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Verizon Enterprise Solutions response to Ofcom's Regulatory Financial Reporting Review

1. Verizon Enterprise Solutions ("Verizon") welcomes the opportunity to respond to Ofcom's Regulatory Financial Reporting review.
2. Verizon is the global IT solutions partner to business and government. As part of Verizon Communications – a company with nearly \$108 billion in annual revenue – Verizon serves 98 per cent of the Fortune 500. Verizon caters to large and medium business and government agencies and is connecting systems, machines, ideas and people around the world for altogether better outcomes.
3. Verizon's approach to responding to this consultation has been to provide a summary of our position in relation to the general issues surrounding Regulatory Financial Reporting and then moving on to address the specific questions raised by Ofcom in the review document.
4. Please note the views expressed in this response are specific to the UK market environment and regulatory regime and should not be taken as expressing Verizon's views in other jurisdictions where the regulatory and market environments could differ from that in the UK.

Summary

5. In general, Verizon considers that Ofcom has prepared a set of positive and constructive measures to improve the current regulatory reporting processes. It is clear that Ofcom has thought carefully about how the current situation can be improved, both for itself and the industry (and indeed BT). If implemented in a practical way, and monitored effectively, they should help to boost much-needed confidence across the industry in the robustness and integrity of the Regulatory Financial Statements ("RFS"). They should also help to make the RFS more user friendly, and enable stakeholders to see more clearly how costs / prices map to regulatory remedies (in particular, charge controls).
6. In particular, we welcome Ofcom's intention to take ownership of the Regulatory Accounting Principles and reviewing BT's Primary Accounting Documents. Such changes will address stakeholder concerns over the level of control that BT currently has over the basis of preparation of the financial statements, as well as improving the degree of transparency relating to any material changes BT may implement concerning allocation methodologies. As a result Verizon broadly welcomes the proposals and looks forward to their implementation.
7. At the same time, however, we would sound a note of caution. While the aspirations are clearly positive – the key test will be whether stakeholders see a tangible benefit once the principles and guidelines filter down to changes at the working level. We are concerned by the idea that Ofcom considers industry only needs "reasonable confidence" that BT is compliant with its obligations from investigating the RFS, and we do not want to see



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precious detail lost from reporting. We also consider that Ofcom needs to be prepared to follow up on issues or inconsistencies that are raised by the reporting or accompanying audit reports. Further detail on these points follows below.

8. The remainder of this response addresses the specific questions posed by Ofcom in the review document. Verizon only offers a response to those questions which have relevance for our business.

Regulatory Financial Reporting Review – Ofcom questions

Quality

Question 3.1 Do you agree that we have identified the purpose of both wider Regulatory Financial Reporting and the Published Regulatory Financial Statements in particular?

9. We agree with Ofcom's view set out at paragraph 3.30 that core attributes of regulatory reporting are relevance, reliability, transparency and proportionality. These are relatively obvious principles that would tend to be associated with financial reporting. The important issue for stakeholders will be how these principles are interpreted and implemented to ensure the reporting is meaningful and delivers value. It is also very important that Ofcom is willing and able to enforce the application of these principles, and it must be adequately resourced to ensure this is the case both now and in future.
10. Ofcom expresses the view at paragraph 3.21 that *"we do not consider that the Published Regulatory Financial Statements can or should provide stakeholders with all the information necessary for them to determine whether an SMP provider has complied with its obligations. It is for BT to demonstrate its compliance to us."* Ofcom goes on to assert in the following paragraph that *"the level of information to be published should be appropriate to provide **reasonable confidence** to stakeholders that an SMP provider is complying with its regulatory obligations."* [emphasis added].
11. ✂. Furthermore, given Ofcom's failure to monitor BT's compliance with its cost orientation obligations in the past (as demonstrated by the PPC and Ethernet disputes/appeals) stakeholders will hold justifiable reservations about Ofcom's ability and appetite to perform such monitoring in the future. Current proposals are hardly likely to deliver the stakeholder confidence in BT's RFS that Ofcom is seeking.
12. If nothing else, it is a matter of logic that allowing the industry access to all the information necessary for them to determine whether BT has complied with its obligations means that it is more likely that inaccuracies or flaws will be uncovered, which is surely what Ofcom would want. There are many examples of (successful) disputes that have been brought to Ofcom which are underpinned by detailed analysis of BT's regulatory reporting. It seems baffling that Ofcom would want to restrict this reporting, especially if BT has to produce it in any event for Ofcom's review. We cannot see how stakeholders can have "reasonable confidence" of BT's compliance without seeing the full range of available information at first hand.



