



# Regulatory Financial Reporting

A review

Consultation

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# Contents

Section		Page
1	Summary	1
2	Introduction	4
3	The purpose of Regulatory Financial Reporting	11
4	How well does current reporting meet these objectives?	29
5	Basis of Preparation	52
6	Reports	75
7	Audit and Review	87
8	Transition to a new regulatory accounting system	93
9	Implementing the new framework	101
10	Simplification of conditions	105
<b>Annex</b>		<b>Page</b>
1	Responding to this consultation	107
2	Ofcom's consultation principles	109
3	Consultation response cover sheet	110
4	Consultation questions	112
5	Glossary	114
6	Proposals for SMP Conditions	117
7	Proposal for direction – Regulatory Accounting Principles	137
8	Proposal for direction – Transparency	141
9	Proposal for modification to Direction 3 and the FA10 Preparation, audit and delivery Direction (BT)	144
10	Proposal for modification to Direction 4 and the FA10 Form and content Direction (BT)	148
11	Proposal for direction – Form of the FPIA opinion for Regulatory Financial Statements	153
12	Proposal for direction – Form of the PPIA opinion for Regulatory Financial Statements	156
13	Template for change control	159
14	Template for error notification	160

## Section 1

# Summary

## The case for change

- 1.1 In September 2012, we set out the case for making changes to the current framework for BT's Regulatory Financial Reporting. We explained that since the framework was first implemented in 2004, the use of financial data has evolved.<sup>1</sup>
- 1.2 We also explained that stakeholders' confidence in Regulatory Financial Statements has gradually been eroded, that BT considers that it is required to publish unnecessary levels of detail, and that we frequently have to make material adjustments to reported information in order to make regulatory decisions.
- 1.3 Responses to our consultation published in September 2012 ('the 2012 Consultation') confirmed the need for change. Respondents agreed that Regulatory Financial Reporting needs to change, although the nature of their concerns inevitably differ.
- 1.4 BT explained its concerns about the amount of information that it is required to report and what it considers to be the unrealistic demands placed on its reporting systems. It has particular concerns about what it sees as the confidential nature of some of the detailed information that it is required to publish. For other stakeholders, the current framework gives BT too much control over the way that Regulatory Financial Statements are prepared.
- 1.5 Informed by these responses, in this consultation, we set out our views on the purpose and attributes of effective Regulatory Financial Reporting. We then assess how the current framework measures up against these attributes before making proposals to address any gaps that we have found. We present a timeline for changes to the Regulatory Financial Statements and a draft of the legal instruments that are required to implement the changes.

## What is Regulatory Financial Reporting for?

- 1.6 In simple terms, we consider that Regulatory Financial Reporting requirements should provide us with the information necessary to make informed regulatory decisions, monitor compliance with SMP conditions, ensure that those SMP conditions continue to address the underlying competition issues and investigate potential breaches of SMP conditions and anti-competitive practices.
- 1.7 We also consider that publishing regulatory financial information supports stakeholders' contribution to an informed regulatory framework, as stakeholders (who may have a better understanding of the relevant activities and costs than us) can review and comment on the information that might otherwise only be seen by us. Publishing regulatory financial information should provide reasonable confidence to stakeholders that the SMP provider has complied with its SMP conditions and by doing so adds credibility to the Regulatory Financial Reporting regime.

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<sup>1</sup> Regulatory financial reporting: a review. Consultation. 6 September 2012.  
<http://stakeholders.ofcom.org.uk/consultations/regulatory-financial-reporting/summary>

- 1.8 To meet these objectives, the regulatory financial information needs to answer the relevant questions. We set out what we consider to be the relevant questions in Section 3. The information must also be reliable and prepared in accordance with suitable rules that are understood by the users of that information. However, the reporting requirements should be proportionate to the benefits of obtaining the information and the publication requirements should be proportionate to the benefits of publication. They must be balanced against the costs of producing and disclosing the information.

## **How well does regulatory financial reporting work?**

- 1.9 In some areas, Regulatory Financial Reporting already works well. We consider that many of the questions that should be answered by effective Regulatory Financial Reporting are adequately addressed. We have also seen some recent improvements to the way data is provided, including for example the provision of the financial data to stakeholders in spreadsheet format.
- 1.10 However, these changes have not improved stakeholders' confidence in the way the financial information is prepared. Specifically, the current Regulatory Financial Reporting requirements give BT significant scope to determine how its financial statements are prepared, and, for example, has enabled BT to make significant changes to the way it allocates costs in its 2012/13 Regulatory Financial Statements. For similar reasons, the Regulatory Financial Statements do not always align with our view of BT's financial position.
- 1.11 Further, the current Regulatory Financial Reporting regime also requires BT to produce extensive supporting documentation that do not help users of the financial information to understand how it was prepared.

## **How can Regulatory Financial Reporting be improved?**

- 1.12 Our key proposals are aimed at giving us a greater role in determining how BT should prepare its Regulatory Financial Statements, starting with the introduction of a new set of Regulatory Accounting Principles and new guidance on how the Regulatory Financial Statements should be prepared.
- 1.13 The Regulatory Financial Statements will remain BT's responsibility, but a new change control process will be introduced that will allow us to prevent BT from making changes to the way it prepares the statements if, for example, they do not comply with the new Regulatory Accounting Principles.
- 1.14 We consider that our proposals should lead to greater consistency between BT's reported data and our regulatory decisions, and provide stakeholders with a better understanding of the way the financial information is prepared.
- 1.15 Our proposals will also give us the flexibility, subject to further consultation, to make more fundamental changes to the way costs are calculated if and when it is appropriate to do so.

## **When will these changes happen?**

- 1.16 We propose to formally implement changes to relevant markets as they are reviewed in the course of a market review. As part of this document, we are consulting on introducing these changes in relation to those markets considered in the Wholesale

Broadband Access (WBA) markets<sup>2</sup> and Fixed Access markets<sup>3</sup> and we expect to make a decision in relation to the proposals formulated in this document alongside our decisions in relation to those markets.

- 1.17 However, to preserve the integrity and consistency of the regulatory accounting system, we consider that the changes we are proposing should be implemented for regulatory accounting as a whole (including for example, reporting of markets considered as part of the Narrowband Market Review and the Business Connectivity Market Review). Our objective is that BT should therefore apply one set of accounting rules across all markets.
- 1.18 We will therefore work with BT to determine how best to implement any changes that we decide to impose in the WBA and Fixed Access markets in all other markets that are subject to regulatory accounting obligations, if necessary on a voluntary basis in the short term, until the relevant market reviews are completed.

### **What happens next?**

- 1.19 Responses to this consultation are due by 14 February 2014
- 1.20 We will consult on our proposals with the European Commission and will publish a policy decision in relation to our proposals at that time. This will take place alongside the EU consultation on proposals made in the WBA and Fixed Access market reviews.

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<sup>2</sup> Wholesale broadband access in market 1.

<sup>3</sup> The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area; Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area; Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area; and Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area.

## Section 2

# Introduction

## Summary

- 2.1 In the 2012 Consultation, we invited stakeholders' views on the key objectives for regulatory financial reporting and set out some early ideas on how we might improve it. We explained that, informed by stakeholders' responses, we would set out detailed proposals in a second consultation on Regulatory Financial Reporting.
- 2.2 In this consultation, we summarise the views we set out in the 2012 Consultation and the responses we received. Informed by these responses, we set out what we consider to be the appropriate objectives and attributes for effective Regulatory Financial Reporting. We then set out our proposals to improve the way BT's Regulatory Financial Statements are prepared and presented.
- 2.3 The timeline that we propose recognises the need for our proposals to be implemented by BT at a time that it is putting in place a new regulatory accounting system. Rather than an obstacle, we see this overlap as an opportunity to deliver change.
- 2.4 In this section, we recap the broad objectives of this review and provide some background information on how we have worked with stakeholders to develop our proposals. We then set out where the key issues are dealt with in this document. We explain how our ability to impose Regulatory Financial Reporting obligations is limited to where a provider has been identified as having significant market power (SMP) in the relevant market.

## Background to this review

- 2.5 In the 2011 Call for Inputs, we sought stakeholders' views about Regulatory Financial Reporting and cost orientation remedies.<sup>4</sup> Informed by responses, we published a consultation on the regulatory reporting regime in September 2012. This was followed by a separate review on our approach to cost orientation, in June 2013 (the Cost Orientation Review).
- 2.6 We noted that communications technology and the way that we use financial data have evolved significantly since the current framework for BT's Regulatory Financial Reporting was introduced in 2004.<sup>5</sup> We said that stakeholders had expressed concerns with current Regulatory Financial Reporting and issues with the accuracy, timeliness and relevance of BT's Published Regulatory Financial Statements in particular. We noted that some stakeholders had expressed concerns about the extent to which BT could change the allocation bases used to prepare its Regulatory

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<sup>4</sup> Review of cost orientation and regulatory financial reporting in telecoms – Call for inputs. 8/11/2011. <http://stakeholders.ofcom.org.uk/consultations/cost-orientation-telecoms/>

<sup>5</sup> The current regulatory framework was established in 2004 in response to the (then) new framework harmonised across the European Union ("EU") for the regulation of electronic communications by the Member States (known as the Common Regulatory Framework of the 'CRF'). It also followed the creation of Ofcom under the Communications Act 2003 and the removal of the BT Licence. The BT Licence already contained accounting obligations providing a framework for regulatory reporting. In a statement of 22 July 2004, Ofcom imposed a range of SMP conditions in relation to regulatory accounting.

Financial Statements. We also noted BT's view that any reporting requirements should be proportionate to the benefits.

- 2.7 In the 2012 Consultation, we set out our thoughts on the purpose and attributes of an effective regulatory reporting regime and invited views on whether we had identified the appropriate set of issues. We considered how well the current regime met those objectives and set out some early thoughts on how the reporting regime might be improved.
- 2.8 We received eight responses to the 2012 Consultation, from stakeholders including BT, UKCTA and other fixed and mobile communications providers. We have published these on our website.<sup>6</sup>
- 2.9 In June 2013, we published the Cost Orientation review, providing our view of when and how we might choose to apply cost orientation remedies in the future. We also set out the form that those cost orientation obligations might take in future, in cases where we do determine that a cost orientation obligation is appropriate.
- 2.10 In July 2013 BT published its Regulatory Financial Statements for the year ending 31 March 2013 (the "2012/13 Regulatory Financial Statements"). We used our statement at the beginning of BT's 2012/13 Regulatory Financial Statements to draw stakeholders' attention to changes in the way in which BT had allocated its costs and assets.<sup>7</sup> We also explained that we had requested that BT prepare and publish a report setting out the reasons for, and effects of, all the material methodological changes. This report was published on 4 October 2013.<sup>8</sup>
- 2.11 We have used the period since the 2012 Consultation to work with stakeholders in bilateral and multilateral meetings. These included three industry workshops which allowed BT and other stakeholders to engage in discussions about issues and possible solutions and gave stakeholders the opportunity to discuss approaches that might be used to improve confidence and transparency. Our proposals set out in this document take account of these discussions.
- 2.12 We also note that, since the 2012 Consultation, we have made changes to the regulatory financial reporting requirements imposed on BT. We have done this as part of annual updates<sup>9</sup>, which seek to reflect developments in the regulatory environment, including outputs of market reviews and charge controls. These updates do not, however, make fundamental changes to the regulatory reporting requirements imposed on BT.

## **Our powers to make changes**

- 2.13 Ofcom's powers to impose Regulatory Financial Reporting obligations are subject to certain limitations. As SMP remedies, they can only be imposed on a provider where

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<sup>6</sup> <http://stakeholders.ofcom.org.uk/consultations/regulatory-financial-reporting/?showResponses=true>

<sup>7</sup> BT, Current Cost Financial Statements for 2013 including Openreach Undertakings.

<sup>8</sup> BT, Report requested by Ofcom for the year ended 31 March 2013.

<http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2013/Reportrequeste dbyOfcomfortheyearended31March2013.pdf>

<sup>9</sup> Changes to BT and KCOM's regulatory and financial reporting. 2012/13 update.

<http://stakeholders.ofcom.org.uk/binaries/consultations/bt-kcom-2012-13/summary/condoc.pdf> and

Changes to BT and KCOM's regulatory and financial reporting 2013/14 update

<http://stakeholders.ofcom.org.uk/binaries/consultations/btkcomreporting/summary/condoc.pdf>

that provider has been identified as having SMP in the relevant market<sup>10</sup>. SMP remedies cannot be imposed in a market which has been found to be effectively competitive.

- 2.14 When imposing SMP conditions and directions, Ofcom needs to consider its general duties under Section 3, Section 4 and Section 4A of the Act.
- 2.15 Section 3 of the Act sets out Ofcom's duties in carrying out its functions, in particular that it furthers the interests of citizens in relation to communications matters and furthers the interests of consumers in relevant markets, where appropriate by promoting competition.
- 2.16 Section 4 of the Act requires that Ofcom acts in accordance with the six Community requirements concerning: the promotion of competition; the development of the European internal market; the promotion of the interests of all EU citizens; non-discrimination; encouraging the provision of network access and service interoperability for the purpose of securing efficiency and sustainable competition, efficient investment and innovation and the maximum benefit for consumers; and facilitating service interoperability and securing freedom of choice for consumers.
- 2.17 Section 4A of the Act requires Ofcom to take into account all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive<sup>11</sup>.
- 2.18 In addition, any SMP obligation needs to satisfy the test that the obligation is: (a) objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates; (b) not such as to discriminate unduly against particular persons or against a particular description of persons; (c) proportionate to what the condition or modification is intended to achieve; and (d) in relation to what it is intended to achieve, transparent<sup>12</sup>.
- 2.19 For certain SMP obligations, additional requirements need to be fulfilled. In particular, obligations imposed under Section 87(9) of the Act, including wholesale cost accounting, may only be imposed where it appears there is a relevant risk of adverse effects arising from price distortion; and it appears the conditions are appropriate for the purpose of promoting efficiency, sustainable competition and conferring the greatest possible benefits on the end-users of public electronic communications services (Section 88 of the Act).

## Legal Tests

- 2.20 The proposals we are making in this document require us to change the SMP conditions and directions set out in the statement of 22 July 2004. We set out below how we meet our duties under sections 3, 4 and 4A of the Act. We discuss how our proposals meet the tests set out in Sections 47(2) and 49(2) of the Act where we discuss our proposals in detail.

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<sup>10</sup>Under paragraph 5.31 of the Undertakings, BT is also required to present the financial result of Openreach in the Regulatory Financial Statements. See [http://stakeholders.ofcom.org.uk/binaries/telecoms/policy/bt/Consolidated\\_Undertakings.pdf](http://stakeholders.ofcom.org.uk/binaries/telecoms/policy/bt/Consolidated_Undertakings.pdf)

<sup>11</sup> Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common framework for electronic communications and services (OJ L 108 24.04.2002, p33), as amended,

<sup>12</sup> Section 47(2) of the Act (in relation to SMP conditions) and Section 49(2) of the Act (in relation to Directions).

- 2.21 As part of the relevant EU market review processes Ofcom has imposed wholesale cost accounting and accounting separation obligations (through SMP conditions and associated directions) on BT in specific identified markets as part of the appropriate remedies to its SMP in these markets. The relevant individual market reviews determined that these regulatory accounting obligations met the tests outlined in Sections 3, 4 and 4A of the Act.
- 2.22 Our proposals are designed to give Ofcom a greater role in determining how BT should prepare its Regulatory Financial Statements, thereby ensuring the Regulatory Financial Statements are aligned with Ofcom's regulatory decision and giving confidence to stakeholders about the absence of bias in the preparation of the Regulatory Financial Statements. They also ensure that the presentation and usability of the Regulatory Financial Statements is improved, and that the obligations that are imposed on BT are proportionate. The proposals thereby seek to ensure the RFS remain relevant, thereby increasing transparency. Ultimately, this promotes competition.
- 2.23 In proposing the changes in detail described in the sections below, Ofcom has also taken into account all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive, in particular Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications.<sup>13</sup>
- 2.24 In consequence Ofcom believes the proposed amendments meet the tests in Sections 3, 4 and 4A.

## Scope

- 2.25 We use the term **Regulatory Financial Statements** to describe the annual regulatory financial statements, prepared according to a defined framework and methodology. We use the term in this document to refer to both the published and unpublished statements. The unpublished financial statements are submitted to us confidentially.
- 2.26 We use the term **Regulatory Financial Reporting** to refer to the whole of the regulatory reporting methodology, systems and legal framework, as well as the Regulatory Financial Statements. The scope of this review therefore includes regulatory financial reporting and the principles and methodologies under which the accounts are prepared.
- 2.27 The term **Published Regulatory Financial Statements** refers only to the subset of the Regulatory Financial Statements that is published by BT.

## Our proposals do not affect KCOM

- 2.28 We explained in the 2012 Consultation that stakeholders did not appear to be pushing for changes to KCOM's reporting requirements. We said that we would consider KCOM's reporting further in this second consultation and, if needed, make specific proposals. While the majority of respondents to the 2012 Consultation did

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<sup>13</sup> OJ L 266 11.10.2005, p64. This recommends, amongst other things, that "a national regulatory authority, when assessing the features and specifications of the cost accounting system, reviews the capability of the notified operator's cost accounting system to analyse and present cost data in a way that supports regulatory objectives", and that "national regulatory authorities make relevant accounting information from notified operators available to interested parties at a sufficient level of detail" (see paragraphs 3 and 5 respectively).

not question this approach, TalkTalk Group (TTG) suggested that Ofcom “focuses its efforts exclusively on BT.”<sup>14</sup>

- 2.29 KCOM explained that while the 2012 Consultation was focussed on BT’s regulatory reporting obligations, and KCOM’s obligations would be subject to a later consultation, it continued to believe that “any major changes to the regulatory reporting regime that applies to KCOM are potentially very disruptive and costly.”<sup>15</sup>
- 2.30 In light of these comments, we will focus in this consultation on the appropriate reporting framework for BT. We will, in due course, consider whether any of the changes that we are proposing here for BT may be appropriate to apply to KCOM.

