

Regulatory financial reporting:  
a review

UKCTA Response to Ofcom

Submitted to Ofcom: 2<sup>nd</sup> November 2012

UKCTA is a trade association promoting the interests of competitive fixed-line telecommunications companies competing against BT, as well as each other, in the residential and business markets. Its role is to develop and promote the interests of its members to Ofcom and the Government. Details of membership of UKCTA can be found at [www.ukcta.com](http://www.ukcta.com).

KCOM is a member of UKCTA and reflecting its particular interests, KCOM's view on some aspects of regulatory financial reporting will differ from the views expressed in this response.

UKCTA welcomes this consultation, believing it to be a very important policy project. UKCTA has long campaigned for a fundamental review of the Regulatory Accounting regime as it applies to BT. Reliable and transparent regulatory accounting output is a prerequisite for a robust, transparent and accountable regulatory regime which is able to effectively remedy instances of market failure and combat market power. Regulatory accounting output is an essential source of information for Ofcom, industry and BT. It goes some way to remedy that lack of comparative information that is typically available in a competitive market. The information contained within the regulatory accounts is vital, with BT's regulatory accounting output increasingly used to underpin regulatory decision making.

This review has come about largely as a result of BT's action to restate the accounts in 2008 and again in 2011, while the decision to undertake a material revaluation of the asset base in 2009/10 highlighted just how BT is able alter its regulatory accounting output to suit its commercial objectives. Things need to change if confidence is to be restored and we need to see a fairer decision making process to ensure less commercial bias and some real reforms to improve the quality of the output produced. Only when this is achieved will stakeholders be able to take advantage of the stability in the market to drive investment and benefit end consumers.

We warmly welcome Ofcom's proposals for an enhanced role for itself in attribution decisions, although this undertaking has to be backed up with additional expert resourcing. We also are pleased that Ofcom is robustly challenging BT's claims of confidentiality, these claims are unfounded and it is only through transparency that integrity will be restored. Ofcom must harness the input of stakeholders, consulting with them on material issues in relation to the accounts. It is after all stakeholders who have played a crucial role in challenging BT's information and its compliance with its regulatory obligations.

Ofcom should not seek to trade off a greater role for itself in return for reduced stakeholder transparency from the accounts. Other stakeholders will be concerned about different issues to Ofcom and have a different type of industry experience that makes our role in questioning and challenging regulatory reporting essential in ensuring its relevance and its integrity. Recent experience has shown this clearly and UKCTA does not foresee a time when Ofcom and auditors alone will be able undertake that role adequately.

Ofcom needs to think hard about what sanctions should be available to it should BT once again seek to undermine the regulatory accounting process. We would also have liked Ofcom to address the problem around incentives BT has in preparing the accounts. It appears easy for BT to seek out and disclose information that is beneficial to its own business, but how do we know that a comparable effort goes in to understanding and disclosing matters that may adversely impact their commercial standing. While it is important that BT owns the accounts, Ofcom should think what rules should apply around their preparation to maintain, as far as is possible, a degree of balance in the information disclosed.

We would make it clear that we firmly support the continued imposition of a cost orientation obligation in key markets and would draw Ofcom's attention to the discussion of this topic in UKCTA's August 2012 BCMR and LCCC response and the accompanying Alix Partners expert report. We believe Ofcom should have dealt with the matter of Cost Orientation within this consultation (as was the original intention) and we believe Ofcom should publish a formal consultation on cost orientation in the near future. The end result must be clear guidance on Cost Orientation that can be referred to across a range of markets.

The issues raised in this consultation are complex and the period allowed to respond has been very short. We have provided as detailed a response as we are able within the time allowed. In the future we would ask Ofcom to provide **a minimum of 10 weeks** for a consultation of this nature. Time and time again Ofcom seeks to catch up lost time caused by internal Ofcom delays by shortening the time allowed to stakeholders to respond. This is becoming a more frequent occurrence across a range of Ofcom projects, and Ofcom should take steps to stop this practice, putting the emphasis instead on trying to minimise internal delays. The Call for Inputs relating to this project closed last year, with Ofcom having over eight months to move matters on, this compares very poorly to the six weeks given to stakeholders to consider the consultation.

In the remainder this response we will focus on the specific questions raised by Ofcom in the consultation.

## Q&A

***Question 3.1: Do you agree with the four attributes we have identified for BT's regulatory financial reporting: relevance, reliability, transparency, and proportionality? Are there any further attributes you would consider?***

The four attributes identified are appropriate in order to assess a suitable financial reporting regime; however, UKCTA considers that the labelling of the attributes is significantly less important than the manner in which they are applied.

The identified attributes are largely self-selecting, as is the requirement to ensure SMP conditions (and therefore regulatory financial reporting obligations applied as conditions under section 87 of the Act), are objectively justifiable (and therefore relevant); proportionate and transparent.

The fourth attribute, reliability, is identified in the EU Recommendation<sup>1</sup>, and UKCTA would agree that it is fundamental to have a reliable system, especially in light of the recent re-statements or error corrections made by BT in the course of regulatory interventions<sup>2</sup>.

Therefore, given that each of the attributes are broad, it will be the specific manner in which Ofcom proposes to apply each attribute that will determine whether the proposed framework is fit for purpose. In this consultation, Ofcom seeks to address each of the individual attributes in a little more detail in the following questions within this section (question 3.2, Relevance; 3.3, Reliability; 3.4, Transparency and Proportionality), which we address below. We would note however, that the overall level of detail that is put forward by BT remains less than sufficient in order to assess the efficacy of a revised financial reporting system.

