



هيئة تنظيم الاتصالات
Telecommunications Regulatory Authority

Changing the audit standard for Batelco's regulatory accounts from "Properly prepared within the bounds of materiality" to "Fairly presents"

Determination

21 July 2011

Ref: MCD07/11/100

Public Version

Confidential information [[X] redacted]

Purpose: To change the audit standard for Batelco's regulatory accounts from "properly prepared" to "fairly presents"

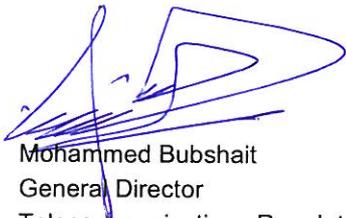
DETERMINATION

1. Having regard to the Legislative Decree No.48 of 2002 promulgating the Telecommunications Law ("the Telecommunications Law"), the Accounting Separation Regulation issued on 2 August 2004 (the "Regulation"), the Annex to this Determination which sets the reasoning for this Determination and taking into account all submissions received from interested parties, the Telecommunications Regulatory Authority ("the Authority") hereby makes the following Determination:
2. In accordance with articles 3(c)(1) of the Telecommunications Law and article 1.2 of the Regulation, the audit standard for the regulatory accounts of Bahrain Telecommunications Company B.S.C ("Batelco") is changed from "properly prepared within the bounds of materiality" to "fairly presents".
3. The "fairly presents" audit standard shall apply for the regulatory accounts as a whole and for the Access Network Business unit or equivalent.
4. The Authority may also request at its discretion additional audit opinions, either in accordance with the "fairly presents" and/or "properly prepared" audit standard at the levels (e.g. product/service, business unit) it deems appropriate. The Authority may also amend the audit requirement applicable to the Access Network Business Unit or equivalent for the 2012 regulatory accounts onwards. Such decisions will be made through the annual approval process of the Accounting Procedure Manual ("APM").
5. As part of its submission of the regulatory accounts, Batelco shall include the audit report as well as the list of changes (with explanation as appropriate) compiled by the auditor, if any, made to the approved APM (including potential override by the auditor of instructions issued by the Authority).
6. Batelco shall continue to comply with its obligations as set out in its licenses and article 1.1 of the Regulation with regard to the preparation of separate regulatory accounts. Batelco's auditor shall audit all regulatory accounts and shall henceforth express its opinion in accordance with this Determination.

Entry into force

7. This Determination shall come into effect from the date of its issuance and shall apply to Batelco's regulatory accounts for the 2011 accounting period onwards.

Signed on 21 July 2011



Mohammed Bubshait
General Director
Telecommunications Regulatory Authority
Manama, Kingdom of Bahrain

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

Annex: Reasoning for the Determination

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Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

List of acronyms and definitions used

APM	Accounting Procedures Manual
Batelco	Bahrain Telecommunications Company B.S.C
CCA	Current Costs Accounting
FAC	Fully Allocated Cost
FP	Fairly Presents
ISA	International Standards on Audit
LRAIC	Long Run Average Incremental Cost
LRIC	Long Run Incremental Cost
OLOs	Other Licenced Operators
PP	Properly Prepared
RO	Reference Offer
SMP	Significant Market Power
The framework	The approved APM and Accounting Separation Regulation

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

1 Introduction

8. This Annex sets out the reasoning for the Authority's decision to change the audit standard applicable to Batelco's regulatory accounts.
9. The purpose of an audit is to enhance the degree of confidence and provide the requisite assurance to intended users as to the accuracy, reliability and quality of information contained in the regulatory accounts. This is achieved by the expression of an opinion by an external auditor on whether the regulatory accounts are prepared, in all material respects, in accordance with an applicable reporting framework, such framework in this instance being specified within the Accounting Separation Regulation issued on 2 August 2004 (the "Regulation") and the Accounting Procedures Manual (the "APM") as approved by the Authority from time to time.
10. As a result of a number of concerns identified by the Authority during its reviews of Batelco's APM, its regulatory accounts, its Reference Offer ("RO") and retail tariffs, the Authority considers that it is necessary to change the scope of Batelco's audit opinion from "properly prepared" to "fairly presents". The change of audit opinion will provide the required level of assurance regarding the accuracy, reliability and quality of information contained in the regulatory accounts.
11. The Authority issued a draft Determination on 8 March 2011 (MCD03/11/027). By the closing date of the consultation period, 21 April 2011, the Authority had received responses from: Bahrain Telecommunications Company B.S.C ("Batelco");¹ Lightspeed;² Menatelecom;³ and VIVA.⁴
12. For clarity purposes, this Annex includes the original text of the draft Determination, with minor amendments. For each section, a summary of the points raised by respondents is provided along with the Authority's analysis and conclusions.

¹ Batelco, Response to the Telecommunications Regulatory Authority of Bahrain (TRA) Draft Determination Changing the Audit Standard (GCL/145/11), dated 21 April 2011 ("Batelco's submission" or "Batelco's response").

² Lightspeed Submission in response to the TRA Public Consultation on the Draft Determination changing the audit standard for Batelco's regulatory accounts from "Properly prepared within the bounds of materiality" to "Fairly presents", received 10 April 2011 ("Lightspeed's submission" or "Lightspeed's response").

³ Menatelecom, Response to TRA Consultation Document on the Draft Determination changing the audit standard for Batelco's regulatory accounts from "Properly prepared within the bounds of materiality" to "Fairly presents", letter dated 21 April 2011 (Exec/75/11) ("Menatelecom's submission" or "Menatelecom's response").

⁴ VIVA, Draft Determination changing the audit standard for Batelco's regulatory accounts from "Properly prepared within the bounds of materiality" to "Fairly presents", letter dated 21 April 2011 (BAH-0411-R074) ("VIVA's submission" or "VIVA's response").

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

2 Background

13. Ensuring that regulated tariffs (both at the wholesale and retail levels) are set at the appropriate level contributes to the development of competition for the benefit of consumers and promotes economic efficiency. This key responsibility of the Authority presupposes that accurate and reliable costing information from the regulated entity is available.
14. Article 1.1 of the Regulation provides that licensed operators shall prepare Fully Allocated Cost ("FAC") regulatory accounts, Long Run Average Incremental Cost ("LRAIC") regulatory accounts and an APM which requires the prior written approval of the Authority.
15. In addition all licenses granted by the Authority contain accounting requirements which require all licensees to "*keep, draw up, submit to independent audit by an external auditor approved by the Regulator and present, in written form, separate accounts for licensed telecommunications activities*".⁵
16. The current scope of the audit requirement of "properly prepared" is contained in article 1.3 of the Regulation. This article states that:

"an auditor approved by the Authority shall audit all regulatory accounts. The auditor shall express an opinion as to whether the regulatory accounts are properly prepared within the bounds of materiality, in accordance with the APM, as approved by the Authority".
17. The audit requirement is referred to in Batelco's audit report as follows:⁶

*"The audit includes an assessment of whether the regulatory accounts, taken as a whole, are **properly prepared** in all material respects in accordance with the requirements of the Accounting Procedures Manual and whether the regulatory accounts include all disclosures required by either the Accounting Procedures Manual or the Accounting Separation Regulation issued by the TRA"* [emphasis added].
18. The accounting requirements are further expanded in the Regulation which sets out the requirements for separate regulatory accounting.
19. Over the last few years the Authority has faced difficulties in reviewing the APM and regulatory accounts as well as when using the information contained in the regulatory accounts to review and set wholesale and retail charges. Examples of errors and issues are detailed in Table 2 below. This is despite the fact that Batelco's regulatory accounts have been provided to the Authority with an audit report that confirms them to be "properly prepared" in accordance with Batelco's APM.
20. The issues described above and listed in Table 2 below have been identified and resolved almost entirely through the Authority's own work. The Authority has had to spend a large volume of hours and internal and external resources reviewing Batelco's APM and regulatory accounts. The Authority does not consider that its function is to vet the APM

⁵ Article 24 of Generic National Fixed Licence: Accounting Requirements.

⁶ 2009 Batelco's APM, Scope of audit requirements, page 130.

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

and audited regulated accounts of a regulated entity to the extent to which it has had to do over the last few years.

21. The effect of the Determination will be to put the onus upon Batelco and its auditors to ensure that its accounts are not only properly prepared but also fairly present the true nature of Batelco's regulatory accounts and that the APM is appropriately documented. In some circumstances this may require Batelco and its auditor to depart from the APM.

3 Legal basis

Draft determination text

22. The legal basis for this Determination is set out in:
- a. Article 3 (c) 1 of the Telecommunications Law which provides that the Authority shall have the power to issue Determinations as necessary for the implementation of the provisions of the Telecommunications Law, inter alia, in connection with accounting separation; and
 - b. Article 1.2 of the Regulation which provides that the Authority shall issue Determinations under this Regulation as it deems appropriate.⁷
23. The Authority further notes that Article 1.3 of the Regulation contemplates a potential change of audit scope. The Regulation anticipated a review of the audit standard by the Authority within two years of the entry into force of the Regulation to establish whether the audit standard provides the required level of assurance.

Summary of Operators' responses

24. Only Batelco commented on this point. Batelco asked the Authority to consider whether a determination is the correct instrument to change the "properly prepared" audit standard for Batelco. Batelco considers *"that such determination may not change the standard set in the Regulation as determinations are issued under the "umbrella" or scope of the existing regulation"*.⁸

⁷ Determinations under this regulation are defined as: *"written determinations issued by the TRA as it sees fit relating to the manner, form and timing of the production of Regulatory Accounts, together with the methodologies and other matters to be applied in their preparation"*. See Definitions and Interpretation, page ii of the Regulation.

⁸ Batelco's submission, paragraph 15.

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

The Authority's analysis and conclusion

25. Having considered Batelco's comments, the Authority remains of the view that it is not necessary to amend the Regulation to achieve a change in the scope of the audit requirement and it is satisfied that its initial view is correct. Together with its general powers under Article 3(c)1 of the Telecommunications Law, Article 1.3 of the Regulation contemplates a potential change in the audit standard following a review of the audit standard by the Authority. The Authority considers that the change of scope that applies solely for Batelco can be achieved through a determination and refers to page ii of 9 of the existing Regulation. Determinations under this Regulation are defined as:

“written determinations issued by the TRA as it sees fit relating to the manner, form and timing of the production of Regulatory Accounts, together with the methodologies and other matters to be applied in their preparation.”

26. Therefore a determination issued under the Regulation can be used to change the audit standard applicable to Batelco.

4 Different audit standards

Draft determination text

27. There are two generally accepted audit standards that are commonly applied in the telecommunications sector for regulatory reporting purposes. They are generally referred to as “**fair presentation framework**” (“**FP**”) and “**properly prepared**” (“**PP**”) or “**compliance framework**”. These are defined in the International Standards on Audit (“ISA”) as follows:⁹

*“The term “**fair presentation framework**” is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:*

- (i) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or*
- (ii) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements.*

*The term “**compliance framework**” is used to refer to a financial reporting framework that requires compliance with the requirements*

⁹ ISA International Standards for Auditing: <http://web.ifac.org/download/a008-2010-iaasb-handbook-isa-200.pdf>.

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

of the framework, but does not contain the acknowledgements in (i) or (ii) above.” [emphasis added]

28. It should be noted that the method of implementing an audit under either “fair presentation framework” or “compliance framework” is subject to the interpretation of the auditor in relation to the circumstances of the audit. With respect to the audit of regulatory accounts in the telecommunications sector the differences between the two approaches have been established through working practices rather than any codified set of rules and regulations.
29. The differences at the practical level between a “fairly presents” opinion and a “properly prepared” opinion and the implications for the audit work performed is subject to the judgment and interpretation of the auditor. Based on the international experience of auditing regulatory accounts in the telecommunications sector, the key differences between a “fairly presents” opinion and a “properly prepared” opinion can be summarized by the following three requirements that are only present in the case of a “fairly presents” opinion:
 - a. The auditor checks the reasonableness of the apportionment methodologies and the objectivity of the selection of those methodologies;
 - b. The auditor checks the appropriateness of the framework documentation; and
 - c. The auditor checks the appropriateness and robustness of the data sources, including methodology driver data (e.g. operational data, volumes).
30. In case any or all of a, b or c fall short of the requirements, the auditor will require the audited firm to make all necessary amendments.
31. Thus, an audit performed under a “fair presentation framework” provides a high level of assurance and requires the auditor to perform more extensive audit work and the wide-ranging application of professional judgment resulting in a true and fair opinion on the regulatory accounts.
32. An audit performed under “compliance framework” provides assurance that the figures contained in the regulatory accounts have been properly prepared in accordance with the “framework”.
33. In the case of Batelco's regulatory accounts, the applicable framework is the approved APM with instructions by the Authority. The “properly prepared” audit opinion – which is consistent with a “compliance framework” audit – gives the Authority the assurance that the regulatory accounts comply with the requirements of the Regulation and are consistent with the APM without any assurance that the accounts are fairly presented. Moreover, the assurance provided by the “properly prepared” audit opinion is largely dependent on the transparency and completeness of the APM and the extent to which it is free from ambiguity.

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

Question 1

Would you like to add anything to the descriptions of audit standards provided by the Authority? Please elaborate.