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13. Indeed Verizon does not understand what Ofcom means by giving stakeholders “reasonable confidence” that BT is compliant, as it suggests at paragraph 3.39. Surely Ofcom should be striving to promote an environment where stakeholders have full confidence, or as close to full as possible. In this respect we would expect Ofcom to have regard to the historical context, where stakeholders have come to Ofcom with concerns over BT’s compliance based on its regulatory reporting, which were upheld. This means that stakeholders have every right to harbour deep concerns over BT’s compliance, and it is surely right that they deserve the ability to fully scrutinise its reporting at least for the foreseeable future.
14. It does not follow, as the consultation seems to imply, that just because BT must demonstrate compliance to Ofcom, other stakeholders should be precluded from the information necessary to reach an equally informed view on compliance. We are also concerned that such an approach places the full burden of scrutiny of BT’s full set of information onto Ofcom. Rightly or wrongly, the perception given by Ofcom is that it is not adequately resourced to scrutinise every aspect of BT’s regulatory reporting. ✕.
15. We fully agree with Ofcom’s view at paragraph 3.70 that “*the Regulatory Financial Statements should be prepared on a basis that is, as far as possible, consistent with [its] regulatory decisions.*” This works to the benefit of all concerned, and should not be controversial.
16. We also agree that requiring publication within four months of the year end remains appropriate. However, we urge Ofcom to be more pro-active in the enforcement of this deadline because in recent years BT has gone far beyond this deadline on several occasions – yet has faced no sanctions. Although Ofcom suggests at paragraph 3.72 that CPs did not provide details of the impact of delays on them, it should not take this as a signal to allow BT to decide which deadlines it meets and which it does not. If BT resources this requirement adequately, there is absolutely no reason why it cannot meet this obligation and Ofcom should take steps to ensure that it does so.
17. We agree with Ofcom’s views on clarity and basis of preparation of the reporting and that the primary audience is the informed regulatory community across industry rather than a wider audience.

Question 3.2 Are there any other questions or issues that either wider Regulatory Financial Reporting or Published Regulatory Financial Statements should seek to address?

18. Verizon considers that Ofcom’s perceived scope for the questions and issues that the reporting / RFS should seek to address is broadly appropriate.
19. However one area of concern which is not addressed directly is the reliability of DSAC data published by BT. Ofcom notes at paragraph 4.49 that the costs shown in the RFSs do not necessarily align with Ofcom’s view of the costs and there is a risk that stakeholders will not understand or may misinterpret the reported cost data. This fact is very apparent when reviewing the DSAC trends in certain markets over a period of years. Even in mature and stable markets, DSAC values for certain products remain volatile and



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unpredictable. The fact that the cost standard is unaudited means that BT has the ability to apportion common costs free of regulatory oversight, and is incentivised to maximise its opportunities to create competitive distortions in its favour.

20. There is evidence that the DSAC/price ratio has been increasing in established markets and this is largely due to increases in the DSAC because the average price has remained relatively constant. The volatility of DSAC suggests that the cost of product components cannot be measured accurately or that each year BT is changing the proportion of common costs allocated to each service. The DSAC cost standard has historically been an important element of Ofcom's test for compliance with cost orientation obligations. Where BT publishes DSAC figures, Ofcom should require BT to audit them, as is the case with its FAC figures.

Question 4.1 Do you agree with our assessment about how well current reporting meets the objectives that we set out in Section 3?

21. As an initial observation, Verizon would align itself with the view of TalkTalk as set down in paragraph 4.5 that *"we are not in the position yet where CPs can have confidence that Ofcom will check compliance and therefore CPs need to be provided the data so that they can check compliance themselves."*
22. For that reason we would disagree with Ofcom's assertion in paragraph 4.6 that allowing stakeholders to check the analysis for themselves should not be a primary factor in determining whether all relevant information is published. ✗. Indeed Ofcom appears to recognise this at paragraph 4.23 where it states *"[s]takeholders play an important role in helping us reach a view about compliance and we also recognise the importance of providing CPs with enough information to enable them to bring disputes when necessary."*
23. In relation to cost orientation, Ofcom states at paragraph 4.25 that *"the appropriate reporting requirements should be determined as and when the remedy is imposed, subject to our normal consultation processes [..]"* It is clearly very important that if cost orientation is imposed in any given market, the relevant reporting requirements to demonstrate compliance are also in place simultaneously. Therefore Ofcom should ensure that BT is in a position to report on the relevant cost standard as soon as any new obligation comes into effect – and not at some point in the future. ✗.
24. In relation to non-discrimination, we agree with Ofcom's view that products that BT is required to provide on an equivalence of inputs ("EOI") basis should be set out on a disaggregated basis in the RFS. We therefore support Ofcom's proposals to require BT to do this.
25. We agree with Ofcom's view at paragraph 4.46 that BT needs to fully explain changes to its cost methodologies, especially in light of the lack of relative consistency over time. The 2012/13 Reconciliation Report published by BT on 4 October 2013 left a lot of questions unanswered, and it is disappointing that Ofcom appears to have simply accepted it rather than following up with BT on the gaps and inconsistencies.