## **Timetable for implementation**

- 2.31 This document sets out our proposals about the changes that we consider are necessary to restore confidence in Regulatory Financial Reporting. Some of our proposals will take effect, if implemented, when the statement is published in spring 2014, others may be implemented over a longer timescale and may be the subject of future consultations and statements. We provide more detail about the way in which we propose to implement our proposed changes together with a timeline of when the changes will come into effect in Section 9.

## **Impact assessment and EIA framework**

### **Impact assessment**

- 2.32 The analysis presented in this document constitutes an impact assessment as defined in Section 7 of the Communications Act 2003 (“the Act”).
- 2.33 Impact assessments provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policy-making. This is reflected in Section 7 of the Act, which means that generally we have to carry out impact assessments where our proposals would be likely to have a significant effect on businesses or the general public, or when there is a major change in our activities. However, as a matter of policy we are committed to carrying out impact assessments in relation to the great majority of our policy decisions. For further information about our approach to impact assessments, see the guidelines, “Better policy-making: Ofcom’s approach to impact assessment”, which are on our website.

### **Equality Impact Assessment**

- 2.34 We are separately required by statute to assess the potential impact of all our functions, policies, projects and practices on race, disability and gender equality. EIAs also assist us in making sure that we are meeting our principal duty of furthering the interests of citizens and consumers regardless of their background or identity.
- 2.35 Unless we otherwise state in this document, it is not apparent to us that the outcome of our review is likely to have any particular impact on race, disability and gender equality. Specifically, we do not envisage the impact of any outcome to be to the detriment of any group of society. Nor are we envisaging any need to carry out separate EIAs in relation to race or gender equality or equality schemes under the

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<sup>14</sup> TTG, 2012 Consultation response, page 15, paragraph 73.

<sup>15</sup> KCOM, 2012 Consultation response, page 1, paragraph 2.

Northern Ireland and Disability Equality Schemes. This is because we anticipate that our regulatory intervention will not have a differential impact in relation to people of different gender or ethnicity, on consumers in Northern Ireland or on disabled consumers compared to consumers in general. Similarly, we do not consider that our proposals will have a particular impact on consumers in different parts of the United Kingdom or on consumers with low incomes.

## Structure of this document

- 2.36 In **Section 3**, we set out our views on the purpose of the Regulatory Financial Reporting, updated to take account of stakeholders' responses to the 2012 Consultation.
- 2.37 In **Section 4**, we consider how current Regulatory Financial Reporting fulfils these requirements, taking account of stakeholder responses to the 2012 consultation and BT's 2012/13 Regulatory Financial Statements, published in July 2013, and identify the main areas where we consider there is scope for improvement. Specifically, we explain why we consider that the Regulatory Financial Statements should be more closely aligned to the financial data used by us for the purpose of our decision making, and that there should be more control over the way that BT can change the basis of preparation of its financial data.
- 2.38 We set out our detailed proposals relating to the basis of preparation of BT's Regulatory Financial Statements in **Section 5**. We propose that we should have a greater role in defining the basis of preparation of the financial data through changes to the Regulatory Accounting Principles (which we propose should now include a new requirement for consistency with regulatory decisions) and new Regulatory Accounting Guidelines. We also propose that we should introduce a new change control process, under which BT must notify us in advance of expected changes to the bases of preparation and that we should be able to block such changes, if we choose to do so.
- 2.39 We set out our proposals on the format of the Regulatory Financial Statements and the extent to which it is published in **Section 6**. Our proposals are aimed at ensuring that information is provided to the extent it meets one of the objectives identified in Section 3. As a result, our proposals include the removal of reporting requirements in some areas and the addition of new requirements in others.
- 2.40 In **Section 7**, we consider the way the data prepared by BT is reviewed. We explain why we do not propose any significant changes to the current audit arrangements but do propose that the Regulatory Financial Statements should be signed by a Director for and on behalf of BT's Board of Directors.
- 2.41 We explained in the 2012 consultation that we consider that the design and specification of BT systems is a matter for BT. We also explained that BT was considering a move to a new regulatory accounting system. We said that we considered that this would over time contribute to more confidence in Regulatory Financial Reporting but noted that we will need oversight on how the transition is managed. In **Section 8**, we provide an update on BT's progress towards the implementation of a new regulatory accounting system and set out our proposals to ensure that the transition itself does not lead to a change in what is reported in the Regulatory Financial Statements.
- 2.42 In **Section 9** we propose a timeline for the implementation of our proposals. We explain the point at which elements will take effect and the point at which BT will

need to be able to comply with our proposed changes. We also explain how these changes will be applied to the markets in which BT has SMP.

- 2.43 In **Section 10** we explain that we have taken the opportunity presented by this review to propose changes that will simplify and bring greater transparency to the Conditions that were first implemented in 2004.
- 2.44 In **Annexes 6 – 12** we set out proposals for the modification of Conditions and Directions that impose obligations on BT and in **Annexes 13 and 14** we set out templates that BT may wish to use for change control and error notification.

## Section 3

# The purpose of Regulatory Financial Reporting

## Introduction

- 3.1 In this section we set out our view on the purpose and the attributes of effective Regulatory Financial Reporting. We consider both the information that should be provided to us and the sub-set of that information that should be published (the Published Regulatory Financial Statements). Specifically, we consider the questions that we consider should be answered by both sets of financial information.
- 3.2 In the 2012 Consultation, we proposed that a key aim for Regulatory Financial Reporting should be to provide information in order to allow us to effectively monitor compliance with other SMP conditions, to enable our timely intervention to ensure that those other SMP obligations continue to effectively address the underlying competition problems identified in our market analysis and to inform our market reviews and the setting of SMP obligations including, potentially, charge controls. We explained that effective Regulatory Financial Reporting needs to provide a proportionate amount of relevant and reliable information in a transparent way.
- 3.3 We also set out our view in the 2012 Consultation that stakeholders have a role to play in respect of Regulatory Financial Reporting while noting that the Published Regulatory Financial Statements could provide them with all the information necessary for them to determine whether an SMP provider has complied with its obligations. Rather, our view was that the level of information to be published and the underlying methodological assurance procedures should be appropriate to provide reasonable confidence to CPs that an SMP provider is complying with its regulatory obligations.
- 3.4 We identified a range of potential questions to be addressed by the regulatory financial information provided to us and the Published Regulatory Financial Statements. We also identified what we considered are the key attributes of effective Regulatory Financial Reporting. We invited stakeholders' views on our early thinking.

## What is Regulatory Financial Reporting for?

- 3.5 We explained in the 2012 Consultation that the Access Directive and the Act reveal that there is a close link between the accounting conditions (cost accounting, accounting separation and publication of accounting information) and other SMP conditions. In particular, cost accounting has a particular role in supporting price regulation (including network charge controls and cost orientation obligations) and accounting separation is important for obligations of non-discrimination. Publication of this information aids transparency.

- 3.6 This is also addressed in the EC Recommendation adopted in 2005 which addressed the implementation of a cost accounting and/or accounting separation system<sup>16</sup>, which states:

“The purpose of imposing an obligation to implement a cost accounting system is to ensure that fair, objective and transparent criteria are followed by notified operators in allocating their costs to services in situations where they are subject to obligations for charge controls or cost-oriented prices.

The purpose of imposing an obligation regarding accounting separation is to provide a higher level of detail of information than that derived from the statutory financial statements of the notified operator, to reflect as closely as possible the performance of parts of the notified operator’s business as if they had operated as separate businesses, and in the case of vertically integrated undertakings, to prevent discrimination in favour of their own activities and to prevent unfair cross-subsidy.”<sup>17</sup>

“The cost accounting and accounting separation systems of the notified operators need to be capable of reporting regulatory financial information to demonstrate full compliance with regulatory obligations.”<sup>18</sup>

“It is recommended that NRAs make relevant accounting information from notified operators available on request to interested parties at a sufficient level of detail to ensure that there has been no undue discrimination between the provisions of services internally (...)”<sup>19</sup>

- 3.7 In a judgment of the Competition Appeal Tribunal (“CAT”) of 22 March 2011<sup>20</sup>, the purpose of Regulatory Financial Reporting, and the Published Regulatory Financial Statement in particular, was also touched on. In relation to the regulatory financial reporting obligations imposed by us on BT and KCOM in 2004, the CAT found:

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<sup>16</sup> “Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications”, OJ L 266, 11.10.2005, p 64. An explanatory memorandum to the EC Recommendation was published alongside.

<sup>17</sup> “Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications”, OJ L 266, 11.10.2005, p 64, at paragraph 1

<sup>18</sup> “Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications”, OJ L 266, 11.10.2005, p 64, at paragraph 2

<sup>19</sup> “Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications”, OJ L 266, 11.10.2005, p 64, at paragraph 5

<sup>20</sup> BT v Ofcom, Case 1146/3/3/09, Judgement of 22 March 2011. BT appealed our determination of 14 October 2009 in respect of certain disputes between BT and various other CPs in relation to BT’s charges for partial private circuits (PPCs). The CAT addressed, among others, questions relating to the data on which Ofcom relied. The judgement of the CAT was upheld by judgement of the Court of Appeal of 27 July 2012, Case C3/2011/1683

“That, after all, is one of the purposes of regulatory financial statements: to ensure that the appropriate data is published to enable compliance with SMP obligations to be monitored.”<sup>21</sup>

- 3.8 Informed by this guidance and stakeholder responses to the Call for Inputs, we considered the purpose of the Regulatory Financial Statements provided to us and the purpose of publishing a sub-set of that information in the form of the Published Regulatory Financial Statements.

### **Regulatory Financial Reporting (as provided to us)**

- 3.9 We proposed in the 2012 Consultation that a key aim for Regulatory Financial Reporting should be to provide information in order to allow us to effectively monitor compliance with other SMP conditions (including cost orientation and non-discrimination) and to enable our timely intervention to ensure that those other SMP obligations continue to effectively address the underlying competition problems identified in our market analysis.
- 3.10 We stated that Regulatory Financial Reporting supports investigations of potential breaches of SMP obligations and anti-competitive practices generally and may be used in resolving disputes. We noted that it provides a useful source of information (for example to inform our market reviews and in setting charge controls) and functions as an anchor point to reconcile other data.
- 3.11 We noted that in many cases these purposes will not be satisfied by annual Regulatory Financial Reporting requirements alone.
- 3.12 We often require more detailed and additional information that we cannot and should not require as part of the annual Regulatory Financial Reporting requirements. Instead, we explained that our information-gathering powers allow us to obtain this information. As such, the SMP provider’s Regulatory Financial Reporting obligations ensure that we obtain such information as is routinely required on an ongoing basis, while our information-gathering powers supplement the Regulatory Financial Reporting requirements to ensure that we are able to obtain specific information where needed to investigate specific matters.
- 3.13 Following the 2012 Consultation, we continued to think about how and when BT could provide us with the additional information that we need to carry out our regulatory duties outside of the Published Regulatory Financial Statements.
- 3.14 We consider that much of the additional information we routinely require from BT is predictable in terms of content and is requested in a standardised format. Routinely required information includes annual breakdowns of FAC information, cost allocations and changes, asset valuations and associated CCA adjustments. As such it should be relatively straightforward for BT to provide this information on an ongoing basis.
- 3.15 However, it would not be possible to impose requirements on BT to provide all the information that we might need in any year in standardised annual reports. We will not know at the beginning of any year all of the information that we will need in order to support our decision making.

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<sup>21</sup> BT v Ofcom, Case 1146/3/3/09, Judgement of 22 March 2011, paragraph 161. The judgement of the CAT was upheld by judgement of the Court of Appeal of 27 July 2012, Case C3/2011/1683.

- 3.16 We can also use our formal powers under S.135<sup>22</sup> and S.191<sup>23</sup> of the Act which allow us to obtain information from SMP providers for the purpose of carrying out our regulatory functions. These are better suited to more targeted questions needed for specific projects or for information that BT does not routinely prepare.
- 3.17 We also have direct access to BT's regulatory accounting data through a data file of the transactions which underpin its Regulatory Financial Statements. We use our own Data Extract Tool to interrogate this data to inform our regulatory decision making.
- 3.18 Informed by stakeholders' responses, our view remains, as set out in the 2012 Consultation, that Regulatory Financial Reporting should provide us with the information necessary to: make informed regulatory decisions, monitor compliance with SMP conditions; ensure that those SMP conditions continue to address the underlying competition issues and investigate potential breaches of SMP conditions and anti-competitive practices. It should also be available quickly when we need it. We consider whether current Regulatory Financial Reporting delivers the information we need, when we want it in Section 4.

### **Published Regulatory Financial Statements (available to all parties)**

- 3.19 We explained in the 2012 Consultation that stakeholders have a role to play in assisting us to monitor compliance effectively and to intervene in a timely fashion. We considered that publishing Regulatory Financial Statements supports stakeholders' contribution to an informed regulatory framework, as stakeholders (who may have a better understanding of the relevant activities and costs than us) can review and comment on the data that might otherwise only be seen by us. We noted that this is consistent with the guidance given in the EC Recommendation, which states that:

“Regulatory accounting information serves national regulatory authorities and other parties that may be affected by regulatory decisions based on that information, such as competitors, investors and consumers. In this context, publication of information may contribute to an open and competitive market and also add credibility to the regulatory accounting system”<sup>24</sup>.

- 3.20 We also explained that we consider that a regulatory environment where stakeholders are simply informed that the regulator is satisfied that the obligations have been met is likely to be less effective than one where the industry is better informed.
- 3.21 However, 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.

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<sup>22</sup> S.135. Information required for the purpose of Chapter 1 functions including the identification and analysis of markets and conducting of reviews.

<sup>23</sup> S.191. Ofcom's power to require information in connection with dispute.

<sup>24</sup> Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications, Official Journal L 266, 11/10/2005 P. 0064 - 0069, Annex – Guidelines on reporting requirements and publication of information.

- 3.22 Rather, our view is 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.
- 3.23 In practical terms, we consider that this means the published information should include enough information to answer the right questions, in the right way and at the right time. More generally, it should allow stakeholders to understand the financial performance of BT's regulated business in total and at the market level on a basis that is broadly in line with the way we would consider BT's financial performance.
- 3.24 We also consider that sufficient information should be published to enable informed stakeholders to contribute to the development of robust regulatory decisions by allowing them to review and potentially challenge the data on which those decisions are made.
- 3.25 We recognise that annual publication of the Published Regulatory Financial Statements is not the only means of providing stakeholders with reasonable confidence that BT has complied with its obligations or enabling stakeholders to contribute to a robust regulatory regime. In some cases, other routes, such as the disclosure of relevant information within the context of a consultation may provide a more focused and proportionate means of meeting stakeholders' legitimate requirements for regulatory financial information.
- 3.26 However, we consider that there are risks of not disclosing any information until the point at which decisions are being considered. Routine annual publication of information might for example provide for a greater level of scrutiny by us and BT than might otherwise occur. It would also allow stakeholders to provide input into our decision making in an ongoing manner. This might mean that concerns about for example particular allocation methods are detected and dealt with before we start work on a particular charge control.
- 3.27 We consider that the nature and scope of information that is published should be consistent with the remedy (the imposed regulatory obligation) and should provide enough information for stakeholders to see how costs move over time. As a result stakeholders should be able to provide input into our decision making.
- 3.28 BT said that it broadly agrees "with the reasons for Regulatory Financial Reporting publication set out by Ofcom"<sup>25</sup>. Cable & Wireless Worldwide (CWW) agreed, saying that "we believe Ofcom have captured the primary purpose of the accounts."<sup>26</sup>
- 3.29 Other CP's generally agree about the purpose of the Published Regulatory Financial Statements. Both BT and other CPs recognised that publication of information outside of the Published Regulatory Financial Statements, particularly in relation to Charge Control review information was an important consideration. BT said "such data may be disclosed as part of the consultation process subject to appropriate consideration of confidentiality issues. The use of such data in setting charge controls (where the specific requirements will vary between controls) should not result in the need for such data to be published to all stakeholders on an annual basis."<sup>27</sup> UKCTA agreed and said that it "accepts that Ofcom will obtain much more

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<sup>25</sup> BT, 2012 Consultation response, page 5, paragraph 20.

<sup>26</sup> CWW, 2012 Consultation response, page 17.

<sup>27</sup> BT, 2012 Consultation response, page 7, paragraph 27.

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.”<sup>28</sup>

## What does good regulatory reporting look like?

3.30 Having established the broad objectives for effective Regulatory Financial Reporting, we now consider the necessary characteristics. In the 2012 Consultation we proposed that effective Regulatory Financial Reporting should have the following attributes:

- **Relevance.** The information needs to answer the right questions, in the right way and at the right time.
- **Reliability.** The underlying data must be reliable, suitable rules for treatment of those data must be chosen and those rules need to be followed.
- **Transparency.** The basis of preparation should be understood by the users of the reports.
- **Proportionality.** The reporting requirements should be proportionate to the benefits.

3.31 We considered this approach was consistent with the EC Recommendation, which states that

“The cost accounting and accounting separation systems of the notified operators need to be capable of reporting regulatory financial information to demonstrate full compliance with regulatory obligations. It is recommended that this capability be measured against the qualitative criteria of relevance, reliability, comparability and materiality”.<sup>29</sup>

3.32 Stakeholders broadly agreed that these attributes were relevant, although there was some difference of opinion on their relative importance. BT proposed a fifth attribute ‘Clarity’ to ensure that users of the Published Regulatory Financial Statements could understand the data presented. However, as explained below, we consider that the proposed attribute of transparency, expanded to include transparency of presentation as well as transparency of the basis of preparation, covers this.

3.33 In light of stakeholder responses, we consider these attributes in more detail below.

### Relevance

3.34 For information to be relevant, we explained in the 2012 Consultation that it needs to answer the right questions in an appropriate way at an appropriate time. We consider these questions in turn below.