Summary of Operators' responses

34. Two licensees (Batelco and Lightspeed) provided comments on this question.
35. Lightspeed supported the Authority's definitions, especially in relation to the three requirements that are only present in the case of a "fairly presents" audit opinion. Furthermore, Lightspeed is of the view that the approved auditor should also verify the sources of information used in the context of current cost valuation as well as analyse the level of efficiency of Batelco's operations to ensure that potential inefficiencies are not passed on to Other Licenced Operators ("OLOs") through higher wholesale charges.
36. While Batelco largely agreed with the definitions provided by the Authority, Batelco described further both standards.
37. Batelco described the properly prepared audit opinion as "*an opinion as to whether the regulatory financial statements have been properly prepared in accordance with a detailed methodology document*".¹⁰ In Batelco's view, this form of opinion does not typically consider the appropriateness of the methodologies or the reliability of the source of non-financial data used to drive cost attributions.
38. By contrast, Batelco describes the fairly presents audit opinion as "*an opinion as to whether the regulatory financial statements are fairly presented in accordance with a methodology*".¹¹ In Batelco's view, the costing principles such as "cost causality" and "objectivity" are key to this form of opinion which considers the appropriateness of the detailed costing methodologies and the robustness of data sources used to implement these principles.
39. Batelco's views regarding the audit work required to meet the different opinion levels are summarized in the following table:

¹⁰ Batelco's submission, paragraph 17, point 1.

¹¹ Batelco's submission, paragraph 17, point 2.

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Table 1: Summary of Batelco’s descriptions for the audit work required under the FP and PP audit standards

Audit work	Summary of Batelco’s descriptions	Is it different under FP and PP?
Methodology Review	Under the fairly presents audit standard, the methodology review will consist of a detailed assessment of the appropriateness of the methodologies used (e.g. appropriateness, robustness, objectivity and adequate level of granularity) while under the properly prepared audit standard the auditor must ensure that the material methodologies used are not wholly unreasonable.	Yes
Methodology application	Under both audit opinions the auditor must ensure that for a given methodology the stated approach has been applied correctly (i.e. correct input data has been used; appropriate calculations have been made; and output driver data has been produced accurately). This requires substantive testing of the models.	No
Data sources	<p>Under a fairly presents audit opinion, a detailed testing of data sources is required and includes the following tests:</p> <ol style="list-style-type: none"> 1. substantive testing of the compilation and extraction of source data; 2. testing source data systems (with focus on management controls and periodic validation procedures); 3. testing of controls over the conduct of each material survey; and 4. assessment of sufficiency of data sources in respect of objectivity and statistical accuracy. <p>Under a properly prepared audit opinion, the audit work would only include the first test (substantive testing of the compilation and extraction of source data).</p>	Yes
System review	Under both audit opinions, the auditor will look at different stages of the costing model and ensure that the models operate as intended through testing (e.g. effectiveness of reconciliation procedures, control totals, systems interfaces, periodicity of data refreshes, etc...). Furthermore, the auditor will ensure that <i>“all model elements have been correctly processed”</i> (Batelco’s submission, paragraph 24).	No
Financial statements	Under both audit opinions, substantive testing of the compilation of the financial statements will be carried out. This includes testing the accuracy of inputs and the additional information; the consistency of the statements; and the key statements’ reconciliations.	No
Analytical review	<p>Under a fairly presents audit opinion the statements would be subject to:</p> <ol style="list-style-type: none"> 1. a detailed review of each primary statement for businesses/activities (including examining trends and profitability); 2. a detailed review of the calculated costs of network components/services to assess whether they fall within ranges experienced in other reviews or identifying local circumstances which lead to a justifiable variance; and 3. a detailed line by line review of the CCA:HCA and LRIC:FAC ratios of network components. <p>Under properly prepared audit opinion, the statements would only be subject to a high level review of the statements’</p>	Yes

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Audit work	Summary of Batelco’s descriptions	Is it different under FP and PP?
	overall consistency with Batelco’s statutory accounts and to investigation of any unusual trends or returns.	
Documentation review	<p>Batelco claims that both audit opinions require largely the same work to be done, namely: (a) an “[a]ssessment of sufficiency of documentation, focusing on the completeness, transparency and suitability of the documentation of the model [...]” (Batelco’s submission, paragraph 28); and (b) an “[a]ssessment of consistency of model documentation with the principles in the framework documentation” (Batelco’s submission, paragraph 28).</p> <p>Batelco also notes that the provision of an opinion does not necessarily require a very detailed document but in such case, regulatory auditors would have to carry out more work to reach their opinion and would require Batelco to complete and clarify the APM when needed.</p> <p>In relation to paragraph 33 of the draft determination, Batelco argued that in case the framework document was not complete and there were sections relating to certain parts of the model missing, the regulatory auditors would require Batelco to complete the document, so they can reach their audit opinion.</p> <p>According to Batelco, one difference between the two standards would be that, under fairly presents, the auditor could require Batelco to override a particular requirement of the Authority’s instructions if such requirement could lead to regulatory accounts which are not fairly presented.</p>	Largely the same work

Source: The Authority based on Batelco’s response.

40. At paragraph 23 of its submission, Batelco contends that *“it is very unlikely to be possible to test the controls in place over the data sources during 2010 as this year has already past”*. It also claims that the relevant testing for data sources could not be completed for the 2011 regulatory accounts.

The Authority’s analysis and conclusion

41. Having reviewed the comments received the Authority remains of view that the definitions of “fairly presents” and “properly prepared” audit standards provided in the draft determination are appropriate. However, in light of Batelco’s response at paragraph 26, the Authority has decided to add a fourth point to the three existing requirements that are specific to a “fairly presents”. The amended requirements for a “fairly presents” opinion are:
- a. The auditor checks the reasonableness of the apportionment methodologies and the objectivity of the selection of those methodologies;
 - b. The auditor checks the appropriateness of the framework documentation;

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- c. The auditor checks the appropriateness and robustness of the data sources, including methodology driver data (e.g. operational data, volumes) and CCA related information (e.g. price quotes obtained); and
 - d. The auditor conducts a detailed analytical review of: each primary statement for businesses/activities; the calculated costs of network components/services; and line by line review of the CCA:HCA ratios and LRIC/FAC ratios of network components/services.
42. In relation to the audit work that should be performed as part of the documentation review, the Authority does not agree with Batelco's view that a properly prepared audit opinion also includes an *"assessment of sufficiency of documentation, focussing on the completeness, transparency and suitability of the documentation of the model for use as a framework for audit purposes"* and an *"assessment of consistency of model documentation with the principles in the framework documentation"* (Batelco's submission, paragraph 28). While a "fairly presents" audit opinion requires that the documentation is appropriate to implement the principles (e.g. cost causation, objectivity) and procedures, the properly prepared opinion only relates to the principles and procedures included in the documentation being properly applied.¹²
43. In this regard, it is worth mentioning that the Authority has highlighted to Batelco the lack of transparency, completeness and traceability of Batelco's APM on various occasions including during the review of the 2009 APM. Such issues have led the Authority to set out detailed requirements and to request Batelco to submit a proposal to improve the lack of transparency and traceability of the APM.¹³ In the "alternative proposals" section of its submission, Batelco acknowledges that it made additions and enhancements to its APM following the Authority's instructions letter dated 9 November 2010 (but in no case following a requirement formulated by its regulatory auditors). This tends to further support the Authority's view that reviewing the appropriateness of the framework documentation is not part of the properly prepared audit opinion but is part of the fairly presents audit opinion.
44. Based on its understanding of the nature of the work that should be done under each audit opinion, the Authority is of the view that reviewing the appropriateness of the framework documentation, more specifically ensuring that the documentation meets an appropriate standard of transparency and completeness, is not generally covered under a properly prepared audit opinion, but is specific to a fairly presents audit opinion.

¹² This is consistent with PwC's audit opinion of BT 2010 Regulatory accounts, page 13, paragraphs 9-10.

¹³ See the Authority's letter dated 9 November 2010, 2009 APM Approval, Instructions for the Preparation of the 2009 FAC and LRIC Regulatory Accounts (MCD/11/10/100).

Determination to change the audit standard for Batelco’s regulatory accounts – Reasoning

5 Reasons for the change of scope of audit requirement

Draft determination text

45. Since the entry into force of the Regulation in 2004, the Authority has had the opportunity to review and analyse the financial information contained in Batelco’s separated accounts which is used in various regulatory proceedings such as the Reference Offer (“RO”) review and retail tariffs analysis. In turn the Authority has had the opportunity to consider the question of the scope of the audit standard, and in particular, whether its application provides the necessary level of assurance that is required.
46. Batelco’s regulatory accounts play a vital role in the promotion of competition in the telecommunications market of the Kingdom of Bahrain. The financial information contained in the regulatory accounts feeds into Batelco’s RO submissions where it is used as the primary basis for the setting of wholesale and retail tariffs. Given the importance of the availability of adequately priced regulated products in Bahrain (both at the wholesale and retail levels), it is critical for the Authority to have a high level of assurance with regards to the information contained in the regulatory accounts.
47. In reviewing Batelco’s regulatory reporting submissions, the Authority has identified a number of deficiencies that need to be addressed. Examples of these deficiencies are set out in more detail in the table below. In light of the deficiencies and issues the Authority has identified with Batelco’s APM and regulatory accounts, the Authority considers it necessary to change the scope of Batelco’s audit to ensure that the required level of assurance is provided.
48. The following table provides a *non-exhaustive* list of examples based on the Authority’s review of Batelco’s regulatory accounts and other regulatory proceedings where the “properly prepared” audit standard failed to provide the Authority with the necessary level of assurance.

Table 2: Examples of issues encountered by the Authority with Batelco’s regulatory accounts

Issues that have arisen during the Authority’s review of Batelco’s regulatory accounts and other regulatory proceedings	How these issues would be avoided using “fair presentation framework”
Appropriate cost apportionment/allocation:	
<p>The cost driver for “[X] IT-Fixed Billing” in the 2009 APM: Batelco used the “[X]” as the cost driver to allocate [X] IT-Fixed Billing to “local billing & retail” and “[X]”. In the 2008 regulatory accounts it appeared that [X] of IT-Fixed Billing total cost was direct opex ([X]). Thus it is questionable whether [X] is an appropriate cost driver for allocating cost between retail and wholesale.</p>	<p>Under the “fairly presents” audit opinion the auditors can depart from the APM and in this case if the auditors find that Batelco used an inappropriate methodology in the APM they can request Batelco to change it to ensure that the financial statements are presented in a fair manner. With a “properly prepared” audit opinion the auditor only ensures that the regulatory accounts are consistent with the requirements of the framework and it is not their responsibility to require Batelco to change inappropriate methodologies. Under the “fairly presents” opinion the responsibility for examining the appropriateness of cost allocations and the allocation methodologies rests primarily with the auditors and not solely with the</p>

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Issues that have arisen during the Authority’s review of Batelco’s regulatory accounts and other regulatory proceedings	How these issues would be avoided using “fair presentation framework”
	<p>Authority through the APM review, as is presently the case. In the event the auditors identify inappropriate cost allocations they will not be able to provide an unqualified audit opinion.</p> <p>Under a “fairly presents” audit opinion the auditor has the responsibility to ensure that the cost drivers used by Batelco are appropriate and would have flagged up this issue. It is the Authority’s view that the independent auditor is best placed to opine on the appropriateness of the methodologies used by Batelco by virtue of its working relationship with the audited firm and the access to information that ensues.</p>
Inappropriate price trends used in the CCA valuation:	
<p>The Authority has identified significant issues with the CCA valuation/price trends (e.g. [X] in the past three years¹⁴ which have required substantial modifications following review by the Authority. Under a “properly prepared” audit opinion the auditor is only required to check that the price trends specified by the Authority in the APM approval letter are applied properly in Batelco’s regulatory accounts. There is no requirement to check that the inputs used in the CCA valuation (e.g. [X]) are true and fair.</p>	<p>Under a “fairly presents” audit opinion the auditor is also required to check that the inputs used in the CCA valuation result in a fair presentation of Batelco’s CCA accounts.</p>
Absence of information or misleading information:	
<p>The current APM is incomplete. For example, the current APM prepared by Batelco under “properly prepared” does not include the description of cost centres or the complete list of allocation destinations, e.g. [X]</p>	<p>One of the critical elements in the “fair presentation” framework is to ensure that all necessary information is documented in the APM to achieve an acceptable level of transparency and enable a proper understanding and assessment of the methodologies used by Batelco while reviewing the APM.</p>
SDH transmission cost:	
<p>During the 2010 review of Batelco’s RO submission, the Authority identified significant issues regarding operational data that greatly impact SDH transmission costs.¹⁵</p>	<p>Under a “fairly presents” audit opinion, this issue should have been clearly identified by the auditors and, if not resolved, it should have been flagged in the Audit report. Instead it was identified by the Authority. However the issue could not be rectified by the point in time it was discovered.</p>
Number of CAT/LLCO E1 equivalent circuits:	
<p>During the 2010 review of Batelco’s RO submission, the Authority identified other significant issues regarding</p>	<p>Under a “fairly presents” audit opinion, auditors would have checked the appropriateness and robustness of the data sources underlying the calculation of cost allocation</p>

¹⁴ See the last three APM approval letters from the Authority, MCD/11/10/100 dated 9 November 2010, MCD/02/10/015 dated 7 February 2010, MCD/1008/070 dated 20 October 2008.

¹⁵ See Reference Offer Order, 25 January 2011, MCD/01/11/006, paragraphs 39, 125, 138, 342-345 and 362-364.

