does not object to the request to prepare A/S information at the level proposed … and would be prepared to model and supply the OUR with information at this level of dis-aggregation. However, C&WJ has some concerns about the relevance of some of these services with regards to providing a greater level of transparency for the telecommunications industry. C&WJ is adamant that aspects of this information should be shared only with the OUR.

Local Calls

2.16 The inclusion of service costs for Intra-Parish and Inter-Parish Calls does not add value to the process of A/S. Intra-Parish and Inter-Parish calls are captured by the Price Cap Regime and wholesale local minutes are based on "Retail-minus" as per the *Telecommunications Act 2000.* The objectives of A/S as outlined by the OUR are not met by the inclusion of the service costs for these services. There does not exist the possibility of discriminatory pricing of wholesale local calls as the services are offered at the retail price less the prescribed margin. C&WJ therefore proposes that the OUR removes these services, as inclusion would simply increase the audit costs of the regulatory accounts without any commensurate benefit."

2.17 **The Office:**
The Office is of the view that the more aggregated the data is, the more likely it is that anticompetitive breaches will remain undetected. Therefore, it cannot be claimed that the proposed level of dis-aggregation does not provide any benefits.

2.18 According to C&WJ, "The Fixed to Mobile call rate is a composite of the Fixed Retention rate (which is set by the OUR) and the rate set by the mobile operators for the termination of calls on their networks. The Fixed Retention rate is outlined in the Reference Interconnect Offer (RIO) which C&WJ has demonstrated to be cost-based to the OUR. C&WJ sees it appropriate to limit Fixed to Mobile Reporting to simply the fixed retention given that one aspect of the rate for Fixed to Mobile calls is beyond the scope of C&WJ Fixed Line operations."

2.19 **The Office:**
The Office agrees that, for the time being, reporting requirement for fixed to mobile calls should be limited to the retention rate. However, after a decision has been reached on the reconsideration of the Office's Assessment of Dominance in Mobile Call Termination, this position may be revised.

Determination 1.3:
Fixed to Mobile reporting shall, for the time being, be limited to reporting on the fixed retention rate for this call service.

Public Payphones

2.20 C&WJ asked that the "OUR must bear in mind …that C&WJ does not earn revenue from Public payphones. The revenue that is generated from the consumer's use of this facility arises from the sale of phone cards. Based on this fact, C&WJ recommends that Public Payphones be removed from the listing in 3.8.0 as a reporting requirement given its lack of relevance."

2.21 **The Office:**
The Office agrees with this position.

Determination 1.4:
Separate service reporting on payphones will not be included in the list of services to be reported on under the Fixed Retail Service Business.

International Outgoing Calls

2.22 The Company stated that "Numerous services as defined in Annex II are now competitive based on the evolution of the telecommunication market over the last few years. These include International Outgoing calls, Data Communication Services and Internet Service Provision where competitors to C&WJ have alternative wholesale inputs to those provided by C&WJ. The market for International Outgoing calls is aggressively competitive and the publication of C&WJ's unit cost information will significantly inhibit the Company's ability to compete effectively. Publication of this information without similar publication from other operators would be discriminatory on the part of the Regulator and would not promote healthy competition. The potential for "margin squeeze" in wholesale market for International

Outgoing minutes is very limited as this service is also offered on a "Retail-minus" basis."

2.23 **The Office:**
The Office agrees that there should be no detailed publication of information on C&WJ's outgoing International Outgoing Call services. However, the Office does not consider the market for these calling services to be competitive primarily because of bottlenecks still being experienced due to alleged anticompetitive conduct by C&WJ.

Determination 1.5:
The Office does not intend to have any detailed publication of information on C&WJ's outgoing International Outgoing Call services.

Data Communication

2.24 C&WJ indicated that "The imminent competition in the provision of Data communication services must be considered along with the publication of any unit costing information for these services. Internet Service Providers are no longer limited to purchasing wholesale inputs for their service provision from C&WJ. There are now wireless technology options available that many operators are utilizing. The submission of detailed financial and operational information and suggested subsequent publication of said information would place C&WJ at a competitive disadvantage. Competitors would have greater insight into the operations of the company without any reciprocal information being made available to C&WJ."

2.25 **The Office:**
Based on information available to The Office, C&WJ remain the dominant provider of data communications services, specifically, national and international leased lines. Therefore, the required information must be submitted. However, given the possibility of increased competition in these markets, the Office will review its position in relation to publishing this information prior to the publication of the first audited report.

Determination 1.6:
Publication of detailed information on data communication services will depend on a market review, prior to the publication of the first audited report.

Supplemental Retail Services

2.26 The Company noted that, “As defined in Annex II, the Supplemental Retail service category may include competitive services such as the sale of international prepaid calling cards. Again, the commercial sensitivity of data on this service must be appreciated. Based on foregoing arguments, C&WJ will provide only the costs for each service level but is unwilling to provide commercially sensitive volume data. It would be exorbitantly expensive to produce profitability reports for different services as well as to audit these reports.”

2.27 **The Office:**
The Office must emphasize that, consistent with the provisions of the Act, confidential information will only be disclosed as per the specified circumstances of the Act. For the avoidance of doubt, The Office has no intention of publishing commercially sensitive information. It is necessary to provide volume information on all services so that, where necessary, appropriate tests can be conducted. The Company is in the best position to determine what information it considers confidential and as such, should attach a confidential marking to such information.

2.28 ***In relation to profitability reports, the Office will only require such reports for the main business categories and not for the individual services.***

Determination 1.7: **Volume data is required for all services.**

Determination 1.8: **Profitability reports are only required for the main business categories.**

Regulatory Financial Statements

Question 4.1: As stated in Annex III, should these constitute the main businesses and where applicable service categories for which C&WJ should be required to prepare statements of profit & loss and mean capital employed? Justify your response.

2.29 According to C&WJ, it "…is willing to produce AS information at the level proposed in Annex III of the document with the exception of detailed reporting on its Mobile business and reporting on individual services. C&WJ would be averse to producing Profit & Loss and Balance Sheet Statements for the individual service levels that are outlined as part of the Fixed Retail Services Business. Justification for this position has been provided in response to Question 3.1. Service cost information will be provided for some of the service levels … as per response to Question 3.2. C&WJ proposes that information be published at the business level and service specific reporting be provided to the OUR (See response to Question 6.1 for proposed level of detail for publication). As outlined below C&WJ believes that a more consolidated set of specific services is appropriate in the initial years of AS. For the mobile business the level of disaggregation should be at the level of the Company's annual statutory accounts and reconciliation submitted to the Office under confidential cover.

2.30 **The Office:**
***As stated in Determination 1.8, p*rofitability reports are only required for the main business categories.**

Determination 1.9:

Subject to review at the end of the first two years of Accounting Separation, the Office will only require C&WJ to produce Profit & Loss and Balance Sheet Statements for the four main business categories identified. The Office also agrees that published information should be restricted to the business level. However, basic information on the results of imputation tests will also be published.

In relation to the mobile business, the Office agrees with the proposal that the level of dis-aggregation should be at the level of the Company's annual statutory accounts with the reconciliation submitted to the Office under confidential cover.

Question 4.2: Should Return (profit/loss) be calculated on the same basis as the cost of capital? Justify your response.

2.31 C&W said it "…agrees in principle that if a pre-tax cost of capital is used, the return on capital employed should also be assessed on a pre-tax basis.

2.32 Furthermore, as the intention of calculating and using a pre-tax cost of capital is presumably to determine a reasonable rate of return that should be permitted in order to reward equity holders from post-tax profits via dividends, it is important that the cost of capital is appropriately adjusted in a timely manner for any changes in the tax burden borne by the regulated entity[3]. To a large extent, the tax burden will consist of the corporation tax rate, although it may also be appropriate to consider the impact of other forms of effective profit taxation such as licensing and compliance costs.

2.33 The situation is slightly different when one considers the position of debt holders and the costs of servicing debt. Debt holders receive their returns in the form of interest paid from the pre-tax profits. Consequently, the returns should be assessed <u>after</u> interest paid (or payable) is deducted and the relevant cost of capital should be appropriately adjusted to reflect the weighted proportion of 'cheaper' debt finance in the regulated entities capital structure.