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<sup>1</sup> See footnote 31 in the EU recommendation

<sup>2</sup> See for example (ISDN30 MR; PPC Dispute)

***Question 3.2: Have we identified the right questions which BT's published financial statements should answer? What further questions do these statements need to answer?***

Ofcom sets out at paragraph 3.46 four criteria identified in its 2004 statement on Financial Reporting, stating that these were “some reasons why publication is necessary” (the 2004 criteria). We assume that Ofcom maintains that these are all valid reasons to publish relevant information.

Additionally, Ofcom then set out the list of issues identified by UKCTA in its response to the CFI document, and from paragraph 3.49 onwards considered the appropriateness of each issue.

*Cost Orientation*

Ofcom states that it is important for CPs to have public assurance of compliance with cost orientation obligations where they apply. It is acknowledged that this is a “key area of concern” and that published information assisted in the bringing of regulatory disputes in relation to PPC and Ethernet pricing.

The requirement to provide assurance to CPs that the services they buy are genuinely cost-oriented is also one of the identified 2004 criteria.

UKCTA wholeheartedly agrees with these comments, and the need to maintain reporting that demonstrates publicly that BT is complying with its cost orientation obligations is vital. Without such publication either the recent disputes would not have been able to be brought, or as Ofcom identifies, CPs would have been forced to bring a large number of “speculative” disputes that would both make it more difficult to discern the genuine and important disputes (such as PPCs) and have a significantly compromising effect on Ofcom’s limited resources.

This consultation suggests that Ofcom have chosen to undertake a separate consultation on cost orientation, and therefore have carved out this aspect of financial reporting from this document. UKCTA considers that given the close relationship between cost orientation and financial reporting, this limits the ability to meaningfully respond to this consultation in some areas, in that we need to understand Ofcom’s proposals in relation to cost orientation to assess the reporting proposals against the identified attributes.

UKCTA is most concerned that, despite the indications within this document that a subsequent consultation would be published shortly, there may now have been a change of position within Ofcom. Following on from the Ofcom / UKCTA stakeholder meeting<sup>3</sup>, UKCTA now understands that Ofcom is not intending to publish a cost orientation consultation at all, and may publish, at most, a “discussion paper”, which would not seek to set down any policy basis for cost orientation and therefore not justify the apparent need to carve out cost orientation from this consultation. If such an approach is taken then UKCTA considers that Ofcom is failing to address a significant and important part of regulatory reporting.

Irrespective of the nature of obligations imposed on a dominant provider within an individual market review (which will be a matter for the individual review to propose and set), this consultation was intended to assess the appropriate manner in which financial information in support of regulatory requirements should be imposed. It is not appropriate to set rules for reporting against charge controls or non-discrimination conditions, and to omit any reference to reporting against a cost orientation condition; to do so would result in an incomplete and flawed assessment.

Throughout this consultation Ofcom has justified a lack of comment on cost orientation issues on the sole basis that a subsequent consultation will address these issues<sup>4</sup>.

This consultation therefore ducks several significant issues in relation to the future of financial reporting, that relate to cost orientation. Whilst we deal with Sections 4 and 5 of the consultation in our response below we note that the appropriate level of common cost reporting<sup>5</sup>; the relevance of BT’s LRIC data<sup>6</sup>; publication of data relating to cost orientation compliance<sup>7</sup>; and reviewing any proposed reduction in publication requirements<sup>8</sup> are specific issues that are not addressed in any way in this document, but go to the heart of an effective reporting regime.

Even if future cost orientation remedies vary from the currently drafted “Basis of Charges” obligation in some markets, UKCTA considers that it remains inevitable that some form of

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<sup>3</sup> UKCTA / Ofcom Meeting on Regulatory Reporting held on the 20<sup>th</sup> of September 2012.

<sup>4</sup> See Paragraphs 1.4; 2.6; 3.50; 3.81; 4.7; 4.87; 4.116; 4.153; 5.109; 5.141; 5.162; 5.170; 5.254;

<sup>5</sup> Paragraphs 4.87 and 5.141

<sup>6</sup> Paragraphs 4.116 and 5.254

<sup>7</sup> Paragraph 5.109

<sup>8</sup> Paragraph 5.170

regulatory control aligning charges to cost needs to remain a necessary regulatory tool going forward.

Therefore, without a full and transparent consideration of these issues as part of this review, any future framework will be incomplete and open to debate (and possible challenge) before it is even in place. UKCTA consider that it is vital that the issue of cost orientation remedies, in general terms, is brought within this consultation process before any change is adopted.

#### *Charge Control modelling and review*

UKCTA accepts that Ofcom will obtain much more detailed information as part of a specific charge control review in order to assess the appropriate level of control to apply as a remedy in a particular market. However, we consider that it remains appropriate for information contained within the RFS to be sufficiently detailed to ensure that charges set by BT give sufficient certainty to industry that they remain within the parameters of the control.

#### *Margin Squeeze*

Ofcom acknowledges that to the extent that SMP obligations are imposed that have relevance to margin squeeze, then an appropriate financial reporting obligation “will help Ofcom and stakeholders to monitor compliance”, and, to the extent that margin squeeze is an identified market failure, which needs to be addressed by the imposition of appropriate remedies, then a publication requirement is a legitimate obligation to impose.