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26. In terms of the scope of published information, ✂. We broadly agree with Ofcom's contention at paragraph 4.125 that the information that is currently published in RFS is at the right level in terms of volume and detail; ✂.

Question 4.2 Where you disagree or consider that there are gaps that we have not identified please set these out together with evidence.

27. Ofcom appears to have identified the key areas in its Table 1, subject to the comments above.

Question 5.1 Taking each of our proposals in turn do you consider that they are proportionate and well balanced? Please provide evidence to justify your views.

28. Verizon agrees with Ofcom's intention, described at paragraph 5.10, to make clear that the ownership of the Regulatory Accounting Principles ("RAPs") lies with Ofcom. We hope that in doing so, Ofcom will set a sound framework for regulatory reporting going forward and ensure that consistency and quality are maintained.

29. Verizon also agrees that Ofcom has identified the appropriate RAPs in Figure 1, and that they appear to be in the correct order in terms of priority and weight that should be attributed to them. We also support Ofcom's intention to issue guidance on the new "Consistency with regulatory decisions" principle, which can and will be amended in line with the latest regulatory decisions. This is a principle which, although highly welcome, will need explaining in some detail in order that both BT and industry have clear expectations in terms of practical application.

30. Although Ofcom at paragraph 5.70 asserts that it does not intend to propose specific requirements relating to the way BT should value its assets (providing that it complies with the RAPs and Regulatory Accounting Guidelines), ✂.

31. Verizon fully agrees with Ofcom's proposal at paragraph 5.75 that BT must notify it about all proposed material changes in the way it intends to prepare its RFS by 30 November for the RFS to be published in the following July. This is an entirely sensible and reasonable proposal which BT does not appear to contest.

32. It is also a welcome proposal that BT must produce an annual reconciliation report with an assurance report from the regulatory auditors. However, as noted above, the 2012/13 Reconciliation Report produced by BT left a lot of questions unanswered and it is not sufficient to simply publish the report and move on. Where issues are raised, either by the auditors or other stakeholders, they must be fully investigated. If not, the report will carry little meaningful value.

33. Verizon also agrees with the proposed process for BT to notify material errors, as this will serve to increase transparency not just to Ofcom but also to stakeholders given the proposal to require BT to publish the relevant information on its website. Again we would hope and expect that Ofcom will follow up such errors in order that they are fully



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addressed in the most appropriate way and in particular to reduce the likelihood of such errors re-occurring.

Question 5.2 Are there any additional proposals for change that you believe should be taken forward by us? Please provide evidence to justify any additional proposals.

34. Verizon considers that Ofcom's proposals taken as a whole constitute a constructive and reasonable set of measures which should help to increase confidence in the integrity of the RFS and regulatory reporting more broadly. They appear to cover the main flaws in the current regulatory reporting process and we do not have any additional proposals.

Question 6.1. Taking each of our proposals in turn do you consider that they are proportionate and well balanced? Please provide evidence to justify your views.

35. Verizon does not wish to see any material reduction in the level of detail that is currently contained in the RFS. The information currently published is highly useful to understand BT's costs, forecast future trends in the various markets and make a high level assessment of BT's compliance with its SMP obligations. While the information provided should of course be as user friendly as possible, ✂.

36. In relation to Ofcom's comment at paragraph 6.11 that it is keen to receive views on if and how stakeholders can be given a better understanding of BT's financial performance from a regulatory perspective: ✂.

37. Ofcom's proposal at paragraph 6.12 to require transparent reporting of EOI costs is sensible and to be welcomed. As Ofcom alludes to in paragraph 6.13, this should help towards more consistency in BT's reporting and make the RFS more user friendly and intuitive.

38. It is pleasing to see that Ofcom recognises the importance of an auditor's report to sit alongside the proposed reconciliation report produced by BT, as again described at paragraph 6.19. This will provide a greater degree of confidence in the RFS as and when changes are introduced.

