



هيئة تنظيم الاتصالات
Telecommunications Regulatory Authority

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

A consultation document issued by the Telecommunications Regulatory Authority

8 March 2011

Ref: MCD03/11/027

Request for comments:

The Telecommunications Regulatory Authority invites comments on this consultation document from all interested parties. Comments should be submitted before **7 April 2011 at 4pm**.

Responses should be sent to the Authority for the attention of the Market and Competition Department preferably by e-mail (or by fax or post) to:

Market and Competition Department

auditscope@tra.org.bh

Telecommunications Regulatory Authority

P.O. Box 10353, Manama, Kingdom of Bahrain

Fax: +973 1753 2125

Public Version

Confidential information is highlighted in black: [REDACTED]

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

Draft Determination
Change of audit standard for Batelco's Regulatory Accounts

Instructions for submitting a response

1. The Telecommunications Regulatory Authority ("the Authority") invites comments on this consultation document from all interested parties. Comments should be submitted by the date set out in the front page.
2. Responses should be sent to the Authority for the attention of the Market and Competition Department preferably by email (or by fax or post) to:

Market and Competition Department

auditscope@tra.org.bh

Telecommunications Regulatory Authority

P.O. Box 10353, Manama, Kingdom of Bahrain

Fax: +973 1753 2125

3. Responses should include:
 - a. the name of the company/institution/association etc.;
 - b. the name of the principal contact person;
 - c. full contact details (physical address, telephone number, fax number and e-mail address); and
 - d. in the case of responses from individual consumers, name and contact details.
4. In the interest of transparency, the Authority intends to make all submissions received available to the public. The Authority will evaluate a request for confidentiality in line with relevant legal provisions and the Authority's published guidance on the treatment of confidential and non-confidential information.¹
5. Respondents are required to mark clearly any information included in their submission that is considered confidential. Where such confidential information is included, respondents are required to provide both a confidential and a non-confidential version of their submission. If a part or a whole submission is marked confidential, reasons should be provided. The Authority may publish or refrain from publishing any document or submission at its sole discretion.
6. Once the Authority has received and considered responses to this consultative document, the Authority will issue a final version of the Determination changing the scope of the audit requirement for Batelco's regulatory accounts.

¹ TRA (2007), "A Guidance Paper issued by the Telecommunications Regulatory Authority on its treatment of Confidential and Non-confidential Information", Guidance Paper No. 2 of 2007, 10 September.

Draft Determination
Change of audit standard for Batelco's Regulatory Accounts

DRAFT DETERMINATION

7. 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:
8. In accordance with articles 3(c)(1) of the Telecommunications Law and 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".
9. The "fairly presents" audit standard shall apply at the service and/or product level.
10. Batelco must submit an audit report to the Authority with and as part of its regulatory accounts.
11. Batelco must ensure that an interim audit report detailing the auditors proposed changes required by Batelco to ensure that the APM meets the requirements of the Regulation and the "fairly presents" standard' is submitted to the Authority no later than 30 working days from the date of submission of the Accounting Procedures Manual ("APM") or part(s) of.
12. The specific requirements of the Authority regarding the content of these two reports are set out in paragraph 42 and 44 respectively. The Authority may amend these requirements from time to time, including the requirement to submit an interim audit report as the Authority deems appropriate.
13. 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 as to whether Batelco "fairly presents" its regulatory accounts in accordance with this determination.

Entry into force

14. This Determination shall come into effect from the date of its issuance and shall apply to Batelco's regulatory accounts for the 2010 accounting period onwards.

For the Telecommunications Regulatory Authority

Signed on [●]

[●]

Dr. Mohammed Al Amer
Chairman of the Board of Directors and Acting General Director
Telecommunication Regulatory Authority
Manama, Kingdom of Bahrain

Draft Determination
Change of audit standard for Batelco’s Regulatory Accounts

Reasoning for the Determination

Table of contents

Instructions for submitting a response2

DRAFT DETERMINATION3

Reasoning for the Determination4

Table of contents4

List of acronyms and definitions5

1 Introduction.....6

2 Background6

3 Legal basis7

4 Different audit standards8

 Question 19

5 Reasons for the change of scope of audit requirement9

 Question 213

6 Audit report on APM and regulatory accounts13

 Question 314

7 Other Issues14

 7.1 Parallel review by the auditor and the Authority14

 7.2 Fairly presents audit opinion applies at service and/or product level.....14

 Question 415

 7.3 Fairly Presents requirement applied solely to Batelco15

 Question 516

 7.4 Treatment of regulatory accounts.....16

 7.5 Other expected benefits from the change of audit standard16

Draft Determination
Change of audit standard for Batelco's Regulatory Accounts

List of acronyms and definitions

| | |
|---------------|---|
| 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 |
| PP | Properly Prepared |
| RO | Reference Offer |
| The framework | The approved APM and Accounting Separation Regulation |