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<sup>28</sup> UKCTA, 2012 Consultation response, page 7.

<sup>29</sup> Commission Recommendation on “accounting separation and cost accounting systems under the regulatory framework for electronic communications”, 19 September 2005 Recommendation 2, paragraph 3.

## What are the relevant questions?

- 3.35 An SMP provider's Regulatory Financial Reporting obligations ensure that we can obtain such information that is routinely required on an ongoing basis. Our information gathering powers supplement the Regulatory Financial Reporting requirements to ensure that we are able to obtain specific information where needed to investigate specific matters. Therefore, for the purpose of this consultation we have focussed on the questions to be answered by the Published Regulatory Financial Statements, although some of our findings may have implications for the Regulatory Financial Reporting regime more widely.
- 3.36 We noted in our 2012 Consultation that, just because a stakeholder might find certain information useful or interesting, it does not follow that BT should be required to provide that information in the Published Regulatory Financial Statements. It may be that the information sought does not link to a regulatory objective. Further, even if there is a regulatory benefit, it does not necessarily follow that the information should be published. It is also necessary to consider whether there is an alternative and more appropriate mechanism by which the information could be obtained if necessary, or whether the information should remain confidential.
- 3.37 BT responded that that they broadly agreed that we had identified the right questions.<sup>30</sup>
- 3.38 Other CPs tended to agree that the right questions were being answered though not in enough detail. UKCTA said the "RFS should be sufficiently detailed to ensure that charges set by BT give sufficient certainty to industry that they remain in the parameters of the control".<sup>31</sup> Regarding tests of margin squeeze, UKCTA said that if stakeholders were to have a role in monitoring compliance then a publication requirement was required; UKCTA also commented on the lack of proposals on cost orientation as it "limits the ability to meaningfully respond to this consultation".<sup>32</sup>
- 3.39 We believe the role of the Published Regulatory Financial Statements is not to demonstrate compliance. We do not agree with TTG who said "CPs need to be provided the data so that they can check compliance themselves".<sup>33</sup> Instead the Published Regulatory Financial Statements should provide CPs with reasonable confidence about compliance. It is this requirement that should drive the level of disclosure in the Published Regulatory Financial Statements.
- 3.40 We consider these points, and others, below.
- 3.41 In respect of **cost orientation**, we explained that other CPs should be given reasonable confidence of compliance with cost orientation obligations and that monitoring compliance with cost orientation is an important consideration. However, we noted we were planning to publish a separate consultation on cost orientation and did not comment further at the time.
- 3.42 BT agreed that where cost orientation obligations were in place, they would expect to provide information such as published LRIC data.<sup>34</sup> CPs were more concerned over the lack of clarity on the cost orientation proposals themselves.

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<sup>30</sup> BT, 2012 Consultation response, page 6, paragraph 20.

<sup>31</sup> UKCTA, 2012 Consultation response, page 7.

<sup>32</sup> UKCTA, 2012 Consultation response, page 5.

<sup>33</sup> TTG, 2012 Consultation response, page 2, paragraph 4.

<sup>34</sup> BT, 2012 Consultation response page 14, paragraph 69.

- 3.43 Our Cost Orientation review was published on 5 June 2013 (the Cost Orientation Review).<sup>35</sup> We explained in the Cost Orientation Review that we may continue to use cost orientation as a remedy, targeted to address specific concerns identified in the market review, if it is the best remedy to address them. We also explained that the exact form cost orientation takes would be tailored in order to address the specific concern.
- 3.44 We said that where we impose a cost orientation obligation in conjunction with a charge control, it was likely to be appropriate to continue to use distributed stand-alone cost (DSAC) to establish or set the price ceiling in advance for the duration of the market review period.
- 3.45 In the more limited circumstances where cost orientation was being used as a fallback from a charge control, we said it might be more appropriate, depending upon the circumstances, to use a 'FAC+' approach, i.e. fully allocated costs plus a small factor to allow for uncertainty of costs from year to year.
- 3.46 In other situations, such as cost orientation in a prospectively competitive market, the details of the condition might be specified somewhat differently (e.g. there might be a stronger argument to use DSAC instead of FAC+).
- 3.47 Providing reasonable confidence to stakeholders that BT has complied with a cost orientation obligation is a key requirement of Regulatory Financial Reporting and the Published Regulatory Financial Statements themselves. However, as explained in the Cost Orientation Review, the nature of the obligation is likely to depend on the issue it is trying to remedy. Therefore we expect that, when we impose a specific cost orientation SMP remedy, we will also set out the appropriate reporting requirements. Consultation on such requirement will provide interested parties with the opportunity to consider how stakeholders can be given reasonable confidence that BT has complied with the obligation.
- 3.48 In respect of **charge control modelling**, we explained that Regulatory Financial Reporting is an important source of information when setting charge controls. We usually request much more detailed information than that which is included in the Published Regulatory Financial Statements, but they are nevertheless used as a starting point in obtaining base year financial cost data.
- 3.49 The Published Regulatory Financial Statements contain helpful information for CPs, for example it allows them to participate in the development of charge controls. The publication of FAC cost stacks for regulated products and baskets is particularly useful in this respect. However, the information contained in the Published Regulatory Financial Statements can never be fully comprehensive. That information will typically be supplemented by information provided and disclosed, if appropriate, during the consultation process.
- 3.50 In response to the 2012 Consultation, BT agreed that data used in setting charge controls "may be disclosed as part of the consultation process subject to appropriate consideration of confidentiality issues"<sup>36</sup> but said that this should not be as part of the Published Regulatory Financial Statements. No other stakeholders made comments about how and when this information should be published and in light of discussions at the stakeholder workshops, we agree that not all information should be provided in the annual Published Regulatory Financial Statements. However, for the reasons we

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<sup>35</sup> <http://stakeholders.ofcom.org.uk/consultations/cost-orientation/>

<sup>36</sup> BT, 2012 Consultation response page 7, para 27.

have given (around the benefits of publication, including the additional scrutiny by informed users of the information) we think that the continued publication of proportionate FAC product and basket information that allows CPs to understand the movement of cost over time remains a legitimate requirement.

- 3.51 In respect of **charge control review**, and, more broadly, the **performance of regulated activities**, we noted in the 2012 Consultation that the Published Regulatory Financial Statements for some other UK sectoral regulators, did include information with this aim in mind.
- 3.52 We consider that we should be able to assess our effectiveness at forecasting costs for the purpose of setting charge controls by periodically comparing actual data to the assumptions we made when making regulatory decisions.
- 3.53 Having set a charge control, we would not typically expect to re-perform our cost calculations (as this is not relevant to whether BT has complied with the obligation). However there are a number of key assumptions, such as volume and efficiency forecasts and capital expenditure forecasts, which can be difficult to predict precisely, where it would be helpful for us to have the information necessary to build up a longer term picture of trends in general and outturns against forecasts.
- 3.54 We do not consider that such information should be published annually. The information that we need to make these assessments may change from year to year and may be commercially sensitive. Whilst we encourage stakeholders to provide their views and opinions on the effectiveness of regulation at the relevant decision points, we do not believe such information should be published outside of the formal consultation processes (at which stage it will be possible for us to properly consider the need for adequate disclosure to allow effective consultation alongside BT's legitimate concerns around confidentiality).
- 3.55 We do not regulate the returns that BT can make. The effect of much of our regulation is to improve its efficiency and this may lead to its making returns that are not equal to its cost of capital in the short term, with benefits for its customers (for example, in the form of lower prices) in the longer term.
- 3.56 Nevertheless, we consider that the extent to which BT is doing better or worse than was expected when the existing regulation came into effect provides useful insight to stakeholders and may inform their views on what this might mean if and when we need to make further regulatory decisions (such as new charge controls).
- 3.57 To provide this insight, the published information should be prepared, as far as possible, on a basis that reflects our view of BT's costs. We consider the need for reporting to be consistent with regulatory decisions later in this section.
- 3.58 In the 2012 Consultation, we proposed that providing information to inform stakeholders' **make or buy decisions** should not be an objective of the Published Regulatory Financial Statements.<sup>37</sup> In response, BT agreed that the Published Regulatory Financial Statements should not be used to allow CPs to inform 'make or

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<sup>37</sup> We explained in the 2012 Consultation that we recognise that the statements may, incidentally contain some information to inform stakeholders' make or buy decisions (by virtue of reporting requirements supporting existing regulatory obligations such as non-discrimination). However, we would not require additional information to support this where that information is not also required for other purposes.

buy' decisions.<sup>38</sup> Other CPs made no comments. On this basis we have not changed our view.

- 3.59 In respect of **margin squeeze** tests, we noted in the 2012 Consultation that SMP obligations may, in some cases, seek to address the ability of an SMP provider to operate a margin squeeze. Where we have imposed such SMP obligations, the Published Regulatory Financial Statements may help stakeholders to monitor compliance with such SMP obligations.
- 3.60 However, we explained that we did not consider that Published Regulatory Financial Statements could ever include all necessary information to identify all possible potential cases of margin squeeze and we did not propose that the Published Regulatory Financial Statements should disclose additional information over and above that required for other purposes.
- 3.61 In response, BT agreed with our 2012 position<sup>39</sup> whilst UKCTA said “an appropriate financial reporting obligation”<sup>40</sup> should be in place. In the absence of any suggestions from stakeholders on what an appropriate financial reporting obligation might be (and in particular on how we might require BT to publish cost information for downstream markets where there have been no findings of SMP), we remain of the view that there should be no additional publication requirements relating specifically to tests of margin squeeze. We therefore we have not changed our view on this.
- 3.62 Finally, we considered **Non discrimination** and **Equivalence of Inputs (EOI)**.<sup>41</sup>
- 3.63 The use of Regulatory Financial Reporting to provide assurance regarding compliance with non-discrimination obligations is well established under Article 11(1) of the Access Directive. We believe that publication of such data (both volumes and prices), within the framework of an audited set of Published Regulatory Financial Statements provides further confidence to CPs. We therefore propose that providing assurance around compliance with non-discrimination should remain one of the purposes of the Published Regulatory Financial Statements.
- 3.64 We explained that EOI and non-discrimination exist as separate remedies and as such, compliance should be considered separately. In addition there are some services that fall outside EOI but nevertheless are still subject to non-discrimination. These would therefore not be captured by EOI reporting. We explained in the 2012 Consultation that we would be interested in stakeholders' views as to what extent EOI requirements are sufficient in this respect. UKCTA said that “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.” On the contrary BT<sup>42</sup> said that EOI and the creation of Openreach should require the removal of volume, revenue and cost information for internal and external sales as justified under Article 11. BT said that using the

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<sup>38</sup> BT, 2012 Consultation response, page 7, paragraph 28.

<sup>39</sup> BT, 2012 Consultation response, page 8, paragraph 29.

<sup>40</sup> UKCTA, 2012 Consultation response, page 7.

<sup>41</sup> For a product or service to be provided on an EOI basis, Openreach must provide the same product or service to all CPs (including BT) on the same timescales, with the same terms and conditions (including price and service levels) by means of the same systems and processes and include the provision to all CPs (including BT) of the same commercial information about such products, services, systems and processes.

<sup>42</sup> BT, 2012 Consultation response, page 8, paragraph 32.

Regulatory Financial Statements for monitoring of EOI was outside the scope of the Regulatory Financial Statements.<sup>43</sup>

- 3.65 The Undertakings<sup>44</sup> require that Openreach should provide certain products on an EOI basis to all CPs (including BT). We agree with BT that compliance with the EOI obligations of the Undertakings is outside the scope of Regulatory Financial Reporting.<sup>45</sup>
- 3.66 However, certain products are covered both by SMP regulation and EOI obligations under the Undertakings. Such products should continue to be reported as part of the RFS. In particular, where an SMP product is reported, it should not be aggregated on the basis that it is an EOI product.

### What is the right way for the information to be provided?

- 3.67 We proposed in the 2012 Consultation that the Published Regulatory Financial Statements would be most useful if they provided data that (as far as possible) has been prepared on a basis that is consistent with the way we set, or test compliance with, the SMP obligations.
- 3.68 We also explained the importance of consistency over time and consistency with other financial data, although we noted that these three versions of consistency would from time to time come into tension with each other.
- 3.69 Stakeholders broadly agreed. BT said “there is merit in requiring consistency with regulatory decisions. Such a treatment could provide greater regulatory certainty and confidence around the perceived relevance of reported numbers moving forward”<sup>46</sup>, though they cautioned on practical difficulties over ‘pricing adjustments’, what the process would be when a charge control was the subject of an appeal, and the need to be given enough guidance from us to implement the required changes to the Regulatory Financial Statements. These valid concerns are discussed in Section 5. CWW also agreed saying “this is long overdue and makes considerable sense. The current approach defies common sense and leads to uncertainty, complicating the regulatory process”<sup>47</sup>, whilst 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.”<sup>48</sup>
- 3.70 We therefore consider that the Regulatory Financial Statements should be prepared on a basis that is, as far as possible, consistent with our regulatory decisions. Subject to that requirement, the basis of preparation should also be consistent with other financial data (specifically BT’s statutory accounts) and then, consistent over time.

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<sup>43</sup> BT, 2012 Consultation response, page 17, paragraph 94.

<http://stakeholders.ofcom.org.uk/consultations/sec155/>

<sup>44</sup> The Undertakings are a legally binding promise given by BT to deliver equality of access.

<sup>45</sup> We note however that under paragraph 5.31 of the Undertakings, BT has to report Openreach financial results as part of the Regulatory Financial Statements

<sup>46</sup> BT, 2012 Consultation response, page 24, paragraph 129.

<sup>47</sup> CWW, 2012 Consultation response, page 20.

<sup>48</sup> UKCTA, 2012 Consultation response, page 17-18.

## What is the right time for the information to be provided?

- 3.71 We noted in the 2012 Consultation that regulatory reporting supports the monitoring of compliance with obligations. Delays in the provision of the Published Regulatory Financial Statements could lead to market distortions through delays in identifying areas of non compliance. It is therefore important that compliance information is reported in a timely fashion. In terms of how to set timeframes for publication, we note that we need to consider the uses of such information and how any delays would impact upon stakeholders using the information for such purposes.
- 3.72 Stakeholders agreed that timeliness was important, although no CPs provided details of the impact of delays on them or what an appropriate period between the end of BT's financial year and publication should be. UKCTA and EE believed that delays were caused by BT not dedicating enough resource to the production of the accounts. EE and TTG considered some enforcement action / incentive should be introduced to prevent delay in the future.
- 3.73 BT agreed a four month publication deadline was achievable but suggested that the requirement to formally consult every January on the form of the Published Regulatory Financial Statements as part of the 'Business as usual' consultation had in the past contributed to delay.
- 3.74 We therefore still consider that the current timetable, requiring publication within four months of the year end, remains appropriate.

## **The data must be reliable**

- 3.75 We stated in the 2012 Consultation that the underlying data must be reliable if the Regulatory Financial Reporting is to be effective. We noted that ensuring that the financial data is reliable, and can be seen to be reliable, would be a key focus of this review.
- 3.76 We considered the need for reliability in three parts: the reliability of the underlying data, the choice of suitable rules and the need for those rules to be followed.

## The underlying data must be reliable

- 3.77 We explained that the data that forms the input to the cost allocation system should be, as far as possible, free from error. We proposed that, for most data, this would mean that data should, as a starting point, be capable of reconciliation to the statutory accounts. The fact that the statutory accounts (and by implication the supporting systems) have been subject to statutory audit provides us with further confidence about the reliability of the underlying data.
- 3.78 UKCTA stated 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>49</sup> Other stakeholders do not appear to disagree with this position.
- 3.79 Therefore we consider that reporting financial reporting should be free from error and should be capable of reconciliation to the statutory accounts.

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<sup>49</sup> UKCTA, 2012 Consultation response, page 19.

### The accounting rules must be appropriate

- 3.80 We noted that, in deciding upon an accounting treatment, there may be a range of options to choose from and the selection will require some judgement. These rules need to cover the way costs and revenues are identified, the way assets are valued, the way these assets are allocated to products and services and the way this information is presented. We proposed that the rules need to be chosen so as to align with the purposes of Regulatory Financial Reporting and to support our regulatory objectives.
- 3.81 We also noted that such choices should be objective.
- 3.82 Stakeholders agreed that the rules chosen should be consistent with our regulatory objectives. Whilst there was agreement over our proposal to be involved in choosing the rules, there were different opinions on the extent of our involvement, which we discuss further in Section 4.
- 3.83 Therefore we consider that the accounting rules used to prepare the Regulatory Financial Statements should align with the purposes of those statements and be chosen on an objective basis. We should have involvement in determining those rules.

### The appropriate rules must be followed

- 3.84 As set out in the 2012 Consultation, we consider that it is not enough to have an appropriate and objective set of rules, if those rules are not followed.
- 3.85 Stakeholders did not comment on our position other than to discuss the terms of the audit, which we consider in section 4. Regulatory Financial Reporting must follow the rules, and be shown to follow those rules.

### **The basis of preparation and the meaning of the data must be clear**

- 3.86 Transparency is essential to ensure that the data can be understood by the target audience and tested and challenged when necessary. We identified two key aspects to transparency (in addition to consistency, which we deal with separately), as follows:
- Clarity of presentation
  - Clarity around basis of preparation
- 3.87 We consider each of these in turn.