39. Ofcom's proposal at paragraph 6.22 for BT to publish a non-confidential version of its Compliance Statement is also to be welcomed. The type of data that such a statement would contain also appears to be the sort of useful information that would help stakeholders form a better picture of BT's overall compliance. It is interesting to note Ofcom's view that *"[a]lthough this will result in an increase in published information it imposes minimal burdens. The information that we will require to be published is already produced and provided to us confidentially."* ✂.

40. It is not fully clear what the full implications are of Ofcom's proposal, summarised at paragraph 6.32, to revise the requirements of the Transparency Direction. However, it appears that this may result in substantially less information being provided by BT on its allocation rules, especially given that Ofcom appears to expect simply a "summary narrative". While we fully agree that there is no value in providing information for



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information's sake, it is important that BT does not have the green light to simply gloss over material elements of its reporting owing to these proposed changes.

Question 6.2. Are there any additional proposals for change that you believe should be taken forward by Ofcom? Please provide evidence to justify any additional proposals.

41. Ofcom makes reference to the concept of scenario reporting at paragraph 6.62 et seq, and makes clear that this type of modelling is likely to become increasingly important as Ofcom plays a more active role in overseeing BT's reporting. However it does not set out any concrete proposals for BT to work towards being in a position to provide scenario reporting. This appears to be a missed opportunity, as this comprehensive consultation is the natural place to at least suggest preparatory measures in this respect. Having said that, this is perhaps something that will be addressed, at least in part, by BT's proposal to develop a new regulatory accounting system as described in section 8. We would hope that BT and/or Ofcom would be able to update the rest of the industry as this initiative develops.

Question 6.3. Do you agree that BT should produce a more accessible easier to understand Detailed Attribution Methodology Document? Do you agree that it should no longer include the internal description of sector allocations contained in the embedded pages of spreadsheets but instead should provide easier to follow explanations of how input costs are allocated to products and services? What type of information do you think is essential to be included in the new Detailed Attribution Methodology Document?

42. Verizon agrees that the current Detailed Attribution Methodology (DAM) document is an extremely complex and difficult document to understand. Accordingly, any proposals to make the DAM more user-friendly and accessible are to be welcomed.
43. To this end, Verizon agrees that the internal description of sector allocations contained in the embedded pages of spreadsheets should no longer be presented in the DAM, as the information only acts as a barrier to trying to understand the process of cost allocation across markets that BT has applied. As such we would agree that an emphasis on greater descriptive clarity of how the allocation system works and about how costs are allocated to markets would be highly beneficial and may go a long way to dispelling the distrust with which the current DAM is viewed by CPs.
44. However, the DAM, by its very nature, addresses complex allocative process issues across a wide range of matters (FAC of network components, SMP markets etc.) and should not be simplified to such an extent that it is no longer able to fulfil its purpose of providing details of BT's cost allocation methodology/systems. So whilst Verizon would agree that the information which is primarily included for internal BT purposes should be removed, we have some concerns over the degree of simplification Ofcom is proposing.
45. Verizon agrees with Ofcom's high level intentions as far as focusing the DAM on providing an understanding about how the allocation system works and how costs are allocated to markets. However, the use of words such as "high level" in relation to the first aspiration and "broad questions" in relation to the second raise significant concerns that



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the document will become too high level and not provide all of the data necessary in order to achieve Ofcom's main goal of providing stakeholders with reasonable confidence that an SMP provider is complying with its regulatory obligations.

46. ✂.

47. Furthermore, we note that Ofcom states that there will still be a requirement for BT to provide the information it is proposing to remove from the DAM to Ofcom, in order for Ofcom to understand how BT's attribution methodology works in detail¹. ✂.

Question 7.1. Taking each of our proposals in turn do you consider that they are proportionate and well balanced? Please provide evidence to justify your views.

48. Ofcom states that it does not propose significant changes to the current audit arrangements and Verizon would agree that it is probably not necessary to do so at this time. The lack of trust stakeholders have in relation to Regulatory Financial Reporting has less to do with the audit regime than the lack of control applied to the basis of preparation of the statements.

49. As for the proposals themselves, Verizon agrees that BT's regulatory auditors should report to Ofcom as to whether or not BT has notified all material methodological changes it has made. Similarly, Verizon agrees with Ofcom's proposal to require BT's regulatory auditors must report whether BT has included and correctly calculated the impacts of all changed methodologies and errors notified through the change control and error notification process.

50. The above requirements are reasonable and justifiable and cannot be considered to be overly onerous or disproportionate. Furthermore, given the resistance BT showed in providing such explanations when changing its accounting methodologies in the preparation of the 2012/13 RFS, it is clearly appropriate to include such requirements in formal obligations.