Draft Determination
Change of audit standard for Batelco's Regulatory Accounts

1 Introduction

15. 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");
16. 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 will provide the required level of assurance regarding the accuracy, reliability and quality of information contained in the regulatory accounts.
17. To support the required change the Authority also considers it appropriate to determine that Batelco should:
 - a. Arrange the submission of an interim auditor's report 30 days after Batelco's submission of its APM or part(s) of; and
 - b. Arrange the submission of an audit report with and as part of Batelco's submission of its regulatory accounts.

2 Background

18. 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 benefits of consumers and promote economic efficiency. This key responsibility of the Authority supposes that accurate and reliable costing information from the regulated entity is available.
19. 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.
20. 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".²
21. 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

² Article 24 of Generic National Fixed Licence: Accounting Requirements.

Draft Determination

Change of audit standard for Batelco's Regulatory Accounts

materiality, in accordance with the APM, as approved by the Authority”.

22. The audit requirement is referred to in Batelco's audit report as follows:³
- “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].
23. The accounting requirements are further expanded in the Regulation which sets out the requirements for separate regulatory accounting.
24. 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 1 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.
25. The issues described above and listed in Table 1 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 and audited regulated accounts of a regulated entity to the extent to which it has had to do over the last few years.
26. 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 procedures.

3 Legal basis

27. 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;⁴

³ 2009 Batelco's APM, Scope of audit requirements, page 130.

⁴ Determinations under this regulation are defined as: “Written determinations issued by the TRA as it sees fit relating the manner, form and timing of the production of regulatory accounts, together with

Draft Determination
Change of audit standard for Batelco's Regulatory Accounts

28. The Authority further notes that Article 1.3 of the Regulation contemplates a potential change of audit scope. It 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.

4 Different audit standards

29. 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:⁵

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

30. 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 has been established through working practices rather than any codified set of rules and regulations.
31. 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:

the methodologies and other matters to be applied in their preparation". See Definitions and Interpretation Page ii of the Regulation.

⁵ ISA International Standards for Auditing: <http://web.ifac.org/download/a008-2010-iaasb-handbook-isa-200.pdf>.

Draft Determination

Change of audit standard for Batelco's Regulatory Accounts

- 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).
32. 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.
33. 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.
34. 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".
35. 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.

Question 1

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

Please elaborate.

5 Reasons for the change of scope of audit requirement

36. 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.
37. 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 feed 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

Draft Determination
Change of audit standard for Batelco’s Regulatory Accounts

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.

38. 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 therefore change the scope of Batelco’s audit to ensure that the required level of assurance is provided.
39. 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 1: Example 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” |
|---|---|
| <p>Appropriate cost apportionment/allocation: The cost driver for “██████ IT-Fixed Billing”: in the 2009 APM: Batelco used the ██████████ as the cost driver to allocate ████████ IT-Fixed Billing to “local billing & retail” and “██████”. In the 2008 regulatory accounts it appeared that ██████████ of IT-Fixed Billing total cost was direct opex (██████████). Thus it is questionable whether ██████████ 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 Authority through the APM review as it 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> |
| <p>Inappropriate price trends used in the CCA valuation: The Authority has identified significant issues with the CCA valuation/price trends ██████████</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> |

Draft Determination
Change of audit standard for 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" |
|---|--|
| <p>██████████ in the past three years⁶ 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 (██████████ ██████████ ██████████) are true and fair.</p> | |
| <p>Absence of information or misleading information: 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 ██████████ ██████████ ██████████ ██████████</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> |
| <p>SDH transmission cost: During the 2010 review of Batelco's RO submission, the Authority has identified significant issues regarding operational data that greatly impact SDH transmission costs.⁷</p> | <p>Under a "fairly presents" audit opinion, such 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> |
| <p>Number of CAT/LLCO E1 equivalent circuits: 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.⁸ First it would appear that a number of high speed circuits are not included in the total number of E1 equivalent circuits. Second, 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>Under a "fairly presents" audit opinion, auditors would have checked the appropriateness and robustness of the data sources underlying the calculation of cost allocation 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.</p> |
| <p>Routing factor table: During the 2010 review of Batelco's RO submission, the Authority has identified several inconsistencies in Batelco's routing factor table.⁹ 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</p> | <p>Under a "fairly presents" audit opinion such issue should be identified by the auditor. Batelco's auditor should make sure that the regulatory accounts prepared by Batelco are free from errors.</p> |

⁶ 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.