#### *Non-discrimination / EOI*

UKCTA agrees with Ofcom’s provisional assessment that the provision of assurance around compliance with non-discrimination should remain one of the purposes of published financial statements. It is not appropriate for a blanket argument that EOI obligations, imposed as an entirely different remedy, should preclude the need for specific non-discrimination provisions within financial reporting obligations.

*Provision of information*

Ofcom suggests that there needs to be a consistency between the production of financial statements and the basis on which the underlying obligations are set and the way that compliance is tested by Ofcom.

UKCTA agrees with this proposition, and note particular concern from the recent practice of restating the basis of reported information which serves to undermine the transparency and usefulness of the information. We discuss this in more detail in an answer to a later question.

*Appropriate Time*

Ofcom makes the comment that information needs to be reported in “a timely fashion”. This is undoubtedly correct, but the wider and more important question is what constitutes a “timely manner”. The potential of enforcement action would help to ensure that any time limits that were set, after consultation, were meaningful and adhered to. We discuss this in more detail in our response to a later question.

***Question 3.3: Have we identified the right factors to consider, in terms of what the regulatory audit should seek achieving? If not, please provide your comments and suggestions and support them.***

The consultation suggests that:

- The data needs to be reliable;
- A suitable accounting treatment needs to be selected that aligns to support regulatory objectives;
- The rules need to produce robust and meaningful results; and
- The regime needs to be audited in order to provide confidence in the data.

All of the above factors are entirely sensible; however, as discussed above, there is little detail in this consultation as to how Ofcom proposes to implement a system that meets these objectives.



In terms of regulatory audit, UKCTA expressed concern in response to Ofcom's Call for Inputs that the current audit regime was not working. Specifically, we noted that the current audit does not cover all parts of the RFS, operates at market level and does not assess the policies that have been adopted to prepare the RFS.

It is therefore essential that in this review Ofcom seeks to ensure that a fit for purpose regulatory audit is an integral part of the financial reporting process. This is simply essential to produce the robust and meaningful results that have been identified as being required.

As identified by Ofcom the rules that set the accounting treatment to be applied need to be objective and transparent to industry. This would help to avoid the concerns over both the appropriateness of assumptions applied by BT in preparing the RFS and any subsequent need to restate them. Ofcom acknowledges that these concerns exist within industry, and therefore the outcome of this project must ensure that any actual or perceived bias is driven out of the system.

We agree with Ofcom's assessment to reject BT's suggestion that greater aggregation would result in more meaningful data. UKCTA remains very strongly of the view that granular information is required to ensure that the overriding aim of providing confidence through robust and reliable reporting is achieved.

***Question 3.4: With reference to specific examples, how do you consider we should balance the needs for adequate disclosure with BT's concerns around confidentiality? Where BT has stated that disclosure of information is commercially sensitive, please explain whether you consider this to be a valid concern. Please provide evidence to support your view.***

UKCTA fully accepts that any system of financial reporting must be proportionate and that an element of proportionality will be the degree to which information that would not otherwise be made publically available by an undertaking with SMP should be required to be published in order to help address identified competition concerns.

That said, it cannot be correct that the party on whom the obligation falls claim either blanket confidentiality or relying on an unsupported claim of confidentiality over information that is

necessary to achieve the aim of the obligation. This would inevitably defeat the effectiveness of the requirement.

It has been suggested that the level of reporting may vary between markets depending upon the degree of market power held by the dominant provider<sup>9</sup>. From a purest perspective there may be merit in this suggestion, as regulatory remedies are only applied to address the competition concerns in a market, which will be less in some markets and more in others where the dominant provider has entrenched SMP. However, to follow that approach to its logical conclusion would mean that the requirements would vary not only between markets, but could also vary significantly following each market review. Such an approach would risk creating a complex and constantly shifting framework, which would not be suited to deal with the shared and common costs that overlap different markets. This would not accord with the reliability or transparency attributes identified by Ofcom.

Of course, requirements do already change to reflect market review decisions with requirements being updated on an annual basis through amendments to the Direction under the financial reporting SMP conditions, but these tend to reflect the imposition or removal of regulation, rather than the level of competition within the market.

BT has consistently claimed that details of internal supply are commercially sensitive. We whole heartily disagree and we believe it is essential that in SMP markets stakeholders can understand what products BT consumers and they can vary from those purchased by CPs. We are unaware how BT believes any harm caused by internal consumption would occur and we would urge Ofcom to press BT for specific examples of harm.

***Question 4.1 – Do you consider that we have correctly identified and described the main issues in relation to BT’s data? If you consider that there are additional issues, please provide evidence of them where possible.***

Ofcom has highlighted that past RFS output has proved to be unreliable with two significant restatements and a major revaluation. Stakeholders remain concerned about the reliability of

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<sup>9</sup> See EE’s comment reported at paragraph 3.102

the data, the apparent discretion that BT has to make changes without consultation or approval. The absence of a fit for purpose feedback loop is also a cause for concern, with questions arising from BT's output having no forum where they can be addressed in order to ensure an accurate and timely answer.