51. In line with Ofcom's instruction to BT to publish its explanatory note of the changes made in the preparation of the 2012/13 RFS, it is hoped and indeed expected that the above information will also be made available to all stakeholders.

52. As for BT's proposed change of accounting system, it is clearly appropriate that BT's regulatory auditors report on whether or not the results of the ASPIRE and new regulatory accounting system have been properly extracted and that the explanations for any differences are comprehensive and robust. The ability to check consistency from year to year is vital in order to retain regulatory certainty and transparency.

53. As for Ofcom's proposals in relation to controls, i.e. that a Director must sign-off the regulatory accounts for and on behalf of BT's Board of Directors and that BT must arrange and pay for third party assurance in relation to ad hoc assignments as required

¹ Ofcom Regulatory Financial Reporting: A Review - Paragraph 6.38



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by Ofcom, such measures appear reasonable but are secondary in importance to the audit report matters referred to above.

Question 7.2. Are there any additional proposals for change that you believe should be taken forward by Ofcom? Please provide evidence to justify any additional proposals.

54. In relation to the proposals relating to the audit and review, Verizon does not have any further specific proposals to present. Indeed, trying to make too many changes at this time, when BT is changing to a new accounting system, could present problems and introduce difficulties in accessing the effectiveness of the changes Ofcom has proposed and highlighting precisely where additional changes may need to be made.
55. However, it is vital that Ofcom ensures the changes it has proposed, as set out at question 7.1, are implemented and all the necessary assurances are provided by the auditors in the manner prescribed.

Question 8.1 Taking each of our proposals in turn do you consider that they are proportionate and well balanced? Please provide evidence to justify your views.

56. Overall, Verizon does agree that Ofcom's proposals are proportionate and well balanced; the proposals recognise, correctly, that when introducing a new regulatory accounting system the financial results produced may vary to some degree.
57. However, Ofcom has set appropriate boundaries for any such variations and has also set in place requirements for all such variations to be explained, all of which are considered to be proportionate. Verizon strongly agrees with Ofcom that a materiality level of 1% is appropriate given that the new regulatory accounting system should not lead to significantly different results to ASPIRE.
58. Verizon agrees with Ofcom's safeguard proposal that where the systems reconciliation report identifies results from the new regulatory accounting system that are significantly different from the old regulatory accounting system, then BT should provide a further assurance statement and prepare the RFS on a basis consistent with the old regulatory accounting system. This is very important in order to protect against any unexpected cost increases purely resulting from the introduction of a replacement regulatory accounting system.

Question 8.2 Are there any additional proposals for change that you believe should be taken forward by Ofcom? Please provide evidence to justify any additional proposals.

59. As long as Ofcom ensures that any inconsistencies between the financial data produced by ASPIRE and the new regulatory accounting system are fully explained and the reasons understood and communicated to all stakeholders, then Verizon considers Ofcom's proposals to be sufficient in terms of addressing the transition to a new regulatory accounting system.



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Question 9.1 Do you agree that our proposed timeline provides a suitable basis for the implementation of changes?

60. Verizon understands that the changes being proposed under this review are considerable and will require time to implement in a controlled and measured fashion. Accordingly, we fully support Ofcom's proposals in relation to the 2013/14 and 2014/15 periods. We also agree that if everything progresses as planned, a reconciliation report will not be required for the 2015/16 reporting period.
61. However, the reasons why the task identified for completion in 2016/17, namely BT to complete the updating of its Accounting Methodology Documents in line with Ofcom's Regulatory Accounting Principles and Regulatory Accounting Guidelines, cannot be completed earlier are not adequately explained.
62. This would be our only concern with the proposed timeline.

Question 9.2. If you don't consider our proposed approach and timeline is appropriate please provide reasons why and proposals for a different approach?

63. Verizon's only concern with Ofcom's proposed timeline is in relation to the overall completion date of the task, i.e. 2016/17. With BT's new regulatory accounting system being used to prepare the RFS in 2014/15 and Ofcom consulting on the Regulatory Accounting Guidelines throughout the period in question, it is hard to see why the guidelines cannot be in place within the 2015/16 period and as a result the total project completed by end March 2016.
64. Our concern is not so much that the delay is necessarily detrimental but more that if such a time period is necessary, the reasons for such delay are not clear and therefore there may be something of significance that has not been brought out in this review and which may be worthy of wider stakeholder scrutiny.

Verizon Enterprise Solutions
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