2.34 Finally, when determining an appropriate rate of return for regulated services and the cost of capital to be used, it is worth considering the currency in which debt and equity holders are remunerated. Cable & Wireless Jamaica's equity holders are remunerated in Sterling, while many of the business's creditors (i.e. short-term debt holders) hold debts denominated in US$. Consequently, when considering the appropriateness of the cost of capital, C&W Jamaica believes that allowance should be made for any discernible trend in J$ currency devaluation i.e. the cost of capital should be uplifted so as to ensure that sufficient J$ profits exist from which to remunerate debt and equity holders in their respective currencies of payment."

[3] C&W Jamaica has prudently adopted International Financial Reporting Standards and appropriately provides for deferred taxation. Consequently, the appropriate tax rate by which to uplift the requisite return of equity holders should be the actual, relevant corporation tax rate, as opposed to any 'effective' corporation tax rate suffered in any particular year.

2.35 **The Office:**
In relation to the treatment of deferred taxation and the corporation tax rate, the Office will respect the applicable international accounting standards and apply best practice in dealing with these issues.

2.36 ***In relation to the alleged "…other forms of effective profit taxation such as licensing and compliance cost", the Office does not consider these to be applicable. These items are expense and must be treated as such.***

2.37 ***The Office does not share the view that the cost of capital should be uplifted based on a Jamaican dollar devaluation. To make this adjustment would be tantamount to double counting. Currently, C&WJ's prices are regulated under a price cap regime, in which prices are adjusted based on the reported inflation rate. In addition asset[s] are revalued to reflect inflationary effects which includes changes in the exchange rate. This would flow through to the depreciation and return on capital in the costing of services. These inflation adjustments should compensate for changes in the value of the currency.***

Determination 1.10
The appropriate tax rate by which to uplift the requisite return of equity holders should be the actual relevant corporation tax rate.

Question 4.3: Should the Statements of mean capital employed be in the format set out in Annex V? If not, propose an alternative.

2.38 The Company indicated that "The format displayed requires a level of detail that requires greater time for compilation of data without significant movement towards achievement of AS objectives. The statement of mean capital employed should simply represent totals for Fixed Assets, Current Assets, Liabilities and the Mean capital employed. C&WJ believes there is no value added by a breakdown of the said data."

2.39 **The Office:**
The Office is of the view that the greater the level of dis-aggregation, the higher the level of competitive safeguard. If the statement of mean capital employed simply reflects the totals for Fixed Assets, Current Assets, Liabilities and the Mean capital employed, there is more scope for the misallocation of assets and liabilities.

Determination 1.11
The Statements of mean capital employed should be in the format set out in Annex V of the *"Regulatory Accounting Guidelines for Cable and Wireless Jamaica"*.

Question 4.4: Should the figures reported in the statement be the average values for the period to which the statement relates?

2.40 The Company indicated that it "…agrees that in subsequent years that the figures reported in the mean capital employed statement should be the average values for the period. For the initial period of A/S C&WJ proposes to use closing values only since opening values for the period are unlikely to be available. This is because, unless the valuation methodology can be agreed prior to March 2006, the Current Cost Accounting (CCA) valuation process required for separated accounting purposes may not have been carried out for the opening period and it would be both difficult and disproportionate to carry out these onerous valuations retrospectively. This approach is typical in the implementation year of an A/S model under CCA. For subsequent periods C&WJ proposes the use of a simple average. C&WJ does not believe the use of weighted average values is operationally feasible or proportional, as this would require C&WJ to perform fixed asset register analysis each month. The differential between weighted average and a simple average is not expected to be material hence the benefits of the use of weighted average values would be limited."

2.41 **The Office:**
Subject to the availability of opening values, the Office agrees that the closing values for capital employed should be used in the initial year. However, the Office is not convinced that a simple average is appropriate for measuring and reporting values in subsequent years.

Determination 1.12
For capital employed, where possible and material, the average values shown should be weighted averages. If information is not available, as in the case of the initial reporting year, a simple average of opening and closing balances may initially be used. For the avoidance of doubt, if only the closing value of capital employed is available in the initial reporting year, this should be used.

Question 4.5: Do you share the Office's view that C&WJ's Statements of Profit and Loss, and Mean Capital Employed should be reconciled with the annual statutory financial accounts (i.e. Profit & Loss, Capital Employed) of the Company? If not, why not?

2.42 C&WJ stated that "It is appropriate that the regulatory accounts be reconciled with the statutory accounts. C&WJ agree that both P&L and MCE reconciliation's will be a necessary requirement in any audit. C&WJ proposes that the reconciliation be provided to the OUR. However, the Company does not believe that the reconciliation should be published. This is because, as set out above, the Mobile arm and certain Retail services of C&WJ's operation should not be subject to separated accounting and consequent reporting of commercially sensitive data. Clearly in any reconciliation to the statutory financial records of the Company the Mobile business would be a necessary balancing element. If the above were followed, that is where reconciliation's are provided to the auditors and OUR only, it would still allow the auditors and the OUR to have full visibility of the A/S process. It would also provide other operators the assurance that the regulatory information has been reconciled to statutory records, while the information pertaining to C&WJ's Mobile business and competitive Retail services would remain out of the public domain.

2.43 Reconciliation will necessarily include CCA adjustments to fixed assets. In turn, this will also result in reconciling items to the P&L reconciliation in order to address unrealized CCA holding gains and losses. Reconciliation is a useful check but there is little value in their publication, particularly given the complexity of the reconciliation. The OUR has not indicated how C&WJ should display reconciling adjustments but C&WJ presumes that these are only required if independently material."

2.44 **The Office:**
The Office concurs with these suggestions. That is, the reconciliation should be provided to the Office without a requirement for publication.

Determination 1.13:
The reconciliation of the regulatory accounting information with the statutory financial accounts should not be published.

Question 4.6: As part of C&WJ Accounting Information, do you think that a statement of cost for its fixed and mobile network services should be produced as per the discussion above? Explain your response.

Fixed Network Statement of Cost:

2.45 C&WJ said that it "…is prepared to provide the OUR with this statement, however, the Company objects to any proposal to make much of this information publicly available. The OUR argues in the consultation that the Act requires that charges for interconnection services be transparent. C&WJ's review of the Act reveals that it requires that the terms and conditions of interconnec0tion charges be transparent. Section 33 (1) of the Act outlines the principles which should guide the OUR in reviewing the charges established by a dominant carrier.

2.46 The Act places the responsibility of ensuring that interconnection charges are properly determined on the OUR and C&WJ maintains that the terms and conditions of interconnection charges will be transparent without the requirement to release C&WJ's commercially sensitive information into the public domain. C&WJ believes that aspects of information suggested by the OUR be included in the Fixed Statement of Costs are confidential and should be shared only with the OUR. For example, C&WJ believes that it should not disclose International Outpayments. The agreements with international partners are confidential and are acutely commercially sensitive the confidentiality of this information is confirmed by the terms and conditions of the contracts. Any disclosure of this information by C&WJ would be a breach of contract."

Determination 1.14:
International out-payments will be treated as confidential and will not be published.

Mobile Network Statement of Cost:

2.47 C&WJ strongly believes that this statement should not be a requirement of Accounting Separation. Given the competitive nature of the mobile market, and given that C&WJ is not the dominant mobile player in Jamaica, the Company is surprised that the OUR would request the production of a Statement of Network Costs for its Mobile business without a similar requirement being made of other mobile operators. C&WJ maintains that while Mobile operations will form a 'basket' of revenue and cost, it should not be further disaggregated. C&WJ does not accept that any level of disclosure greater than that applicable to other mobile operators in the market is appropriate. In this regard C&WJ would be constrained to avail itself of the due process provided under section 7 of the Telecommunications Act which speaks to the treatment of confidential information.

2.48 **The Office:**
The Office intends to treat this statement as confidential so there will be no need for C&WJ to resort to due process.

Determination 1.15:
The Office will not publish the Mobile Network Statement of Cost.

Question 4.7: Should C&WJ be required to publish a statement of cost for a list of retail services and containing such particulars as set out in Annex IX?

