



BT's comments on Ofcom's consultation paper:

“BT's regulatory financial reporting: changes to BT's 2007/08 regulatory financial statements”

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Comments should be addressed to:

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Summary of BT's position

BT acknowledges the significance of financial reporting to effective regulation. We continue to invest substantial resources (about £7m per year) to deliver robust financial information in a timely manner through our annual regulatory financial statements.

The structure and detail of our financial statements and supporting explanatory documentation are designed to ensure that the information available to stakeholders and Ofcom is transparent, reliable and relevant in the context of demonstrating our ongoing compliance with ex-ante SMP obligations in relevant markets.

In proposing any changes to financial reporting information supplied by BT in the 2007/08 financial statements, Ofcom must be guided by the principle of proportionality – namely, as set out in Ofcom's Better Policy Making guidelines (21 July 2005), striking an appropriate balance between, on the one hand, the perceived benefits of any proposed changes on stakeholders and competition and, on the other, the operational and financial burdens any additional requirements would place on BT.

In practical terms, this means that where Ofcom believes that changes may be required to address a perceived "gap" in the current reporting structure, it should consider, and ultimately balance, at least two key questions:

1. How does the existing level of information provided by BT fail to meet Ofcom's stated objectives of ensuring that stakeholders and Ofcom can monitor and enforce BT's compliance with relevant SMP obligations, and how does this perceived "gap" impact stakeholders and competition?
2. What are the operational and financial burdens on BT of any additional requirements, and are there less burdensome and less intrusive alternatives? For example, rather than provide additional detail within the structure of the financial statements, BT could be required to provide additional information under Ofcom's Communications Act information gathering powers where specific concerns exist. Ofcom must therefore consider the extent to which the potential impacts of "gaps" could be met by these different means. Ofcom should adopt the least intrusive and burdensome means of addressing any gaps in order to ensure regulation is kept to the minimum necessary.

This proportionality assessment should be reflected in Ofcom's Impact Assessment (Annex 5) and its analysis of the relevant legal tests for imposing regulation (Annex 7). BT does not believe it is fully reflected in either.

Nonetheless, in general BT is satisfied that most of the changes Ofcom is proposing for the 2007/08 regulatory financial statements, with the exception of those identified below, represent a reasonable balance between the burdens placed on BT and Ofcom's desire to address identified gaps and concerns with existing regulatory reporting structures. However, we would make the following points:

- We have significant concerns about the level of disaggregated reporting Ofcom is proposing for the AISBO market, which would require that BT report at a more granular level than the end-to-end services it sells to customers. On the basis of the information contained in the consultation paper, we remain unconvinced about why such disaggregation is necessary and why the present level of reporting does not provide sufficient transparency to achieve Ofcom's stated objective. As such, in proposing these changes we do not feel that Ofcom has properly addressed the issue of proportionality. Specifically, paragraphs 7.56 and 7.65 within the Legal Tests annex (Annex 7) include only general, conclusory statements about proportionality without any assessment of the factors identified above. We would welcome further dialogue with Ofcom on these proposals to understand its reasoning more fully.
- Ofcom should not seek to make any adjustments around the inclusion of Low User Scheme costs without conducting a full review of the USO "net cost" analysis, particularly around the intangible benefits.

This response sets out our views on the specific questions raised in Ofcom's consultation.

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 to the revenue recognised in BT's general ledger for 2007/08 for the markets covered by the replicability review?

We accept the need to provide greater transparency via the provision of additional financial information for 2007/08 to enable Ofcom to get a better understanding of the key reasons for the differences between revenue shown in the regulatory accounts and revenue reported in the ledgers.

As the actual differences will vary according to the specific commercial circumstances for the year in question, it is important that the format specified in Annex 26 is sufficiently flexible to enable BT to describe these differences in a way that gives Ofcom a full understanding.

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?

BT accepts that providing greater transparency by breaking out revenue in these areas may be appropriate to help allay the "replicability" concerns raised by Ofcom. It should be recognised that in accepting to provide revenues at this level of granularity, we are moving away from the standard approach of having a £10m *de minimis* limit to the reporting of individual items. For the avoidance of doubt, we still believe that in general the *de minimis* limit is appropriate and, notwithstanding the reporting of these items to address the "replicability" concerns, revenues below this level should be grouped with similar services in the appropriate market.

