

BT's regulatory financial reporting

Changes to BT's 2007/08 regulatory financial statements

UKCTA Response to Ofcom Consultation

Submitted to Ofcom: 29th May 2008

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.

Introduction

The regulatory financial reports are a vital part of the current regulatory regime. They provide a first order test that BT has complied with some of their most important SMP obligations and they enable other Communications Providers to investigate areas where they have concerns. It is the detail that is important. BT retains a degree of discretion on cost apportionment and may believe that they have complied with their obligations, however Ofcom and other Communications Providers will have their own interpretation of those obligations and detailed and granular information is required for any meaningful assessment.

Despite the numerous improvements made to the regulatory financial reports over recent years, BT still retain a significant amount of discretion which allows them to apportion costs in a way that is sympathetic to their own business. It is only through Ofcom dialogue with BT and questions raised by industry stakeholders that a number of issues have come to light. UKCTA remain keen to work with both Ofcom and BT to help deliver improvements to the published regulatory information.

The proposals in this consultation are a step forward; UKCTA welcomes Ofcom's efforts to improve the content and transparency of the reports and believes these proposals will achieve that. We recognise that this is an iterative process and that further changes are required for future regulatory reports. Over the coming years the Regulatory Accounts need to adapt to properly reflect the developing Openreach business, the impact of geographic markets and the introduction of 21CN. UKCTA look forward to the opportunity to address these issues and help drive further improvements to BT's regulatory financial reporting.

Q & A

In the following section, UKCTA responds to the specific questions (1 – 11) posed in the consultation document.

Question 1: Do you agree with Ofcom's proposal that BT provides an AFI that explains the difference between the revenue reported in the regulatory financial statements compared the revenue recognised in BT's general ledger for 2007/08 for the markets covered by the replicability review?

We support Ofcom's proposal to require BT to provide additional financial information to reconcile the difference between the revenue reported in the regulatory financial statements and BT's general ledger. We think this information will be of value to all CPs and we believe that BT and Ofcom should publish this information (or an appropriately redacted summary version of it) either as part of the Current Cost Financial Statements or as a separate document.

Question 2: Do you agree with Ofcom's proposal for BT to report OSPs, resilience and third party equipment charges separately in the relevant markets within the regulatory financial statements?

Yes. It is vital that BT is required to report separately on these items. As Ofcom noted in its June 2007 report 'Replicability and the PPC Charging Model': *there are no charges for OSP, resilience or third party equipment. This appears to be a significant omission, as these charges taken together account for about 20% of external PPC revenue.* Without this information users of the accounts are not able to fully understand the differences between BT's internal and external sales, limiting the usefulness of the Current Cost Financial statements. We would welcome more information around how this information will be audited. In particular we would like to understand the linkage to BT internal charging arrangements (including what cost items BT's downstream businesses take into account when selling services).

Question 3: Do you agree that BT should calculate and disclose service revenues on the CLZ and non-CLZ based prices in the relevant market statements?

Yes. In order for BT to accurately demonstrate compliance with its cost-orientation and no undue discrimination obligations it must accurately record internal and external revenue, including taking into account CLZ pricing. In 2005/6 BT itself estimated that its failure to incorporate the value of CLZ pricing discounts resulted in an overstatement in 2005/6 of £13m for its own services. This change is required if the Current Cost Financial Statements are to provide an effective measure of compliance with BT's obligations.

Question 4: Do you agree that BT should update its Accounting Documents to transparently describe how the transfer charges and external revenues are calculated?

Yes. We welcome this improvement. As it currently stands the users of the regulatory accounts are left guessing as to how BT has derived internal and external revenue. While we accept that due to the complexity of the pricing structure that some assumptions will have to be made, the detail behind these assumptions should be transparent in order to help readers assess the fairness / appropriateness of the methodology applied. We therefore welcome a formal requirement to describe how transfer charges and external revenues are calculated.

Question 5: Do you agree with Ofcom's proposal for BT to amend their current calculation of debtor days which is used to calculate notional debtors?

Yes. We believe that it is not appropriate to continue to use 59 days as it does not reflect the actual debtor days experienced by BT. We believe Ofcom proposal to revise the figure based on the actual debtor days experienced by BT (corrected to prevent one off events like billing disputes materially distorting the calculation). We believe BT should recalculate this number every year and should there be any significant (+/- 10%) variation in the figure from one year to the next, BT should publish an explanation within the accounts.

Question 6: Do you agree with Ofcom's proposals to amend the list of Network Components?

We welcome any steps that aid user transparency, including the revision of the list of Network components to include 21CN and improve PPC and leased line components. As the consultation document points out, 21CN is such a large undertaking it is important that costs are captured accurately and the apportionment methodology should be transparent and open to scrutiny. UKCTA views this revised list as very much a first step and this should be a key area of focus going forward, particularly during the period of parallel running (when 20CN and 21CN co-exist) to ensure costs aren't double counted. The rationale for 21CN is primarily about cost savings going forward, and while implementation costs are significant, these costs should be apportioned appropriately. With 21CN we would expect underlying network costs to fall over time and Ofcom should be alert to any attempt by BT to double up on costs or create a price shock in the early years of 21CN due to high set up costs.

Question 7: Do you agree with Ofcom's proposal requiring BT to provide Ofcom with the details of the cost stack underlying the regulated PPC and technical area services?

We welcome progress in this area and Ofcom efforts in working with BT to come up with a solution going forward. We would look forward to commenting further on the

output that will be presented to UKCTA for 2007/08 and the revised component list to be used in 2008/09.

Question 8: Do you agree with Ofcom's proposal for additional disclosure of non-matched sales and costs in the RFR to assist users understanding of the underlying return for that market?

Yes. Provided sufficient data is included then this move will greatly assist users of the Current Cost Financial statements, helping them make sense of the non-matched sales and costs.

Question 9: Do you agree with Ofcom's proposal to expand the list of services reported in the ASBO market?

Yes. We believe more granular cost information is required in this area.

Question 10: Do you agree with Ofcom's proposal to expand the list of disclosed services in the AISBO market?

Currently the regulatory financial statements provide very little insight into the alternative interface symmetric broadband origination market. Ofcom are right to state that the AISBO market is become increasingly important, with many end users of traditional interface services expected to migrate some or all of their services on to alternative interface services. We therefore welcome Ofcom proposal to expand the number services currently disclosed in the published financial statements.

Question 11: Do you agree with Ofcom's conclusion that the attribution treatment of LUS costs is currently inappropriate in the context of BT's USO obligations and therefore the Accounting Documents and in turn the Regulatory Financial Statements should be amended?

Until this consultation we were unaware that BT was attributing LUS costs to the wholesale market. We agree that this type of cost has no place within any wholesale market and should be taking into account within BT Retail's costs. This type of practice demonstrates the level of discretion that BT retains in cost allocation and serves to remind all stakeholders of the importance of scrutinising the regulatory accounts. We welcome Ofcom's proposal to require BT to immediately cease this practice. We understand that this practice has not resulted in increase wholesale charges to alternative providers, however should this not prove to be the case we would expect Ofcom to require BT to refund any overcharge back to the affected CPs (who would have unknowingly contributed to this aspect of BT's costs).

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