***Question 4.2 – Do you consider that we have correctly identified and described the main issues in relation to BT's systems? Please provide evidence where possible.***

While there was much optimism ahead of Ofcom gaining access to the data extract tool, to date stakeholders are not aware of any benefits that have arisen from this enhanced access and this consultation highlights the problems encountered by Ofcom in making productive use of the tool. Until the tool proves workable, giving Ofcom reliable access to relevant and contemporary data, with Ofcom staff having the necessary time and skill to manipulate it, then it cannot be relied upon.

***Question 4.3 – Do you consider that we have correctly identified and described the main issues in relation to BT's reports? Please provide evidence where possible.***

We believe Ofcom's analysis has captured the main issues around BT's current output. We note that Ofcom has not considered the issues raised at the Call for Input stage around the culture of preparation, with BT staff preparing the accounts having a natural and understandable desire to act in the best commercial interest of BT leading to potential conflict. We accept that BT has to 'own' the data produced and it is important it remains data that BT stands behind, however those producing the data should have an obligation to present fair and accurate information regardless of the commercial consequences for BT. Sanctions for failing to provide balanced and accurate information could be one way to achieve a more impartial culture around the preparation of the report.

***Question 4.4 – Do you agree with our analysis, as summarised in Figure 3, concluding that, in terms of scope, the published financial statements broadly answer the right questions?***

We have not carried out a detailed critique of the table, but considered it broadly correct. We would however question if the current audit can be accurately described as amounting to

independent verification, given its limited scope and inability to identify the matters that resulted in restatement.

***Question 4.5 – Do you consider that we have correctly identified and described the main issues in relation to controls around the data and systems? Please provide evidence where possible.***

While we accept that the audit will always have limitations, what Ofcom propose will do nothing to address the failures of the past, where the auditors signed off accounts that were based on incorrect information. We note that Ofcom has rejected the suggestions made by UKCTA in relation to the audit in our response to the Call for Inputs, however our views on audit reform are unchanged. The issue is not one of stakeholder misunderstanding; rather it is Ofcom's own past over-confidence in the audit that has led to a situation where the accounts were seen as beyond reproach as a result of the auditor signing them off.

While Ofcom's proposed enhanced role in decision making will go some way to improving assurance and confidence in the output, the audit itself requires some degree of reform. Changing to a new costing system is an ideal time to consider a change of auditor. An auditor would have to spend a lot of time on the new system and fresh audit eyes may prove especially valuable at this time. There is no reason why the regulatory auditor has to also do the statutory accounts and it may be the case that Ofcom and industry would be better served through the use of a hungry second tier firm that conducted an audit with a wider scope, possibly at the same cost of the current audit. Ultimately the choice of auditor is one for BT as they fund the audit, however Ofcom should use their joint duty of care influence to encourage the most rigorous audit possible. We welcome further ideas on what could be achieved as the current proposals on audit fall well short of what is needed.

#### ***Questions in Section 5: Proposals for improved regulatory financial reporting***

In this section of the response, UKCTA considers Ofcom's proposals to improve the regulatory financial reporting regime. Ofcom states that its proposals have been designed in order to provide a proportionate set of reporting requirements that will deliver relevant and reliable information to support their regulatory decisions and published information and thereby provide stakeholders with the necessary confidence that BT is complying with its obligations.

Ofcom makes great play of their aim to increase stakeholder confidence in the regulatory reporting regime and to ensure that it is fit for purpose and delivers reliable, accurate information. However, whilst the consultation goes to great lengths to identify the issues that have resulted in stakeholders doubting the credibility of the current regulatory financial statements (“RFS”), there is little detail contained in this first consultation as to precisely what Ofcom considers necessary to address these issues. The consultation leaves a lot of unanswered questions as to precisely what Ofcom intends to do so as to make things better in substantive terms and grow stakeholder confidence in the outputs.

Furthermore, we will only really know how useful Ofcom’s proposals will be once we have seen the cost orientation consultation (if indeed Ofcom intends to publish a formal consultation). In the absence of any clear proposals (or even directional indications) from Ofcom on the issue of cost orientation, it is hard to see how stakeholders can comment with any conviction on whether the current proposals will result in an increase in confidence in the financial statements, as it remains unclear precisely what information BT will be required to report and how that might affect the presentation within the RFS.

However, in general terms on the question of any changes to the publication requirements under the reporting regime, UKCTA very much agrees with Ofcom’s sentiment expressed in section 5 of their review document:

*“...until stakeholders have more confidence that BT has a robust and reliable reporting system that is supported by a strong review process, we consider that the scope to reduce the level of published information is limited.”<sup>10</sup>*

The requirement for clear, detailed and timely information is paramount, and based on the above it is hoped that Ofcom fully appreciates this point. However, later in the consultation document Ofcom expresses a contrary view:

*“...there may be alternative approaches to providing stakeholders with the information that they need, potentially including a shift of emphasis away from the current level of detail.”<sup>11</sup>*

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<sup>10</sup> Ofcom Regulatory financial reporting consultation paragraph 5.6

UKCTA members would be extremely concerned if this became Ofcom's preferred outcome and it is unfortunate that Ofcom's proposed position is somewhat ambiguous given these two statements and accompanying lack of detail. Unless Ofcom is clear on the requirements to fulfil its stated aim, the potential is, as demonstrated by these two conflicting statements, that Ofcom will fall between two stools and the outcome will be a set of obligations which satisfy neither BT nor any other stakeholder, including Ofcom.