#### Clarity of presentation

- 3.88 We explained in the 2012 Consultation that the presentation of the Published Regulatory Financial Statements should be clear and easy to understand. Different users of the data will, we said, be likely to have different views about what is clear and easy to understand.
- 3.89 We also set out the views that we received to our 2011 Call for Inputs including UKCTA's view that "the accounts are always going to be specialist publications

designed for industry experts”,<sup>50</sup> and Verizon’s view that the accounts should be presented “in such a way as to make them accessible to a person familiar with BT’s regulatory obligations but not necessarily an expert in financial accounting or reporting.”<sup>51</sup>

- 3.90 Although we said that the primary audience is likely to be the informed regulatory community across industry we would need to develop our thinking about what clarity of presentation for this audience actually means.
- 3.91 We received one response to the 2012 Consultation about the target audience. KCOM said that it “agrees that the primary audience for regulatory financial account is likely to be the informed regulatory community across industry.”<sup>52</sup>
- 3.92 While we understand that financial analysts also make use of the Published Regulatory Financial Statements our view remains that the primary audience is the informed regulatory community across industry rather than a wider audience. We also believe that for these users clarity means that they are able to see and understand information presented that answers the relevant questions that we have identified and therefore gain reasonable confidence that BT is complying with its obligations.

### Basis of preparation

- 3.93 We explained that users of any financial statements need to understand how and why they were prepared. In the case of the Published Regulatory Financial Statements there should be clarity of the following:
- the purpose of the Published Regulatory Financial Statements in aggregate and of any individual statement;
  - the methodologies that BT follows in preparing the Published Regulatory Financial Statements, such as how to allocate costs and how to value assets; and
  - the respective roles and responsibilities of Directors;
- 3.94 In respect of clarity around the methodologies used, we considered that this may require a balance to be found between the need for the information to be complete and sufficiently detailed with the need for the information to be accessible.
- 3.95 In the 2012 Consultation, we explained that the basis of preparation of the Regulatory Financial Statements should be understood by users of the reports. By this we mean that stakeholders should understand the methodologies that BT follows in preparing the accounts, such as how to allocate costs and how to value assets. These, we explained, are currently documented in the Primary and Secondary Accounting Documents. We went on to say that while there is an abundance of information about the basis of preparation, much of this is unclear. We said that the supporting documentation to the Published Regulatory Financial Statements, illustrates how at present the provision of detailed information is contributing to a lack of transparency.

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<sup>50</sup> UKCTA, Call for Inputs Response, page 16, question 26.

<sup>51</sup> Verizon, Call for Inputs Response, question 23.

<sup>52</sup> KCOM, 2012 Consultation response, page 3.

- 3.96 In response to the 2012 Consultation stakeholders confirmed the need for transparency about the basis of preparation and supporting accounting documentation:
- EE said that “there needs to be transparency about the process by which the Regulatory Financial Statements are constructed, but also about the key metric and algorithms which go into creating the figures.”<sup>53</sup>
  - EE stressed the need for transparency, in particular in terms of the methodology adopted by BT for the allocation and attribution of costs. EE considered that the methodology to be applied “must be transparent and not create surprises (either for Ofcom as regulator or purchasing CPs).”<sup>54</sup>
  - UKCTA said that “increasing the accessibility of BT’s accounting documents is to be welcomed and can only be beneficial.”<sup>55</sup>
  - CWW said that there is “a need to have a coherent and auditable package of regulatory accounting information.”<sup>56</sup>

### **The requirements must be proportionate and have regard to legitimate concerns of confidentiality**

3.97 We explained in the 2012 Consultation that the requirements imposed on BT should be proportionate to the benefits that are expected to result from those requirements. The CRF<sup>57</sup> and the Act specify that obligations placed on operators should be proportionate. We noted that a related issue is that of confidentiality.

3.98 We said that confidential data should normally not be published. We also noted that there may be some merit in BT’s point that:

“...as competition becomes more established over time and is expected to develop further (including in markets where BT may currently be found to hold SMP), there is a clear risk that placing commercially sensitive information on our costs and volumes into the public domain for our competitors to use could actually undermine the effectiveness of competition.”<sup>58</sup>

3.99 However, while acknowledging BT’s concern, we also broadly agreed with UKCTA’s statement that “Claims of confidentiality should be treated with caution.”<sup>59</sup>

3.100 We explained that, while the principle of not publishing commercially sensitive information is clear, the application of this principle is less so. Whilst some data may be obviously commercially sensitive, most data will probably sit somewhere on a spectrum between public knowledge and business secrets.

3.101 Similarly the case for publication of data is likely to be somewhere between strong, where publication is essential if reasonable confidence is to be provided, to weak,

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<sup>53</sup> EE, 2012 Consultation response, page 5, paragraph 9.

<sup>54</sup> EE, 2012 Consultation response, page 10, paragraph 38.

<sup>55</sup> UKCTA, 2012 Consultation response, page 19, question 5.5.

<sup>56</sup> CWW, 2012 Consultation response, page 14, paragraph 5.9.

<sup>57</sup> The Common Regulatory Framework (CRF) is composed of five Directives. For more information about the CRF see Section 3 of the 2012 Consultation.

<sup>58</sup> BT Call for Inputs Response page 7.

<sup>59</sup> EE, 2012 Consultation, page 9.

where publication perhaps provides some secondary evidence to support other data. We noted that in some cases (for example the disclosure of business secrets that do not provide significant evidence, or of essential evidence that is not commercially sensitive), the decision on whether to require publication will be straightforward. However, most evidence will not fall into either of these categories and some judgment will be necessary. We therefore invited stakeholders to set out their arguments for or against the disclosure of data on grounds of commercial sensitivity and the potential harm that might be caused by the publication of that data.

- 3.102 Stakeholders other than BT, agreed with the need for proportionality but rejected “blanket confidentiality”.<sup>60</sup> Everything Everywhere’s (EE) view was that “Where SMP has been found and non-discrimination or cost orientation obligations have been imposed, then it is clearly unsatisfactory for any ability to assess compliance with those obligations to be hidden behind commercial confidentiality claims. In such cases the onus needs to be on BT to establish in a concrete way how competition may be harmed from disclosure”<sup>61</sup> CWW considered that BT’s claims around confidentiality are “massively overstated”.<sup>62</sup>
- 3.103 BT also made the point that “It is a general characteristic of an effectively competitive market that enterprises are not able to access the commercially sensitive information of their competitors...Wholesale cost accounting obligations may only be imposed where it appears there is a relevant risk of adverse effects arising from price distortions; and the conditions are appropriate for the purpose of promoting efficiency, sustainable competition and conferring the greatest possible benefits on end-users (s.88(1) of the Act). Ofcom should be able to demonstrate that these conditions are met wherever we are required to publish commercially sensitive information.”<sup>63</sup>
- 3.104 We agree that the appropriate level of disclosure does require a balance to be found between the need to publish to achieve the regulatory objectives of the type described above and BT’s legitimate concerns around the publication of commercially sensitive information. This is an issue that needs to be considered at the time of the SMP remedy, taking account of the specific circumstances.

## Conclusions

- 3.105 Regulatory Financial Reporting should provide us with the information necessary to: make informed regulatory decisions, monitor compliance with SMP conditions; ensure that those SMP conditions continue to address the underlying competition issues and investigate potential breaches of SMP conditions and anti-competitive practices.
- 3.106 The Published Regulatory Financial Statements should, alongside other information provided to stakeholders (such as in the context of a charge control consultation), provide reasonable confidence to stakeholders that the SMP provider has complied with its SMP conditions and add credibility to the Regulatory Financial Reporting regime.

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<sup>60</sup> UKCTA, 2012 Consultation response, page 9.

<sup>61</sup> EE, 2012 Consultation response, page 9.

<sup>62</sup> CWW, 2012 Consultation response, page 3, paragraph 2.7.

<sup>63</sup> BT, 2012 Consultation response, page 10, paragraph 41.

3.107 Stakeholders have a legitimate interest in seeing the following information, although it does not follow that this should be provided within annual Published Regulatory Financial Statements:

- visibility of information that will be taken into account in regulatory decisions, such as charge controls which they can comment on;
- a reasonable understanding of BT's financial performance from a regulatory perspective;
- reasonable confidence regarding compliance with non-discrimination obligations;
- reasonable confidence of compliance with cost orientation obligations and monitoring compliance with cost orientation is an important consideration; and
- products which BT needs to provide on an EOI basis under the Undertakings which are also covered by SMP regulation should be reported as required under BT's Regulatory Financial Reporting obligations.

3.108 Additionally, we consider that Regulatory Financial Reporting more broadly should allow us to monitor the effectiveness of regulation imposed on BT.

3.109 We also consider that an effective Regulatory Financial Reporting regime should have the following characteristics:

- The Regulatory Financial Statements should be prepared on a basis that is, as far as possible, consistent with our regulatory decisions. Subject to that requirement, the basis of preparation should also be consistent with other financial data (specifically BT's statutory accounts) and then, consistent over time;
- there should be clarity of the following:
  - the purpose of the Regulatory Financial Statements in aggregate and of any individual statement;
  - the methodologies that BT follows in preparing the Regulatory Financial Statements, such as how to allocate costs and how to value assets; and
  - the respective roles and responsibilities of Directors.
- there should be some assurance to users of the Regulatory Financial Statements that the published rules have been followed;
- Regulatory Financial Reporting should be free from error and should be capable of reconciliation to the statutory accounts;
- Reports should be provided in good time, which we currently consider to be similar to the current reporting timetable, requiring publication within four months of the year end; and
- Information, including detailed product information, should be published only if it meets an objective of Regulatory Financial Reporting.

3.110 We consider how well the current regime meets these objectives in Section 4.

## Consultation questions

*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?*

*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?*

## Section 4

# How well does current reporting meet these objectives?

## Introduction

- 4.1 In Section 3, we set out our views on the purpose and attributes of effective Regulatory Financial Reporting.
- 4.2 In this section we consider how well the current Regulatory Financial Reporting arrangements achieve these objectives and identify a number of areas where we consider improvement is required.

## Does the current regime achieve the stated objectives?

- 4.3 Having established the requirements of effective Regulatory Financial Reporting, we now consider how well current arrangements meet those requirements. To do so, we follow the structure of Section 3 and therefore consider in turn whether the current arrangements:
- provide the answers to the right questions (which we consider below, under Relevance);
  - provide reliable data based on suitable rules, properly applied (Reliability);
  - follow a basis that is clear and understood by users (Transparency); and
  - impose requirements in a way that is proportionate to the benefits (Proportionality).

## The Regulatory Financial Statements must be relevant

- 4.4 To be relevant, information needs to answer the right questions in an appropriate way and at the appropriate time. We have set out in Section 3 what we consider to be the relevant questions and consider below the extent to which we think the current reporting requirements answer them.
- 4.5 In deciding how much of the information provided to us should be published, we recognise that some CPs consider that publication of some data is necessary as they are not confident that the underlying data is robust or that it has been adequately reviewed. For example, TTG explained on reporting compliance 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.”<sup>64</sup>
- 4.6 While we consider that the need to ensure that the information is robust is a reasonable one, we think this issue is better addressed directly by improvements to the way the data is prepared and reviewed. We do not think that publication of additional data to allow other stakeholders to check the analysis for themselves

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<sup>64</sup> TTG, 2012 Consultation response, page 2, paragraph 4.

should be a primary factor in determining whether all relevant information is published.

4.7 We now consider how well the current requirements meet the criteria set out in Section 3.

#### Access to data to inform regulatory decision making could be improved

4.8 As we explain, we consider that the current regime does provide us with the information we need to make regulatory decisions, but access to that information is more complicated than it should be.

4.9 We explained in Section 3 that Regulatory Financial Reporting should provide us with the information necessary to:

- make informed regulatory decisions;
- monitor compliance with SMP conditions;
- ensure that those SMP conditions continue to address the underlying competition issues; and
- investigate potential breaches of SMP conditions and anti-competitive practices.

4.10 There are two main sources through which we currently obtain information in addition to that set out in the published Regulatory Financial Statements.

- Annual submissions of information required under Regulatory Financial Reporting. This confidential information forms the unpublished Regulatory Financial Statements provided to us.
- Formal information requests under S.191 and S.135. Formal information requests allow us to request that BT provides specific information in a specified manner and within a reasonable time.

4.11 This information (together with that in the Published Regulatory Financial Statements) is used by us to monitor BT's compliance with its regulatory obligations and to inform our regulatory decision making. In order to enable CPs to participate in the development of, for example, charge controls we draw on these two sources to publish additional information to that set out in the published Regulatory Financial Statements. In doing so we make an assessment, on a case by case basis, about what is needed to allow stakeholders to participate in a meaningful way.

4.12 BT provides us with Regulatory Financial Reporting information annually on a confidential basis. This Additional Financial Information (generally provided in a series of documents called AFIs) provides more detail about BT's products and services in those markets in which it has SMP.<sup>65</sup> One piece of the Additional Financial Information is a set of data (called the 'flat file') which we use to populate our analysis tool called the Data Extract Tool.

4.13 We have found maintenance and use of the Data Extract Tool to be resource intensive. BT considers provision of the flat file "is neither relevant nor proportionate

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<sup>65</sup> Annex 26 to Direction

to what the Regulatory Financial Reporting SMP condition is intended to achieve.”<sup>66</sup> This is particularly so given BT considers that the flat file has not reduced the amount of financial information that BT is required to provide through Additional Financial Information and formal information requests.<sup>67</sup> UKCTA explained that we should not rely on the Data Extract Tool unless it gave us “access to reliable and contemporary data, with Ofcom having the necessary staff time and skill to manipulate it.”<sup>68</sup>

- 4.14 The flat file and Data Extract Tool have not provided the expected benefits to us or BT, nor have they significantly reduced the burden of AFIs and formal information requests. Nevertheless, for the time being at least we consider that it provides a useful, if not perfect, source of data, although, as explained in Section 6, there may be better ways of obtaining this information in the future.
- 4.15 While we also obtain information through formal information requests that we use to inform our regulatory decision making, in response to the 2012 Consultation, BT suggested that we would gain more assurance over the information we require if they provided the information on a more targeted basis. BT suggested we revise the requirement on the flat file and explain what information would be required as a substitute.<sup>69</sup>
- 4.16 Formal information requests alone cannot provide all the information we need. In part this is because we cannot request through S.191 or S.135 of the Act, information that does not already exist. This means that BT cannot be asked to create information such as scenario analysis.

#### Stakeholders cannot see whether BT has complied with some charge controls

- 4.17 We explained in Section 3 that the Regulatory Financial Statements should provide stakeholders with reasonable confidence on compliance with SMP obligations. We consider that, while BT provides us with sufficient information to determine whether it has complied with its charge controls, the current publication requirements do not give enough information to allow other stakeholders to see this for themselves. Stakeholders should be able to see that the prices that they pay for charge controlled products comply with regulatory requirements.
- 4.18 BT provides us with spreadsheets that aim to demonstrate compliance with the relevant basket controls. These spreadsheets provide detailed information about the price and volumes of each product within each basket. The provided information allows us to check that:
- weighted average basket calculations have been correctly calculated;
  - prior year adjustments are correctly accounted for;
  - the correct RPI has been used; and
  - any sub-basket controls have been complied with.

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<sup>66</sup> BT, 2012 Consultation response, page 14, paragraphs 74.

<sup>67</sup> BT, 2012 Consultation response, page 14, paragraphs 71, 75 and 76.

<sup>68</sup> UKTA, 2012 Consultation response, page 11, question 4.2.

<sup>69</sup> BT, 2012 Consultation response, page 14, paragraphs 79 and 80.

- 4.19 The Published Regulatory Financial Statements provide some information about BT's compliance with obligations in Annex 24.<sup>70</sup> However, the information in Annex 24 is not sufficiently detailed to allow stakeholders to see whether BT has complied with the basket of products and services to which charge controls apply. In particular, it does not provide the information about individual products within a charge control basket. Nor does it make clear how the specific products that stakeholders purchase contribute to the overall performance of the basket.
- 4.20 BT agreed in its response to our 2012 Consultation proposal that reporting on charge control compliance should be formalised but explained that our proposals were contrary to previous arrangements. CPs in general felt that they did not have enough information to give them reasonable confidence that BT had complied with its basket charge controls.
- TTG explained that "the breakdown by product is important" and provided its views about the information that BT should disclose.<sup>71</sup>
  - UKCTA considered that "it remains appropriate for information contained within the Regulatory Financial Statements 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."<sup>72</sup>
- 4.21 Under existing arrangements there is no clear link between the price of products and charge controls. CPs are unable to see in which baskets the products they buy are included and have no clear statement about the extent to which products and baskets of products comply with charge control obligations.
- 4.22 As a result we make proposals in Section 6 about the way in which information about BT's compliance with charge controls should be published.

#### Reporting of cost orientation should reflect the obligation

- 4.23 Stakeholders 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.
- 4.24 In the context of the existing cost orientation obligations, we note that the publication of DSAC ceilings and DLRIC floors within the Published Regulatory Financial Statements was important in enabling CPs to bring disputes relating to cost orientation of PPCs and Ethernet services.<sup>73</sup>
- 4.25 As noted in the Cost Orientation Review, the nature of cost orientation obligations imposed in the future may change. Given that we consider that Regulatory Financial Reporting should provide CPs with reasonable confidence of BT's compliance with cost orientation obligations we consider the appropriate reporting requirements should be determined as and when the remedy is imposed, subject to our normal consultation processes. Given that reported information should relate to the remedies

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<sup>70</sup> Price Controls in Access and Other Wholesale Markets (Annex 24)(Unaudited).

<http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2013/CurrentCostFinancialStatements2013.pdf>

<sup>71</sup> TTG, 2012 Consultation response, page 11, paragraph 51.

<sup>72</sup> UKCTA, 2012 Consultation response, page 7, question 3.2.

<sup>73</sup> Disputes between each of Sky, TalkTalk, Virgin Media, Cable & Wireless and Verizon and BT regarding BT's charges for Ethernet services. Determinations and Explanatory Statement.

[http://stakeholders.ofcom.org.uk/binaries/consultations/ethernet-services/annexes/Ethernet\\_FD.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/ethernet-services/annexes/Ethernet_FD.pdf)

that are imposed we would expect that the need for publication of information about cost orientation will change over time.