Determination to change the audit standard for Batelco’s regulatory accounts – Reasoning

Issues that have arisen during the Authority’s review of Batelco’s regulatory accounts and other regulatory proceedings	How these issues would be avoided using “fair presentation framework”
operational data on CAT/LLCO which greatly impact transmission cost. ¹⁶ Firstly, it would appear that a number of high speed circuits are not included in the total number of E1 equivalent circuits. Secondly, it is only after repeated questioning regarding the number of E1 used to calculate the transmission cost per E1 and despite initial denial by Batelco, that Batelco finally acknowledged that its calculation of the cost per E1 was erroneous.	drivers. Such issues should have been clearly identified by the auditors and, if not resolved, it should have been flagged in the Audit report. Instead the issue was identified by the Authority.
Routing factor table:	
During the 2010 review of Batelco’s RO submission, the Authority identified several inconsistencies in Batelco’s routing factor table. ¹⁷ For instance, routing factors of the RAN network elements applicable to mobile data services, SMS, and MMS were not divided by 2 as they were for voice services in order to account for the split of traffic between the 2G and the 3G radio access network. For SMS and MMS services, Batelco was applying different routing factors for the cost allocation of the mobile switching centre server and media gateway whether the service was on-net or off-net (regulated terminating services).	Under a “fairly presents” audit opinion this issue should be identified by the auditor. Batelco’s auditor should make sure that the regulatory accounts prepared by Batelco are free of errors.
Different cost allocation to retail service groups between FAC and LRIC accounts:	
During the review of the 2008 regulatory accounts the Authority found that the distribution of the costs of the international network to the retail service groups was different in the LRIC accounts compared to the FAC accounts. ¹⁸ The above issue has arisen as a result of Batelco grouping together network components in the LRIC accounts and adding the routing factors for individual components together to get the combined routing factor for the component group. This is being done with outpayments in the international network.	This issue should have been identified under a “properly prepared” audit opinion, but it was not. This issue would have been directly addressed under the more stringent “fairly presents” audit opinion.
Change in cost driver and cost allocation without prior approval:	
In the 2008 approved APM, the cost driver to allocate the cost of “Market comm” was [X] and this cost centre was allocated to only three activities: [X] However, during the 2010 RO review, the Authority noticed that the cost driver had changed to a [X] and [X] has been added as an allocation destination without approval from the	This issue should have been identified under a “properly prepared” audit opinion in which it provides assurance that the regulatory accounts are consistent with the approved APM. Under a “fairly presents” audit opinion Batelco’s auditor should make sure that not only the regulatory accounts prepared by Batelco are consistent with the approved APM but also that all figures are fair

¹⁶ See Reference Offer Order, 25 January 2011, MCD/01/11/006, paragraphs 362-364.

¹⁷ See Reference Offer Order, 25 January 2011, MCD/01/11/006, paragraphs 179-180.

¹⁸ See Review of Batelco’s 2008 regulatory accounts – Questions for Batelco – May 2010 (MCD/05/10/062), Letter sent by the Authority to Batelco on 27 May 2010.

Determination to change the audit standard for Batelco’s regulatory accounts – Reasoning

Issues that have arisen during the Authority’s review of Batelco’s regulatory accounts and other regulatory proceedings	How these issues would be avoided using “fair presentation framework”
Authority ¹⁹ .	and true. The audit standard is more stringent.
Issues with operational data that may impact allocation of costs:	
During the 2010 review of Batelco’s RO submission, the Authority identified potential issues with the total adjusted duct length which decreased by [X]km between 2007 and 2008. ²⁰ The Authority considers such a decrease to be improbable and it raises concerns not only about the robustness of operational data sources but also about the appropriateness of the methodology used to collect and treat raw data.	Under a “fairly presents” audit opinion, this issue should have been clearly identified by the auditors and, if not resolved, it should have been flagged in the Audit report.

Source: The Authority

49. Taking into consideration both the use of the regulatory accounts and the difficulties the Authority has in forming an opinion on the overall reasonableness of the regulatory accounts (as evidenced by the serious practical issues identified above), the Authority determines that the current scope of the audit standard, being “properly prepared”, does not provide the necessary level of assurance and therefore should be revised from “properly prepared” to “fairly presents”. The Authority considers that a “fairly presents” audit opinion will provide all interested parties with the necessary level of assurance as to the accuracy, reliability and quality of information contained in the regulatory accounts.
50. Under a “fairly presents” audit opinion the auditor has the responsibility to ensure the reasonableness and appropriateness of the APM in addition to the accuracy of the regulatory accounts and compliance with the framework. This will contrast with the present situation where the responsibility to ensure the reasonableness and appropriateness of the APM falls on the Authority. At present, the current audit scope places too much responsibility on the Authority. Considering the difficulties encountered and the position of asymmetry of information of the Authority, the Authority is of the view that it is appropriate to change the audit standard. The core expertise of an auditor is to assess accounting and financial frameworks. By virtue of their role and working relationship with the audited firm they have direct access to any information they deem necessary to perform their duties.

¹⁹ See Reference Offer Order, 25 January 2011, MCD/01/11/006, paragraph 569.

²⁰ See Reference Offer Order, 25 January 2011, MCD/01/11/006, paragraph 261.

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

Question 2

Do you believe it is appropriate to change the audit standard to “fairly presents” in light of the issues identified by the Authority on Batelco's regulatory accounts?

Please elaborate.

Summary of Operators' responses

51. Four licensees have responded to this question.
52. Both Lightspeed and Menatelecom agree with the justifications provided by the Authority to change the audit standard applying to Batelco's regulatory accounts.
53. While VIVA fully supports the improvement of market transparency, market competition and the objective to ensure that the Authority “*can effectively manage the development of the sector*” (VIVA's response, page 1), it does not support the Authority's decision to change the audit standard. VIVA's main concern is that changing the audit standard would limit the involvement of the Authority in the review process which would be left to the discretion of Batelco's regulatory auditors.
54. Batelco provides comments on each of the examples cited in the draft determination. Table 3, page 21 in the next section reproduces Batelco's comments and includes the Authority's views on Batelco's comments.
55. In its response Batelco asks whether all the listed examples in the draft Determination are material and whether a costly “fairly presents” audit opinion would remove all the issues which have been listed.
56. Batelco also mentions that many improvements are currently in the process of being implemented either as a result of the instructions issued by the Authority or as a result of Batelco's own initiatives.
57. In relation to paragraph 50 above which said that “[u]nder a “fairly presents” audit opinion the auditor has the responsibility to ensure the reasonableness and appropriateness of the APM [...]” Batelco considers that even under the “properly prepared” audit opinion, there were and are instances where the regulatory auditors requested Batelco to depart from the allocation method documented in the APM. To illustrate this point, Batelco provided an example in which the regulatory auditors recommended Batelco to change the allocation method of one of the retail activities from ‘pure revenue’ to ‘revenue and volume’. In its example, Batelco does neither specify which retail activity it is referring to nor when such cost allocation method has been modified. Batelco concludes by saying “[t]herefore, the regulatory auditor does practice a similar responsibility to ensure reasonableness and appropriateness of the APM as well as the compliance with the framework under the current audit scope” (Batelco's submission, paragraph 35).

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

The Authority's analysis and conclusion

58. Having carefully considered the responses received the Authority remains of the view that the audit standard applicable to Batelco should be changed from properly prepared to fairly presents. An obligation to provide a high level of assurance from the auditors performing extensive audit work and the wide ranging application of professional judgement by the auditors should ensure that the accounts are “fair” and that, in doing so, the likelihood of current and future issues (as in Table 2) occurring is greatly reduced, if not eliminated.
59. The Authority would also like to clarify that the change of audit standard to fairly presents does not mean that the Authority will no longer be involved in reviewing Batelco's APM and regulatory accounts. Under a fairly presents audit opinion the Authority will still perform its duties to review and approve Batelco's APM as stipulated in article 1.1 (c) of the Regulation. The revised audit standard should actually enable the Authority to conduct a more effective and focussed review of the APM. Henceforth, the Authority will no longer need to review the whole documentation line by line as the auditors will be doing that as part of their more thorough review under the fairly presents audit opinion.
60. The Authority considers that the issues contained in the non-exhaustive list of Table 2 in the draft Determination are non-trivial and would have been picked up upon by the auditor under the fairly presents standard (see the Authority's view on Batelco's comments included in the table below).
61. Further while Batelco questions the materiality of the examples listed by the Authority in that table, it has not provided any evidence that the examples cited by the Authority are immaterial. Taken in isolation, some of these examples may have a limited impact on the regulatory accounts. However the combination of identified issues may altogether have a material impact on the regulatory accounts and/or parts of the regulatory accounts and/or on the costing for products/services. The Authority considers that the extensive list in Table 2 provides sufficient weight to its reasoning that the audit standard should be increased. This strongly suggests the presence of a pattern of serious issues on a wide spectrum of areas affecting the regulatory accounts (e.g. operational data, data sources, and cost allocation).
62. Moreover, the Authority is of the view that the issues that have been identified to date may only represent the “tip of the iceberg”. Due to the position of asymmetry of information between Batelco and the Authority, it is highly possible that other issues have remained undetected. Only a fairly presents audit opinion will alleviate those concerns.
63. The current audit standard of “properly prepared” does not provide the Authority with the required level of assurance regarding the accuracy of the regulatory accounts. The properly prepared audit standard does not give any assurance that the accounts represent the underlying performance and financial position in a ‘fair’ manner.²¹ Without this, the quality of the accounts depend largely on the quality and transparency of the bases of preparation on which there are clearly issues as shown in this Determination (see e.g.

²¹ See e.g. Ofcom, 2004, The regulatory financial reporting obligations on BT and Kingston Communications in markets where SMP has been demonstrated, Accounting separation and cost accounting: Final notification and explanatory statement issued 8 April 2004.

Determination to change the audit standard for Batelco’s regulatory accounts – Reasoning

Table 2). When reviewing costing information for the purpose of setting wholesale charges for example, it is reasonable for the Authority to expect underlying data to be accurate.

Table 3: Examples of issues encountered by the Authority with Batelco’s regulatory accounts – Batelco’s comments and the Authority’s response

Issues listed in the draft determination by the Authority	Batelco’s comments as included in its response at pages 23-26	The Authority’s comments
Appropriate cost apportionment/allocation:		
<p>The cost driver for “[X] IT-Fixed Billing” in the 2009 APM: Batelco used the [X] analysis as the cost driver to allocate [X] IT-Fixed Billing to “local billing & retail” and “[X]”. In the 2008 regulatory accounts it appeared that [X] of IT-Fixed Billing total cost was direct opex (X). Thus it is questionable whether the [X] is an appropriate cost driver for allocating cost between retail and wholesale.</p>	<p><i>“Most types of assets including [X] IT fixed billing would comprise [X] as the major component of its costs. Accordingly, the cost driver used to allocate an asset cost depends on the type of service the concerned asset serves. In the case of [X] IT fixed billing, this system is used by [X] Therefore, despite the fact that the cost mainly consists of [X], the asset function and daily operation is maintained by [X], hence the use of [X] as the basis of allocation is appropriate from a costing point of view. This was discussed with the TRA and further explanation was provided in the driver and allocation details underpinning this particular cost item during the course of the reference offer assessment.”</i></p>	<p>Based on information available to the Authority, the Authority remains unconvinced by Batelco’s explanation to justify the use of [X] as an appropriate driver to allocate the cost of IT fixed billing. Using the [X] as a cost driver to allocate the cost of IT-Fixed Billing between wholesale and retail is likely to lead to a misallocation of cost to products.²²</p>
Inappropriate price trends used in the CCA valuation:		
<p>The Authority has identified significant issues with the CCA valuation/price trends (e.g. [X]) in the past three years which have required substantial modifications following review by the Authority. Under a “properly prepared” audit opinion the auditor is only required to check that the price trends specified by the Authority in the APM approval letter are applied properly in Batelco’s regulatory accounts. There is no requirement to check that the inputs used in the CCA valuation (e.g. [X]) are true and fair.</p>	<p><i>“Batelco undertakes a detailed and time-intensive data gathering process to collect this data as required by the TRA. There are also existing regulatory auditor checks of the CCA system and templates are used. More specifically, the auditor performs sample tests on the application of the methodology including the testing of prices, which was also carried out in 2008. Hence, the overall price trend in the CCA valuation has all been subject to audit tests. The foreign currency point is now resolved after assessment and instructions in 2010.”</i></p>	<p>As acknowledged by Batelco,²³ under the properly prepared audit opinion, the statements are only subject to a high level review of their overall consistency with Batelco’s statutory accounts, and this does not provide the Authority with the acceptable/ necessary level of assurance contrary to the more demanding fairly presents standard.</p> <p>Under the fairly presents standard, the CCA valuation will be subject to further scrutiny (e.g. data sources, analytical review)</p>
Absence of information or misleading information:		

²² See also RO order dated 25 January 2011, paragraphs 495-499 and 574-575.

²³ Batelco’s submission, paragraph 27.