That said UKCTA members consider that there are some positive suggestions contained in the consultation. For example, we agree with the proposals to align the RFS with the regulatory methodologies used by Ofcom and to require reconciliations, e.g. with Regulatory Asset Value ("RAV"), where appropriate. However, as a package there is insufficient detail and a lack of clear concrete proposals that would give us comfort that Ofcom's stated aim of increasing stakeholder confidence in the reporting regime will be met by the current set of proposals. We would therefore urge Ofcom to provide far more detail in its proposed second consultation and to spell out in simple terms the practical steps and measures that it would require of BT, its auditors and indeed itself to improve the regime.

The remainder of this section provides UKCTA's response to the specific questions that Ofcom pose in section 5 of the consultation, in which Ofcom sets out its outline proposals for improving Regulatory Financial reporting.

***Question 5.1: Do you consider our proposals relating to Ofcom's role in setting basis of preparation to be effective and proportionate? Please provide explanations and evidence to support your views.***

In general, UKCTA agrees that Ofcom needs to be more involved in setting the rules that underpin the preparation and reporting of BT's regulatory financial statements. The current arrangements, which allow BT far too much scope and control over the basis of preparation, must change as they have resulted in widespread distrust in the regime which is a key element in the general lack of confidence which Ofcom has highlighted.

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<sup>11</sup> Ofcom Regulatory financial reporting consultation paragraph 5.15

As to the question of effectiveness and proportionality – more detail is required in order to assess whether the measures being considered will achieve these requirements. What we would say at this stage is that any reduction in the level of detail BT provides in the RFS is almost certain to reduce its effectiveness and we do not consider that the current arrangements represent an unfair or disproportionate burden on BT.

More specifically, on Ofcom's five outlined proposals for increasing their involvement in setting the basis of preparation, UKCTA offers the following observations:

*Proposal 1a: Primary responsibility for ensuring that the basis of preparation is consistent with the Regulatory Accounting Principles should remain with BT*

Whilst there seems little doubt that BT is best placed to “own” and produce the data that feeds into the RFS, Ofcom cannot expect stakeholders to hold confidence in the RFS when BT also benefits from full control over the basis of preparation, and especially decisions regarding the allocation of costs. Any confidence is further undermined by BT's ability to decide post-publication that in fact the published information is materially wrong, and proceed to make significant changes without fear of sanction.

BT (and Ofcom) cites concerns regarding “ownership” of the reporting. We do not disagree that BT should continue to assume ownership of the information contained in the RFS. However it is crucial that there is a degree of independent control over the basis of the preparation of the RFS, including the principles and rules governing the preparation. This is so important because currently, rightly or wrongly, there is a perception externally that BT uses its freedom to determine the rules governing the preparation of the RFS as a means to further its own commercial ends. If this control is not transferred to an independent third party then Ofcom need to take steps to ensure that bias in preparation is removed as far as is possible, with Ofcom creating the right incentives to ensure output is fair with the individuals preparing the accounts having an obligation to provide balance. Without this it will not be possible for Ofcom to meet its objective of generating confidence in the RFS.

*Proposal 1b: Ofcom should review and, if necessary revise the Regulatory Accounting Principles to ensure that they provide the appropriate framework for determining the appropriate basis of preparation*

We fully agree with the proposal that Ofcom review and if necessary revise the Regulatory Accounting Principles (“RAPs”). We welcome the fact that Ofcom already has ideas about how to strengthen the RAPs, such as a requirement to take account of all relevant data, latest regulatory decisions, BT’s non-discrimination obligations and the need for an adequate degree of accuracy.

*Proposal 1c: Ofcom should identify and review the most significant allocation bases*

Whilst UKCTA can see substantial benefits in requiring an independent third party to set the basis of preparation and the actual preparation of the RFS, we do recognise that this could introduce additional issues, at least initially. For example, such a change would likely be more expensive and may lose accuracy initially due to a lack of familiarity with the current process, although such issues should be relatively short lived. Accordingly, UKCTA considers that an acceptable compromise would be for Ofcom to regularly review the principles following relevant regulatory statements. This not only overcomes the issues around cost and accuracy but also supports Ofcom’s goal of aligning more closely the RFS with Regulatory decisions. On this last point, UKCTA strongly supports Ofcom’s thinking that the RFS should reflect regulatory decisions as far as possible.

However, based on Ofcom’s previous performance in monitoring BT’s financial statements, UKCTA has some reservation over Ofcom’s ability and willingness to conduct the necessary in-depth review and further detail is required as to how Ofcom would perform such a process in order to alleviate this concern. For example, Ofcom would need to be prepared to potentially commit significant resources to this initiative in the event that a cluster of relevant regulatory decisions were published over a relatively short period of time. We would also be interested to understand whether, by “regulatory decisions”, Ofcom would also intend to conduct reviews following decisions by external bodies that may be relevant, such as judgments of the Competition Appeal Tribunal (“CAT”).

*Proposal 1d: BT should notify Ofcom in advance of proposed changes to accounting methodologies, sufficiently far in advance to allow a review of the proposals*

UKCTA welcomes this suggestion; any move towards greater transparency can only be seen as positive and will aid to a degree Ofcom’s ambition to promote confidence in the reporting



regime. As for pre-notification of changes, it makes absolute sense for BT to notify Ofcom in advance, so as to provide Ofcom the opportunity to conduct a thorough review of the proposed change, in advance of publication of the RFS. If as a result of the review Ofcom reject BT's change, such a decision would not impinge on BT's publication timetable, thus not impacting BT's ability to publish the RFS on time.