2.49 C&WJ stated that it "…strongly disagree with the proposal to produce and publish all elements of this statement. As far as C&WJ is aware there is no precedent for incumbents to publish a statement that details respective volumes of Retail products. C&WJ is willing to produce and publish unit costs for Fixed Retention, International Incoming Calls and Remaining Services, as discussed in response to Question 3.2. This will reflect much of the information outlined in Annex XI. However C&WJ is unwilling to publish commercially sensitive volume data."

2.50 **The Office:**
Volume data is necessary for the OUR to conduct critical tests on the information submitted by C&WJ, however, it may not be necessary at this time to place this information in the public domain. Volume information supplied based on the format of the Table in Annex XI will not be for publication. However, the Office maintains that all the information required based on Annex XI should be submitted.

Determination 1.16:
Volume information supplied based on the format of the Table in Annex XI of the "Regulatory Accounting Guidelines for Cable and Wireless Jamaica" shall not be for publication.

Accounting Framework Documents

Question 5.1: Do you agree that the key components of the Accounting Documents should be Regulatory Principles, Attribution Methods, Transfer Charging, and Accounting Policies? If not, why not?

2.51 According to C&WJ, it "…agrees that four of the key components of the Accounting Documents should be the Regulatory Principles, Attribution Methods, Transfer Charging and Accounting Policies. The OUR however has not commented on the method used for valuing assets although C&WJ notes that a valuation methodology is mentioned in the 'Notice of Proposed Rule Making' (NPRM).

2.52 On July 31, 2003, the OUR issued its determination titled "*Principles and Methods of Asset Valuation for Regulatory Purposes*". In this Determination, the OUR approved the use of the industry standard approach of Current Cost Accounting (CCA) using Modern Equivalent Asset (MEA) and absolute valuations as necessary for asset valuations. The OUR has directed that that these values be rolled forward, for regulatory purposes, until further specific studies are done. Coming out of that Determination, MEA values were used to derive the current interconnection rates and in the setting of the price cap regime. C&WJ would therefore expect that the A/S information would be produced on a current cost basis.

2.53 C&WJ proposes that, in addition to the components specified in paragraph 5.1 documentation on the Detailed Asset Valuation Methodology (DVM) should be produced by The OUR. The DVM provides an outline of the methodologies adopted for deriving gross replacement costs for each of the asset classes that comprise the fixed asset register as well as the basis of valuation of various assets classes within the fixed assets register of C&WJ. The OUR needs to specify an indexation method and possibly, the accounting entries to reflect changes in the CCA valuation year on year.

2.54 The OUR has outlined the key components of the Accounting Documents and also indicated their order of priority in the event of conflict between all or some of these documents. The order of priority as suggested by the OUR indicates a possible departure from typical accounting policies as regulatory edict would supersede established accounting policies. This departure will need to be documented. For example, C&WJ has adopted accounting for deferred taxation in accordance with international accounting standards but the OUR has been silent on this issue."

2.55 **The Office:**

In relation to the method to be used for asset valuation, the Office has decided to continue using the valuation methodology set out in its Determination Notice (TEL: 2003/06) July 31, 2003. That is, the Modern Equivalent Asset (MEA) methodology outlined in that Document. Specifically, with regard to the valuation of assets for regulatory purposes for future years, Determinations 9.0 and 9.1 remain applicable. For the avoidance of doubt, accounting separation information should be provided on a current cost basis using the methodology outlined in the aforementioned Determination Notice. However for audit and reconciliation purposes the methodology should be the same as used in the statutory financial statements.

2.56 ***Regarding the documentation on the Detailed Asset Valuation Methodology (DVM), it is not the regulator that usually produces this document. As in the case of the UK, BT produced the DVM. This should however, be subject to review by the regulator.***

2.57 ***The Office does not see any conflict between deferred taxation and the key components of the proposed accounting documents or the order of priority of these components.***

Determination 1.17:

Accounting separation information should be provided on a current cost basis using the methodology outlined in the Office's Determination Notice ”Principles and Methods of Asset Valuation for Regulatory Purposes”, July 31, 2003**.**

Question 5.2: Is three months from the publication date of the final determination notice a reasonable time period to assemble the Accounting Documents and submit them to the Office for consultation and review?

2.58 C&WJ stated that it "…believes that the OUR may have misinterpreted the timing of the production of Accounting Documents and their purpose in a typical Accounting Separation process. C&WJ would expect that as an output of this consultation the OUR will publish comprehensive Regulatory Accounting Guidelines (RAG). It is these guidelines that should include, by way of example, detailed information on the regulatory accounting principles, principles of cost causality, cost allocation principles, the level of separation of the accounts, transfer charges, definitions of main businesses and the high-level valuation approach to be taken. Until these comprehensive guidelines are established C&WJ will not be in a position to begin building a separated accounting model that complies with the OUR.'s requirements.

2.59 The Accounting Documents produced by C&WJ will be a 'living' document that will be developed as the accounting separation model is built. For example, it could not be possible for C&WJ to provide detail on the model structure in the Accounting Documents until the model is constructed and finalized. C&WJ notes that the OUR has gone some ways to provide a broad overview of this type of information within Chapter 3 of the NPRM. However, typically, Accounting Guidelines are more detailed as can be seen from the '*Regulatory Accounting Guidelines for Cable & Wireless Guernsey*', published by the Office of Utility Regulation in Guernsey and which can be found at http://www.regutil.gg/docs/OUROUR.0425.pdf.

2.60 It is C&WJ's expectation therefore that the Accounting Documents are submitted together with the Accounting Separation statements themselves. It is also C&WJ's understanding that typically the Accounting Documents will be audited in the same manner as the model and statements themselves to ensure that they have been correctly interpreted and have complied with the requirements of the OUR as set out in the RAG.

2.61 C&WJ believes that this process has precedence in all jurisdictions that carry out Accounting Separation. C&WJ would be prepared to submit a framework Accounting Document to the OUR prior to submission but this could only be on the understanding that this would be a 'framework' and would be amended as necessary as the accounting separation process and model develops. C&WJ would also suggest that once the Regulatory Accounting Guidelines are finalized that a collaborative approach be adopted between the OUR and C&WJ to facilitate the creation of the A/S model and the initial separated accounts. For example, this could be by way of monthly meetings between the two parties where C&WJ can explain progress on the model build and driver collection process and seek assurances from the OUR that the RAG has been interpreted correctly."

2.62 **The Office:**
The Office is in general agreement with the above statements except to say that the Accounting documents, subsequent to review by the OUR, should be finalized before the first audit. It is also important to note that the Office will publish Guidelines for Accounting Separation

for Cable and Wireless Jamaica along with this Determination Notice. These Guidelines should be read in conjunction with this Notice.

Determination 1.18:
The Accounting Documents should be submitted to the OUR for review and finalized before the first regulatory audit.

Publication of Financial Information

Question 6.1: Should the Accounting statements along with related information and notes be published?

2.63 C&WJ noted that it "…does not support the OUR.'s proposal to publish 'commercially sensitive' or 'competitive service' information.

2.64 C&WJ believes that to produce (and publish) statements at a very detailed level … in the initial years of separated accounting may not be in the best interest of any party. ….

2.65 …C&WJ proposes that, while it is prepared to provide a split of Retail activities … to the OUR, …for publication[,] the sub-categories be [should be] consolidated. This will enable greater reliability to be placed on the statements while the model is 'bedded in'. This approach has been adopted during the development stages of costing models by regulators in other jurisdictions, such as Guernsey, and in no way reflects any failure by the incumbent or a softening on the part of the regulator but is simply a pragmatic approach that acknowledges the difficulty and complexity of developing a robust model to produce disaggregated separated accounts.

2.66 C&WJ’s would welcome further discussions with the OUR. as to the most appropriate consolidation. Analysis of necessary cost drivers and best practice in other jurisdictions suggests that the following may be appropriate:

<u>3.2.1 Consolidation of Fixed Retail Services Business</u>

<u>Proposed by OUR.</u>	<u>Consolidation proposed by C&WJ</u>
	Exchange line rental & connection
Intra-Parish Calls Inter-Parish Calls Fixed to Mobile Calls	Inter-Parish and Intra-Parish to be removed Fixed to Mobile to be changed to Fixed Retention Rate
Public Payphones	Remove from reporting requirement No longer relevant
International Outgoing Calls[4] International Incoming Calls	International calls
Directory Enquiries (DQ) Data Communication Services Internet service provision Supplemental Retail Remaining Services	Remaining Services”

2.67 **The Office:**

The Office is cognizant that the publication of ’commercially sensitive’ information is not desirable. However, in relation to the specific consolidation of information for publication as proposed by C&WJ, the Office does not agree with the consolidation of the line rental and the connection charges or the complete removal of Inter-Parish and Intra-Parish calls. Regarding the latter, the Office agrees that these should be consolidated to reflect domestic calls as per the service offering.