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

Issues listed in the draft determination by the Authority	Batelco's comments as included in its response at pages 23-26	The Authority's comments
<p>The current APM is incomplete. For example, the current APM prepared by Batelco under "properly prepared" does not include the description of cost centres or the complete list of allocation destinations, e.g. [X]</p>	<p><i>"This incompleteness of the APM should be resolved by the proposed enhancements as regards transparency and traceability of the 2010 APM."</i></p>	<p>The Authority would like to clarify that the "proposed enhancements" referred to by Batelco only came after several communications²⁴ from the Authority whereby Batelco was invited to make proposals to address the lack of transparency and traceability of its APM. Batelco did not submit anything by the deadline (which was extended by almost three months). It was only after the Authority informed Batelco that failure to meet the requirements set in the 2009 APM approval letter dated 9 November 2010 would result in the Authority rejecting the 2010 APM that Batelco finally made amendments in its 2010 APM along the lines defined by the Authority.</p> <p>Under the fairly presents standard the auditor will ensure that all the necessary information is adequately documented within the APM each year.</p>
<p>SDH transmission cost:</p>		

²⁴ For example during the July 2010 workshop, in the letters dated 20 July 2010 (MCD/07/10/075), 8 September 2010 (MCD/09/10/087) and 9 November 2011 (MCD/11/10/100).

Determination to change the audit standard for Batelco’s regulatory accounts – Reasoning

Issues listed in the draft determination by the Authority	Batelco’s comments as included in its response at pages 23-26	The Authority’s comments
<p>During the 2010 review of Batelco’s RO submission, the Authority identified significant issues regarding operational data that greatly impact SDH transmission costs.</p>	<p><i>“This related to a network SDH migration project in 2010 which unearthed discrepancies held. This has been resolved.”</i></p>	<p>As indicated in the RO Price Order dated 25 January 2011, this issue, identified by the Authority after repeating questioning (see paragraphs, 307-309 of the 2011 RO Price Order) was ultimately acknowledged. However, this has resulted in the Authority having to make assumptions regarding SDH cost for CAT/LLCO as the impact of this issue on 2008 cost could not be modelled.</p> <p>The resolution of this issue does not remove the need to change the audit scope to “fairly presents” as the more stringent requirements (e.g. checking the data sources) implied by such audit opinion will greatly reduce the likelihood of other issues of similar nature occurring. It would be the auditor’s primary responsibility to check, detect and address this type of issues each year.</p> <p>When reviewing cost stacks for the purpose of setting wholesale charges or review of retail tariffs, the Authority should expect underlying data to be accurate.</p>
Number of CAT/LLCO E1 equivalent circuits:		
<p>During the 2010 review of Batelco’s RO submission, the Authority identified other significant issues regarding operational data on CAT/LLCO which greatly impact transmission cost. Firstly, it would appear that a number of high speed circuits are not included in the total number of E1 equivalent circuits. Secondly, it is only after repeated questioning regarding the number of E1 used to calculate the transmission cost per E1 and despite initial denial by Batelco, that Batelco finally acknowledged that its calculation of the cost per E1 was erroneous.</p>	<p><i>“This point was rectified for the 2009 regulatory accounts.”</i></p>	<p>The resolution of this issue does not remove the need to change the audit scope to “fairly presents” as the more stringent requirements (e.g. checking the data sources) implied by such audit opinion will greatly reduce the likelihood of other issues of similar nature occurring. It would be the auditor’s primary responsibility to check, detect and address this type of issues each year.</p> <p>When reviewing cost stacks for the purpose of setting wholesale charges or review of retail tariffs, the Authority should expect underlying data to be accurate.</p>
Routing factor table:		

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

Issues listed in the draft determination by the Authority	Batelco's comments as included in its response at pages 23-26	The Authority's comments
<p>During the 2010 review of Batelco's RO submission, the Authority identified several inconsistencies in Batelco's routing factor table. For instance, routing factors of the RAN network elements applicable to mobile data services, SMS, and MMS were not divided by 2 as they were for voice services in order to account for the split of traffic between the 2G and the 3G radio access network. For SMS and MMS services, Batelco was applying different routing factors for the cost allocation of the mobile switching centre server and media gateway whether the service was on-net or off-net (regulated terminating services).</p>	<p><i>"The routing factor table is one such additional information requirement added to the APM and regulatory accounts which we believe provides a significant net benefit to addressing the information asymmetry. We believe this inconsistency was resolved quickly.</i></p> <p><i>Further, the SMS and MMS issue was also resolved quickly by referring to the most up-to-date routing factor table.</i></p> <p><i>We do not expect a "fairly presents" audit to provide 100% assurance that such an error will not occur in the future."</i></p>	<p>Following identification of the issue by the Authority during the 2010 RO submission review, Batelco has acknowledged it and rectified it in the 2009 regulatory accounts.</p> <p>The resolution of this issue does not remove the need to change the audit scope to "fairly presents" as the more stringent requirements (e.g. checking the data sources) implied by such audit opinion will greatly reduce the likelihood of other issues of similar nature occurring. It would be the auditor's primary responsibility to check, detect and address this type of issues each year.</p> <p>When reviewing cost stacks for the purpose of setting wholesale charges or review of retail tariffs, the Authority should expect underlying data to be accurate.</p> <p>While the Authority accepts Batelco's comment that the "fairly presents" audit opinion may not provide 100% assurance that similar errors would systematically be detected and corrected, the Authority considers that the level of assurance will be greatly enhanced by the change of audit standard. More specifically, the Authority would expect the errors mentioned to be detected under a fairly presents standard.</p>
<p>Different cost allocation to retail service groups between FAC and LRIC accounts:</p>		

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

Issues listed in the draft determination by the Authority	Batelco's comments as included in its response at pages 23-26	The Authority's comments
<p>During the review of the 2008 regulatory accounts the Authority found that the distribution of the costs of the international network to the retail service groups was different in the LRIC accounts compared to the FAC accounts. The above issue has arisen as a result of Batelco grouping together network components in the LRIC accounts and adding the routing factors for individual components together to get the combined routing factor for the component group. This is being done with outpayments in the international network.</p>	<p><i>"We believe this was an understanding which was reached in 2004 but had to be re-assessed and resolved with the new TRA assessment team."</i></p>	<p>Following identification of the issue by the Authority during the 2008 regulatory accounts review, Batelco has acknowledged it and rectified it in the 2009 regulatory accounts.</p> <p>Such issue should not occur under a fairly presents standard.</p> <p>The resolution of this issue does not remove the need to change the audit scope to "fairly presents" as the more stringent requirements (e.g. checking the data sources) implied by such audit opinion will greatly reduce the likelihood of other issues of similar nature occurring. It would be the auditor's primary responsibility to check, detect and address this type of issues each year.</p> <p>When reviewing cost stacks for the purpose of setting wholesale charges or review of retail tariffs, the Authority should expect underlying data to be accurate.</p>
Change in cost driver and cost allocation without prior approval:		
<p>In the 2008 approved APM, the cost driver to allocate the cost of "Market comm" was [X] and this cost centre was allocated to only three activities: [X]. However, during the 2010 RO review, the Authority noticed that the cost driver had changed to a [X] and [X] has been added as an allocation destination without approval from the Authority.</p>	<p><i>"This change arose as a result of a known debate between the parties over the calculation of the interconnect specific cost, specifically, which relevant cost categories should be included in the calculation. The TRA's instructions letter dated 9 November 2010 removed this cost item."</i></p>	<p>The fact is that Batelco departed from the APM without approval from the Authority. Batelco also used a specific product list as allocation driver which the Authority has demonstrated was clearly incorrect and resulted in an over-allocation of cost to wholesale products (see paragraph 492 of the 2010 RO Price Order).</p> <p>Such issue of using inappropriate cost driver should not occur under a fairly presents standard.</p> <p>With the fairly presents audit standard, Batelco's auditor will require Batelco to use fair and reasonable cost allocation drivers and will ensure that any changes of such drivers are documented in the APM. More generally, the added scrutiny under a fairly presents standard means that the likelihood of issues of similar nature occurring will be greatly reduced.</p>
Issues with operational data that may impact allocation of costs:		

Determination to change the audit standard for Batelco’s regulatory accounts – Reasoning

Issues listed in the draft determination by the Authority	Batelco’s comments as included in its response at pages 23-26	The Authority’s comments
<p>During the 2010 review of Batelco’s RO submission, the Authority identified potential issues with the total adjusted duct length which decreased by [X] km between 2007 and 2008²⁵. The Authority considers such a decrease to be improbable and it raises concerns not only about the robustness of operational data sources but also about the appropriateness of the methodology used to collect and treat raw data.</p>	<p><i>“The difference is not material (less than 1% of the overall reported kms). We maintain that there was indeed a drop in the total number of duct kms.”</i></p>	<p>Batelco acknowledged the problem but failed to explain the reason for the drop in the total number of duct kms.</p> <p>Under the fairly presents audit standard, the auditor will make a detailed check of the appropriateness and robustness of the data sources and provide the Authority with a greater level assurance.</p>

Source: Batelco’s response and the Authority

64. For the reasons set out in the draft determination (and in particular at paragraphs 46 and 49-50 above, and having regards to the Authority’s view on Batelco’s comments as detailed in the above table, a change of audit standard is required. While the Authority acknowledges that some of the issues identified by the Authority have been fixed by Batelco and that Batelco has improved its APM following repeated insistences by the Authority (see above table), only the fairly presents audit opinion will provide an adequate mechanism to ensure that the occurrence of those or similar issues is greatly reduced, if not eliminated, and that the required level of assurance is provided.
65. As described above in paragraph 41, under a fairly audit standard, the auditor will conduct various checks regarding cost allocation, the documentation, the data sources and the financial statements themselves. The change to a fairly presents audit opinion will not only require the auditor to address the type of issues mentioned above and more generally to guarantee that the regulatory accounts are accurate and compliant with the framework but it will also be the primary responsibility of the auditor to ensure the reasonableness and appropriateness of the APM. This will contrast with the current situation where that responsibility falls onto the Authority, although it is not in the best position to fulfil this role for the reasons set out in paragraph 50 above and as acknowledged by Batelco at paragraph 48 of its submission.
66. In relation to the example provided by Batelco, the Authority emphasizes that the main responsibility of the auditor under a properly prepared audit standard is to ensure that the framework is correctly and properly applied in the preparation of the regulatory accounts; it is not to ensure that the statements are presented in a fair manner contrary to the claim made by Batelco in paragraph 35 of its response. Under a properly prepared audit standard, the auditor may, in some instances, recommend a change in the framework. However, such recommendation/review is not systematic under the properly prepared audit opinion, contrary to the fairly presents audit opinion.
67. In light of the above, the Authority is still of view that, given the issues and reasons specified above, the audit standard for Batelco’s regulatory accounts should be changed to the fairly presents audit standard. Further examples of issues (some of which have

²⁵ See Reference Offer Order, 25 January 2011, MCD/01/11/006, paragraph 261.

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

come to the Authority's attention following the issuance of the draft Determination) where the current audit standard has failed to provide the Authority with the necessary level of assurance and hence which contribute to further justifying the change of audit include:

- a. **Errors in the values reported for certain network elements in the 2009 regulatory accounts:** Through the review of Batelco's 2009 regulatory accounts, the Authority has identified substantial errors in the reported values of access network elements AN04, AN05, AN06, AN07 and AN20 in the LRIC regulatory accounts;²⁶
 - b. **Misallocation of cost in CN38 (MPLS Core Data) and CN39 (MPLS Core Voice):** During the same review, the Authority has identified a discrepancy in the ratio used to allocate the cost of the network elements CN39 (MPLS Core Voice) and CN38 (MPLS Core Data) between voice and data products. Such allocation ratio is equal to [x] in the effective bandwidth calculation while it is [y] in the FAC regulatory accounts. In response to the Authority's question highlighting the discrepancy, Batelco acknowledged that a cost misallocation between the items NP29- MPLS and NP11- Core Network Duct & Infrastructure is the source of the error;²⁷
 - c. **Concerns over the LRIC model and CCA valuation** The Authority still has concerns regarding the LRIC model and the CCA valuations performed by Batelco (e.g. the processes for the gathering of information for CCA valuation). By changing the audit opinion to fairly presents, the auditor will conduct a detailed analytical review. As highlighted by Batelco, this analytical review will include a line by line review of the CCA:HCA and LRIC:FAC ratios of network components; and
 - d. **Inherent difficulties in assessing an APM before the production of the regulatory accounts:** At paragraph 48 of its submission, Batelco implicitly acknowledges those difficulties when it highlights the impossibility to assess the appropriateness and completeness of the detailed accounting procedures when reviewing the APM independently from the regulatory accounts which are still to be produced. This is, at present, the position in which the Authority has found itself where the responsibility to ensure the reasonableness and appropriateness of the APM falls on the Authority. This issue will be addressed with the change of audit requirement.
68. The Authority also notes Batelco's comments in Table 5 below regarding the likely cost associated with "testing data sources" whose magnitude would suggest that they are likely issues with the [x]. This provides further justification to changing the audit scope as operational data is a fundamental element underpinning the accuracy and reliability of the regulatory accounts. Similarly the Authority has raised significant concerns in relation to the cost of Batelco's Wholesale Department.²⁸

²⁶ See Article 53 information request regarding Batelco's regulatory accounts (MCD/04/11/051) dated 24 April 2011, question 10.

²⁷ See Article 53 information request regarding Batelco's regulatory accounts (MCD/04/11/051) dated 24 April 2011, question 9.

²⁸ See Reference Offer Order, 25 January 2011, MCD/01/11/006, Section 13.

