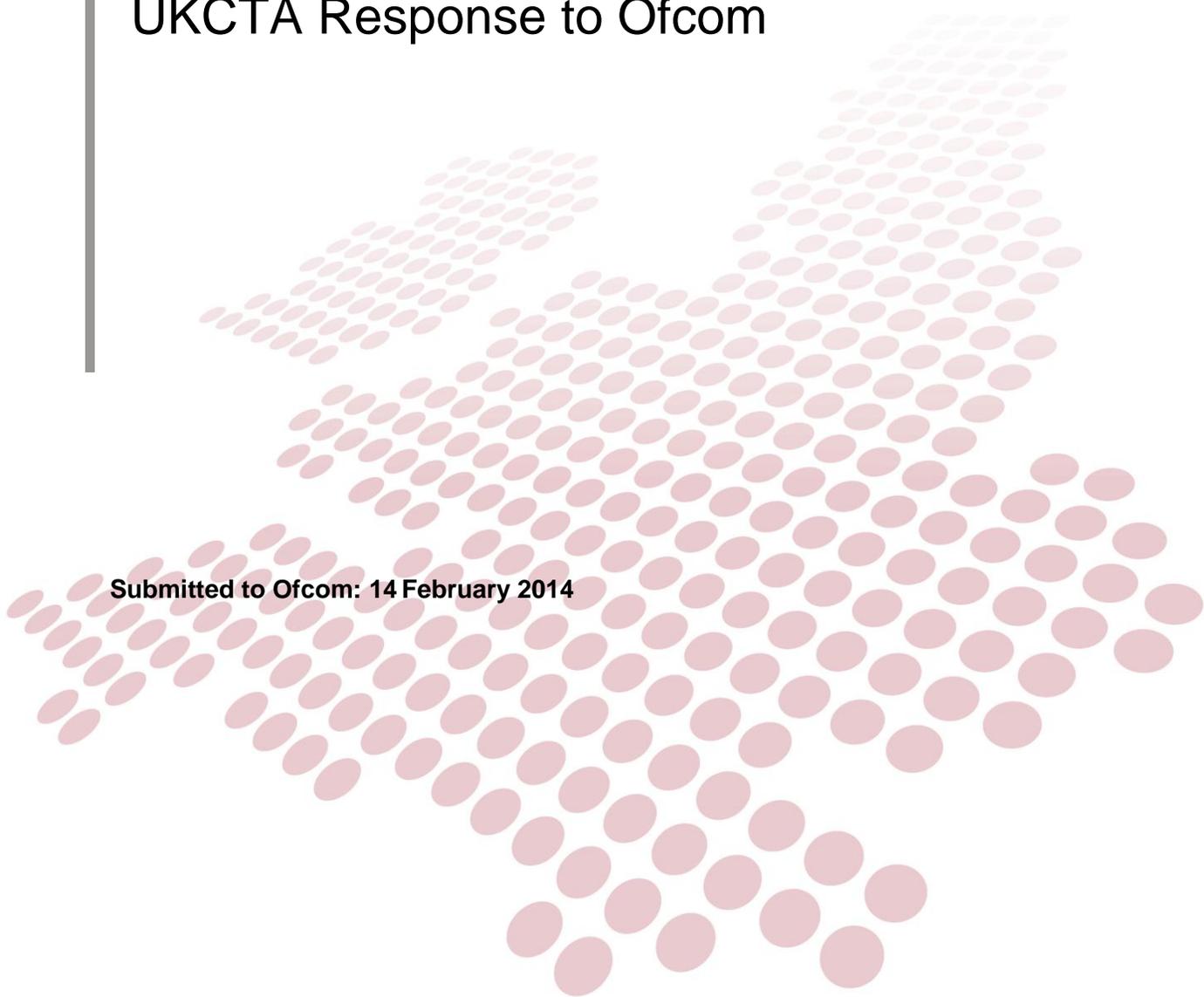


Regulatory financial reporting:
a review

UKCTA Response to Ofcom

Submitted to Ofcom: 14 February 2014



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. 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. Details of membership of UKCTA can be found at www.ukcta.com.

1. UKCTA has been a long term campaigner 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 effectively to remedy instances of market failure and combat market power. Reliable, unbiased Regulatory accounting output isn't just a nice to have; it is an essential source of information for Ofcom, industry and indeed BT. In recent years' stakeholders have had to adapt as the Regulatory Financial Statements have become less relevant, reflecting BT's commercial perspective rather than the unbiased and trusted output that they were envisaged as being. With so many regulatory adjustments required to correct for this bias, it is no wonder that industry confidence in the accounts has hit at an all-time low.