⁷ See Reference Offer Order, 25 January 2011, MCD/01/11/006, paragraphs 39, 125, 138, 342-345 and 362-364.

⁸ See Reference Offer Order, 25 January 2011, MCD/01/11/006, paragraphs 362-364.

⁹ See Reference Offer Order, 25 January 2011, MCD/01/11/006, paragraphs 179 and 180.

Draft Determination
Change of audit standard for 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" |
|---|---|
| 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>Different cost allocation to retail service groups between FAC and LRIC accounts:</p> <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.¹⁰ 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> | 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. |
| <p>Change in cost driver and cost allocation without prior approval:</p> <p>In the 2008 approved APM, the cost driver to allocate the cost of "Market comm" was [REDACTED] and this cost centre was allocated to only three activities [REDACTED] [REDACTED] [REDACTED]</p> <p>However, during the 2010 RO review, the Authority noticed that the cost driver had changed to a [REDACTED] and [REDACTED] has been added as an allocation destination without approval from the Authority¹¹.</p> | 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 and true. The audit standard is more stringent. |
| <p>Issue with operational data that may impact allocation of costs:</p> <p>During the 2010 review of Batelco's RO submission, the Authority has identified potential issues with the total adjusted duct length which is decreasing by [REDACTED] km between 2007 to 2008. ¹²The Authority considers such decrease to be improbable and it raises concerns not only on the robustness of operational data sources but also on the appropriateness of the methodology used to collect and treat raw data.</p> | Under a "fairly presents" audit opinion, such issue should have been clearly identified by the auditors and if not resolved, it should have been flagged in the Audit report. |

¹⁰ 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.

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

¹² See Reference Offer Order, 25 January 2011, MCD/01/11/006, paragraph 261.

Draft Determination
Change of audit standard for Batelco's Regulatory Accounts

Source: The Authority

40. 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.
41. 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.

Question 2

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

Please elaborate.

6 Audit report on APM and regulatory accounts

42. 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. Incomplete 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;

Draft Determination
Change of audit standard for Batelco's Regulatory Accounts

- f. Changes made to the APM.
43. The requirements detailed above at paragraph 42 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.
44. 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) of. Such 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.
45. 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.

7 Other Issues

7.1 Parallel review by the auditor and the Authority

46. In order for the regulatory accounts to be submitted in a timely basis, the audit shall be conducted in parallel with the Authority's review of the accounting procedures manual ("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.

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

47. 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 from errors as the cost stacks of wholesale charges often require a greater level of cost allocation as 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.

Draft Determination
Change of audit standard for Batelco's Regulatory Accounts

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 details how it would be practically different from a requirement at the product/service level?

Please elaborate and formulate alternative proposal if necessary.

7.3 Fairly Presents requirement applied solely to Batelco

48. 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 termination services for which the Authority Position Paper on Mobile Termination Rates apply.¹³ 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, 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, has revenues which account for between 60% to 70% of total

¹³ The Authority, 2010, "The Regulation of Mobile Termination Services, Position Paper", 1 February 2011.

Draft Determination
Change of audit standard for Batelco's Regulatory Accounts

revenues in 2009.¹⁴ In the same period, its share of revenue in the fixed lines market¹⁵ was greater than 90%. In 2010 it has a market share of between 40% to 50% in 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 which are not regulated on an ex-ante basis. It would place an unnecessary burden on them.

49. 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 nor 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

7.4 Treatment of regulatory accounts

50. 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.
51. 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 charge.

7.5 Other expected benefits from the change of audit standard

52. 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

¹⁴ Telecommunications markets indicators in the Kingdom of Bahrain, TRA confidential version, December 2010

¹⁵ Revenues including: usage revenues, lines rentals and lines installation fee.

Draft Determination

Change of audit standard for Batelco's Regulatory Accounts

review process for both Batelco and the Authority, the benefits of which will ultimately flow onto consumers.

53. 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.
54. Overall changing the scope of audit to "fairly presents" will be beneficial to the telecommunications market in the Kingdom of Bahrain.