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

69. There are also two contextual elements which are relevant to raising the audit standard for the 2010 regulatory accounts:
- a. [X]
 - b. **Multi-year price control:** As explained in its Draft Position Paper on the development, implementation and use of bottom-up fixed and mobile models in the Kingdom of Bahrain issued on 19 May 2011 (MCD05/11/064), the Authority intends to introduce multi-year prices controls in order to provide greater visibility, and certainty to the regulated firm(s) and the market; incentives for cost minimisation; and minimise regulatory compliance cost.
70. The accuracy and reliability of the regulatory accounts are critical for those contextual elements.

6 Audit report on the APM and the regulatory accounts

Draft determination text

71. The audit report, submitted as part of the regulatory accounts, shall include a section detailing all the issues encountered during the audit, including:
- a. Inappropriate cost drivers or cost allocation and how the issue has been addressed/corrected;
 - b. Incompleteness or absence of a cost driver or cost allocation process description in the APM and how the issue has been addressed/corrected;
 - c. Incomplete/inadequate documentation and how the issue has been addressed/corrected;
 - d. Issues with data sources (e.g. robustness of data collection and reporting, accuracy of the data) and how these issues have been addressed/corrected;
 - e. Specific areas which the Authority requests the Auditors to focus on as specified in the APM approval letter;
 - f. Changes made to the APM.
72. The requirements detailed above in paragraph 71 are necessary to inform the Authority of the audit work conducted. They may be amended by the Authority from time to time as deemed appropriate.
73. Batelco shall submit an interim audit report to the Authority no later than 30 working days from the date of submission of the APM or part(s) thereof. The interim report shall be prepared by the auditors in parallel to the Authority's review of the APM. It shall indicate what changes to the APM the auditors are intending to make in order for the regulatory accounts to conform with the "fairly presents" requirement. For practicality, the interim report can either cover the entire APM or be divided in sub-interim reports to cover parts of the APM (e.g. FAC, LRIC/CCA) but shall always be submitted within 30 working days of submission of the APM to the Authority.

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

74. The requirement to submit an interim audit is necessary to enable the Authority to monitor the audit work at the APM review stage. The Authority anticipates that this requirement will be necessary only in the first few years following the change of audit standard. This requirement may be amended by the Authority as deemed appropriate.

Question 3

Do you agree with the Authority on the audit report? Do you agree with the Authority on the interim audit report? Please elaborate and formulate substantiated alternative proposals if necessary.

Summary of Operators' responses

75. Three licensees have responded to this question.
76. While Lightspeed supports the Authority's initial view, VIVA did not respond to this question as they do not support the Authority's proposed decision to change the audit standard.
77. Batelco disagrees with the Authority's initial proposal to have a detailed audit report as outlined in the draft determination. Batelco is of the view that the additional requirements cannot be complied with as the form and content of audit opinion is prescribed by international standards on auditing.
78. To clarify its view, Batelco provides an example of a standard description of the basis of audit opinion. Batelco also mentioned that the audit report does not include details regarding the audit tests performed or their findings with the exception of issue(s) that lead(s) to a modification to the auditor's opinion. Batelco also adds that audit reports do not normally include issues that have been corrected prior to the finalization of the accounts.
79. In its response to this section, Batelco proposes the following three options (paragraphs 40-45 of Batelco's submission):
- a. The provision of information limited to issues that, if not corrected, would have caused a material error in the regulatory accounts. Such information would be provided separately under appropriate "*contractual terms and conditions*".
 - b. The provision of a management letter. This would take the form of a report detailing the immaterial issues that have been identified by the auditors along with Batelco's view of how it will correct these issues over time.
 - c. Introduction of a tripartite agreement between Batelco, the Authority and Batelco's auditors whereby the Authority would be a party to the audit engagement.²⁹

²⁹ This is also one of the alternative proposals formulated by Batelco under the "alternative proposals" section of its submission (please refer to Section 8.1 at page 2).

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

80. In relation to the tripartite agreement, Batelco identified three areas in which the Authority could be involved, namely:
- a. Involvement in the audit planning process with the ability to request from the auditor to conduct specific reviews of certain areas through agreed-upon procedures. However, the Authority will not be able to direct the auditors to perform certain tests;
 - b. Participation to a tripartite meeting at the final stage of the audit during which auditors will provide an overview of any significant issue affecting the audit opinion; and
 - c. Possibility of receiving the audit management letter following the finalisation of the audit. This letter would include a list of all the issues identified by the auditor which are not material to the regulatory accounts and therefore did not require immediate correction. Batelco would typically produce a response describing how and when it intends to address each of those issues.
81. Regarding the interim audit report, Batelco is of the view that having an opinion on an interim APM before the production of the regulatory accounts is not feasible. Two reasons are put forward to support this view (Batelco's submission, paragraph 48):
- “The APM is not a set of financial statements and as a consequence it cannot be subject to audit in accordance with international auditing standards; and*
- The appropriateness and completeness cannot be assessed through a non-audit review of the interim report as the materiality of individual cost items can only be determined when considering the regulatory accounts.”*
82. Batelco also considers that when the auditor provides an opinion on the accounts, it is also attesting to the appropriateness of the framework documentation.
83. Another point made by Batelco is that it is not clear to it why the proposed approach with the interim report would be needed in the context of a fairly presents audit opinion because the auditor will be primarily responsible for the appropriateness and reasonableness of the methodologies used and this judgement can, according to Batelco, only be made once the final APM is issued in conjunction with a set of regulatory accounts. This contrasts with the current approach (i.e. review and approval of the APM with instructions as appropriate prior to the preparation of the regulatory accounts) as the Authority is the only body providing an assessment of the methodologies used to prepare the regulatory accounts. However, this will not be the case once the audit standard is changed to fairly presents.
84. Batelco also made two other points, which do not appear directly related to this section but which are summarized here for the sake of completeness:
- a. Batelco claims that the annual review process of the APM, which takes place prior to the preparation of the regulatory accounts, is one of the main reasons for Batelco's delay to produce the regulatory accounts on time. Batelco contends that this delay is a result of the duration needed to approve the APM, which can take months and the annual additional requirements and enhancements on the APM instructed by the Authority as part of the APM approval.

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

- b. Batelco added that one of the benefits of the “new approach” will be that there would be no reason why under steady state conditions the production of the APM and regulatory accounts could not be reduced to 6 to 7 months instead of the current 14 months plus. However, Batelco stated that the timetable would remain subject to the changes which are currently implemented, such as the lengthening of the asset lives of certain assets. Batelco also clarified that having a shorter timetable will not be possible in the first year or two under the new audit standard due to the significant enhancements to the systems and data for example which are required to achieve the new level of audit.

The Authority's analysis and conclusion

85. As explained in the draft determination (paragraphs 71-72 above), the Authority was of the preliminary view that the audit report, submitted as part of the regulatory accounts, should include a section detailing all the issues encountered during the audit. Having considered the responses received, the Authority has decided to remove this requirement. The Authority no longer requires these details to be submitted as part of the audit report as this would result in an audit report non consistent with the format prescribed by international audit standards.
86. However, necessary amendments should be made to the current audit report to reflect the revised audit standard, including in the pro-forma audit opinion and certificate section of APM.
87. The auditors should also document any changes made to the approved APM (including potential override by the auditor of instructions issued by the Authority) to produce the regulatory accounts. Those changes should be communicated to the Authority as part of the regulatory accounts submission in an appropriate form (e.g. this might be as notes to the accounts).
88. Following Batelco's comments that it is not practical to have an interim audit report, the Authority has decided to remove this requirement.
89. The Authority agrees with Batelco that some interaction between the Authority and Batelco's auditor could have merits. The Authority may therefore request to meet Batelco's auditor (with or without the presence of Batelco) at various stages of the audit process. Batelco's contractual relationship with its auditor should allow for this to occur. The Authority will also continue to highlight to Batelco's auditor certain areas of concerns or areas of interest in its APM approval letters as it has done in the past. The Authority also reserves the right to require the implementation of “agreed upon procedures” from time to time. It may also request Batelco to provide a copy of the management letter. At this point in time, the Authority does not consider it necessary to put in place the kind of tripartite agreement referred to by Batelco, although the Authority reserves the right to do so. The Authority notes that while the tripartite agreement is an “umbrella agreement” it is not a pre-condition for any “agreed upon procedures”. The ability to do “agreed upon

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

procedures” exists in its own right as per the International Standard on Related Services (ISRS 4400).³⁰

90. The Authority disagrees with Batelco's claim that the delay in producing the regulatory accounts is a result of the duration needed to approve the APM. This is factually incorrect. The considerable delays observed in the last few years have been the direct consequence of Batelco's failure to document changes made to its APM and to submit a complete and satisfactory APM on time.³¹ The Regulation set out clear timelines: review and approval of the APM within 45 working days by the Authority; submission of FAC accounts 6 months after the end of the accounting period (i.e. 30 June), LRAIC accounts 9 months after the end of the accounting period (i.e. 30 September). The first timeline is binding on the Authority while the other two are on Batelco (see also the “timeline” section of this determination below). Delays in the submission of regulatory accounts have a flow on effect on Batelco's RO submission. Ultimately this results in delays to the introduction of price changes and the Authority having to rely on cost information which is out-dated.

7 Other Issues

7.1 Parallel review by the auditor and the Authority

Draft determination text

91. In order for the regulatory accounts to be submitted in a timely fashion, the audit shall be conducted in parallel with the Authority's review of the APM. This will not present an issue for the auditors as they will need to form their own opinion on the APM and can no longer rely on the Authority's approval of the APM.

Summary of Operators' responses

92. As explained above Batelco is of the view that the auditor can perform its audit and form an opinion on the APM only “*in the context of statements*” (Batelco's response, paragraph 48), which the Authority understands as once the regulatory accounts are prepared.

³⁰ Available at http://www.ire.lu/fileadmin/media/Env_normatif_international_non_ISA/isrs4400_20070612.pdf

³¹ See paragraph 148 and e.g. the Authority's letter “APM review”, (MCD/07/09/052), dated 30 July 2009 and the Authority's letter “2009 Accounting Procedures Manual Review – CCA valuations submission”, (MCD/07/10/085), dated 15 August 2010.

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

The Authority's analysis and conclusion

93. While the Authority understands Batelco's argument that it may not be feasible for the auditor to perform a complete audit review of the APM prior to the production of the regulatory accounts, this does not mean that the auditor cannot start the work prior to the approval of the APM by the Authority. For example the auditor can begin its review of the documentation to ensure it is sufficient and appropriate. In light of the considerable delays regarding the production of regulatory accounts in the last few years, it is important that Batelco prepare its regulatory accounts in a more timely fashion.

7.2 Fairly presents audit opinion applies at service and/or product level

Draft determination text

94. The "fairly presents" audit opinion shall apply at the service and/or product level. This will provide the Authority with the assurance that subsequent RO submissions are free of errors as the cost stacks of wholesale charges often require a greater level of cost allocation than is currently reported under the APM. Similarly, the application of the "fairly presents" standard will provide the necessary level of assurance regarding the accuracy, reliability and quality of information at the retail level.

Question 4

Do you agree with the Authority that the "fairly presents" audit requirement should apply at product/service level?

If you disagree, please indicate and justify at which level the audit requirement should apply and explain in detail how it would be practically different from a requirement at the product/service level?

Please elaborate and formulate alternative proposals if necessary.

Summary of operators' responses

95. Four licensees have responded to this question.

96. Both Lightspeed and Menatelecom agree with the Authority's preliminary position that the fairly presents audit requirement should apply at the product/service level.

97. In contrast, VIVA and Batelco disagree with the Authority's initial view of having the fairly presents audit standard applied at the product/service level. VIVA believes that the current Regulation "*provide a good approach for the audit report*" (VIVA's response, page 2).

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

98. While the Authority's question clearly requested respondents to "*indicate and justify at which level the audit requirement should apply and explain in detail how it would be practically different from a requirement at the product/service level*" in case of disagreement with the Authority's draft view, Batelco has not done so. Instead, Batelco only states that the provision of a fairly presents opinion at the service/product level is unlikely to be possible. This claim did not come along with an alternative proposal regarding the level at which the fairly presents standard may be applied. Instead Batelco recommended adopting a market-based approach to the preparation and reporting of regulatory accounts whereby Batelco would be required to prepare regulatory accounts only for markets in which it is expected to be dominant or otherwise have significant market power ("SMP").
99. Leaving aside the consideration of the incremental cost of having the fairly presents audit standard applied at service/product level,³² Batelco provides three reasons to support its position that the fairly presents audit at the service/product level is unlikely to be possible:
- a. the quality of data to support cost attribution methods may be insufficient for such a granular level of reporting and assurance;
 - b. the objectivity of generic attribution bases cannot be assessed at such a granular level; and
 - c. it may not be possible to assess the overall reasonableness of one service where it is too immaterial relative to the overall business.
100. As a consequence of the relative small size of Bahrain's market compared to larger country such as the UK, Batelco considers that applying a fairly presents audit standard might impose net costs on consumers instead of net benefits.
101. To support its position against the application of the fairly presents standard at the service/product level, Batelco made reference to the UK which experienced difficulties in the application of the audit standard at a granular level. To illustrate this point, Batelco quotes the audit report of BT's 2005 regulatory accounts and argues that "*the requirement to provide assurance at individual small markets has lead [sic] to the qualifications of audit opinions on numerous occasions [...]*" (Batelco's response, paragraph 55).
102. In its response, Batelco also summarizes the audit requirements applicable in the UK and Ireland, where the operators are not required to apply the fairly presents audit standard at the product/service level.
103. Batelco explains that BT's separated accounts are produced on a market basis and there is a tripartite agreement between BT, Ofcom and BT's auditors. The fairly presents audit opinion applies to:
- a. the market financial statements as a whole;
 - b. 9 individual markets;
 - c. 2 market groups; and
 - d. Openreach (access network).