#### It is difficult to show compliance with all aspects of non-discrimination obligations

- 4.26 We consider that Published Regulatory Financial Statements should provide reasonable confidence to CPs that they pay the same price as BT's other customers (including BT's own downstream divisions) for the same products and services.
- 4.27 CPs believe that current arrangements are of limited value. For example, in its 2012 Consultation response TTG said that "the 'price' of the product or the accounting transfer charge is not a genuine amount that the downstream unit actually pays."<sup>74</sup> TTG went on to explain that "we do not agree that the Regulatory Financial Statements are of use when it comes to assessing compliance with non-discrimination obligations."<sup>75</sup>
- 4.28 Although UKCTA agreed that we should assess and provide assurance about BT's compliance with non-discrimination obligations in the Regulatory Financial Statements,<sup>76</sup> BT explained that it did not believe that the published financial statements should include assurance of compliance with non-discrimination obligations. BT questioned the need to "publish detailed volume, revenue and cost information for internal and external sales (as opposed to "internal transfer prices" – as referred to in Article 11)."<sup>77</sup>
- 4.29 We recognise some stakeholder concerns that the publication of internal prices is of only limited value. However, we consider that publication of such data provides a useful control over the way that BT reports its costs and revenues in different parts of its business and that the current arrangements are adequate.

#### Equivalence of Input (EOI) cost reporting is not clear

- 4.30 Regulatory Financial Reporting should ensure that where there is a product which is subject to SMP regulation, it should continue to be reported as required under BT's Regulatory Financial Reporting obligations, even where BT is required to provide that product on an EOI basis under the Undertakings.
- 4.31 Where products that BT is required to provide on an EOI basis are inputs into other regulated products, BT currently aggregates them as a single item in the Published Regulatory Financial Statements. For example, products that BT is required to provide on an EOI basis are an important input into regulated products within the WBA market. Whilst the input components costs that are not required to be provided on an EOI basis ('Wholesale costs') are disclosed within the FAC unit cost stack, those input components that are required to be provided on an EOI basis are aggregated. Whilst stakeholders made no specific comment on the reporting of products that BT is required to provide on an EOI basis in responses to the 2012 Consultation, our own analysis indicates that the reporting of them has been aggregated in Published Regulatory Financial Statements and is not transparent.<sup>78</sup>

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<sup>74</sup> TTG, 2012 Consultation response, page 7, paragraph 29.

<sup>75</sup> TTG, 2012 Consultation response, page 7, paragraph 30.

<sup>76</sup> UKCTA, 2012 Consultation response, page 7, question 3.2.

<sup>77</sup> BT, 2012 Consultation response, page 8, question 34.

<sup>78</sup> <http://stakeholders.ofcom.org.uk/consultations/review-wba-markets/> WBA Consultation, 1 July 2013, page 162, para 749.

4.32 In particular, attempts to understand and explain cost movements from one year to the next is made difficult by the reclassification of input costs between ‘Wholesale’ costs, which were disclosed and ‘EOI’ which were aggregated. However, we consider that it is necessary for us and for stakeholders to be able to see and understand them. As a result we make proposals in Section 6 to require BT to report products that it is required to provide on an EOI basis on a disaggregated basis.

#### Regulatory financial data is not consistent with regulatory decisions

4.33 In several significant respects, BT’s Published Regulatory Financial Statements are not consistent with our regulatory decisions.

4.34 TTG’s response to the CFI identified some of the differences:

“The Regulatory Financial Statements must be prepared on Ofcom’s view of assumptions. Currently the Regulatory Financial Statements are prepared on BT’s assumptions even where Ofcom has stated its own assumptions (which are different). For instance, the asset valuation is BT’s preferred approach (direct CCA) rather than the one Ofcom considers appropriate (CCA and RAV<sup>79</sup>). The costs include (we understand) costs that Ofcom disallows. Also the costs are based on BT’s allocations. This means that the costs shown do not represent Ofcom’s view of the costs. This clearly diminishes the usefulness of the Regulatory Financial Statements.”<sup>80</sup>

4.35 We consider that there is scope for greater consistency between the published Regulatory Financial Statements and regulatory decision-making, and that this would support the provision of relevant data that was understood by users of the Regulatory Financial Statements. Specifically, we consider that the relevance of the Regulatory Financial Statements is reduced because they are not prepared on a RAV basis.

4.36 Additionally, we consider that understanding of the Regulatory Financial Statements is reduced because the extent to which BT’s choice of allocation rules differs from those adopted by us in our recent decisions is not clear to some stakeholders. As a result we make proposals in Section 5 and 6 that will lead to a greater consistency of the Regulatory Financial Statements with our regulatory decisions.

4.37 TTG also made the point in the CFI that the Regulatory Financial Statements include costs that we disallow. This raises the broader question of if and how adjustments made by us, say, in the context of setting prices, should be reflected in the Regulatory Financial Statements.

4.38 These regulatory adjustments can take different forms, and include, for example:

- The exclusion of some costs that we consider should not be recovered through regulated prices;
- The reallocation of costs from one service to another for the purposes of setting appropriate prices for various policy reasons (rather than matching the cost to the activity that caused the cost); and

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<sup>79</sup> The RAV is a methodology we apply for valuation of access duct and copper in our charge controls. However, in the Regulatory Financial Statements and Information BT values these assets on a CCA basis.

<sup>80</sup> TTG, Call for Input response, paragraph 24.

- Restating asset values, for example to provide an estimate of the steady state cost of providing a service.

4.39 Currently, these price adjustments are not always reflected in the Regulatory Financial Statements. However, as we discuss further in Section 6, it is not obvious to us whether the benefits of requiring BT to reflect these adjustments in its Regulatory Financial Statements offset the practical difficulties of adopting such an approach.

#### The basis of preparation is not consistent over time

4.40 We consider that the current reporting arrangements allow for significant changes in the basis of preparation which makes the Regulatory Financial Statements harder to understand and creates at least the perception that information is not prepared on an objective basis. Further, the current reporting requirements do not always help users of the financial statements to understand the impact of those changes.

4.41 In recent years, BT has changed the bases for some of the figures in the Regulatory Financial Statements. Some of these changes are one-off changes in asset values (resulting in large holding gains or losses). However, we consider that the scope for significant holding gains and losses causing major changes in the reported costs has been reduced by BT's decision in 2013 to estimate its copper and duct valuations on the basis of historical spend indexed by RPI. This should reduce the volatility of the reported holding gains (and reduce the extent to which they reflect changes in BT's assumptions rather than changes in the underlying valuation).

4.42 Others reflect changes in the way BT allocates costs. The justification for these changes is not always clearly set out in the information provided in the Regulatory Financial Statements. For example, in July 2013 BT published its Regulatory Financial Statements for the year ending 31 March 2013. BT made a number of changes to cost allocation methodologies that made the Regulatory Financial Statements more difficult to understand. In particular, BT identified a number of changes where it considered the restatement of comparative information for the year ended 31 March 2013 not to be practicable. One of the changes that BT has not reflected in its restated comparatives relates to the new organisational structure following the merger of BT Innovate & Design and BT Operate to create BT Technology, Service & Operations ("TSO reorganisation"). BT has explained to us that, although the impact of this change is material, it is unable to restate the 2011/12 Regulatory Financial Statements.

4.43 Stakeholders have stated that the Published Regulatory Financial Statements do not help them to understand these changes. The 2012/13 Regulatory Financial Statements also reflected changes in the way BT valued some of its assets, which offset the effect of the allocation rule changes, so without further detailed financial analysis and access to confidential information it was not possible to see the impact of the cost reallocations between markets.

4.44 Under current Regulatory Financial Reporting arrangements, the scope for us to prevent BT from making such changes is limited. Ofcom can require BT to include in its Regulatory Financial Statements an Ofcom statement that we do not agree with some of the changes that BT have made. By signalling our intention to do so BT might reconsider its decision to make the changes. We used our statement at the front of BT's 2012/13 Regulatory Financial Statements to draw stakeholders'

attention to changes in the way in which BT had allocated its costs and assets.<sup>81</sup> We also explained that we had requested that BT should prepare and publish a reconciliation report setting out the reasons for, and effects of, all the material methodological changes.

- 4.45 This report (the 2012/13 Reconciliation Report) published by BT on 4 October 2013,<sup>82</sup> set out the impact of the most material allocation and valuation changes. It set out affected schedules that showed the aggregate change, explained individual changes and showed the impact of these changes on markets. This reconciliation report is additional to the reconciliation to statutory financial statements.
- 4.46 While we recognise that there will be the need to change methodologies to take account of new information from time to time, a lack of consistency over time, coupled with lack of clarity around the impact of such changes makes it harder for stakeholders to make comparisons between years, or form a view on the performance of BT's regulated business over time. As a result, we make proposals in Section 5 that we consider will lead to greater consistency over time, and in Section 6 require BT to explain the reasons for changes that are made and their impact.

#### Regulatory financial data is consistent with other financial data

- 4.47 In respect of consistency with the statutory accounts, we remain of the view that the ability to reconcile the Published Regulatory Financial Statements to the audited statutory accounts is essential if stakeholders (including us) are to gain confidence in the published financial statements.
- 4.48 BT currently provides such reconciliation and we do not consider that there is any specific issue to address regarding the consistency of the regulatory financial data with other financial data.

#### It is difficult to interpret the financial performance of BT's regulated activities from the Published Regulatory Financial Statements

- 4.49 As explained above, the costs shown in the Regulatory Financial Statements do not always align with Ofcom's view of the costs. As a result, they might provide only limited insight into Ofcom's view of BT's costs in that market or the possible outcome of future decisions that Ofcom might make. The ability for stakeholders to understand long term trends or make comparisons from year to year is further limited by changes in allocation rules from time to year. As a result there is a risk that stakeholders will not understand or may misinterpret the reported cost data.

#### The current reporting deadline is appropriate

- 4.50 We explained in the 2012 Consultation that BT is currently required to publish its financial statements within four months of the year end. This compares with the requirement for statutory accounts to be filed at Companies House within 9 months and 1 day of the year end.

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<sup>81</sup> BT, Current Cost Financial Statements for 2013 including Openreach Undertakings. <http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2013/CurrentCostFinancialStatements2013.pdf>

<sup>82</sup> BT, Report requested by Ofcom for the year ended 31 March 2013. <http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2013/ReportrequestedbyOfcomfortheyearended31March2013.pdf>

- 4.51 BT has not always delivered its Regulatory Financial Statements in time to meet this requirement. We noted that in the ten years to 2012, BT had published its Regulatory Financial Statements on time only twice. Timeliness has also been an issue for the provision of the confidential information required to be submitted to us in the form of Additional Financial Information.
- 4.52 In response, both UKCTA and CWW stressed the need to avoid delays in the publication of the Regulatory Financial Statements. UKCTA suggested that previous delays were the result of “BT’s failure to adequately resource the production of accurate regulatory accounting output” or “BT’s desire to re-present the output, usually when confronted with a dispute that may have an adverse financial outcome for them.”<sup>83</sup> BT agreed that current deadlines for publication should not be changed and pointed out a dependency on us providing “sufficient notice and detail of any regulatory reporting changes in the year or changes in our audit requirements.”<sup>84</sup>
- 4.53 BT has since submitted its 2012/13 Regulatory Financial Statements on time. This means that it has published its Regulatory Financial Statements on time for three of the last four years. After several years of late delivery, the confidential data was also provided on time in 2012 and again in 2013.
- 4.54 Given the improvement in timeliness of Regulatory Financial Statements and Additional Financial Information, and the fact that the deadlines are already set out in the form of a conditions we do not propose any changes to the current arrangements about timeliness.

### **The data must be reliable**

- 4.55 We explained in Section 3 that reported data must be reliable. In the 2012 Consultation, we summarised the main data reliability issues as:
- The current regime allows BT some discretion to determine the appropriate allocation bases for preparing its regulatory financial information.
  - Errors and restatements of the Regulatory Financial Statements have undermined stakeholder confidence in the reliability of the data.
  - The trigger for restatement may be too low, resulting in unnecessarily frequent restatements of the Regulatory Financial Statements.
- 4.56 In response BT confirmed that “the main issues had been identified by Ofcom”<sup>85</sup> and UKCTA explained that “stakeholders remain concerned about the reliability of data, [and] the apparent discretion that BT has to make changes without consultation or approval.”<sup>86</sup>
- 4.57 We now consider each of the three aspects of reliability in turn.

### **Aspects of the financial data do not appear to be as robust as we would expect**

- 4.58 In Section 3 we explained that to be reliable the underlying data must be free from error. Currently, this is not always the case. As we explained in the 2012

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<sup>83</sup> UKCTA, 2012 Consultation response, page 22, question 5.8.

<sup>84</sup> BT, 2012 Consultation response, page 27, paragraph 147.

<sup>85</sup> BT, 2012 Consultation response, page 11, paragraph 46.

<sup>86</sup> UKCTA, 2012 Consultation response, page 10, question 4.1.

Consultation, errors and restatements of the Regulatory Financial Statements have undermined stakeholder confidence in the reliability of the data. In response to the 2012 Consultation:

- Virgin noted that it is “errors, restatements and changes in accounting treatment that have undermined the confidence in the current arrangements.”<sup>87</sup>
- CWW pointed out that “Past Regulatory Financial Statements output has proved to be unreliable with two significant restatements and a major revaluation and this has had the impact of undermining stakeholder confidence in the accounts.”<sup>88</sup>

4.59 BT has, as we set out in the 2012 Consultation, made a number of restatements to its Published Regulatory Financial Statements in recent years. For example in the 2010/11 Regulatory Financial Statements BT restated prior year comparatives for the TISBO Market (above 45Mbit/s up to and including 155 Mbit/s) to reflect a correction in its calculation of internal links volumes.<sup>89</sup>

4.60 Subsequently, in the 2012/13 Regulatory Financial Statements, we identified an error. There was an error in Section 6.3 for Mean Capital employed 2012 for the restated 11/12 amounts. An error in the split between the Non-current Assets amounted to c£2m.<sup>90</sup>

4.61 From time to time other errors in the Regulatory Financial Statements may be identified either by BT, stakeholders, or by us. For example, in the Ethernet disputes we made adjustments to “correct for what we considered to be straightforward volume and revenue errors.”<sup>91</sup>

4.62 We accept that, from time to time, some errors may be inevitable. However, while it is difficult to determine what might be considered to be an acceptable level of error, we consider that the current level of error does reduce the extent to which the Regulatory Financial Statements could be considered to be reliable. We make proposals in Section 5 to address the reliability of underlying data. Where errors and restatements do occur, there should be clear disclosure of the cause and effect. We therefore make proposals in Section 6 to ensure that stakeholders are provided with adequate disclosure of the cause and effect of errors and restatements.

#### The current regime gives BT too much discretion over the choice of accounting rules

4.63 In Section 3 we said that the rules about preparation of the Regulatory Financial Statements need to cover the way that costs and revenues are identified, assets are valued, assets are allocated to products and services and information is presented. We explained that the rules need to be chosen so as to align with the purposes of Regulatory Financial Reporting and to support our regulatory objectives.

4.64 We also explained that one important aspect is objectivity although we recognised that in particular in the context of allocating costs, there may be scope for

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<sup>87</sup> Virgin Media, 2012 Consultation response, page 1, paragraph 2.

<sup>88</sup> CWW, 2012 Consultation response, page 18, question 4.1.

<sup>89</sup> It should be noted that BT decided that the change had an immaterial impact on the TISBO (up to and including 8Mbit/s) Market and therefore did not restate comparatives for this market.

<sup>90</sup> <http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2013/AdditionalinformationinrelationtoBTsCurrentCostFinancialStatements2013.pdf>.

<sup>91</sup> Disputes between each of Sky, TalkTalk, Virgin Media, Cable & Wireless and Verizon and BT regarding BT's charges for Ethernet services. Determinations and Explanatory Statement. [http://stakeholders.ofcom.org.uk/binaries/consultations/ethernet-services/annexes/Ethernet\\_FD.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/ethernet-services/annexes/Ethernet_FD.pdf)

judgements to be made. Nevertheless, we explained that it is important that the set of rules used to prepare the Regulatory Financial Statements is free (and is seen to be free) of any inherent bias that favours BT.

4.65 We went on to explain in the 2012 Consultation that BT has considerable control over both the selection of the basis of preparation including the rules that it chooses, and the changes to that basis. We also said that stakeholders claim this permits BT to shape the data in its favour.

- UCKTA said that “Ofcom cannot expect stakeholders to hold confidence in the Regulatory Financial Statements 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.”<sup>92</sup> UCKTA also explained that BT’s revaluation of its asset base in 2009/10 “highlighted just how BT is able to alter its regulatory accounting output to suit its commercial objectives.”<sup>93</sup>
- TTG said that it did not consider that “BT can be trusted to prepare ‘fair’ Regulatory Financial Statements”<sup>94</sup> and drew attention to what it sees as BT’s “track record of estimating and allocating costs in a manner that maximise profits rather than a manner which is fair, efficient or promotes effective competition.”<sup>95</sup>

4.66 As we explained in the 2012 Consultation, the Regulatory Accounting Principles provide a frame of judgment against which the appropriateness of the basis of preparation, including the rules chosen, can be judged. We consider that the current form of Regulatory Accounting Principles provides BT with a greater level of freedom and flexibility to choose the basis of preparation than is appropriate.

4.67 In particular we note that the Regulatory Accounting Principles, as currently published in BT’s Primary Accounting Documents do not require consistency with regulatory decisions.

4.68 BT’s ability to change rules as they relate to the allocation of costs and assets also causes concern for stakeholders. Stakeholders are concerned that BT is able to choose the basis of preparation that is favourable and then change methodologies both as the result of its own circumstances and in anticipation of changing regulatory environment.