Determination 1.19:

The information on the Fixed Retail Services Business should be published in the format outlined in the “Regulatory Accounting Guidelines for Cable and Wireless Jamaica” in Appendix IX, X and XI.

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[4] International Outgoing Calls should be removed, as there now exists effective competition for this service. Publication of costing information for this service would place C&WJ at a competitive disadvantage, as other operators would be able to adjust their strategies given this information without C&WJ being privy to any reciprocal information from these operators.

Question 6.2: Do you agree that the Publication of C&WJ's regulatory accounts should not exceed six (6) months from the end of the financial year to which they relate?

2.68 The Company stated that "It is accepted that industry 'best practice' is to publish regulatory accounts within six (6) months of the end of the financial year to which they relate. C&WJ would point out however that in almost all cases in other jurisdictions, for example Guernsey and Bahrain, operators have required an extended time frame to submit initial sets of accounts. The complexity and resource requirements of activity based costing and separated accounting should not be underestimated. By way of example, and setting aside from the onerous model build itself; a system to measure and allocate engineering staff activity information (a key cost driver) takes significant time and resource to establish. Clearly once this system is embedded, fine-tuned and staff become more familiar with the requirements of accounting separation, the collection of the data will become less burdensome year on year. Given there are potentially hundreds of cost drivers requiring data collection such as this, the hurdle of establishing these processes and methodologies in the first years of accounting separation becomes more obvious. C&WJ would ask that the OUR bear this in mind when imposing initial deadlines and suggest that a more appropriate timeframe for submission and publication in the initial year of production of regulatory accounts would be nine (9) months, moving towards six (6) months in subsequent periods.

2.69 **The Office:**
The Office agrees that publication in the initial year of production of regulatory accounts may be done up to nine (9) months after the end of the financial year and six (6) months in subsequent years.

Determination 1.20:
Regulatory accounts may be published not later than nine (9) months after the end of the initial financial year of regulatory compliance and not later than six (6) months in subsequent years.

That is, in accordance with section 4(5) of the Act which provides for the Office to "….make rules, subject to affirmative resolution, prescribing the system of regulatory accounts to be kept by a dominant carrier or service provider", except for the initial reporting year, Cable & Wireless Jamaica is directed to prepare, submit and publish Regulatory Accounts each year no later than six months after the end of the company's financial year in accordance with this

Determination Notice and the associated Guidelines and any amendments thereof.

Cost, complexity and timing of Separated Accounting

Cost

2.70 C&WJ indicated that, it "…acknowledges the OUR.'s views that the Company will need to have similar costing information for its normal business operations. However the production of A/S information to support C&WJ's business operations will not be of the form proposed by the OUR. A significant proportion of the cost involved in the proposed systems is the required external audit. Providing an audit opinion at the level of individual services will be extremely expensive and C&WJ is unwilling to directly bear this cost, particularly given the overall dynamics of the Jamaican telecommunication market. C&WJ has justified this position with alternative solutions to proportionally allocate the burden of this cost in its response to the NPRM. To reiterate the key points:

2.71 C&WJ strongly believes that the industry as whole should directly bear the cost of the regulatory audit. It must be noted that in terms of total share of the telecommunications (mobile and fixed) market that C&WJ has approximately 0.8 million subscribers against the 1.4 million held by Digicel[5]. Viewed in this context C&WJ is not the major player in Jamaica and it is interesting to note that Digicel, although misinterpreting the proposed requirements of Mobile Network operators (MNOs) as regards this and the NPRM states its belief that the resource requirements (and cost) of accounting separation and the audit process places a disproportionate burden on operators. In addition Jamaica has, as occurred globally in developing telecommunications markets, seen high levels of mobile versus fixed penetration. C&WJ estimates that fixed line teledensity in Jamaica is approximately 15% while mobile penetration has reached 70%. Importantly, of this mobile market C&WJ has less than 50%. …

2.72 It should …be noted that in the other jurisdictions to which the OUR refers, the incumbents have had clear dominance in the telecommunications market as a whole, both in terms of market share and total revenue. Arguably it is more proportional in such instances to expect the incumbent to bear the regulatory audit cost. C&WJ agrees with Digicel '*that it is*

[5] Market analysis done by C&WJ.

disproportionate to burden one operator', C&WJ, with such costs. To be clear, accounting separation is a requirement of the OUR and benefits other operators in the wider market. C&WJ already has in place costing systems for its internal operating purposes therefore any additional costs, particularly as regards an external audit, will bring no additional benefit to the Company.

2.73 On this basis C&WJ strongly believes, while it is prepared to meet the significant costs associated with the necessary systems and resource requirements of preparing separated accounts, that the audit costs should be met directly by all players in the industry. There are a number of possible ways that this could be achieved, one of which is prorating the cost by eligible revenue. Examples of this type of cost allocation between competing operators can be seen in many USO funding mechanisms. Recovery of the audit cost is also possible via an additional charge on the bills of interconnecting parties as well as wholesale customers. This item would be clearly identified as the "Regulatory Audit Cost" and would be applied to all interconnecting parties and wholesale customers on an equitable basis. The charge would be applied on a monthly basis. C&WJ would welcome the opportunity to discuss this issue further.

2.74 The Company is also likely to incur significant additional costs resulting from the outcome of this consultation. As an example of cost levels that other operators have incurred when implementing A/S, the incumbent in Guernsey attributed direct costs of over £1M (J$100M) in its first year to A/S because of the excessive and disproportionate requirements placed on the company by the regulator. This cost must be viewed in the context of an island of 60,000 inhabitants and a network comprising only five switches. C&WJ continues to strive to become a more efficient operator and is anxious to avoid this type of excessive regulatory cost. The Company therefore is very keen to have the OUR carefully consider all of the requirements made within this consultation. Reporting detail equals cost in an A/S environment."

2.75 **The Office:**
The Office is aware that a significant proportion of the cost involved in the proposed systems of separated accounts is attributed to external auditing. However, the Office is also cognizant of the fact that auditing services can be obtained at relatively reasonable rates if they are obtained from non-traditional sources.

2.76 ***From an economic perspective, the principle of cost causation is fundamental to the efficient pricing of goods and services. This principle states that the users of a service should only pay for those costs that are caused, or triggered, by the provision of service to them. In addition to access seekers, C&WJ also benefits from accounting separation through the appropriate pricing of access services from which C&WJ derive substantial revenue. Further, even in the absence of any requirement by the Office the company would need to know the cost and revenues of its various services and thus would incur these costs anyhow.***

2.77 ***Therefore, it may be appropriate for all access seekers and C&WJ to pay the costs associated with the auditing since they benefit from the system of accounting separation and associated level of audit assurance. Additionally, if only purchasers of wholesale services (including interconnection seekers but excluding C&WJ) are asked to pay this cost, C&WJ would have less incentive minimize its regulatory audit cost. Consequently, the Office has decided that the regulatory audit cost should be recovered from the industry, that is, from purchasers of wholesale services (including interconnection seekers and C&WJ).***

Determination 1.21:

The regulatory audit fees shall be recovered from the entire industry, that is, from purchasers of wholesale services (including interconnection seekers and C&WJ).

Complexity and timing of A/S

2.78 C&WJ noted that it "…looks forward to working with the OUR to design and implement a pragmatic and proportional A/S solution. Notably C&WJ has already proactively begun implementing a new accounting separation system that has the capability to produce separated accounts. C&WJ's existing costing system is not capable of producing regulated accounts as specified by the OUR.

2.79 As outlined below it is essential in any A/S process to have year-on-year continuity in terms of systems use and development. The projected timeline to complete the roll out of the new accounting separation system is April 2006.