³² Batelco's comments on and estimates of the incremental cost of applying the audit opinion at the service/product level were provided in a separate section of its submission. See Section 151 of this Determination where Batelco's points are summarized and addressed.

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

104. Batelco further explains that whereas there are five other individual smaller markets which are audited under the “properly prepared” audit opinion, the less material markets (e.g. wholesale ISDN2) are not subject to individual audit opinions. Those smaller markets are audited as part of wider group of markets.
105. Batelco also mentioned the case of Ireland and more specifically Comreg’s consultation paper titled “*Accounting Separation and Cost Accounting Review of Eircom Limited*” which was issued on 31 August 2010.
106. Batelco indicated that the preliminary view expressed by ComReg in its consultation paper was to have a “fairly presents in accordance with” audit opinion for both separated accounts and the “*Additional Financial Information*”. However, ComReg changed its preliminary view after considering the respondents’ concerns over the cost of implementing such a standard and over the possibility of having qualified audit opinion if the fairly presents standard was applied below the market level.
107. The Authority notes that Comreg’s final decision was as follows:
- a. Application of fairly presents audit standard to the statements as a whole;
 - b. Application of either fairly presents or properly prepared for individual markets; and
 - c. Removal of the audit requirement for the “*Additional Financial Information*” where Eircom discloses product/service information.
108. In response to this section of the draft determination, Batelco made comments regarding the proportionality of accounting separation as a regulatory remedy and the proportionality of the fairly presents audit standard.
109. Regarding the question of proportionality of accounting separation as a regulatory remedy, Batelco proposes a reduction in oversight/reporting for markets deemed to be competitive. This, according to Batelco would be in line with the approach taken in Europe where regulators can impose regulatory remedies (including accounting separation) at the market level only where operators have been found to have SMP in the relevant market considered. While Batelco acknowledges that the regulatory framework in Bahrain is different from the European regulatory framework, it proposes to reduce the oversight/reporting for “*markets deemed to be competitive*” (Batelco’s response, paragraph 69). It further contends that there would be 4 retail markets³³ and 3 wholesale markets³⁴ where Batelco is expected to have SMP or be dominant respectively.
110. With regards to the proportionality of the fairly presents obligation, Batelco argues that it may not be appropriate for smaller jurisdictions such as Bahrain. It contends that in “*[i]n small markets there is a real and present danger that remedies injudiciously applied may end up imposing net costs, instead of benefits on consumers*” (Batelco’s submission paragraph 76). Batelco further argues at paragraph 78 of its submission that “*it is imperative that TRA adopts a careful and systematic approach to the specification of accounting separation which explicitly considers expected costs and benefits*”.

³³ They are: Fixed access narrowband services markets; Domestic calls originating on fixed lines markets; Fixed originated international calls markets; and Dial-up internet access from a fixed location.

³⁴ They are: Wholesale physical network infrastructure access; Wholesale mobile termination on Batelco’s network; and Wholesale call termination on fixed public networks.

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

The Authority's analysis and conclusion

111. Having reviewed the two examples mentioned by Batelco, the Authority would like to clarify that:

- a. Ofcom requires specific markets to be audited under the fairly presents audit standard. These are subject to change on an annual basis at Ofcom's discretion. As such, Ofcom's final decision states the following:³⁵

“A requirement for the highest level of assurance (i.e. a “fairly presents” opinion) over the financial statements as a whole (instead of the existing requirements for opinions on all market and service statements) plus further opinions on specific financial statements in areas of particular interest or sensitivity, to be identified by Ofcom on an annual basis. BT's reporting obligations have now been amended in line with these proposals.”

- b. Comreg decided that to achieve the desired level of assurance:³⁶

“(a) A “Fairly presents in accordance with” audit opinion is appropriate for the Separated Accounts.

(b) A “Fairly presents in accordance with” or “Properly prepared in accordance with” audit opinion may also be provided for individual markets specified and required by ComReg.

(c) A “Properly prepared in accordance with” audit opinion or a report based upon “Agreed Upon Procedures” is appropriate for the AFS and AFI as specified and required by ComReg.

(d) Verification of Eircom's compliance with its cost accounting obligations can be achieved through the use of qualified independent bodies and “Agreed Upon Procedures”.

In its conclusion, Comreg considered that *“on an ad hoc basis it will require Eircom to either obtain a “Properly prepared in accordance with” opinion on specified services and products or else do alternative testing and reporting through the use of “Agreed Upon procedures”. Both of these approaches would involve the preparation by Eircom of detailed Accounting Documentation, which is a requirement of the Decision Instrument”*.³⁷ These requirements will altogether provide ComReg with the desired level of assurance.

³⁵ See Ofcom, changes to BT's regulatory financial reporting and audit requirements, explanatory statement and notification, page 4, paragraph 1.8, 16 August 2006

http://stakeholders.ofcom.org.uk/binaries/consultations/reg_bt/statement/statement.pdf

³⁶ See ComReg, Response to consultation document No. D09/75 and final direction and decision: Accounting separation and cost accounting review of Eircom limited, page 76, issued on 31 August 2010.

³⁷ See ComReg, Response to consultation document No. D09/75 and final direction and decision: Accounting separation and cost accounting review of Eircom limited, page 74, issued on 31 August 2010.

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

112. While Batelco makes reference to a market-based approach to regulatory accounting reporting and cites examples where this is the case, it is worth mentioning that Batelco's regulatory reporting is based on business units (e.g. core network business unit, the fixed retail business unit) and so the adoption of a market-based approach is not currently feasible (the Authority understands that it is likely to require a significant change to Batelco's reporting and accounting separation/cost model).
113. Given the regulatory accounting reporting of Batelco, an audit opinion could be required at various levels, such as (in descending order of granularity):
- a. Product/service level (this is as per the Authority's draft view);
 - b. Group of product/services, referred to as TRA's categories in the product mapping used by Batelco in the regulatory accounts;³⁸
 - c. Business unit level and group of business units; and
 - d. To the statements as a whole.
114. Similar to the UK, an audit opinion could also be required for a set of group of products/services and/or product/service.
115. Although Batelco did not propose an alternative proposal and thus did not fully answer the above question, having reviewed Batelco's submission the Authority concurs with Batelco that the application of the fairly presents audit standard to each and every individual product/service is likely to be unpractical, unnecessarily complicated and costly. While a fairly audit opinion for certain product/services of particular interest or concern may be fully justified and proportional it is unlikely to be the case of all products/services, especially for immaterial ones.
116. Thus, the Authority has decided to no longer require a separate audit opinion for each individual product/service. Instead, for the first year of implementation of the new audit standard the Authority considers that a reasonable level of assurance can be provided by having:
- a. A "fairly presents" audit opinion for the separated accounts as a whole; and
 - b. A "fairly presents" audit opinion for the Access Network Business unit of Batelco's regulatory accounts or equivalent. This business unit concentrates the ~~8x~~ of the capital employed in Batelco's regulatory accounts and of enduring bottlenecks.
117. In subsequent years, the Authority reserves the right to require additional opinions, either in accordance with the "fairly presents" and/or "properly prepared" audit standard for specified services/products and/or group of services/products, and/or business units and/or any other level deemed appropriate by the Authority. These may be set annually by the Authority as part of the APM approval process having regards factors such as: costing concerns the Authority may have; importance of the service/business unit for competition; dominance/SMP of Batelco; sensitivity of the service/business unit, etc. The Authority may also amend the audit requirement applicable to the Access Network Business unit or equivalent as part of the APM approval process.

³⁸ See e.g. 2009 Batelco's APM and regulatory accounts materials, (GCL/58/11), 10 February 2011, Product Mapping_2009_10022011.

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

118. This brings the Authority's position firmly in keeping with international practice on the application of the fairly presents audit standard.
119. The Authority also notes that regulators of smaller countries and microstates requires their incumbent operators to prepare their regulatory accounts in accordance with the fairly presents audit standard. This includes Oman (population of ~2.8M),³⁹ Malta (population of ~0.4M),⁴⁰ and in the Hull area in the UK the operator Kingston Communications (population of ~0.25M).⁴¹ Based on recommendations by the audit firm KPMG, the telecommunications regulator of Jersey is proposing to apply the fairly presents standard to the local incumbent, Jersey Telecom (population ~0.1M).⁴²
120. Regarding Batelco's concern about the possibility of imposing net costs instead of net benefits on consumers due to the small size of Bahrain compared to larger countries, the Authority refers to the benefits of having a fairly presents audit standard detailed in various places in this Determination as well as to the examples mentioned in paragraph 119. Given Batelco's position in the market place, the benefits of having regulatory accounts which provide the appropriate level of assurance should not be underestimated. The significant issues encountered with the APM and regulatory accounts have resulted in substantial delays to the introduction of revised wholesale and retail charges, thereby delaying significantly economic welfare gains to the detriments of OLOs and end-users. They have also potentially led to incorrect costing of products and services. Those issues have also meant that the Authority has had to incur significant direct internal and external cost to review Batelco's APM and regulatory accounts as well as when reviewing cost stacks at the retail and wholesale levels. The Authority's cost should be significantly reduced as a result of the change of audit scope. Further, as explained in Section 151 below, the Authority is of the view that the range of estimates of the incremental cost to change the audit standard provided by Batelco cannot be relied upon and significantly over estimate the incremental cost of the change of audit standard.
121. Overall, the Authority considers that its decision to change the audit standard is appropriate having regards to the objectives of the change, the issues identified with the current audit standard, and the expected benefits and costs of the change of audit standard.

³⁹ Resolution No. 112/2009: Regulation on Accounting Separation, Regulatory Accounting & Reporting Requirements, dated 25 November 2009, Article 11.

⁴⁰ See KPMG, 2011, Review of Jersey Telecom Limited's Regulatory Separated Accounts, for the Jersey Competition Regulatory Authority, 20 May 2011, page 32.

⁴¹ See KPMG, 2011, Review of Jersey Telecom Limited's Regulatory Separated Accounts, for the Jersey Competition Regulatory Authority, 20 May 2011, page 32.

⁴² See Jersey Competition Regulatory Authority, 2011, Proposed Direction to Jersey Telecom Limited Concerning the Publication, Format and Audit Requirements of its Regulatory Separated Accounts – Initial Notice, 27 May 2011, page 10 as well as the background report by KPMG, 2011, Review of Jersey Telecom Limited's Regulatory Separated Accounts, for the Jersey Competition Regulatory Authority, 20 May 2011.

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

7.3 Fairly Presents requirement applied solely to Batelco

Draft determination text

122. The Authority considers that for the time being the change of audit scope to “fairly presents” should apply only to Batelco. There are a number of reasons for this decision, which include:
- a. **Serious issues have been identified with Batelco's regulatory accounts.** As described in the previous table, such issues would have been addressed if the “fairly presents” audit standard had applied. To date, similar deficiencies have not been identified with other operators' regulatory accounts, none of which, with the exception of Zain, are subject to ex-ante regulation. Batelco's regulated services are wide ranging compared to Zain, whose regulated services are at present limited to mobile termination services for which the Authority's Position Paper on Mobile Termination Rates apply.⁴³ Thus, even if issues were identified with Zain they may not have the same potential implications such that they would warrant a change of the audit scope.
 - b. **The regulatory accounts feed directly into the cost stack of wholesale charges submitted as part of the RO and retail tariffs.** As a dominant and SMP operator in a large number of wholesale and retail markets, there are a number of obligations which fall on Batelco, including the offering of access to its telecommunications network and facilities, the submission of a RO for the Authority's approval, and compliance with the Retail Tariff Regulation issued 21 February 2010. An essential requirement to support the development of fair and effective competition is that regulated services are adequately priced based on accurate information and a sound underlying costing framework. Given Batelco's size, failure to meet that requirement could have a significant impact in terms of welfare loss as products would not be priced adequately.
 - c. **It would be discriminatory and non-proportional to change the audit scope for other operators which prepare regulatory accounts.** By virtue of its control of the fixed infrastructure which is not easily replicable, its size and overall market share, Batelco is in a unique position. Batelco still controls the vast majority of the fixed infrastructure, and has revenues which account for between 60% to 70% of total revenues in 2009.⁴⁴ In the same period, its share of revenue in the fixed lines market was greater than 90%.⁴⁵ In 2010 it had a market share of between 40% to 50% in the mobile market. The Authority considers that it would be discriminatory to apply the same audit requirement to other operators in so far as it would mean applying a similar treatment to operators that are in different situations. Furthermore, it would not be proportional to apply this remedy to smaller operators

⁴³ The Authority, 2010, “The Regulation of Mobile Termination Services, Position Paper”, 1 February 2011.

⁴⁴ Telecommunications markets indicators in the Kingdom of Bahrain, TRA confidential version, December 2010.

⁴⁵ Revenues including: usage revenues, lines rentals and lines installation fee.

Determination to change the audit standard for Batelco’s regulatory accounts – Reasoning

which are not regulated on an *ex-ante* basis. It would place an unnecessary burden on them.