Similarly, in line with the response to proposal 1c, the success of this proposal will very much rely on Ofcom's ability to conduct a thorough review and to analyze the full impact of BT's proposed change.

*Proposal 1e: BT can illustrate the effect of areas of disagreement with Ofcom*

Ofcom's proposal to allow BT to illustrate the effects of any disagreement over the rules underpinning the accounts seems fair and sensible. Any support BT can provide to Ofcom and ultimately other users of the statements should be accepted and welcomed. However, it is imperative that Ofcom retains overall control of the rules determining the basis of preparation of the RFS.

***Question 5.2: Do you have any comments on the status and detail of the Regulatory Accounting Principles and their role in determining the appropriate basis of preparation for the RFS?***

UKCTA's overriding view is that the principles should be set by Ofcom. The key factor in ensuring the principles are fit for purpose is the level of detail that the resulting RFS provides, which to meet stakeholder's requirements needs to be at product and service level not at an overall basket level.

***Question 5.3: Do you consider our proposals to align the RFS more closely to regulatory decisions to be appropriate, effective and proportionate? Please provide explanations and evidence to support your views.***

In principle, UKCTA agrees that Ofcom's proposal to more closely align the RFS to regulatory decisions is a positive step. Whether it will be effective and/or proportionate is hard to judge at this time as Ofcom has only set out its associated proposals in broad terms. However, overall UKCTA would encourage Ofcom to continue to develop its policy position in this area

and formulate concrete proposals for how it might do this in practice. What can be stated clearly is that UKCTA fully agrees with Ofcom's statement that the RFS should follow policy and not the other way around.

As for each of Ofcom's outline proposals in this area, UKCTA offers the following comments/observations.

*Proposal 2a: Apply an overarching consistency requirement*

UKCTA fully agrees with Ofcom that a consistency requirement is paramount in any considerations to align the RFS with regulatory decisions. In the same way that industry relies on certainty and consistency in Ofcom's decision making, we are equally reliant on consistency in the way BT prepares its RFS. It is to a large degree due to the degree of uncertainty that exists as to precisely how the RFS has been prepared that has resulted in the widespread lack of confidence in the RFS.

*Proposal 2b: Specify necessary changes to align the RFS more closely to regulatory decisions*

UKCTA agrees that consistency with regulatory decisions is, on balance, more important than year on year consistency. In any event, it is not currently the case that there is fully year on year consistency anyway, so we will not necessarily be losing an element of consistency that we currently enjoy.

However, in any event, Ofcom would need to ensure that any regulatory decisions were clear, robust and material enough to warrant changes to the RFS. This is especially the case if Ofcom chose to take account of external bodies such as the CAT and Competition Commission ("CC"), where decisions might involve a degree of interpretation.

*Proposal 2c: The RFS should continue to be prepared on a CCA basis, but with reconciliation to equivalent numbers prepared on a RAV basis*

UKCTA considers that reconciliation of Current Cost Accounting ("CCA") with RAV is a sensible development as RAV offers, potentially, significant benefits in terms of accuracy. For example, and a reason why UKTA members have a preference for RAV over CCA where

possible, reporting on a RAV basis would go some way to reducing the possibility of over-recovery by BT, which has been a massive issue in recent years.

***Question 5.4: Do you agree that the basis for valuing BT's assets should be determined by BT? If not, how would you propose that the assets be valued?***

In principle, UKCTA considers it would be preferable to move to a process where BT does not have sole responsibility for determining the basis on which its assets are valued. It would add to the credibility of the financial documents if this valuation were overseen by an independent body and this would be another way to potentially increase confidence in the regime. At the very least, we suggest it would be appropriate for Ofcom to test how BT applies the RAP in practice so that the variation between valuations based on CCA and RAV are better understood. As mentioned above, UKCTA sees advantages to the adoption of a RAV approach rather than a BT's current utilization of CCA.

***Question 5.5: Do you consider our above proposals to improve transparency to be effective and proportionate? Please provide explanations and evidence to support your views***

In general increasing the accessibility of BT's accounting documents is to be welcomed and can only be beneficial. However, this should not be achieved by simplifying the reporting requirements, especially if this means a reduction in the detail provided.

The overview document referred to by Ofcom also appears to be a good suggestion but again, only as long as it is not the only publicly available document, and supports rather than replaces the detailed published accounting documents. Whilst additional high level explanatory information will undoubtedly be of use, it can in no way be a substitute for detailed statements.

UKCTA also considers that there is a need for BT to take a more engaged and pro-active stance after the RFS is published. The RFS will often raise questions that need to be answered or at least addressed if stakeholders are to gain confidence in the process. For example, it is still the case that there are significant fluctuations in DSAC and DLRIC values year on year in relatively mature markets. However, it is often difficult, if not impossible, to engage BT to explain why, especially where there are commercial disputes ongoing. It would

therefore significantly aid the sense of transparency if there were a formal process or mechanism for obtaining a response to reasonable questions that are raised following the publication of the RFS.

Overall Ofcom's approach appears to be heading in the right direction. However, it is difficult to comment in detail without seeing exactly how these proposed changes would change the current process for preparing and publishing the RFS. We would hope and expect this to be addressed in the second consultation.