4.69 CWW argued out that BT decisions to restate numbers within its Regulatory Financial Statements and make material changes to valuation assumptions, “were detrimental to BT’s competitors and helpful to BT Group interests in the context of disputes and the setting of charge controls.”<sup>96</sup>

4.70 However, TTG stated that it is important that the Regulatory Financial Statements are consistent with regulatory decisions and that “if the Regulatory Financial Statements have to change (and be restated) because the allocation rules change then so be it.”<sup>97</sup>

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<sup>92</sup> UKCTA, 2012 Consultation response, page 15, question 5.1.

<sup>93</sup> UKCTA, 2012 Consultation response, page 2, paragraph 4.

<sup>94</sup> TTG, 2012 Consultation response, page 3, paragraph 6.

<sup>95</sup> TTG, 2012 Consultation response, page 3, paragraph 8.

<sup>96</sup> CWW, 2012 Consultation response, page 2, paragraph 1.5.

<sup>97</sup> TTG, 2012 Consultation response, page 13, paragraph 37.

- 4.71 UKCTA said that “Ofcom needs to be more involved in setting the rules that underpin the preparation and reporting of BT’s regulatory financial statements.”<sup>98</sup> which EE appeared to support; “Ofcom’s proposals to have greater involvement in the process are therefore to be welcomed.”<sup>99</sup>
- 4.72 Other stakeholders felt we should have a more secondary role. BT recognised “that there is value in Ofcom having greater (albeit, proportionate) involvement in setting methodologies in advance of the publication of the statements as such involvement would provide greater regulatory certainty for us and other stakeholders.” However, they said they were better placed to develop and understand the rules for attribution due to the complexity of their business.<sup>100</sup> CWW also envisaged our involvement as “a more hands on secondary role.”<sup>101</sup>
- 4.73 UCKTA and CWW stated that we had not considered the issues around the culture of preparation in the 2012 Consultation that had been identified during the Call for Inputs stage and suggested that sanctions for failing to provide balanced and accurate information could lead to a more impartial culture for preparation of the Regulatory Financial Statements. However, we already have certain powers if we believe that the Regulatory Financial Statements and/or BT’s Accounting Documents are deficient.<sup>102</sup> We may for example direct that BT amends its Accounting Documents to correct deficiencies, restate Regulatory Financial Statements, obtain an audit opinion on restated Regulatory Financial Statements and publish the restated Financial Statements and corresponding audit opinions.
- 4.74 Further, for the time being, we consider that the proposals set out in Section 5 address these concerns directly and therefore more effectively than the threat of new sanctions, by introducing more guidance and control over the way in which the basis of preparation can be changed.

### The rules are followed, but mistakes are made

- 4.75 In Section 3 we said that it is not enough to have an appropriate and objective set of rules if those rules are not followed. BT appears to follow the published rules, but, as explained above, the Regulatory Financial Statements have contained errors in the past.
- 4.76 This also raises a question regarding the effectiveness of the audit.
- 4.77 In the 2012 Consultation we explained that internal controls, review by us and independent audit, all have a role to play in providing confidence that the published rules are followed.
- 4.78 We noted that while we continue to attach significant value to the audit, it appears that other users of the Regulatory Financial Statements do not consider that the audit alone provides enough confidence that the Regulatory Financial Statements are reliable. In its response to the 2012 Consultation EE recognised the role that audit

<sup>98</sup> UKCTA, 2012 Consultation response, page 14.

<sup>99</sup> EE, 2012 Consultation response, page 7.

<sup>100</sup> BT, 2012 Consultation response page 20, paragraph 108-107.

<sup>101</sup> CWW, 2012 Consultation response, page 19.

<sup>102</sup> Requirements relating to deficiencies in the Regulatory Financial Statements and the Accounting Documents. OA 22. The regulatory financial reporting obligations on BT and Kingston Communications. Final Statement and notification. 22 July 2004.

[http://stakeholders.ofcom.org.uk/binaries/consultations/fin\\_reporting/statement/finance\\_report.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/fin_reporting/statement/finance_report.pdf)

plays but noted that it cannot be the only mechanism to “ensure the robustness and reliability of the financial statements.”<sup>103</sup>

4.79 Other stakeholders confirmed that they lack confidence in the audit process:

- UKCTA recalled that in its Call For Inputs response it had explained that the “current audit regime was not working”<sup>104</sup> and that what it saw as “Ofcom’s own over-confidence in the audit” lead to the Regulatory Financial Statements being seen “as beyond reproach as a result of the auditor signing them off.”<sup>105</sup>
- CWW explained that “it cannot be satisfactory for the auditor to repeatedly sign-off accounts only to have them restated a year later, again signed off by the auditor and for this to recur.”<sup>106</sup>
- TTG said that the “current level of audit is weak”<sup>107</sup> providing specific examples of attributions that it considered had been allowed which were “clearly biased in BT’s favour”.<sup>108</sup> TTG explained that in its view the current approach means that the audit would “only at best identify implausible allocations.”<sup>109</sup>

4.80 CPs expressed dissatisfaction with the audit in both their responses to the 2011 Call for Inputs and their responses to the 2012 consultation. They explained that in recent years, there had been a series of restatements. This had led to a loss of confidence in the results themselves, as well as a loss of confidence in the audit. They could not understand how the auditors could sign-off the accounts in one year, only to sign-off a restated version in the subsequent year.

4.81 In our view, concerns over the audit can be better resolved by dealing with the root causes of these restatements, via our proposals elsewhere, rather than changes to the audit. In our view, there are two reasons for a restatement:

- A change in methodologies from one year to the next; and
- Errors.

4.82 In recent years, most of the restatements have either been due to a methodology change or to an adjustment that has been characterised by BT as a methodology change, rather than an error. There have been few instances of pure data, computation or presentation errors. For example, the 2012/13 Published Regulatory Financial Statements (see Section 6.4 Attribution of Wholesale Current Cost Mean Capital Employed 2012 (Annex 6A) on page 29 of the Statements.<sup>110</sup>

4.83 Some CPs were pragmatic about the ability of audit to pick-up on methodology changes. For example:

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<sup>103</sup> EE, 2012 Consultation response, page 9, question 3.3.

<sup>104</sup> UKCTA, 2012 Consultation response, page 9, question 3.3.

<sup>105</sup> UKCTA, 2012 Consultation response, page 12, paragraph 56.

<sup>106</sup> CWW, 2012 Consultation response, page 11, paragraph 4.19.

<sup>107</sup> TTG, 2012 Consultation response, page 13, paragraph 60.

<sup>108</sup> TTG, 2012 Consultation response, page 13, paragraph 63.

<sup>109</sup> TTG, 2012 Consultation response, page 13, paragraph 62.

<sup>110</sup> BT’s 2012/13 Regulatory Financial Statements.

<http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2013/AdditionalinformationinrelationtoBTsCurrentCostFinancialStatements2013.pdf>

- EE stated “generally an audit will only identify whether a stipulated methodology has been reasonably carried out. Whether the methodology itself is reasonable is, as Ofcom identifies, much harder to achieve through an audit regime.”<sup>111</sup> EE went on to say that “rather alternative means must be established to ensure that any more “subjective” elements to the methodology are achieved through a proper process. EE notes that in other regulated sectors, for example the water sector, this is achieved through specific regulatory guidelines.”<sup>112</sup>
- TTG explained: “probably the best comfort that the audit can offer is that the allocation bases are not unreasonable. In practice the audit lets through attributions that are clearly biased in BT’s favour.”<sup>113</sup>

4.84 We believe that the most effective way to deal with methodology changes is directly via our proposals in Section 5 rather than through the audit.

4.85 As regards the potential auditor sign-off, in future, of Regulatory Financial Statements containing material errors at market level (and subsequent restatements), we will keep this under review. As we explain in Section 6, we believe that we already have the necessary powers to change the auditors, should it be deemed necessary.

### **The basis of preparation must be clear and the reports easy to use**

4.86 In the 2012 Consultation, we said that we consider that the requirements for transparency impact on both the transparency of the basis of preparation and the ease of use of the data produced.

4.87 We now consider the degree to which the basis of preparation is transparent using the objectives that we set out in Section 3, before considering whether the data that is reported is clear and easy to use.

### The basis of preparation is not always clear

4.88 In the 2012 Consultation we explained that it is essential that any user of the Regulatory Financial Statements understands how and why they are prepared. There are three aspects, each of which we consider in turn:

- The purpose of the Regulatory Financial Statements in aggregate and of any individual statement.
- The respective roles and responsibilities of directors. We have explained that a lack of appreciation of these roles is likely to reduce confidence and that the roles should therefore be clearly articulated.
- The methodologies that BT follows in preparing the accounts, such as how to allocate costs and how to value assets.

4.89 It is important that users of the Regulatory Financial Statements understand the overall purpose of the Regulatory Financial Statements. We have in Section 3 set out, in the light of stakeholder responses, what we consider to be the purpose of the Regulatory Financial Statements.

<sup>111</sup> EE, 2012 consultation response, page 9, question 3.3.

<sup>112</sup> EE, 2012 consultation response, page 9, question 3.3.

<sup>113</sup> TTG, 2012 consultation response, page 14, paragraph 63.

- 4.90 Each set of Published Regulatory Financial Statements contains an introduction in which BT sets out the regulatory background and the obligations imposed on it that lead to the publication of the Regulatory Financial Statements. BT's Primary Accounting Document (Primary Accounting Documents) also provides background to the reporting requirements imposed on it.
- 4.91 We note that stakeholders have not made significant comments about the roles and responsibilities of directors in relation to the Regulatory Financial Statements either in aggregate or individually. We did, however, say in the 2012 Consultation that we would consider whether it is appropriate to require the Regulatory Financial Statements to be signed by a BT Director. In response both CWW and UKCTA said that the BT Group CFO should sign off the Regulatory Financial Statements and TTG said that "sign off of the accounts should be by a senior BT Director."<sup>114</sup> BT said that current arrangements had not led to any problems.
- 4.92 As we have said in Section 3, the basis of preparation of the Regulatory Financial Statements are currently documented in the Primary and Secondary Accounting Documents together with the Wholesale Catalogue. The Primary Accounting Documents contain the high level principles of attribution.
- 4.93 The Secondary Accounting Documents contain detailed descriptions of the policies, methodologies, systems, processes and procedures for deriving or calculating the costs, revenues, assets and liabilities underlying the Regulatory Financial Statements. The Secondary Accounting Documents consist of:
- The Detailed Attribution Methodology, which describes processes used to derive FAC of network components, SMP markets, Technical Areas and Disaggregated Activities.
  - The Detailed Valuation Methodology which provides a concise view as to how BT values its assets.
  - The LRIC Model. The LRIC element within the Secondary Accounting Documents (Relationships and Model Parameters) describes the calculation of the long run incremental values for the network.
- 4.94 The Wholesale Catalogue describes the attributes of all the regulated products that BT sells.
- 4.95 Stakeholders have told us that parts of the current Secondary Accounting Documents are difficult to understand. Attention focuses on the Detailed Attribution Methodology which is comprised of 358 pages with another embedded 756 pages of spreadsheets. CWW see the Detailed Attribution Methodology in its current format as an internal BT document that "does not lend itself to be useful to stakeholders." CWW went on to say that its "ideal outcome would be something more descriptive and user friendly."<sup>115</sup>
- 4.96 In our view the Detailed Attribution Methodology is unlikely to be clear to even the most experienced of users. It seems to us that the Detailed Attribution Methodology fails to be transparent because it aims to do two things. As well as providing a description of BT's cost allocation system, it sets out the detailed rules that BT staff

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<sup>114</sup> EE, 2012 Consultation response, page 14, paragraph 65.

<sup>115</sup> CWW, 2012 Consultation response, page 10, paragraph 5.11.

and auditors use for reference. With nine levels of allocation and attribution rules it is difficult to understand.

- 4.97 BT said that while concerns about supporting documentation are justified it is not its aim to confuse users “by the production of excessive documentation.” BT explained that it is the requirements of the transparency principle together with the “necessary scale of our accounting records which drives the scale and complexity of the Detailed Attribution Methods.”<sup>116</sup> BT went on to explain that the audit requirement to ensure compliance of the Detailed Attribution Methodology and other secondary documents with the transparency principle means that these documents must be produced in a comprehensive form.<sup>117</sup>
- 4.98 In BT’s view “the wording of the transparency principle and the associated audit requirement has proved to be counterproductive. The volume and detail of data that this has required us to provide has in practice obscured key messages and through its complexity prevented users from gaining the understanding of our methodologies that they seek.”<sup>118</sup>
- 4.99 We proposed in the 2012 Consultation that BT should provide interested parties with an opportunity to discuss the Regulatory Financial Statements shortly after publication. Stakeholders agreed that an opportunity to raise questions, through for example a feedback process, and get answers would be useful. On reflection we consider that the proposals that we make in this document will provide stakeholders with a better understanding of the basis of preparation and, through the change control and error notification process, an opportunity to understand the impact of changes to methodologies and restatements.
- 4.100 A requirement on BT to answer questions from stakeholders about its Regulatory Financial Statements would be difficult to monitor and enforce. Our decision not to propose a formal mechanism does not however prevent BT from itself putting in place a way for stakeholders to ask questions and make comments.
- 4.101 Our view is that the Detailed Attribution Methodology should describe high level rules rather than the detailed rules for every cost and product. A reader of the Detailed Attribution Methodology should, first, be able to gain an understanding about how the allocation system works at a high level. This should include providing some but not all examples using data that could be seen in the Regulatory Financial Statements. Secondly, the Detailed Attribution Methodology should answer broad questions about how costs are allocated to markets.

#### Transition to new system must be transparent

- 4.102 In the 2012 Consultation, we also explained that the way in which BT’s regulatory accounting systems have evolved means that they appear to be overly complex and time consuming to change. We explained that they require significant manual intervention to run, and lack transparency. In our view, this lack of transparency about BT’s accounting systems contributes to the lack of transparency that stakeholders perceive about the basis of preparation. We note however BT’s intention to replace the current regulatory accounting system with a new regulatory accounting system. While BT needs to ensure that its current system complies with

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<sup>116</sup> BT, 2012 Consultation response, page 11, paragraph 49.

<sup>117</sup> There are 6 Directions imposed on BT in relation to accounting separation and cost accounting. Direction 2 imposes a transparency principle in BT in relation to the accounting documentation.

<sup>118</sup> BT, 2012 Consultation response, page 11, paragraph 50.

the Regulatory Financial Reporting requirements that are in place, we consider that we should focus on ensuring that the transition to any new system is well managed.

- 4.103 Any new system must be capable of complying with the Regulatory Financial Reporting from its implementation. While the design and specification of BT's regulatory accounting systems is ultimately a matter for BT to decide we are keen to ensure that we are kept informed about progress in implementation of any new system and to prevent transition leading to any unexplained differences in reported numbers.
- 4.104 In its response to the 2012 Consultation, CWW saw the need for BT to invest in new systems that it considered would bring benefits for BT's own businesses by helping it to better understand costs and drive efficiencies while helping to better inform both us and stakeholders. CWW explained that it would "like to see as much transparency as possible in the design process itself to ensure that the new system is fit for purpose and remains so."<sup>119</sup>

### Some reports could be clearer

- 4.105 In Section 3, we explained that the presentation of the published Regulatory Financial Statements should be clear and easy to understand. We recognise that there can be a tension between the volume and detail of data published, and its accessibility. BT considers that "the current requirements encourage volume of publication rather than its clarity."<sup>120</sup>
- 4.106 BT explained that "the level of detail published actually works against providing a truly relevant and reliable set of data in a clear way that can inform decision making".<sup>121</sup> Additionally, BT argues that the need to restate the Regulatory Financial Statements for material changes "goes against clarity."<sup>122</sup> While the aim is to provide transparency about the impact of material changes in allocation methodology and material error, stakeholders have made clear that the outcome can be counterproductive serving to undermine confidence in the Published Financial Statements.
- 4.107 We note that BT considers that the existing requirement to report methodology changes (and errors) which impact a market by 5% may not always be proportionate. Indeed BT said that consideration for restatement should be "on a case by case basis" with the threshold increased where appropriate.<sup>123</sup>
- 4.108 We recognise that in the case of both errors and methodological changes there will be cases where the 5% trigger is exceeded in markets which are relatively small in the context of BT's overall business. Nevertheless, changes in these markets may affect particular stakeholders disproportionately. It would be inappropriate for these stakeholders to be provided with less transparency than those operating in other larger markets.
- 4.109 Other stakeholders such as CWW consider that "there is a strong need to continue publication of BT data at a detailed level."<sup>124</sup> Gamma said that "the financial data provided by BT needs to be in a form (and at a level of detail) to enable Ofcom and

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<sup>119</sup> CWW, 2012 Consultation response, page 7, paragraph 4.4.

<sup>120</sup> BT, 2012 Consultation response, page 11, paragraph 47.

<sup>121</sup> BT, 2012 Consultation response, page 27, paragraph 151.

<sup>122</sup> BT, 2012 Consultation response, page 12, paragraph 56.

<sup>123</sup> BT, 2012 Consultation response, page 12, paragraph 56.