123. Overall, the Authority still considers that at this stage in the liberalisation of the telecommunications sector in Bahrain, Batelco, as the incumbent operator, is still in a unique position in respect of the significance of its regulatory accounts for the setting of wholesale and retail tariffs. The Authority does not consider it necessary or proportionate for the scope of the audit requirement to apply to all other Licensed Operators at this stage in the development of the telecommunications market in Bahrain.

Question 5

Do you agree with the Authority that the “fairly presents” audit requirement should apply solely to Batelco for present purposes? Please elaborate.

Summary of operators’ responses

124. Four licensees responded to this question. While Lightspeed and Mena Telecom agree with the Authority’s position that the “fairly presents” requirement should apply solely to Batelco, VIVA does not agree with the change of standard.

125. In its response, Batelco stated that if its alternative proposals were adopted (see below), these proposals should apply to Batelco alone. However, Batelco also explained that if the Authority was still of the view that a “fairly presents” audit opinion should be applied, these requirements may be extended to other operators with a dominance designation, should the need arise.

The Authority’s analysis and conclusion

126. Having reviewed the comments received, the Authority remains of the view that for the time being the change of audit scope to “fairly presents” should apply solely to Batelco.

7.4 Treatment of regulatory accounts

Draft determination text

127. As per the Regulation, Batelco is required to prepare its regulatory accounts in accordance with an approved APM and to comply with the Regulation. The regulatory accounts are used by Batelco to prepare its RO submission and notifications for regulated retail tariffs.

Determination to change the audit standard for Batelco’s regulatory accounts – Reasoning

128. While changing the scope of the audit opinion for Batelco’s regulated accounts to “fairly presents” is expected to provide the Authority with the required level of assurance, the Authority reserves the right to make any adjustment it deems necessary to the output of Batelco’s regulatory accounts when setting wholesale charges.

Summary of operators’ responses

129. None of the respondents expressed views on this section.

The Authority’s analysis and conclusion

130. As explained in the draft Determination, the Authority reserves the right to make any adjustment it deems necessary to the output of Batelco’s regulatory accounts in regulatory proceedings, including for example when setting wholesale charges or reviewing retail tariffs to reflect the particular circumstances of the case at hands. In other words, the Authority is not bound to follow the audited accounts values.

7.5 Other expected benefits from the change of audit standard

Draft determination text

131. While the change of audit standard will provide the required level of accuracy, reliability and quality of the information contained in the regulatory accounts, it is also expected to bring additional benefits. Given the protracted nature of previous reviews of Batelco’s APM and regulatory accounts, multiple information requests and the strain on resources for both Batelco and the Authority, the application of the “fairly presents” audit opinion can be expected to lead over time to a more efficient, less time-consuming and resource-intensive review process for both Batelco and the Authority, the benefits of which will ultimately flow onto consumers.

132. The change of audit scope, via its positive effect on the robustness and reliability of regulatory accounts is also likely to benefit Batelco as the Authority understands that regulatory accounts (more specifically the FAC accounts) are the only source of financial information on which Batelco rely for the setting of retail tariffs. With the change of audit scope, auditors will have to provide an opinion on the current APM. As a result, the level of interactions between Batelco’s auditor and Batelco’ staff involved in the audit (e.g. Accounting, Finance, Internal Audit, IS/IT departments) will intensify. These numerous interactions can have an indirect beneficial effect in terms of expertise development and knowledge transfer. It will also provide Batelco with a fresh eye on its current reporting practices and thus foster operational improvements.

133. Overall, changing the scope of audit to “fairly presents” will be beneficial to the telecommunications market in the Kingdom of Bahrain.

Determination to change the audit standard for Batelco's regulatory accounts – Reasoning

Summary of operators' responses

134. None of the respondents expressed views on this section.

The Authority's analysis and conclusion

135. The Authority has no further comments to make in this section (see below section 151 page 47 regarding the question of the cost associated with the change of audit standard as well as paragraph 119).

8 Additional comments raised by Batelco in its response

136. The Authority has added this section to address the additional comments raised by Batelco in its response.

8.1 Alternative proposals to the Authority's proposal to change the audit standard to fairly presents

Summary of Batelco's response

137. Instead of changing the audit standard to fairly presents, Batelco proposed to keep the current audit standard to "properly prepared" and to make amendments and improvements which, in Batelco's view, will achieve the same objectives as changing the audit standard.

138. Batelco's alternative proposals are summarized in Table 4 below where the Authority provides its comments on each proposal.

The Authority's analysis and conclusion

139. For the reasons set out in the following table (Table 4), the Authority considers that the alternative proposals put forward by Batelco *in lieu* of raising the audit standard would neither individually nor collectively achieve the key objective to change the audit standard which is to provide the Authority with the required level of assurance regarding the accuracy, reliability and quality of information contained in the regulatory accounts.

140. While some proposals have some merits, the Authority considers that they will not provide sustainable incentives and discipline to Batelco. This contrasts with the change of audit standard which will provide an appropriate mechanism as Batelco will have to meet the

Determination to change the audit standard for Batelco’s regulatory accounts – Reasoning

more demanding standard each year. Thus, Batelco will be required to keep improving and amending its systems and methodology, for instance.

141. The Authority welcomes Batelco’s admission that it has certain issues with the accuracy and quality of its information sources and some of the data it submits to the Authority. Improvements in this area are critical to support evidenced-based regulation and should take place regardless of whether the audit standard is changed. When the Authority requests information, it is reasonable for the Authority to expect the submission received to be free from error. Further, the change of audit standard will lead to improvement regarding the accuracy of the underlying data and systems as they will be thoroughly checked by the auditor.

Table 4: Summary of Batelco’s alternative proposals and the Authority’s comments

Summary of Batelco’s proposal	The Authority’s comments
Providing more detailed non-audited information/disclosure	
<p>Batelco proposed to provide more non-audited information in addition to what is already provided to the Authority. This additional information could include:</p> <ul style="list-style-type: none"> • Volume information for regulated and unregulated products and services; • Revenue and direct costs by services; and • Detailed FAC and LRIC network costs for products and services. 	<p>Providing additional unaudited information will not achieve the main objective of changing the audit standard which is to provide the Authority with the required level of assurance regarding the accuracy, reliability and quality of information contained in the regulatory accounts. As shown above, there have been a number of instances where the information provided by Batelco, including information related to the audited regulatory accounts has been erroneous.</p> <p>The audit opinion is first and foremost a way of demonstrating that the numbers and underlying data are fit for purpose. It is not appropriate to rely on the regulator to do its own checks at its own expense to assess the accuracy of the numbers.</p> <p>Thus the provision of additional unaudited information is likely to generate further work for the Authority which will have to check the accuracy of veracity of the submitted information. This is contrary to one of the intended purposes of this determination, which is to put more responsibility on the auditor to ensure that the information contained and data underlying the regulatory accounts provide a higher level of accuracy and reliability.</p> <p>Only a change of audit standard will provide the necessary discipline to Batelco to continuously maintain its systems and data sources.</p> <p>This being said, the Authority has the power under Article 53 of the Telecommunications Law to request information from licensed operators it deems necessary to carry out its duties. Further, when the Authority requests information, it is reasonable for the Authority to expect the submission received to be free from error.</p>
Increasing depth of documentation provided	
<p>As requested in the Authority’s instructions letter dated 9 November 2010, Batelco has started enhancing and adding more information to the APM.</p>	<p>The Authority does not consider this enhancement as an alternative to changing the audit standard. This enhancement was made by Batelco following instructions from the Authority.</p> <p>The change of audit standard will provide Batelco with the required discipline to continuously review its APM in order to meet the fairly presents audit standard.</p>
Providing commentary on regulatory accounts	
<p>To enable the Authority to better understand and review the regulatory accounts, Batelco proposed to provide commentary on the</p>	<p>While this proposal is interesting, it would not achieve the key objective of changing the audit standard.</p> <p>This proposal would greatly facilitate the annual review of the</p>

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Summary of Batelco’s proposal	The Authority’s comments
regulatory accounts, such as providing a management discussion of key market changes for each P&L and the key factors affecting costs and capital.	regulatory accounts by the Authority. Thus, the Authority invites Batelco to implement this proposal under the new audit standard and, ideally, to submit such commentary as part of the regulatory accounts as it is done in the UK by BT. The preparation of such commentary will also mean that Batelco’s senior management has to focus its attention as to the accuracy of the numbers before they sign the regulatory accounts off in so far as those commentary, based on the information contained in the regulatory accounts, would need to be consistent with the trends of the corresponding statutory accounts which have already been signed off. Batelco’s management will also greatly benefit from this proposal.
Tripartite audit arrangement and providing the Authority with a management letter	
The advantage of having a tripartite agreement is to involve the Authority at various stages of the regulatory accounts process. Moreover, Batelco proposed to provide the Authority with the management letter which includes immaterial issues identified by the auditor that do not require correction of the regulatory accounts due to their immaterial nature.	The Authority’s position in relation to the tripartite audit arrangement is set out at paragraph 89 above. This being said, this proposal will not achieve the main objective of changing the audit standard. The Authority welcomes the opportunity of reviewing the management letter and look forward to receiving the last two management letters so that it can better prepare itself for the forthcoming set of accounts.
Providing “reasonableness review of methodology” from regulatory auditors	
Batelco also proposed to provide the Authority an “ <i>external reasonableness review of methodology</i> ” instead of the Authority’s proposed interim report. This external review will be performed against “ <i>good international practice</i> ” and could be shared with the Authority under a tripartite arrangement.	The Authority’s position in relation to the tripartite audit arrangement is set out at paragraph 89 above. This being said, this proposal will not achieve the main objective of changing the audit standard. As per Batelco’s comment at paragraph 48 of its submission, the review will only be a non-audit review which accordingly to Batelco “ <i>cannot conclude to the appropriateness and completeness of the detailed rules[...]</i> ”. Also this proposal will give no guarantee that each year the methodology remains reasonable.
Improving the process for responding to other requests from the Authority	
Batelco stated that they are willing to review and enhance the quality and accuracy of the information.	The Authority welcomes Batelco’s admission that it has issues with the quality and accuracy of information it submits to the Authority. The Authority also welcomes Batelco’s willingness to make improvements in that regards. However, the Authority considers that improvement should be made regardless of whether the Authority decides to change the audit standard to fairly presents. When the Authority requests information, it is reasonable for the Authority to expect the submission received to be free from error. In that regards, the change of audit standard will lead to improvements regarding the accuracy of the underlying data and systems which will be thoroughly checked by the auditor.
Improving internal quality control procedures	
As an alternative to a fairly presents audit opinion Batelco proposed the implementation of a more formal approach to quality control involving a data review and a separated accounts review with the creation of an	The Authority welcomes Batelco’s admission that the quality and accuracy of information can be improved. This is an issue which has been raised in the past. ⁴⁶ However, the Authority considers that improvement should be made regardless of whether the Authority decides to change the audit

⁴⁶ See various examples mentioned in this determination as well as the Authority’s letter dated 28 July 2010 (MCD/078/10/083) for example.

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Summary of Batelco’s proposal	The Authority’s comments
“oversight panel or person”.	<p>standard to fairly presents. When the Authority requests information, it is reasonable for the Authority to expect the submission received to be free from error.</p> <p>In that regards, the change of audit standard will lead to improvement regarding the accuracy of the underlying data and systems which will be thoroughly checked by the auditor.</p>

Source: Batelco’s response and the Authority

8.2 Timelines

142. The Draft Determination indicated that the change of audit opinion from properly prepared to fairly presents should be implemented for the 2010 regulatory accounts.

Summary of Batelco’s response

143. Batelco expressed concerns over the requirement to implement the change in audit opinion for the 2010 regulatory accounts in two sections of its response.

144. In its executive summary, Batelco proposed to postpone the implementation of the new audit scope to the 2012 regulatory accounts. Batelco justified this request by stating that the proposed changes cannot be implemented in time neither for the 2010 nor for the 2011 regulatory accounts *“given the likely testing requirements on processes and controls on data, likely not to be ready for 2011. If “fairly presents” was required, then we would expect the 2012 regulatory accounts to be the first available set for submission”* (Batelco’s submission, paragraph 9).

145. In its response to question one of the Draft determination, Batelco also explained that the *“proposed timetable does not take into account the fact that it is very unlikely to be possible to test the controls in place of the data sources during 2010 as this year has already past. Indeed, it is unlikely given the timing of this draft determination that the relevant testing could be implemented for 2011 either”* (Batelco’s submission paragraph, 23).

146. Under the “Timetable” section (paragraphs 80-82) of its response, Batelco also states that, if the audit standard was to be changed to “fairly presents”, then it would be possible to dispense with the review of Batelco’s APM by the Authority. Batelco considers the Authority’s review of the APM as a key factor in the current production timescales. Batelco argues that the removal of the Authority’s review of the APM would enable Batelco to submit the regulatory accounts sooner. It contends that the regulatory timelines for the FAC regulatory accounts and LRIC/CCA regulatory accounts, which are 30 June and 30 September respectively, should be achievable.

147. Finally, Batelco explained that *“[f]or the initial year of a ‘fairly presents’ audit standard it would be reasonable to assume an additional 3 months to the normal timeframe”* (Batelco’s submission, paragraph 81). If the alternative proposals were accepted by the Authority and the Authority were not to review the APM, *“Batelco would expect the overall timetable to be speeded up”* (Batelco’s response, paragraph 82) – although Batelco

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provided neither a timetable for the implementation of its alternative proposals nor an indication of the time that could be gained.