2.80 There are very many technical issues, processes and resource requirements that must be addressed during the ABC model build and A/S process. To put this into context C&WJ believes it is beneficial to outline some of the necessary work-streams, such as:

- The disaggregation, re-classification and the re-valuation to current cost (CCA) of individual assets that make up approximately thirty (30) fixed asset categories. This process also requires a model to be built that calculates CCA depreciation, holding gains and losses and supplementary depreciation so that CCA inputs may be fed into the Activity Based Costing (ABC) model.
- The definition and subsequent collection of cost driver information for (typically) in excess of one hundred and fifty (150) drivers. By way of example this will include detailed analysis of network component use, staff activity and non-network assets to name just three areas. Defining appropriate driver methodologies and the driver collection process normally requires several fulltime staff dedicated solely to this task. It should be noted that often the A/S driver data sought is reliant on an output spanning the financial year in question. This data is difficult or impossible to source retrospectively, for example analysis of staff activity, as this will clearly change materially from year to year as the business focus changes. Deriving and documenting the driver methodologies is also a particularly onerous task.
- The new accounting separation system model design and build. This is highly specialized skill that can be expected to require the fulltime attention of an A/S expert during the first year of the A/S process. The complexities of the model build itself are too numerous to document here however C&WJ would be happy to discuss these issues further with the OUR. Again C&WJ reiterate a willingness to use a collaborative approach during this model design and build.
- Statement production: A system must be implemented to interrogate the ABC model so that the appropriate information can be extracted to construct accurate and reliable financial statements. This is a highly specialized skill that is a time and resource intensive process.
- The statutory financial information must be analyzed and disaggregated so that the regulatory information is coherent and consistent with the ABC model structure. This is a complex analysis that requires significant resource in the initial years(s) of accounting

separation prior to establishing a workable and accepted process and methodology.

2.81 This is a 'high level' summary of **some** issues that will need to be addressed. It is important to note that much of this work can be started only after the OUR has published detailed Regulatory Accounting Guidelines. Specific to C&WJ it should also be appreciated that the format of information required for A/S reporting, by the OUR, is fundamentally different to that currently being implemented by the Company in the new accounting separation system. Therefore a redesign of the new system, once implemented, will be necessary before this information will be in a form that supports A/S. Also, any meaningful regulatory reporting will require financial, cost driver, operational and statistical data for a complete financial year.

2.82 For these reasons it would not be possible for C&WJ to comply with A/S requirements, as specified in the OUR's Supplemental Consultation, before the financial year ending March 2006/07. C&WJ would again emphasize that the methodology, model and systems must be in place at the beginning of the reporting year for which A/S is required. This timeframe for system and process implementation is typical of the experience in other jurisdictions. C&WJ would be happy to justify this position more fully by way of a draft project plan and reference to model-build timelines in other jurisdictions should the OUR require further explanation to the above."

2.83 **The Office:**
The Office acknowledges the fact that establishing a system of accounting separation involves some degree of complexity. Further, in carrying out its functions, the Office is careful not to impose any unfair or unreasonable burden on any carrier or service provider. Therefore, for the reasons outlined by C&WJ, the Office agrees that the first set of audited regulatory accounts should be for the financial year ending March 31, 2007.

Determination 1.22:
The first set of audited regulatory accounts should be for the financial year ending March 31, 2007.

COMMENTS ON C&WJ's RESPONSES TO THE NPRM

2.84 Regarding the OUR's NPRM, C&WJ stated that it has concerns with regards to:

- The requirement for a tri-partite audit agreement and associated costs;
- The appointment of the auditor;
- The burden of administration and cost for the regulatory audit;
- The content of the audit report;
- The appropriate level of audit assurance in the initial years of accounting separation;
- The function of, and timing for, the production of Accounting Documents;
- The proposed drafting instructions; and
- The statement of responsibilty

Tri-partite audit agreements

2.85 The Company indicated that the "…OUR cite precedent for a tri-partite audit agreement in the UK between BT, PwC and Ofcom. C&WJ would point to the specific context of the UK market in which this decision was made. The UK market has been liberalised since 1984 and the regulatory framework and accounting separation requirements have evolved greatly since. The new rules now being developed for BT follow on from a framework incorporating accounting separation that has operated for more than 10 years. The market, regulatory framework and accounting separation process in the UK is therefore mature. The same cannot be said of C&WJ just two (2) years after full liberalisation and entering into its first run of accounting separation. Comparisons between communications markets and regulatory and accounting separation solutions in the UK and Jamaica are therefore difficult and unlikely to always yield helpful conclusions.

2.86 The OUR makes extensive reference to the guidelines developed by the Institute of Chartered Accountants in England and Wales (ICAEW) in the ICAEW technical release titled " *Reporting to Regulators of Regulated Entities*". The OUR concludes that the tripartite agreement between British Telecom (BT), BT's Auditors Price Waterhouse Cooper (PwC) and Ofcom produces the benefits that the OUR wishes to derive from the audit relationship, contained in paragraph 2.7 of the NPRM.

2.87 C&WJ notes that the guidelines referenced above were arrived at after extensive consultations with all the affected parties, being the regulators, the regulated companies and the accountancy profession in England and Wales. No such engagement has occurred in Jamaica where one can say that there is industry consensus to develop such guidelines. The Office cannot circumvent the process that is necessary to arrive at some consensus for benefits that C&WJ is convinced can be otherwise achieved.

2.88 C&WJ is further constrained to note that these guidelines do not have the force of law nor are they enforceable in Jamaica. Further at paragraph 7 of "*Reporting to Regulators of Regulated Entities"* there is a disclaimer that states that "……*this guidance should not be regarded as a substitute for the specific legal and professional advice which firms may need to take on particular matter of engagements*"

2.89 C&WJ rejects the OUR's proposal that the contractual agreement with the auditors should be tripartite, which the ICAEW guidelines recognize at paragraph 15 as being uncommon. C&WJ believes that a bipartite agreement between the Company and the auditor is most suitable. Therefore paragraph (ix) and (x)(a) of the OUR's "*Auditing Guidelines for Regulatory Accounts*" would be inapplicable.

2.90 C&WJ further believes the additional costs that will be incurred through such an agreement will outweigh any benefit. C&WJ would also point to other jurisdictions, such as Guernsey, where no such tri-partite agreement has been necessary as the separated accounting model has been developed by way of regular meetings between C&W Guernsey staff and the regulator. In this case the regulator also has the ability to carry out an independent review of the model if it deems appropriate. C&WJ proposes that this type of collaborative approach is appropriate to separated accounting in Jamaica. C&WJ would like to make clear that it in no way wishes to reduce the OUR's visibility of either the model build or the accounts themselves but simply that it believes that this can be achieved without the requirement to incur additional audit cost, to be borne by the industry, that will result from any tri-partite agreement.

2.91 Notwithstanding that C&WJ does not support a tripartite agreement as defined by the OUR, C&WJ does support a collaborative arrangement between itself, the auditors and the OUR that will allow the OUR to have confidence in the audit report that is published. In this respect C&WJ would welcome input from the OUR as to how this could be achieved."

2.92 **The Office:**

The Office concedes that its proposal for a tri-partite audit agreement may best be implemented after consultation with all parties (including the Institute of Chartered Accountants of Jamaica). However, the Office is not convinced that the cost of such a requirement will outweigh the benefits. Notwithstanding this, the Office is willing to follow a collaborative arrangement among C&WJ, the auditors and the OUR. This approach will be review after the second year of regulatory accounts are produced to determine if this approach provides sufficient confidence in the system of accounting separation..

Determination 1.23:

The Office will undertake a collaborative arrangement with C&WJ and the auditors in determining the specifics audit agreement. This approach will be reviewed after the second year of regulatory accounting compliance to determine if this approach provides sufficient confidence in the system of accounting separation.

The appointment of the auditor

2.93 C&WJ said that it "…agrees with the proposal that the Company should appoint the regulatory auditor while the OUR will have the ability to appoint an alternative if this audit firm is not deemed acceptable. Any changes however would only be effected following full consultation with C&WJ. C&WJ would stress that continuity across the audit process is essential in gaining year on year efficiency and cost reduction and this would be affected by change in auditors. Again C&WJ reiterates a willingness to discuss these issues, such as the efficiencies that may be derived from using statutory auditors for the regulatory audit, with the OUR as they arise. "

2.94 **The Office:**

The Office wishes to note that it is obligated to observe reasonable standards of procedural fairness in exercising its functions under that Act. Therefore, C&WJ will be consulted if the Office is of the view that it should make an alternative appointment of an auditor for regulatory accounts.