2. We have become all too familiar with BT's desire to restate prior year numbers when faced with an overcharging claim, and with BT's attempts to inflate its regulatory asset base to recoup even more revenue in future years. The most recent regulatory accounting output proved to be no exception with the 2012/13 RFS providing yet another opportunity for BT to produce numbers that blatantly sought to enhance its commercial advantage. In doing so these most recent accounts provide a very clear illustration of all that is wrong with the current system, with BT able:
 - To make attribution decisions based on gaming the market review timeline in an attempt to over-recover costs in multiple markets;
 - Include inappropriate cost categories such as those for the Career Transition Centre (a unique and expensive discretionary activity) and Health & Safety claims within the cost base of regulated charges;

3. If accepted, the net result of these changes would be some stakeholders having to pay many millions in additional costs every year for bottleneck services and in all likelihood these additional costs would be passed on in full or in part to consumers, with the extra revenue raised by BT enhancing their profitability in SMP markets.
4. While we commend Ofcom's swift decision to strike out some of the most blatant attempts by BT to enhance profitability in SMP markets through its manipulation of the regulatory accounts, the fact is that this annual cat and mouse game should never have been allowed to become an annual fixture of the regulatory landscape in our industry.
5. We aren't suggesting that BT has broken any rules, its accounts are signed off by the appointed auditor. In fact BT has a strong commercial incentive to act in this way and with so much profitability at stake, why wouldn't any rational business behave like this? Over the years Ofcom have been powerless to prevent this damaging cycle, seeking instead to correct the more outrageous aspects of it through a series of adjustments that in themselves harm transparency and increase the likelihood of errors occurring in charge setting.
6. Indeed, with the accounts themselves so far removed from reality, the very function of them has been compromised, with active compliance assurance badly impaired. It is from this low point that we must seek to rebuild trust and confidence in the regime. Significant Change is needed and quickly. 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.
7. It is from this perspective that we welcome Ofcom's proposals for a significantly 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 and confidence can be restored. Indeed stakeholders have been instrumental in improving consumer outcomes by relentlessly challenging the very worst aspects of the current regime. Ofcom should

do everything it can to harness the input of stakeholders, consulting with them on material issues in relation to the accounts. 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.

8. There is a clear discrepancy between Ofcom's forecasted charge control outcomes and reality, with considerable evidence to suggest that BT has enjoyed excess profits from past charge control decisions and it is appropriate to examine ways to maintain the incentive effects on BT while ensuring no excessive recovery. The regulatory accounts have an important role to play in ensuring that all stakeholders have a clear picture of BT's regulated profitability by market and in aggregate, without the need for significant adjustments. We believe Ofcom must include improved profitability analysis within the new Regulatory Reporting output to assist stakeholders' ability to critique price control remedies.

9. In order to improve the efficiency of the regulated cost base, Ofcom must take steps to ensure that discretionary costs such as BT's supplementary labour costs are made transparent within the regulatory accounts. BT labour practices are a matter for BT, but consumers must not be left to fund discretionary practices that add significantly to BT's labour costs. Ofcom have failed to eradicate BT's ability to pass through some of these costs in regulated charges and BT's 12/13 RFS output demonstrates that BT is understandably keen to include items like the Career Transition Centre costs within the cost base for regulated charges. Where such charges have been included within a cost stack, that should be made transparent in order to ensure that informed decisions can be made over the appropriateness of what should or shouldn't be included with regulated charges.

10. Some thought is required regarding creating opportunities for stakeholders to engage and seek answers on RFS issues that arise from the published accounts. Stakeholders should be able to legitimately ask questions and expect answers within a reasonable timeframe. There is currently no active engagement forum for industry, and UKCTA believe the absence of such a proposal is a significant flaw in the plans for a new regulatory accounting regime. Active litigation has effectively ended any direct BT and stakeholder engagement and we think Ofcom need to facilitate a forum to enable questions to get answered. This may help reduce the need for such

litigation, an outcome which would be to the benefit of all concerned. It would be unacceptable if the new regime continued to allow BT to ignore difficult questions which it finds it commercially uncomfortable to answer.

11. While Ofcom's proposed enhanced role in decision making will go some way to improving assurance and confidence in the output, we have questions around the proposals for the audit. We would like to gain a better understanding of what Audit level will apply to each area of the accounts, including what areas are to be signed off at the PPIA level (properly prepared in accordance with) and what areas are to be signed off at the higher standard of FPIA (Fairly Presented in accordance with).

12. In conclusion, 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 itself has highlighted.

- END -