The Authority's analysis and conclusion

148. The Authority disagrees with the claims made by Batelco regarding the production of regulatory accounts. In accordance with Article 1.1 (c) of Regulation, the Authority has 45 working days to review Batelco's APM. The last 3 complete APM submissions were made on: 13 December 2009, 5 September 2010 and 31 May 2011. The submission dates effectively meant that Batelco would not be able to submit its regulatory accounts on time, although the Authority has emphasized on many occasions the importance for Batelco to submit its APM and regulatory accounts in a timely manner.⁴⁷
149. Regarding the implementation date of the change of audit standard, Batelco has not sufficiently justified why and how the auditors would not be able to perform the audit under the fairly present standard for the 2010 regulatory accounts. Batelco advances some vague arguments regarding controls and testing. The Authority does not understand why the auditor would not be able to perform the necessary checks for data sources. Controls in place should be documented and therefore the auditor should be able to check them after the relevant year has passed.
150. In light of the issues identified with the current audit standard and the centrality of Batelco's regulatory accounts the Authority is of the view that the new audit standard should be implemented immediately.⁴⁸
151. Overall, while the Authority considers that it would be entirely justified for the change of audit standard to apply for the 2010 regulatory accounts and that Batelco has not provided convincing justifications to postpone the change of audit standard to the 2011 or 2012 regulatory accounts, the Authority has decided to make the change of audit standard applicable for the 2011 regulatory accounts onwards. In reaching this view, the Authority has had to balance the need for the 2010 regulatory accounts to be submitted with limited delays against the added benefits of the change of audit opinion. Given the comments made by Batelco, it would appear that the amount of time that Batelco would require to prepare itself would result in substantial delays to the submission of the 2010 regulatory accounts. The Authority's decision will give Batelco further time to prepare itself to meet the "fairly presents" audit standard and to submit its 2011 regulatory accounts in a timely

⁴⁷ See e.g. various letters from the Authority: "APM and Regulatory Accounts Submission" (MCD/11/09/096) dated 24 November 2009; "2009 Accounting Procedures Manual Review" (MCD03/10/029) dated 16 March 2010; "Request for extension for the submission of Regulatory Accounts and 2010 Reference Offer submission date" (MCD/06/10/072) dated 11 July 2010; "Re: Batelco's 2010 APM submission – 2nd Request for extension" (MCD04/11/046) dated 12 April 2011.

⁴⁸ Batelco was formally informed by the Authority of the Authority's concerns with the existing audit standard since May 2010 (letter titled "2008 Regulatory Accounts and Potential improvement to the APM and Regulatory Accounts" dated 27 May 2010, MCD/05/10/062). In the 2010 APM approval and instructions letter dated 9 November 2010 (MCD/11/10/100), the Authority also informed Batelco that it was of the preliminary view that the current audit standard and process did not provide the Authority with the necessary level of assurance and that it would shortly consult on this issue.

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fashion. Further, the 2010 regulatory accounts should see some improvement as a result of Batelco's preparation for the change of audit standard.

8.3 Estimated implementation costs

Summary of Batelco's response

152. As part of its response, Batelco estimated the implementation costs of implementing the fairly presents audit standard. It indicated that the revised audit standard will comprise *“not only the increase audit fee but also the likely increase in internal costs”* (Batelco's response, Annex B). While Batelco stated that its estimates are based on experience of similar work in other jurisdictions, it did not specify the source of such information. Batelco also said that the figures are indicative and the estimates of external costs are not based on any detailed analysis.

153. Based on the assumption that the fairly presents audit requirement will be applied at the market or business level, Batelco provided the following indicative estimates of potential costs (Table 5 below summarizes Batelco's estimates by category. It also includes the Authority comments on each cost category):

- a. External costs of USD [X] for audit work per annum;
- b. External costs of USD [X] for audit-led or consultancy review and recommendations (set-up rather than on-going);
- c. Internal costs of USD [X] (on-going annual cost of about USD [X]);
- d. Total incremental costs: USD [X].

The Authority's analysis and conclusion

154. Having reviewed in details the estimate of the incremental cost of changing the audit standard submitted by Batelco (see comments in Table 5 below), the Authority considers that the overall range of USD [X] does not represent a plausible range of the incremental cost of changing the audit standard. In effect, Batelco estimates that the one-off and on-going annual costs of changing the audit standard are USD [X] and USD [X] respectively.

155. Batelco has in particular included various cost categories which are neither incremental nor relevant to the change of audit requirement. There are costs categories which Batelco would need to incur irrespective of the change of audit. For instance, one of Batelco's alternative proposals was to “increase the depth of documentation provided” and improve internal quality control procedures. As explained in the table there are also areas where Batelco appears to be double counting costs (e.g. on testing data sources, quality assurance).

156. Batelco has also submitted cost estimates regarding for example the costing team and data sources which tend to imply that there are significant problems with the current audit

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standard and to question the overall integrity of the regulatory accounts. Irrespective of the audit opinion, the data sources, bases and cost apportionment should already be at the appropriate standard to ensure the numbers are correct in the first place. These make evident the need to change the audit standard to fairly presents.

157. Overall, the Authority is of the view that the only true incremental costs of changing the audit stand are the external audit fees with perhaps some limited increase in the internal cost (see table below). The Authority considers that the estimates of audit fees provided by Batelco appear on the high end of the scale, especially given the way the Authority has decided to apply the fairly presents standard. Further, while the Authority accepts that there may be other incremental costs related to the change of audit such as costs related to the internal costing team (see table below), the magnitude of the increase in these cost should be limited and clearly not on the scale submitted by Batelco. For these reasons, the Authority considers that Batelco significantly overestimates the likely incremental costs of changing the audit opinion.

Table 5: Summary of Batelco’s estimated implementation costs and the Authority’s comments

The estimated incremental cost provided by Batelco	The Authority’s comments
External audit cost :	
<p>The current cost is approximately USD [X].</p> <p>The increase in audit fees depends on a number of factors. The key factor is the level at which the audit opinion is required. Two ranges were provided:</p> <ul style="list-style-type: none"> - USD [X] for the audit opinion at the market or business level - USD [X] for the audit opinion at the product/services levels (assumes new audit opinion for large services only) 	<p>While the Authority accepts that the audit fee for the fairly presents standard is the incremental cost of changing the audit standard and that it will be greater than for the properly prepared standard, the estimates provided by Batelco appear on the high end of the scale, especially given the way the Authority has decided to apply the fairly presents standard and given that Batelco’s auditor, having audited the accounts for several years, should be very familiar with the systems.⁴⁹</p> <p>The Authority would not expect an increase in audit fees greater than [X] times the current audit fees. An increase beyond this could be indicative of fundamental weaknesses in the underlying models generating the base data and be of considerable concern regarding the integrity of the existing regulatory accounts.</p>
Increased costing team	

⁴⁹ To give a point of comparison, KPMG, the audit firm, indicated that the audit fees for the fairly presents audit opinion for Jersey Telecom in the first year could be in the region of £ 150,000 - 250,000 (US\$ 240,000 – 400,000). KPMG also expected “*these costs to fall significantly in subsequent years as the systems and the auditors understanding of them improved. Based on audit costs for smaller incumbents in other European countries, we would expect that [Jersey Telecom] could expect an audit fee in subsequent years to decline, possibly to £100,000 [US\$ 160,000]*”. KPMG, 2011, Review of Jersey Telecom Limited’s Regulatory Separated Accounts, for the Jersey Competition Regulatory Authority, 20 May 2011, page 34.

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The estimated incremental cost provided by Batelco	The Authority’s comments
Initial incremental cost of USD [X] and on-going incremental cost of USD [X]	<p>The Authority is surprised that Batelco claims it would increase the core costing team from [X] to [X] staff in order to meet the fairly presents standard. Irrespective of the audit opinion, the bases and cost apportionment should already be at the appropriate standard to ensure the numbers are correct in the first place. This contributes to questioning the overall integrity of the regulatory accounts. This also contributes to questioning whether this estimate correctly reflects the cost incremental to the change of audit or mostly reflects an expansion of the team that Batelco would have done anyway.</p> <p>While the Authority accepts that there may be some incremental cost related to the change of audit, the magnitude of the increase in the cost of the costing team should be limited and clearly not on the scale submitted by Batelco.</p>
Testing data sources	
<p>USD [X]</p> <p>Batelco anticipates that it would need to first do a ‘fit-for-purpose’ review of data sources (e.g. [X]) with an estimated cost of US\$ [X] - [X]. As result some remedial actions (e.g. [X]) may be required with an estimated cost of US\$ [X] for internal salary costs and US\$ [X] for remediation of data sources.</p>	<p>The Authority is surprised by Batelco’s estimates regarding testing data sources in order to meet the fairly presents standard. Irrespective of the audit opinion, the data sources should be already at the appropriate standard to ensure the numbers are correct in the first place. This contributes to questioning the overall integrity of the regulatory accounts and is therefore worrying.⁵⁰</p> <p>Overall, the Authority considers that this cost cannot be considered as incremental to the change of audit opinion.</p> <p>The Authority also notes that as part of the audit, the auditors will be testing data sources. This will be included in the audit fees and hence Batelco’s estimates may double count the cost of the external review of data sources. As suggested by Batelco, the Authority considers that it would be appropriate for the auditor to lead the work in this area.</p>
Increased involvement from business	

⁵⁰ Taking the annual salary cost of US\$ [X] provided by Batelco, Batelco’s implicitly estimates that it would take between [X] and [X] full time equivalents just to get the data fit for purpose.

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The estimated incremental cost provided by Batelco	The Authority's comments
<p>USD [X] for external support in reviewing and critiquing allocation keys and assumptions used. On an on-going basis an estimated internal cost of USD [X] per annum</p>	<p>The Authority is surprised by Batelco's estimates regarding this cost category in the context of changing the audit standard. Irrespective of the audit opinion, the allocation keys and assumptions should be reasonable and robust. This is also inconsistent with Batelco's claim at paragraph 35 of its response where it argues that <i>"the regulatory auditor does practise a similar responsibility to ensure reasonableness and appropriateness of the APM [...]"</i>.</p> <p>The Authority is unconvinced by the estimates presented by Batelco as being driven by the change of audit scope.</p> <p>While the Authority accepts that there may be some incremental cost related to the change of audit, the magnitude of the increase should be limited and clearly not of the scale submitted by Batelco.</p> <p>Under the current audit standard, the business should review and amend allocations as a matter of course. Irrespective of the audit opinion, the allocation keys and assumptions should be reasonable and robust. The scale suggested by Batelco may be indicative of internal control weaknesses.</p>
Improvement in quality assurance of model inputs and results	
<p>An initial cost for external support of USD [X] to implement more formal and rigorous quality control in order to meet the fairly presents standard and on-going annual internal costs of USD [X]. Batelco acknowledges that even without changing the audit standard <i>"Batelco should consider [this requirement] as a tool for improving the TRA's confidence in the Regulatory Accounts"</i> (Batelco's submission, Annex B page 28)</p>	<p>While the Authority appreciates that under the fairly presents standard the auditor will perform a detailed testing of data sources, it is unclear to the Authority why these costs are incremental to the change of audit. Irrespective of the audit opinion, the appropriate quality assurance processes should be in place. This is a fundamental issue regarding the integrity of the regulatory accounts. Further as explained by Batelco, those changes should be considered regardless of whether the audit is changed.</p> <p>The auditors will also make any recommendations as part of the fairly presents audit review if quality controls are not appropriate and therefore this would be expected to be included in the audit fee.</p>
Cost of providing commentary	

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The estimated incremental cost provided by Batelco	The Authority's comments
<p>An initial cost for external support of USD [X] and internal cost of USD [X].</p> <p>On-going annual internal cost of USD [X]</p>	<p>It is unclear to the Authority what Batelco is referring to. This cost does not appear to be relevant to the change of audit opinion. The analytical review will be conducted by the auditor as part of the audit not by Batelco.</p> <p>In line with the current practice, the Authority may continue to ask questions to Batelco following review by the Authority of the regulatory accounts. Thus, Batelco may be required to provide clarification and commentary irrespective of a change of audit opinion.</p> <p>If Batelco is referring to its proposal "Providing commentary on the regulatory accounts" summarized in Table 4, then the cost associated with it cannot be considered as incremental to the change of audit as it is not required by the change of audit, it is a voluntary proposal by Batelco. However, as a matter of principle, even if it was required, the Authority would not expect any external cost as the Authority would expect Batelco's own management to be able to write commentary on the performance of their own areas of business. This should be part and parcel of the internal review of the accounts.</p>
Cost of improving documentation	
<p>An initial cost for external support of [X] and internal cost of USD [X]</p> <p>On-going annual internal cost of USD [X]</p>	<p>It is not clear to the Authority why there will be costs for improving the documentation. This cost category is inconsistent with Batelco's own submission which argues in the section describing the two audit standards that the documentation review is almost the same under both standards. Further, in the "alternative proposals" section of its submission, Batelco indicated that it would continue with enhancements and additions to the APM as required by the Authority in its letter dated 9 November 2010 (Batelco's submission, paragraph 79, point b).</p> <p>Therefore, the Authority considers this cost not to be incremental to the change of audit standard.</p>

Source: The Authority and Batelco's response