<sup>124</sup> BT, 2012 Consultation response, page 27, paragraph 151.

other CPs to evaluate whether BT is meeting its regulatory obligations and commitments.”<sup>125</sup> UKCTA said that it “does not consider that there should be any reduction in the level of detail that is provided in the Regulatory Financial Statements.”<sup>126</sup>

- 4.110 In the 2012 Consultation, we explained that the presentation of the Regulatory Financial Statements needed improvement to make them more accessible and transparent and that extending the format in which the Regulatory Financial Statements is published, such as in spreadsheet format, would be appreciated by stakeholders. CWW said that it would like to see the accounts made more accessible with greater use of spreadsheet format files as this would “improve stakeholder’s ability to digest the information.”<sup>127</sup> By doing so CWW thought that it might mean that previously underused schedules would become more useful. We subsequently directed BT to provide the 2012/13 Regulatory Financial Statements in spreadsheet format.<sup>128</sup>
- 4.111 To have reasonable confidence that BT has complied with obligations, stakeholders need to understand the way in which regulated prices flow through to the products and services that they purchase, and how they contribute to the overall performance of charge control baskets. In the 2012 Consultation we said that a formal requirement for this information was essential.
- 4.112 In their response, UKCTA said that they “support the ability of stakeholders to map the services listed to regulatory financial statements.”<sup>129</sup> TTG said that information should be provided that allow CPs to assess “the contributions of different products to changes in the basket price change.”<sup>130</sup>
- 4.113 While Annex 24 of the Regulatory Financial Statements provides high level information, it does not make clear how the specific products that stakeholders purchase contribute to the overall performance of reported baskets. Stakeholders are unable to map purchased products and services to those set out in Annex 24.
- 4.114 We consider that at present the Published Regulatory Financial Statements are not easy to use.
- In some cases the volume and detail of information provided has prevented accessibility and understanding.
  - In the past users have been unable to access and make use of the data contained within the Regulatory Financial Statements. Providing the published Regulatory Financial Statements in spreadsheet format has increased user accessibility.
  - Users are unable to make comparisons with products that they purchase with what is reported in the Regulatory Financial Statements. Information about compliance with price controls is at a level which delivers no real value to stakeholders.

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<sup>125</sup> Gamma, 2012 Consultation response, page 1, paragraph 4.

<sup>126</sup> UKCTA, 2012 Consultation response, page 21, question 5.6.

<sup>127</sup> CWW, 2012 Consultation response, page 13, paragraph 5.4.

<sup>128</sup> Changes to BT and KCOM’s regulatory and financial reporting 2012/13 update, 25 April 2013, <http://stakeholders.ofcom.org.uk/binaries/consultations/bt-kcom-2012-13/statement/bt-kcom-statement.pdf>

<sup>129</sup> UKCTA, 2012 Consultation response, page 24, question 5.10.

<sup>130</sup> TTG, 2012 Consultation response, page 1, paragraph 51.

4.115 As a result we make proposals in Section 6 to increase the clarity of the Regulatory Financial Statements reports.

### **The requirements must be proportionate and have regard to legitimate concerns of confidentiality**

4.116 We have explained in Section 3 that there are two aspects to be considered:

- The volume and detail of data that is required to be published and provided to us.
- The degree to which data is commercially sensitive and should not be published.

### Regulatory reporting should follow policy and should explicitly be linked to SMP conditions.

4.117 We recognise that any obligation that requires information to be produced and published will incur some cost to BT. These costs should only be imposed where necessary. As such we should only require BT to publish information to the level necessary to meet the requirements and objectives of Regulatory Financial Reporting. Stakeholders should not expect information to be published that goes beyond the purposes that we have identified. In considering the need for information to be published we must consider the extent to which it might be commercially confidential.

4.118 We understand that some CPs have been seeking greater amounts of data (both volume and detail) to compensate for what they perceive to be weaknesses in Regulatory Financial Reporting. Some CPs consider that this additional information will provide a greater degree of confidence through their own review of data. In part this is to obtain assurance about compliance. As TTG points out “we are not in a position yet where CPs can have confidence that Ofcom will check BT’s compliance and therefore CPs need to be provided the data so that they can check compliance themselves.”<sup>131</sup>

4.119 BT expressed concerns about the need for it to publish what it sees as “a large volume of granular service level data on volumes, revenues and costs.”<sup>132</sup> BT considers that “the current level of reporting goes far beyond what is proportionate” and that the detail published “falls more into the category of data that is “useful and interesting” to CPs rather than data that is necessary.”<sup>133</sup>

4.120 BT considers that the level of detail that it is required to publish is greater than is required elsewhere in the EU and that the requirement does not always appear to be linked to an SMP Condition. As a consequence, BT considers that it is required to publish information that is commercially confidential. Indeed BT points to a Deloitte report that it commissioned that states that “the requirements of BT’s annual regulatory submission are among the most detailed and onerous in Europe.”<sup>134</sup> While we accept that requirements might, for good reason, be different in other administrative areas of the EU, we do not consider that the different requirements imposed by other administrations should limit those requirements that we see as necessary. It is for other administrations to consider what is appropriate in the markets that they regulate.

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<sup>131</sup> TTG, 2012 Consultation response, page 2, paragraph 4.

<sup>132</sup> BT, 2012 Consultation response, page 3, paragraph 7.

<sup>133</sup> BT, 2012 Consultation response, page 3, paragraph 9.

<sup>134</sup> <http://stakeholders.ofcom.org.uk/binaries/consultations/reg-financial-report/annexes/deloitte.pdf>

4.121 Other CPs however felt differently from BT:

- TTG explained that in its view “there are limited commercial sensitivity concerns that result from disclosure in the Regulatory Financial Statements.”<sup>135</sup>
- TTG said that “BT’s claims regarding commercial confidentiality which are vague and un-evidenced seem to be little more than a ploy to limit disclosure in order to prevent others scrutinising their costs.”<sup>136</sup>
- CWW set out its view that the starting position should be “that all cost information relating to SMP products must be open to scrutiny, unless there is sound justification for it remaining confidential.”<sup>137</sup>
- CWW said that BT’s continued claims of confidentiality “are massively overstated”. CWW went on to “challenge BT to elaborate on just how the information published on SMP markets could compromise the parts of their business that do operate within competitive markets.”<sup>138</sup>

4.122 Regulatory Financial Reporting should, as set out in Section 3, follow policy and should explicitly be linked to SMP conditions. For example, in the Narrowband Market Review, we removed certain publication obligations, because we considered that the information was no longer required in light of the other SMP conditions we had set. We will in each individual market review continue to consider the necessary reporting requirements in conjunction with the other SMP obligations.

4.123 BT is currently required to publish detailed service analysis and FAC cost information at the component cost level based on usage factors. This currently includes aggregations of products where the financial importance of the individual products does not warrant individual disclosure. There is a question, for aggregated groups of products in the Published Regulatory Financial Statements, the extent to which this information adds value. For example ‘Tie Cables’ covers over 50 price listed products, yet BT is required to publish average price and FAC information for the aggregated product which does not relate to any single purchased product.

4.124 We have carefully considered, and will continue to do so, the need for the publication of information (in terms of volume and detail) in the Regulatory Financial Statements and any submissions by BT as to the confidentiality of data will be part of our considerations. We note however that even information which is confidential may, under certain circumstances, be published, in particular were the information would be disclosed for the purpose of facilitating the carrying out by Ofcom of any of their functions.<sup>139</sup>

4.125 It is our view that in the main the information that is currently published in Regulatory Financial Statements is at the right level in terms of volume and detail. However there are some areas where we consider that the volume and level of detail is more than should be published.

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<sup>135</sup> TTG, 2012 Consultation response, page 6, paragraph 22.

<sup>136</sup> TTG, 2012 Consultation response, page 2, paragraph 4.

<sup>137</sup> CWW, 2012 Consultation response, page 10, paragraph 4.17.

<sup>138</sup> CWW, 2012 Consultation response, page 3, paragraph 2.7.

<sup>139</sup> Section 393 Communications Act 2003

- 4.126 For example, Section 7.10.2 of the 2012/13 Published Regulatory Financial Statement presents an FAC cost stack for ‘Co-mingling rentals’<sup>140</sup> despite no such product being shown on the Openreach price list. The disclosure actually relates to an aggregation of various Co-mingling products including Accommodation, Power and Tie Cables and others. These individual products within this aggregation are charge controlled within a basket that includes connection costs. We will consider, as part of the relevant market review which will review this charge control, whether this level of detail is necessary.
- 4.127 As a result we make proposals in Section 6 about the information that BT must publish.

## What needs to be done?

- 4.128 We have identified a number of areas where we think Regulatory Financial Reporting could be improved. In the following sections, we set out how we propose to change the Regulatory Financial Reporting requirements in line with our findings.
- 4.129 Our proposals are based around the four key elements of the reporting framework we proposed in the 2012 Consultation, as follows:
- the information that BT produces for regulatory reporting purposes (which we originally termed “**Data**”). Our proposals relating to the basis of preparation of the data are set out in Section 5, “Basis of Preparation”;
  - the published and unpublished reports (“**Reports**”). Our proposals relating to the way the data should be provided (in published reports are elsewhere) are set out in Section 6, “Reports”;
  - the mechanisms by which the data, reports and systems are defined, updated, reviewed and verified (“**Controls**”). We make some proposals relating to review of data in Section 7 “Audit and Review”; and
  - the infrastructure by which the data is produced (“**Systems**”). Our proposals relating to BT’s reporting systems are set out in Section 8 “Transition to a new regulatory accounting system”.
- 4.130 Taken as a whole, we consider that these proposals will provide a coherent, proportionate and practicable means of improving the usefulness of regulatory financial reporting in general and the published Regulatory Financial Statements in particular.
- 4.131 We have identified areas where improvements can be made to current arrangements for Regulatory Financial Reporting. We have summarised areas for improvement in the following table, and have linked them to the proposals that we make in the remainder of this document.

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<sup>140</sup> Wholesale Local Access (WLA) calculation of FAC based on component costs and usage factors (annex 16).

**Table 1. Areas for improvement and key proposals**

<b>Areas for improvement</b>	<b>Proposal</b>	<b>Reference</b>
Regulatory financial data is not consistent with regulatory decisions	Regulatory Financial Statements must be produced in line with revised Regulatory Accounting Principles that require consistency with regulatory decisions.	Section 5: Basis of Preparation
The basis of preparation is not consistent over time	By taking greater control over the basis of preparation we will bring stability and consistency to Regulatory Financial Statements	Section 5: Basis of Preparation
Current regulatory reporting gives BT too much discretion over the choice of accounting rules	We will take greater control over the basis of preparation we will bring stability and consistency to the Regulatory Financial Statements.	Section 5: Basis of Preparation
The rules are followed, but mistakes are made	The Regulatory Financial Statements must be produced in line with revised Regulatory Accounting Principles that require accuracy. BT must notify material errors it decides to correct.	Section 5: Basis of Preparation
Stakeholders cannot see whether BT has complied with charge controls	BT must publish non-confidential versions of compliance spreadsheets that will allow CP's to map the services they buy to the Regulatory Financial Statements.	Section 6: Reports
Reporting of cost orientation should follow the obligation	Reporting of cost orientation must follow regulatory decisions set out in the Market Review.	Section 6: Reports
Equivalence of Input (EOI) reporting is not clear	BT must report products that it is required to provide on an EOI basis on a disaggregated basis.	Section 6: Reports
Aspects of the financial data do not appear to be as robust as we would expect	Stakeholders will be provided with adequate disclosure of the cause and effect of errors and	Section 6: Reports

	restatements	
The basis of preparation is not always clear	We will revise requirements around the Transparency Direction to help BT publish Accounting Methodology Documents to improve the content and accessibility.	Section 6: Reports
Regulatory reporting should follow policy and should explicitly be linked to SMP conditions.	We will only require the publication of information linked to regulatory obligations.	Section 6: Reports

## Conclusions

4.132 We have assessed how well the current arrangements meet the objectives, purpose and attributes of effective regulatory reporting. Our assessment is that there are areas where improvements can be made to existing regulatory financial reporting arrangements.

4.133 In the following sections we set out how we propose to address these areas.

### Consultation questions

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

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

## Section 5

# Basis of Preparation

## Introduction

- 5.1 In Section 4, we identified a number of areas where improvements could be made to current Regulatory Financial Reporting arrangements by making changes to the way BT is required to prepare its Regulatory Financial Statements.
- 5.2 In this section, we set out our proposed changes to the requirements relating to the basis of preparation. These build on three broad objectives identified in the 2012 Consultation relating to the basis of preparation, as follows:
- *Increasing our involvement in setting the basis of preparation.* The proposals that we set out in this section seek to address the issues around reliability that we identified in Section 4. They build upon proposals that we made in 2012 to increase the level of our involvement in the basis of preparation.
  - *Aligning the published financial statements with regulatory decisions.* We make proposals in this section which, together with those that we make in Section 6 about changes to reporting arrangements, are intended to bring BT's Published Regulatory Financial Statements more into line with the basis of our regulatory decisions.
  - *Maintaining greater control over the basis of preparation.* We make proposals in this section which together with those that we make in Section 6 about changes to reporting arrangements should make it easier for stakeholders to understand how the Published Regulatory Financial Statements are prepared.
- 5.3 With these aims in mind, we make three main proposals around the following themes:
- *Establishing new Regulatory Accounting Principles.* The revised Regulatory Accounting Principles will set out the fundamental principles with which BT's Regulatory Financial Reporting must comply and will replace the existing Regulatory Accounting Principles. We propose that the revised Regulatory Accounting Principles will be aligned to our regulatory objectives and will provide the basis for the 2014/15 Regulatory Financial Statements.
  - *Establishing Regulatory Accounting Guidelines.* The Regulatory Accounting Guidelines will be prepared by us and will set out high level accounting rules with which Regulatory Financial Reporting must comply. In particular they will ensure consistency with our regulatory decisions. They will replace the existing Primary Accounting Documents, which are prepared by BT, but will be similar in scope and level of detail to BT's current Primary Accounting Documents. Developing the Regulatory Accounting Guidelines is likely to be a significant exercise that will require further review and consultation.
  - *Maintaining greater control over the basis of preparation.* We propose that responsibility for the preparation and accuracy of BT's regulatory financial data remains with BT. This means that BT will still be able to propose changes to the detailed rules that it uses to apply the requirements set out in the new Regulatory

Accounting Principles and Regulatory Accounting Guidelines. We propose that BT will be required to notify us of material changes to its accounting methodologies and source data in advance. A version of the notification will also be published by BT and will include the reason for the change and an estimate of the financial impact of each proposed change, based on the previous year's Regulatory Financial Statements. We propose that we could prohibit the change if we consider it is not in accordance with the Primary Accounting Documents or Regulatory Accounting Guidelines, but not 'approve' any change and our silence on proposed changes will not indicate our agreement. Our view, or absence of a view on any proposed changes, will be in the context of Regulatory Financial Reporting only.

- 5.4 Regardless of any decision (or absence of decision) that may be made as part of a new change control process, BT, other CPs and ourselves will be able to propose and challenge changes to the basis of preparation (such as the way costs are allocated) for the purpose of our regulatory decisions, such as charge controls, as part of the relevant consultations.
- 5.5 We set out how we would implement these proposals in Section 9.

## **Establishing revised Regulatory Accounting Principles**

- 5.6 The Regulatory Accounting Principles are the principles BT must apply or use in its Regulatory Financial Reporting (including the preparation of its Regulatory Financial Statements, its Accounting Methodology Documents (see below), its accounting records and its Regulatory Accounting System). We consider that the current Regulatory Accounting Principles provide BT with a greater level of freedom and flexibility to introduce methodological changes than is appropriate. The existing Regulatory Accounting Principles as set out in BT's Primary Accounting Documents<sup>141</sup> are as follows:
- Priority
  - Definitions
  - Cost causality
  - Objectivity
  - Consistency of treatment (from year to year)
  - Compliance with applicable law and the IAS
  - Transparency
  - Sampling
- 5.7 In response to the 2012 Consultation BT and other stakeholders agreed that we should review the current Regulatory Accounting Principles.
- 5.8 BT made the following points in its response:

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<sup>141</sup> BT, Primary Accounting Documents. 31 July 2013. Pages 13-14:  
[http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2013/Primary\\_Accounting\\_Doc\\_2013.pdf](http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2013/Primary_Accounting_Doc_2013.pdf)

- they agreed that we should review the Regulatory Accounting Principles;
- specifically they said that cost causality should be proportionate so the cost attribution methodologies do not become unduly complex;
- the ‘consistency’ principle should only trigger a restatement for the changes that are material;
- the ‘transparency’ principle requires too much complex data which prevents users from understanding the accounts;
- sampling is a technique for gathering data and should be removed from the list of principles.

#### 5.9 Other stakeholders made the following points:

- UKCTA’s view was that the Regulatory Accounting Principles “should be set by Ofcom.”<sup>142</sup>
- CWW welcomed the proposals to strengthen and clarify the key Regulatory Accounting Principles. TTG said that the current Regulatory Accounting Principles “are not fit for purpose today since they have allowed BT to make wholly inappropriate allocations.”<sup>143</sup>
- TTG also saw the Regulatory Accounting Principles as “brief and vague.”<sup>144</sup> Specifically they gave an example of the ‘objectivity’ principle being meaningless due to the way it is worded.
- TTG suggested that there should be an underlying principle that a cost cannot be recovered twice and gave examples of over-recovery in the past.<sup>145</sup>
- EE said that having “a clear set of principles underlying the production of the Regulatory Financial Statements is clearly important” and that they would support greater involvement from us in setting and reviewing these principles.
- EE specifically commented that “transparency should have a requirement to ensure that the way in which the principles have been applied (and where appropriate traded off between each other) is made clear to a reasonably informed reader.”<sup>146</sup>
- EE suggested two new principles: 1) that the accounts are constructed and presented in such a way as to complement other SMP obligations and demonstrate compliance; 2) that costs should be attributed in a way which is at least competitively neutral in its impact on relevant and related markets, by ensuring that common costs are fairly allocated between internally and externally consumed products.

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<sup>142</sup> UKCTA, 2012 Consultation response page 17, paragraph 88.

<sup>143</sup> TTG, 2012 Consultation response, page 11, paragraph 47.

<sup>144</sup> TTG, 2012 Consultation response, page 11, paragraph 47.

<sup>145</sup> TTG, 2012 Consultation response, page 11, paragraph 49.

<sup>146</sup> EE, 2012 Consultation response, page 11, paragraph 46.

- EE were concerned that the current allocation on the basis of cost causality leaves BT too much leeway in taking subjective decisions.<sup>147</sup>

5.10 Having considered stakeholder responses, we propose that we should update the Regulatory Accounting Principles. In doing so we will clarify that their ownership rests with us. The newly established Regulatory Accounting Principles will set out the fundamental principles with which BT's Regulatory Financial Reporting must comply. It will define the attributes which the Regulatory Financial Statements must have, and the fundamental standards they must meet. By introducing a new principle, consistency with regulatory decisions, the Regulatory Accounting Principles will require better alignment of reporting to our regulatory decisions.