Administration and cost of the Audit

2.95 *Liability for the cost of the regulatory audit:*
The Company stated that "The OUR states that the annual audit cost for the purposes of preparing regulatory statements must be borne by the Company alone. The OUR makes the analogy between a regulatory audit being akin to a statutory audit, in that the Company should absorb the cost of both. A statutory audit is required by law for the protection of the shareholders and the audit is in fact paid for by the shareholders. A regulatory audit is produced by a regulated entity for use by the regulator and interested parties. Were it not for specific compliance regulation as the OUR is seeking to develop, regulatory statements and the attendant audit opinion would not be produced.

2.96 …C&WJ strongly believes, while it is prepared to meet the significant costs associated with the necessary systems and resource requirements of preparing separated accounts, that the audit costs should be met directly by all players in the industry. There are a number of possible ways that this could be achieved, one of which is prorating the cost by eligible revenue. Examples of this type of cost allocation between competing operators can be seen in many USO funding mechanisms. C&WJ would welcome the opportunity to discuss this issue further.

2.97 C&WJ proposes that the OUR makes it clear to the industry that the audit cost will have to be recovered and that the industry be invited to comment as to how this may be achieved."

2.98 **The Office:**
Refer to the Office's comments on "Cost" under the heading "Cost, complexity and timing of Separated Accounting".

2.99 C&WJ said it "…accepts that industry 'best practice' is to have regulatory accounts audited within six (6) months of the end of the financial year to which they relate. As stated in C&WJ's response to the Supplemental Consultation, in almost all cases in other jurisdiction of which this Company is aware, for example Guernsey and Bahrain, operators and auditors have required an extended time frame to submit initial sets of accounts. …"

2.100 **The Office:**
The Office reiterates that publication in the initial year of production of regulatory accounts may be done up to nine (9) months after the end of the financial year and six (6) months in subsequent years.

The Content of the Audit Report

2.101 C&WJ said that it "…concurs that the auditors should assess the materiality of the separated accounts as a whole, rather than considering any analysis of the separated accounts for individual components. This approach is supported by international best practice. However, as the OUR has not provided any examples of the specific factors that it may consider material for the auditors when they are reviewing the accounts C&WJ is not able to comment on the reasonableness of this statement. C&WJ therefore reserves any further comment until such time as the OUR clarifies these factors and its position further."

2.102 **The Office:**
In relation to materiality, while the Office agrees that the auditors should assess the materiality of the separated accounts as a whole, rather than assessing individual components, this position will be subject to review after the first year of separated accounts. Materiality is a matter of professional judgment as to what would influence a user of the financial statements. Although the Office will not provide any specific factors that it may consider material, the auditors should be guided by the international standards on auditing. It should be sufficient to note that:

In assessing materiality, the regulatory auditor should consider:

- ***The aggregate level of error acceptable to management, the AS auditor and appropriate regulatory agencies, and***

- ***The potential for the cumulative effect of small errors or weaknesses to become material***

Additionally, since the regulatory audit's objective relates to systems or operations that process financial transactions, the value of the assets or the value of transactions processed per day/week/month/year should be considered in assessing materiality.

The Appropriate Level of Audit Assurance

Audit

2.103 C&WJ noted that "…The level of audit opinion has been a contentious issue in many jurisdictions that have been subject to AS requirements. The contention primarily relates to the additional cost associated with a 'fairly presents' versus 'properly prepared' opinion measured against potential benefits. C&WJ believes that it is not widely understood how these two opinions differ as regards accounting separation and how each may affect (or otherwise) the users of the financial statements.

2.104 Putting aside the ability to sample, the predominant difference between the two opinions is that a properly prepared audit attests that the costs and revenues in the Activity Based Costing (ABC) model have been driven and/or allocated as documented in the Detailed Attribution Methodology (DAM). A fairly presents audit will attest not only that the costs and revenues have been driven and/or allocated as documented in the DAM but will also involve a review of the logic used for each of the drivers in the DAM. C&WJ believes that the significant additional cost of a 'fairly presents' audit can be avoided by adopting a collaborative approach to the model build whereby the drivers, outlined in the DAM, can be agreed through discussion and reference to best practice by both the OUR and C&WJ. C&WJ further believes that the expertise within the Company and the OUR will in many cases better qualify this type of analysis and decision making than would be available to any external auditor. The OUR state in the consultative document, at paragraph 2.1 that it and other third parties, may use the regulatory accounts in the course of their business and will therefore need to place reliance on the statements.

2.105 C&WJ believes that through a transparent and consultative model build that a 'properly prepared' opinion will enable the users of the statements to have equal confidence in the information to that should the statements be audited on a 'fairly presents' basis.

2.106 Notwithstanding the above, C&WJ believes that if the OUR is determined to move the accounts from 'properly prepared' to 'fairly presents' then the Company should have a minimum two year period of being audited on a 'properly prepared' basis. This approach has been determined as more suitable by the TRC in Bahrain for Batelco. C&WJ would also draw the OURs attention to the separated accounts in Guernsey where a 'properly prepared' opinion has been provided for the published accounts for both the 2002, 2002/03 and 2003/04 submission, as opposed to 'fairly presents' as stated by the OUR."

2.107 **The Office:**
The Office concurs with the approach outlined above to adopt the properly presents opinion with a collaborative approach to determining the required model. This should assist in reducing the audit cost for the initial years. After the first year of regulatory audit, the Office will consult on whether to move to a fairly presents opinion.

If deemed necessary, the third year of separated accounts would be audited with an opinion of fairly presents.

Determination 1.24:
The first year of regulatory audit should be accompanied by a properly presents opinion. After the first year of regulatory audit compliance, the Office will consult on whether to move to a fairly presents opinion. If deemed necessary, the third year of separated accounts would be audited with an opinion of fairly presents.

Regulatory Accounts 2005/6

2.108 The Company stated that it "…agrees with the OUR that it in fact is not "starting from scratch" in the preparation of the first set of regulatory accounts. Since consultations on accounting separation have begun, C&WJ has had further opportunity to refine its costing system. The Company will be implementing OROS in Jamaica by April 2006, which is the standard software used to produce regulatory accounts. This system has already been implemented in other C&W business units in the Caribbean.

2.109 …Even if the OUR insisted that C&WJ produce regulatory accounts for the year ending March 31, 2006, the Company could not attest to the validity or reliability of the information and in fact any audit opinion on such accounts would have to be qualified.

2.110 The current costing system, used by C&WJ and which will be replaced by April 2006, cannot produce regulatory accounts as defined by the OUR."

2.111 **The Office:**
See Office's response to C&WJ's comments on "Complexity and timing of Accounting Separation".

Audit Conduct

2.112 **The Office:**
See Office's response to C&WJ's comments on "Complexity and timing of Accounting Separation".

Proposed Drafting Instructions for Regulatory Accounting Rules

2.113 C&WJ commented on a number of issues raised in the NPRM. These are addressed below:

2.114 The Company indicated that “The Office has charged C&WJ to be compliant with all directives issued by the Office. C&WJ is willing to be compliant with any uncontested directive from the Office, however the Company stresses that it must be given adequate notice of any changes, three (3) months before the start of the fiscal to which the accounts apply being a reasonable time frame within which to secure compliance.

2.115 **The Office:**

The Office is not reluctant to give the suggested three months notice of such changes but equally, the Office must have at least three months to review C&WJ’s suggested changes under this regime. For the avoidance of doubt, in relation to the second reporting year, this notice period cannot obtain on either side if the initial submission is made nine (9) months after the end of the first financial year. Therefore, in the initial year, six (6) weeks notice should suffice.

Determination 1.25:

Three (3) months notice should be given (by the OUR or C&WJ) for any suggested change to this regime.

2.116 C&WJ stated that it “…agrees that the accounting documents will contain the elements as outlines in points “a” to “f”. However, as outlined in our response to the supplementary consultative document on accounting separation, C&WJ believes that the OUR have misinterpreted the timing of the production of Accounting Documents in a typical Accounting Separation process. C&WJ would expect that as an output of this and the aforementioned consultation that the OUR will publish comprehensive Regulatory Accounting Guidelines (RAG). It is these guidelines that should include, by way of example, detailed information on the regulatory accounting principles, principles of cost causality, cost allocation principles, the level of separation of the accounts, definitions of main businesses, transfer charging process and the high-level valuation approach to be taken. Only once these comprehensive guidelines are set in place will

C&WJ be in a position to begin building a separated accounting model that complies with the OUR's requirements.