We now address each of Ofcom's four outline proposals to improve transparency of the basis of preparation in turn.

*Proposal 3a: We will review the current transparency obligations to ensure that BT can publish accounting documents that are more accessible to the users and simpler to produce for BT*

We agree that Ofcom should seek to ensure that the information provided is presented in a clear accessible way – but as previously indicated by UKCTA, this should not be at the expense of detail which stakeholders rely on.

*Proposal 3b: BT to publish revised accounting documents that are more accessible to users of the financial statements*

*Proposal 3c: BT should be required to publish an additional overview document*

These two proposals are to some extent, as Ofcom recognise, complementary and therefore are considered together.

Proposal 3b appears to suggest a reduction in the level of detail that BT provides in its accounting documentation, which is something UKCTA would oppose. Proposal 3c is to require BT to publish an additional overview document which would be focused on providing guidance to stakeholders, other than the auditors, on accounting rules and cost allocation. Whilst such guidance may be helpful, it should not be provided at the expense of the detail that BT currently provides.

Overall, it is difficult to comment in further without having additional information about how these changes might impact the material currently available.

*Proposal 3d: The requirement to publish schedules showing the Attribution of Wholesale Current Cost and Mean Capital Employed should be removed*

On the face of it, this proposal does not raise any significant concerns for UKCTA members. However, further details around exactly what form the overview will take and what information it will contain are needed to ensure the loss of detail that will result from this change will not prove detrimental. Until Ofcom is able to provide more details on the content of the new documents, it remains unclear as to whether simplification of the format of the documents and a new overview document will sufficiently meet the needs of stakeholders.

***Question 5.6: Do you believe that, in relation to transparency, there is a tension between the objectives of stakeholders and the need for detailed rules to allow auditors to reach an opinion, as discussed above? If applicable, do you have suggestions for resolving this tension?***

In general there should not be significant tension between the objectives of stakeholders and the requirement for detailed rules required by auditors to reach an opinion. Although stakeholders and auditors may have differing requirements when considering the information provided by BT, they share a common objective. They both have the same ultimate goal, which is to ensure the data contained in the financial statements is fairly and accurately derived and is reliable. If auditors ensure the correct inputs are utilized, the output to stakeholders should be accurate and reliable.

As stated earlier, UKCTA does not consider that there should be any reduction in the level of detail that is provided in the RFS under any revised regime (accepting that it necessary to ensure that the accounts reflect up to date regulatory obligations and the wider framework). What is required is that the basis of preparation and presentation of the detail should be independently reviewed and improved. This should not result in any significant tension.

We consider that, as far as any such tension does exist, it can be mitigated by Ofcom's suggestion of an additional overview document which may aid stakeholders by providing additional clarity whilst retaining the level of detail that the auditors, as well as other

stakeholders, require. As Ofcom suggests, these two approaches may well complement each other. We do not consider that this would represent an undue burden on BT and, depending on the substance, may help all parties to quickly get to grips with the core points.

In summary, our strong view is that the key to transparency is an improvement in the way that the current detail is presented, rather than any reduction in the level of detail that BT provides. If Ofcom further develops its thinking on presentational changes, we would urge it to take the opportunity of a second consultation to set the details out clearly, in order that we might make more detailed comments.

***Question 5.7 – Do you consider our above proposals to ensure that the RFS provide relevant information to be effective and proportionate? Please provide explanations and evidence to support your views.***

We cautiously welcome Ofcom's proposals, however until the matter of cost orientation is clarified we are presented with an incomplete picture. It is therefore impossible to determine at this stage whether the proposals would be fully effective.

***Question 5.8 – To inform our assessment of the appropriate response to delays in the publication of the published financial statements, please explain if and how your organisation has been affected by such delays in the past.***

All delays are unfortunate and should be avoided where possible. In the past delays have arisen as a result of BT's failure to adequately resource the production of accurate regulatory accounting output, which would typically result in a shorter delay, or through BT's desire to re-present the output, usually when confronted with a dispute that may have an adverse financial outcome for them.

We accept delays can sometime occur, even when due care and adequate resourcing is made available, however lengthy delays which can be characterised more by the need to buy extra time in order to mitigate an adverse dispute outcome are the most harmful, leading to both a loss of confidence and prolonged uncertainty. We would rather the accounts are accurate than rushed and inaccurate, but with a set timetable in place BT should be able to meet the required publication date every year, rather than once or twice in a decade. There is

already a considerable time lag between the first data being included within the accounts and them being made available for scrutiny, so a publication delay should become a very rare event indeed in any new regime.

***Question 5.9 – Do you consider that there is scope to change the focus of the published financial statements? Please explain the impact this would have on the current approach to the published financial statements, including for example what information would need to be added and what requirements might no longer be necessary as a result. Please explain why you consider your proposals would allow stakeholders to monitor BT's compliance with its regulatory obligations***

As the regulatory regime evolves it is inevitable that the regulatory financial information produced evolves with it. There are clearly areas where reporting could be reduced, but also there are areas where it could be enhanced. We hope this debate will occur in the next consultation; however we identify two types of information that are suitable for review. There is summary information contained within the accounts that is duplicated from other parts of the documentation. If the accounts were provided in spread sheet form then this detail may not be necessary as stakeholders could derive their own summary information.