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?

BT accepts that splitting out these revenues to show CLZ and non-CLZ will help clarify the construction of the overall internal and external revenues and therefore more clearly demonstrate the consistency between internal and external charges to allay any "replicability" concerns.

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

BT will review and provide greater clarity in its Accounting Documentation to explain the transfer charging process and calculation of external revenues. This combined with the additional level of services disclosed for the markets in the business connectivity market review should give the reader a more comprehensive understanding of the revenue for these markets.

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?

We agree that the figure of 59 days used in the 2006/07 regulatory statements should be reviewed to reflect current market conditions. We agree that in such a review the calculation of notional debtor days used should be based on actual equivalent settlement periods experienced by BT and not just based on contractual terms for payments as these would not take into account late payments by communications providers.

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

BT agrees with the proposals to amend the list as part of the ongoing review of the network components between BT and Ofcom.

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?

BT agrees with Ofcom's proposal for addressing its specific concerns by providing additional financial information to Ofcom before discussing with UKCTA. The review of components to be used in 2008/09 can then be based on these discussions and take full account of the final decisions in the business connectivity market review.

Section 5: Improving disclosure in the regulatory financial statements for 2007/08

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?

BT agrees that this proposal will provide a greater understanding of where the impact of non-matched sales and costs are deemed significant to the particular market.

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

and

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

For both ASBO and AISBO markets, Ofcom proposes that BT should increase the detail of services reported, as set out in modified Direction 4. For AISBO markets specifically, Ofcom states that the current level of reporting has "made it difficult for stakeholders to assess if BT has met its non-discrimination and cost orientation obligations".

BT accepts that greater granularity of services within the ASBO and AISBO markets may be appropriate subject to the relevant revenues and costs exceeding the materiality threshold of £10m. Revenues beneath this threshold would be shown as "other" with appropriate explanatory notes in the regulatory financial statements.

However, in the AISBO market, Ofcom also proposes amendments to Annex 11 to Direction 4 which include separate disclosure of “main link” revenues and costs. This moves beyond the level of the end-to-end service actually sold to communications providers to look at revenues and costs for constituent charging elements within a service. The “main links” are not sold separately and so the relevance of disaggregating to this level is unclear. The perceived “gap” created by the current level of reporting (i.e. at the end-to-end service level), the impact this “gap” has on stakeholders and competition, and the impact the increased level of reporting will have on BT and whether there are less burdensome and less intrusive alternatives are not clearly articulated in Ofcom’s consultation paper.

We would also point out that where Ofcom has specific concerns in relation to the structure of a price for a particular end-to-end service in relation to, say, the balance between fixed and distance-related charges, Ofcom can – and, in the past, has – use its information gathering powers under the Communications Act to request specific information from BT in a more focussed way.

BT therefore remains unconvinced that the proposed level of disaggregation for AISBOs is justified and consistent with Ofcom’s legal requirements in relation to, among other things, proportionality. We would welcome further dialogue with Ofcom to understand its reasoning and specific concerns and explore how these could best be addressed to minimise regulatory reporting burdens.

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?

We do not agree with Ofcom’s view that our universal service obligations place no undue burden on us. We have recently made submissions to Ofcom arguing that the “net cost” calculation should be revisited, in particular to reassess the intangible benefits calculation under which the USO was claimed to be of value to BT in terms of brand enhancement and reputational issues. Our arguments included customer research analysis which we believe showed that customers did not attach significance to BT’s position as the universal service provider in the UK.

Our view, therefore, is that BT does incur net costs in providing the light user scheme and meeting our other USD obligations and that, therefore, such costs need to be recovered. In these circumstances, any decision by Ofcom to remove LUS costs from the cost stacks for wholesale SMP markets as required by the proposed Directions should only be taken alongside a more complete review of the level of those net costs and how they should be

recovered. Ofcom has not yet committed to such a review and we would urge them to do so at the earliest opportunity.