2.117 The Accounting Documents produced by C&WJ will be a 'living' document that will develop as this model is built. For example, it could not be possible for C&WJ to provide detail on the model structure in the Accounting Documents until the model is constructed and finalised. C&WJ note that the OUR has gone some way to provide a broad overview of this type of information within Chapter 3 of this NPRM. However, as an example of more detailed Regulatory Accounting Guidelines, C&WJ refer the OUR to the 'Regulatory Accounting Guidelines for Cable & Wireless Guernsey', published by the Office of Utility Regulation in Guernsey at the following link, http://www.regutil.gg/docs/our0425.pdf.

2.118 It is C&WJs expectation therefore that the Accounting Documents are submitted and published together with the Accounting Separation statements themselves. It is also C&WJs understanding that typically the Accounting Documents will be audited in the same manner as the Activity Based Costing model and statements themselves to ensure that they have been correctly interpreted and are compliant with the requirements of the OUR as set out in the RAG. C&WJ believes that this process has precedent in all jurisdictions where Accounting Separation is carried out. C&WJ would be prepared to submit a framework Accounting Document to the OUR prior to submission but this could only be on the understanding that this would be a 'framework' and would be amended as necessary as the accounting separation process and model develops."

2.119 **The Office:**
As noted above, the Accounting documents must be finalized before the first audit. Further, the "Regulatory Accounting Guidelines (RAG) will be issued along with this Notice.

2.120 C&WJ said that it "…does not agree with all requirements a set out in 'i' to 'vi', particularly as regards any regulatory reporting requirements on its mobile operation where the Company currently has less than 30% market share. Please refer to our response to the supplementary consultative document on accounting separation for further justification to this position."

2.121 **The Office:**
Refer to the Office's comments on "Mobile Network Statement of Cost" above.

2.122 According to C&WJ, it supports the proposal of a 28-day notice for change of auditors.

Determination 1.26:
The 28 days notice period will be adopted regarding a change of auditors.

2.123 C&WJ said that it "…strongly disagrees that the full cost of the regulatory audit shall be at the expense of the Company. Please refer to our response to 2.16 to 2.18 for further justification for this position. Moreover, where an audit firm is jointly agreed by the Company and the OUR, C&WJ will not assume any responsibility for cost incurred where as in paragraph G.2 (x)(c) of Annex 1, the OUR chooses to appoint auditors directly to undertake further work, subsequent to the completion of the audit."

2.124 **The Office:**
Refer to the Office's comments on "Cost" under the heading "Cost, complexity and timing of Separated Accounting".

Statement of Responsibility

2.125 C&WJ indicated that the Company does not "…wish to obstruct the separated accounting process and is committed to working with the OUR to build a robust model and publish accurate and reliable regulatory statements. However, neither C&WJ as a Company nor any of its officers would sign a Statement of Responsibility as worded by the OUR in Annex 1. C&WJ does not think that this position is unreasonable and would ask that the OUR review the Statement's of Responsibility in other jurisdictions.

2.126 *C&WJ suggests that a more appropriate statement as:*
Cable and Wireless Jamaica Limited ("C&WJ") is required under Condition X of its licence to maintain accounting records in a form which enables the activities of any of its businesses specified in any direction given by the OUR to be separately identifiable, and which the OUR considers to be sufficient to show and explain the transactions of each of these businesses.

The Separated Regulatory Accounts for the year ended 31 March 200X comprise:

For each Business:
i) a profit and loss account;

ii) a statement of mean capital employed

They also include a:

iii) Statement of costs of network service for the Network Business;

iv) Transfer charge statement; and

v) (As to be determined through consultation)

The directors are responsible for keeping proper accounting records for each of the separate businesses that disclose, with reasonable accuracy, at any time, the financial position of each separate business to enable them to ensure that the regulatory accounts comply with the Licence. C&WJ confirms that the Separated Regulatory Accounts for the year ended 31 March 200X have been reconciled to the relevant Statutory Accounts and to the best of its knowledge have been prepared in accordance with the requirements of the relevant Conditions of its Telecommunications Licences.

Senior Officer, C&WJ”

2.127 **The Office:**
The Office has no objection to the proposed form of the “Statement of Responsibility” and has adopted this general construct in its Decision.

Determination 1.27:
Consistent with the declaration of dominance, Cable and Wireless Jamaica Limited ("C&WJ") is required under Sections 4 (5) and 35 (1) to provide the Office with regulatory accounts that maintain accounting records in a form which enables the activities of any of its businesses specified in any direction given by the Office to be separately identifiable, and which the Office considers to be necessary in showing and explaining the transactions of each of these businesses.

The Separated Regulatory Accounts for the year ended 31 March 200X comprise:

For each Business:

i) **a profit and loss account;**
ii) **a statement of mean capital employed**

They also include a:

iii) **Statement of costs of network service for the Network Business; and**
iv) **Transfer charge statement.**

The directors are responsible for keeping proper accounting records for each of the separate businesses that disclose, with reasonable accuracy, at any time, the financial position of each separate business to enable them to ensure that the regulatory accounts comply with the Licence. C&WJ confirms that the Separated Regulatory Accounts for the year ended 31 March 200X have been reconciled to the relevant Statutory Accounts and to the best of its knowledge have been prepared in accordance with the requirements of the Regulatory Accounting Guidelines and the directives of the Office.

…………………………………..
Senior Officer, C&WJ

CHAPTER 3: DIGICEL'S COMMENTS ON ACCOUNTING SEPARATION FOR CABLE AND WIRELESS JAMAICA

3.0 This Chapter addresses the concerns raised by Digicel in its response to both documents (Accounting Separation for Cable and Wireless Jamaica and Proposed Drafting Instructions for regulatory Accounting Rules). The Office will respond to each comment based on the questions they relate to or the segment of the Consultative document which it addresses.

Objectives of Separated Accounts

3.1 According to Digicel, it "…believes that account separation is important because it helps to guard against incumbent operators engaging in anti-competitive behaviour such as predatory pricing and/or cross subsidisation which can often be disguised through cost misallocation. Consumers can also be protected from abuse of dominance through excessive pricing. The OUR is mandated under the Telecommunications Act 2000 to implement competitive safeguard rules which prescribe inter alia the separation of accounts of the dominant public voice carrier Digicel believe this can be achieved without overburdening Cable and Wireless. In addition, the welfare loss that is negated by the use of accounting separation will more than compensate for any increase in cost associated with providing separated accounts."

3.2 **The Office:**

The Office agrees that accounting separation should assist in guarding against anti-competitive practices by a dominant operator. However, on a note of correction, the Office is not "mandated under the … Act 2000 to implement competitive safeguard rules which prescribe inter alia the separation of accounts of the dominant public voice carrier."

Section 35 (1) of the Act states that, "The Office may, after consultation with the Fair Trading Commission and such participants in the telecommunications industry as it things fit and subject to subsection (3), make rules subject to affirmative resolution (hereinafter referred to as "Competitive Safeguard Rules") prescribing the following matters in relation to dominant public voice carriers -

(a) separation of accounts;

(b) keeping of records;

(c) provisions to ensure that information supplied by other carriers for the purpose of facilitating interconnection is not used for any uncompetitive purpose;

(d) such other provisions as the Office considers reasonable and necessary for the purposes of the competitive safeguard rules. ….”

The use of the term “may” suggest that this is not obligatory.

3.3 Digicel stated that it “…has seen clear evidence of misallocation of costs by Cable and Wireless in other jurisdictions. This has reaffirmed its view that accounting separation should be introduced as soon as possible in Jamaica. Digicel contends that there is strong anecdotal evidence in Jamaica that suggests that C&W has engaged in misallocating costs for the purposes of gaining a competitive advantage in the market. As stated in previous documentation submitted by Digicel to the OUR, C&W J’s accounts as published in a national newspaper for the quarter ended December 31, 2004, suggested the fixed line operations are highly profitable while its mobile division is apparently losing money. This raises concerns whether anti-competitive cross subsidization is taking place e.g. Digicel believes that there may be cross subsidisation between CWJ mobile and fixed networks through interconnect rates that are not cost based (too high for fixed interconnect, too low for mobile interconnect).”