Secondly there is a desired to see a future reporting regime report on the right set of SMP products, both in terms of current and future demand and the workings of the regulatory regime. This may mean for example that if call termination moves to a top down pricing outcome then information on BT's cost of provision may not be needed. Equally if for example, NGN and VULA obligations are enhanced then we would expect this cost information to feature in a sensible and informed way within the accounts.

***Question 5.10 – Do you consider that our proposals regarding the level of detail to be published are effective and proportionate? Please provide explanations and evidence to support your views.***

We look forward to more detailed Ofcom proposals on this matter and wish to understand the impact that Ofcom's future stance on Cost Orientation will have on the proposed level of detail (Ofcom highlight in the consultation that much will turn on the outcome of the future Cost Orientation consultation). We fully support the principle that the information should be provided not just at a market level but at a product and service level. We also welcome

Ofcom clear intension to require disclosure of internal and external volumes. We believe sensible rules on proportionately should be followed on the issue of aggregation as BT have benefited previously from too much aggregation (indeed it is a difficulty encountered within the PPC Higher Bandwidth dispute, culminating in BT being unable when pressed to provide further granularity). We also support the ability of stakeholders to map the services listed to regulatory financial statements and would like to see greater details on how this would be achieved.

***Question 5.11 – How do you consider we should take account of the findings set out in the Deloitte report in determining the appropriate reporting requirements for BT? Please be as specific as possible.***

The Deloitte report forms part of BT's response to this review and while it is interesting to understand the approach taken by other NRAs, Ofcom's primary experience of the dynamics of the UK market and the needs of its consumers is far more informative. The common regulatory framework gives the NRA suitable discretion to enact the framework in a national context and Ofcom need to focus on the needs of UK consumers and focus efforts in resorting trust and formulating a relevant fit for purpose regulatory reporting regime designed to underpin the regulatory regime in the UK.

***Question 5.12 - Do you consider our proposals to improve the presentation of RFS to be effective and proportionate? Please provide explanations and evidence to support your views.***

We welcome Ofcom's proposals in this area, believing it would genuinely improve the usability of the accounts, providing both a better understanding of the changes to the data featured in the accounts and giving context to those changes. BT gain significantly from the current disconnect in the data which makes year on year comparatives difficult. While this proposal will not resolve all the issues that arise they will represent a significant improvement.



***Question 5.13 - Do you consider our above proposals regarding the review of the RFS to be effective and proportionate? Please provide explanations and evidence to support your views.***

As highlighted early in this submission, we believe Ofcom must do more to enhance the audit. It is insufficient to focus on raising stakeholder understand of the audit regime in its current form. Ofcom cannot preside over an outcome where audit control is so loose that future restatements are again possible. Ofcom must think again on this issue and come back with proposals that are both realistic and go some way to addressing the issues of past where restatement has occurred and the audit effectively failed stakeholders on each occasion. Ofcom also need to make more active use of the auditor's duty of care to Ofcom.

We believe Ofcom needs to have strong enforcement powers and sanctions available should BT be deemed to have fallen short in any material way. UKCTA look forward to Ofcom's proposals in this regard in the next consultation.

***Question 5.14 - Do you have any further comments or evidence to inform our assessment of other issues identified in connection with the review of the RFS including a) the arguments for and against a requirement for a BT Director to sign the RFS and b) the cause and/ or effect of errors in the RFS?***

BT needs to pay far more attention to its obligations to produce quality regulatory reporting information. BT's CFO should be required to sign off the accounts and to provide official explanations for any departures/errors that arise in their preparation. This senior level sign off is a key part of restoring trust in RFS output.

***Question 5.15 - Do you agree with Ofcom's proposed approach regarding potential improvements to BT's regulatory reporting systems?***

We welcome a more collaborative approach to systems design and have no wish to reach an outcome where BT design out future flexibility and hamper the evolution of the reporting regime. Ofcom should have a significant oversight role in the system design process, with stakeholder views sought on material issues at key points in the design process. Ultimately Ofcom need the back stop power to require BT to make changes if necessary, however BT should be encouraged to participate in stakeholder engagement (ideally facilitated by Ofcom)

on design decisions. It would be financially inefficient to close the design stages to stakeholders, only to have a redesigned forced upon BT at a later day due a failure to address a particular requirement.

***Question 5.16 – Do you have any comments on the suggested timing and implications of a transition to a new system?***

UKCTA is in no doubt that BT requires a new reporting system but there is inevitably a lot of risks associated with the introduction on any new system and the consultation does not appear to recognise these inherent risks:

- There would need to be a parallel run period (2 or 3 years) where all the glitches are eliminated
- The results WILL be different (even using the same base data – BT will introduce or rationalise the costing process) so how will these differences be handled?
- Will the implementation plan allow for industry input at key stages before BT commits to establishing a possible black box approach?

It is vital therefore that transparency is built into the system to ensure that all key stages of introducing a new system are subject to industry scrutiny (starting with the system design).

***Question 5.17 – Do you agree that there may be scope to reduce the level of published information if BT's regulatory reporting systems are improved in the way described above?***

We are not convinced the issues are necessarily linked. While improvement to systems are welcome, helping to ensure better quality and more reliable output at least in the medium to long term, it does not follow that there should be a reduction in published information. There may be scope to stop automatically publishing some details that are largely used by BT for internal purposes when preparing RFS output, however such material is not confidential and should be disclosed upon request if the need arises.

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