3.4 **The Office:**
If these claims are true, the accounting separation system should be able to identify such cross-subsidy in order that corrective action can be taken.

Question 1: Do you agree that for the purposes of regulatory accounts C&WJ should split its activities into four Main Business Activities, namely: Fixed Access, Fixed Network, Fixed Retail Services and Mobile Business?

3.5 Digicel said that it “…is not quite sure if the Fixed Access and Fixed Network categories referred to are wholesale. If both categories are wholesale, then Digicel would agree that the fixed network should be segmented into the three categories listed. However, Mobile Business should also be divided into wholesale and retail since C&WJ is offering wholesale and retail services on both the fixed line and mobile networks. This will help the Office in ensuring that C&WJ is not allowed to use its relative strength in both markets for any anti-competitive behaviour.”

3.6 **The Office:**
The Office wishes to note that additional dis-aggregation may increase the cost of separation and audit. Further, this kind of detailed separation of wholesale and retail mobile services may become necessary if mobile operators are declared dominant.

Question 2: Should C&WJ be asked to disaggregate its Retail Services Business into the nine service categories listed at 3.8.0 above? Respondents should justify their response.

3.7 Digicel is in firm support of the various service categories that are being proposed for the separation of C&WJ retail services, though we suggest that Supplemental Retail be further aggregated by itemising emergency services and free phone services. Digicel are pleased to note that the OUR has included in its list the Directory enquiry service. As the OUR is aware Digicel has requested a wholesale DQ service from C&WJ in recent months but have only been offered the service at terms that are considerably above are unacceptable and at rates that are considerably above international benchmarks for same. Digicel anticipate that the OUR will be able to assess what an appropriate cost for a wholesale DQ service is subsequent to this process.

3.8 **The Office:**
Given the context, the Office assumes that Digicel meant to use the term "disaggregated" instead of aggregated in the above statement. Again, the Office wishes to note that increasing granularity is likely to be associated with higher costs. Further, it is not clear that the suggested dis-aggregation would achieve increased net benefits.

Question 4: Should Return (profit/loss) be calculated on the same basis as the cost of capital? Justify your response.

3.9 In general, Digicel would answer yes to the question as it is posed, however, Digicel are somewhat confused by the following statement in the preamble to the question:

> "For example if weighted average cost of capital is on a pre-tax and pre-interest basis…". Digicel believes interest payments (or the cost of debt) is fundamental to calculating the weighted average cost of capital. Therefore, while WACC can be calculated on a pre-tax or post-tax basis it is not clear how it is calculated pre-interest. Digicel believes that it would be helpful if the OUR provided more detailed

on this to clarify what is being proposed although we would note that the format proposed in Annex IV of the consultation appears the correct approach.

3.10 **The Office:**
Digicel correctly pointed out this error. It is the profit or loss that may be reported on a pre-interest basis.

Question 5.1: Should the Statements of mean capital employed be in the format set out in Annex V? If not, propose an alternative.

3.11 Digicel disagrees with the format for the Statements of mean capital employed and wishes to refer the OUR to the proposed statement in Annex C of the consultative document on Regulatory Accounts for a Dominant Carrier or Service Provider 2000 (a copy is provided below). Any attempt to aggregate the items will prevent proper analysis of the funding structure of each of C&WJ's business, thereby weakening the effect of the accounting separation. Hence it is essential that C&WJ is asked to provide detail statements which will allow the Office to use regulatory accounting as an effective tool to police cross-subsidization activities.

ANNEX C: Statement of Capital Employed
Business or Service Category Notes Previous Year Current Year

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Fixed assets
Investments
Deferred expenditure

Total Fixed Assets

Current assets
Cash & short-term deposits
Accounts receivable
Due from related companies
Inventories
Current portion of deferred expenditure

Total current assets

Total Assets

Current liabilities
Bank overdraft
Accounts payable
Current portion of loans
Current portion of obligations under finance lease
Taxation
Due to ultimate parent company
Due to related companies
Dividends payable
Dividends proposed

Total current liabilities
Net current assets (liabilities)
Long-term liabilities Loans Obligations under finance leases Deferred taxation
Total Long-term Liabilities
Shareholders' equity Share capital Capital reserve Retained earnings
Total shareholders equity
Capital employed

Source: OUR consultative document on Regulatory Accounts for a Dominant Carrier or Service Provider 2000

3.12 **The Office:**
Although the Office expects to receive a detailed Statements of mean capital employed, it is intended to publish such statements as per Annex V of the "Regulatory Accounting Guidelines for Cable and Wireless Jamaica".

Question 5.2: Should the figures reported in the statement be the average values for the period to which the statement relates?

3.13 It is also important that every effort is made by the OUR in having the incumbent produce a weighted average mean capital employed statement. The simple average will not give a true reflection of the capital employed over the reporting period.

3.14 **The Office:**

As stated above in response to C&WJ's suggestion that a simple average would be used to calculate the capital employed, the Office is not convinced that a simple average is appropriate for measuring and reporting these values.

CHAPTER 4: RELIANT'S COMMENTS

4.0 This Chapter addresses the concerns raised by Reliant Enterprise Communications in its reply comments in relation to both documents (**Accounting Separation for Cable and Wireless Jamaica** and **Proposed Drafting Instructions for regulatory Accounting Rules**). The Office response to each comment based on the segment of the Consultative document or the NPRM which it addresses.

RELIANTS COMMENTS ON THE NPRM

Tri-partite audit agreements

4.1 According to Reliant, "A tri-partite audit agreement is the only way that the regulators can ensure that the audit product is reliable in terms of reflecting the needs of the regulator. It is impractical to assume that C&WJ will reflect these needs when negotiating on a bi-partite basis. It is tantamount to asking C&WJ to represent the needs of the regulator when negotiating with the auditors. Resistance to the tri-partite agreement is justifiably self-serving on C&WJ's part but does not meet the needs of the regulator."

4.2 **The Office:**
See response to C&WJ's comments on this issue.

Cost of the Audit

4.3 Reliant indicated that "A statutory audit undertaken to protect shareholders was not requested by the shareholders but by the lawmakers. To follow the logic of C&WJ then the lawmakers should pay for the statutory audit. The regulatory audit is also for the protection of the shareholders because their risk of ownership does not stop at the door of a regulatory requirement. The regulatory requirements also impinge on the value and risks of ownership because it is part of the totality of operations. As a result the shareholders cannot ignore the fact that C&WJ is a regulated entity. In the final analysis a regulatory audit is helpful in the value analysis by shareholders because it reveals compliance/non-compliance much the same as reporting to the Securities and Exchange Commission or Jamaica Stock Exchange required reports.

4.4 Consequently the cost of a regulatory audit has the same cost responsibility as a statutory audit and reports to financial regulatory authorities. C&WJ should pay it.

4.5 In terms of cost recovery C&WJ may take some hints from companies in the USA that have had to comply [with]… the Sarbannes-Oxley requirements as to how they coped."

4.6 **The Office:**
See the Office's response to C&WJ's comment in the cost subsection of the Section titled "Cost, complexity and timing of Separated Accounting".

Audit Assurance

4.7 The requirement and basis of the OUR for a "properly prepared" assurance migrating to a "fairly presents" assurance after the first year is reasonable. C&WJ has extensive international accounting experience in this regard. Asking for more time to comply is not reasonable.

4.8 **The Office:**
After the first year of regulatory audit, the Office will consult on whether to move to a fairly presents opinion. If deemed necessary, the third year of separated accounts would be audited with an opinion of fairly presents.

RELIANTS COMMENTS ON SEPARATED ACCOUNTS FOR C&WJ

4.9 These comments and concerns seem to be focused on:
(1) Transfer pricing,
(2) cross-subsidies,
(3) Allegation of predatory pricing
(4) Appropriate pricing for wholesale services

4.10 **The Office:**
The Office intends that the system of accounts will address these concerns. Additionally, the OUR will shortly consult on competitive safeguards for the Telecommunications industry which should include rules on all the issues raised above.