5.11 We propose that the new Regulatory Accounting Principles should be as follows:

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<sup>147</sup> EE, 2012 Consultation response, page 11, paragraph 46.

**Figure 1: Proposed draft of the revised Regulatory Accounting Principles**

## ***Regulatory Accounting Principles***

*The Regulatory Accounting Principles set out below must be applied to all material items of revenue, costs, assets and liabilities in the Regulatory Financial Statements, or material changes in those items. A material item of revenue, costs, assets or liabilities, or a material change in those items, is one which is reasonably expected by virtue of its magnitude or nature, to affect the views of any competent user of the Regulatory Financial Statements.*

### **1. Completeness**

*Regulatory Financial Reporting must encompass all revenues, costs, assets and liabilities of the Markets and Technical Areas, together with residual activities (including wholesale and retail).*

### **2. Accuracy**

*Regulatory Financial Reporting must maintain an adequate degree of accuracy, such that the information included in the Regulatory Financial Statements are free from material errors and double-counting. Materiality must be determined in accordance with the definition set out above.*

### **3. Objectivity**

*Each element of Regulatory Financial Reporting, so far as is possible, must take account of all the available financial and operational data that is relevant to that element.*

*Where an element of Regulatory Financial Reporting is based on assumptions, those assumptions must be justified and supported by all available relevant empirical data. The assumptions must not be formulated in a manner which unfairly benefits BT or any other operator or entity, or creates undue bias towards any part of BT's or any other operator's business or product.*

#### **4. Consistency with regulatory decisions**

*Regulatory Financial Reporting must be consistent with OFCOM's regulatory decisions as set out in the Regulatory Accounting Guidelines.*

#### **5. Causality**

*Regulatory Financial Reporting must ensure that:*

- a) revenues (including revenues resulting from transfer charges)*
- b) costs (including costs resulting from transfer charges)*
- c) assets, and*
- d) liabilities.*

*are attributed in accordance with the activities which cause the revenues to be earned, or costs to be incurred, or the assets to be acquired, or liabilities to be incurred respectively.*

#### **6. Compliance with the statutory accounting standards**

*Regulatory Financial Reporting must comply with the accounting standards applied in BT's statutory accounts; with the exception of any departures as OFCOM may direct from time to time (including in the Regulatory Accounting Guidelines).*

#### **7. Consistency of the Regulatory Financial Statements as a whole and from one period to another**

*Regulatory Financial Reporting must be applied consistently in all the Regulatory Financial Statements relating to the same period.*

*Regulatory Financial Reporting must be applied consistently from one period to another.*

*All the changes in Regulatory Financial Reporting from one period to another must be justified by reference to the Regulatory Accounting Guidelines and the Regulatory Accounting Principles.*

*If there are material changes in Regulatory Financial Reporting from one period to another, BT must restate the previous period's Regulatory Financial Statements, applying the changes to the Regulatory Financial Statements for that period.*

- 5.12 The order of the principles set out in the Regulatory Accounting Principles is important. It defines the hierarchy of the principles. Each principle takes precedence over the principle following it. For example, accuracy and objectivity rank above consistency. This ensures that the application of a more accurate or more objective accounting rule is not prevented for the sake of consistency. Another example is the precedence of the principles of consistency with regulatory decisions. This precedence ensures that Regulatory Financial Reporting is aligned with our regulatory objectives and decisions.
- 5.13 We have considered stakeholders' views in developing our proposed Regulatory Accounting Principles. In particular, we have introduced the principle of Accuracy in response to Regulatory Financial Statements errors in recent years.
- 5.14 Costs can often be allocated in more than one way which would comply with the principle of causality. However, it is important that BT changes allocation methods only if the new methods are more accurate or more objective, or more compliant with other principles ranking above the causality principle, than the previous methods are. The current hierarchy of principles is designed to ensure this.
- 5.15 As we made clear in the 2012 Consultation, one of our objectives is to better align Regulatory Financial Reporting with regulatory decisions. We propose to reflect this objective as a Regulatory Accounting Principle. The proposed Regulatory Accounting Guidelines will be more prescriptive and detailed, providing specific rules for the most significant cost allocations. The Regulatory Accounting Guidelines will be updated by us when a new regulatory decision is taken.
- 5.16 We have also removed some principles (Sampling, Definitions, Transparency and Priority) that we do not consider represent accounting principles or do not add anything to the proposed principles set out above.

### **Summary of proposals and legal tests**

- 5.17 In summary, we propose to amend the regulatory reporting obligations on BT so that BT's Regulatory Financial Reporting must comply with the Regulatory Accounting Principles directed by Ofcom. We propose that, in order of priority, such Regulatory Accounting Principles should be:
- i) Completeness
  - ii) Accuracy

- iii) Objectivity
  - iv) Consistency with regulatory decisions
  - v) Causality
  - vi) Compliance with statutory accounting standards
  - vii) Consistency of the Regulatory Financial Statements as a whole and from one period to another
- 5.18 The requirements to comply with the Regulatory Accounting Principles will be implemented in the SMP conditions. The Regulatory Accounting Principles itself will be directed.
- 5.19 We have considered our proposals about the Regulatory Accounting Principles against the tests set out in S.47(2) and S.49(2) of the Act and have concluded that they are:
- Objectively justifiable because we need to take a greater role in the basis of preparation of the Regulatory Financial Statements to ensure they are free and are seen to be free of any bias and are consistent with regulatory decisions. The proposed Regulatory Accounting Principles will establish the basic attributes for BT's Regulatory Financial Reporting and provide a necessary reference point in the absence of more specific guidelines.
  - Not unduly discriminatory because KCOM is the only other SMP provider which has regulatory accounting obligations, but we have not at present established the need for such regulation. We will however keep under review whether any of the changes that we are proposing may be appropriate to apply to KCOM in due course.
  - Proportionate because our proposals, in conjunction with our other proposals which see us taking a greater role in establishing the basis of preparation of the Regulatory Financial Statements, are no more than is required to ensure an absence of bias and consistency with regulatory decisions. While we are establishing Regulatory Accounting Principles, as well as Regulatory Accounting Guidelines and implementing a change control process, BT retains an important role in determining the basis of preparation of the Regulatory Financial Statements, and can continue to put through changes where this is in line with the Regulatory Accounting Principles and Regulatory Accounting Guidelines.
  - Transparent because it is clear that the intention of our proposals is to ensure we take a greater role in the basis of preparation of the Regulatory Financial Statements to ensure an absence of bias and consistency with regulatory decisions.

## **Establishing Regulatory Accounting Guidelines**

- 5.20 We have set out, in section 4, that the current regime allows BT some discretion to determine the appropriate allocation basis for preparing its regulatory financial information that the Regulatory Financial Statements do not align with our regulatory

decisions and are subject to changes in BT's chosen basis of preparation. We therefore propose to introduce new Regulatory Accounting Guidelines.

- 5.21 The proposed Regulatory Accounting Guidelines will replace the Primary Accounting Documents that are currently prepared by BT. Therefore, we will remove the requirement for BT to prepare and publish its Primary Accounting Documents. The Regulatory Accounting Guidelines will set out high level accounting rules with which Regulatory Financial Reporting must comply. As such, they will be similar in scope and level of detail to BT's Primary Accounting Documents.
- 5.22 We propose that the initial version of the Regulatory Accounting Guidelines will be based on the current Primary Accounting Documents. We will provide, within the initial version of the Regulatory Accounting Guidelines, guidance about the application of our proposed new Principle 4: Consistency with regulatory decisions.
- 5.23 As explained above, we propose that Regulatory Financial Reporting should be consistent with the methodologies and treatments applied in the latest regulatory decisions (such as charge controls). We propose that, amongst other things, the Regulatory Accounting Guidelines will stipulate the manner in which that principle should be applied in the Regulatory Financial Statements.
- 5.24 We will then review and consult on changes to the Regulatory Accounting Guidelines. The Regulatory Accounting Guidelines will need to be updated to align them with regulatory decisions made in controls and market reviews. The relevant considerations and the detail of the change will be set out in charge control consultations and statements. The updated Regulatory Accounting Guidelines will come into force at the date of the relevant charge control statement. If a subsequent appeal and a decision by the CAT or CC affect one of our policy decisions, we will revise the Regulatory Accounting Guidelines accordingly.
- 5.25 We will ensure that the Regulatory Accounting Guidelines comply with the Regulatory Accounting Principles. Where there is no clear guidance in the Regulatory Accounting Guidelines, then the appropriate methodology must be determined by reference to the Regulatory Accounting Principles, i.e. by going back to first principles.

### **Ensuring consistency with regulatory decisions**

- 5.26 In the 2012 Consultation, we proposed that BT's Regulatory Financial Statements should be prepared and presented in a way that more closely follows the bases of our regulatory decisions.
- 5.27 We note that all respondents including BT agreed that consistency of the Regulatory Financial Statements with regulatory decisions would be beneficial. We consider that it is an important step and we expect to achieve full alignment of the Regulatory Financial Statements with regulatory decisions once we have set up the Regulatory Accounting Guidelines.
- BT said that there is merit in requiring consistency with regulatory decisions and this could provide greater regulatory certainty and confidence in the reported information.
  - BT asked us to address some practical issues in relation to the proposal. In particular, BT highlighted a distinction between regulatory decisions regarding cost allocation and the decisions that adjust reported costs for policy reasons,

such as re-inflating depreciated assets in order to ensure prices incentivise investment. BT did not expect the latter set of decisions to be reflected in the Regulatory Financial Statements.

- BT wanted clarification on what methodology should be used when an appeal on a cost allocation decision is in progress.
- BT stated that decisions on cost allocation may not clearly say how the relevant excluded or reallocated costs should be treated in other services or markets. They said that such clarity will be required in the future.

5.28 Other CPs made the following points:

- UKCTA expressed strong support for the alignment of the Regulatory Financial Statements to the regulatory decisions as far as possible.
- UKCTA stated that we would “need to ensure that any regulatory decisions were clear, robust and material enough to warrant changes to the Regulatory Financial Statements.”<sup>148</sup> This was particularly so when taking into account CAT and CC decisions which may require interpretation.
- TTG fully agreed with the proposal to align the Regulatory Financial Statements with regulatory decisions as such consistency would increase the usefulness and relevance of the Regulatory Financial Statements. They noted that the proposal to align the Regulatory Financial Statements with regulatory decisions “seems in some areas tantamount” to the proposal for us to decide the allocation rules.<sup>149</sup>
- EE was supportive of the proposal and saw it as a move “in the right direction.”<sup>150</sup>
- CWW said that the alignment of the Regulatory Financial Statements with regulatory decisions is ‘long overdue’ and explained that “the current approach defies common sense and leads to uncertainty.”<sup>151</sup>

5.29 Informed by these responses, we remain of the view that BT's Regulatory Financial Statements should be prepared and presented in a way that more closely reflects the bases of our regulatory decisions and propose, above, that the Regulatory Accounting Principles should include a principle ensuring consistency with regulatory decisions.

5.30 However, the need for consistency raises a question of which aspects of the regulatory decisions should be relevant to the purpose of determining how the Regulatory Financial Statements should be prepared and presented.

5.31 In this respect there seem to be three broad areas where the need for consistency might apply, as follows:

- The reporting convention; for example, whether the Regulatory Financial Statements should adopt the Regulatory Asset Value (or “RAV”) used by us in some of our pricing decisions; and/or

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<sup>148</sup> UKCTA, 2012 Consultation response, page 18, paragraph 97.

<sup>149</sup> TTG, 2012 Consultation response, page 12, paragraph 56.

<sup>150</sup> EE, 2012 Consultation response, page 11, paragraph 48.

<sup>151</sup> CWW, 2012 Consultation response, page 20, question 5.3.

- The basis of calculation; for example, whether the Regulatory Financial Statements should follow the same allocation rules as those reflected in recent decisions; and/or
- Regulatory adjustments that might be described as “Pricing Adjustments” in that they relate to the way we consider costs should be recovered (or not recovered) for policy reasons, rather than a preferred basis for calculating or allocating those costs.

5.32 As we will explain, we consider that the requirement for consistency should relate only to the first two of these three issues; we do not propose that the Regulatory Financial Statements to reflect any Pricing Adjustments.

### The Regulatory Financial Statements should be prepared on the RAV basis

5.33 The RAV is a methodology we apply for valuation of access duct and copper in our charge controls. However, in the Regulatory Financial Statements BT values these assets on a CCA basis. This means that we have to make an adjustment for each charge control and investigation that includes access duct and copper to revalue these assets on a RAV adjusted basis. It also makes it difficult for stakeholders to see in the Regulatory Financial Statements, the revised returns for the markets where we apply the RAV adjustment, which we consider to be a more accurate representation of the returns in those markets.

5.34 We noted in the 2012 Consultation that a significant source of differences between the reported numbers and our regulatory decisions relates to the RAV.

5.35 However, we also saw good reasons why the Published Regulatory Financial Statements should normally be prepared on a Current Cost Accounting (CCA), rather than a Historical Cost Accounting (HCA) basis. The CCA basis enables regulated prices to be set based on what it would currently cost to replace or build the network. This encourages a new entrant or existing competing operator to build its own network more efficiently and compete with BT on price.

5.36 We proposed that the Regulatory Financial Statements should include reconciliation between the CCA numbers and the equivalent of those numbers on a RAV basis. We considered that such a disclosure would allow users of the Regulatory Financial Statements to better understand the effect of the RAV adjustment on the costs of relevant services.

5.37 BT considered that:

- “The Regulatory Financial Statements should continue to be prepared on a CCA basis as set out in the European Commission recommendations.”<sup>152</sup>
- BT is best placed to value its assets given to the in-depth knowledge of its network and the design of specific products.
- Reconciling CCA values in the Regulatory Financial Statements to the RAV numbers may help improve the relevance of the published data.

5.38 Other stakeholders made the following points

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<sup>152</sup> BT, 2012 Consultation response, page 24, paragraph 132.

- UKCTA considered that the reconciliation of CCA and RAV potentially offers significant benefits in terms of accuracy and would reduce the possibility of over recovery by BT.
- TTG stated that there must be a set of the Regulatory Financial Statements including total and disaggregated costs that are prepared on a RAV basis. TTG disagreed with the proposal that the Regulatory Financial Statements would be prepared on a CCA basis and reconciled to the RAV basis. TTG pointed out that the Regulatory Financial Statements will be inconsistent with our valuation approach.
- EE noted that we had in the past taken a view about the valuation of BT's assets that differed from BT's. EE considered that our regulatory decisions regarding BT's asset valuation should be "in some way reflected in the Regulatory Financial Statements", for example via the proposed reconciliation of the CCA and RAV valuations.<sup>153</sup>

5.39 In its response BT said "we believe that the published RFS should continue to be prepared on a CCA basis as set out in the European Commission recommendations"<sup>154</sup> quoting the Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications.

5.40 However, the same Recommendation that BT quoted continues "it is recommended that a national regulatory authority, when assessing the features and specification of the cost accounting system, reviews the capability of the notified operator's cost accounting system to analyse and present cost data in a way that supports regulatory objectives". In our view this leaves the decision on which cost accounting standard for the NRA to decide. This means that where we set obligations on a RAV basis, Regulatory Financial Reporting should follow this regulatory objective.

5.41 We have implemented the RAV consistently in recent charge controls. Our decisions have been appealed by stakeholders and upheld by the CAT. We therefore consider that it is appropriate to align the Regulatory Financial Statements with this policy. We will amend the Regulatory Accounting Principles to require the Regulatory Financial Statements to be prepared on a RAV basis from 2014/15. A related issue is the way in which BT estimates the value of its assets.

### The Regulatory Financial Statements will reflect accounting bases used in regulatory decisions

5.42 Reporting requirements should reflect our decisions rather than drive them. In other words, the Regulatory Accounting Guidelines and therefore the Regulatory Financial Statements should follow the policies that were set in the latest charge control or other regulatory decision. The subsequent charge controls may take the reported information into consideration, but will not be constrained by it. If, for example, in the process of developing subsequent charge controls, we identify errors or more appropriate cost allocation methods, we will update the Regulatory Accounting Guidelines to reflect the new policies.

5.43 The Regulatory Accounting Guidelines will continue to evolve to reflect our regulatory policy as well as decisions. The Regulatory Accounting Guidelines may therefore

<sup>153</sup> EE, 2012 Consultation response, page 11, paragraph 51.

<sup>154</sup> BT, 2012 Consultation response, page 24, paragraph 132.

change to accommodate our views on for example common cost allocation or LRIC methodology.

**The Regulatory Financial Statements will not be required to reflect “price adjustments” unless explicitly stated**

- 5.44 When we set prices, we may include adjustments to cost calculations that do not strictly reflect BT’s costs (for reasons that we disclose and consult upon). For example, we have in the past:
- Restated asset values to bring them into line with our view of a “steady state” valuation (for example, in setting prices for ISDN30);
  - Calculated prices using a bottom up cost model (for example, in setting prices for Narrowband);
  - Set prices that recover costs from one service through the price of another (for example, costs relating to some transfers have been recovered through rental charges); and
  - Excluded some costs from the costs to be recovered through regulated prices (for example in setting the prices for LLU rentals).
- 5.45 We have considered if and how it may be appropriate for BT to reflect these adjustments in its Regulatory Financial Statements.
- 5.46 We consider that attempting to model the impact of recent price adjustments such as steady state valuation adjustments and how they might uplift costs in later years, would require BT to make difficult judgements about how it thinks we deal with these costs on an ongoing basis.
- 5.47 Therefore with the exception of items that should be explicitly excluded from the costs used by us to inform prices and which we consider should instead be allocated to residual activities<sup>155</sup>, we do not propose to require BT to attempt to reflect the effect of price adjustments in the Regulatory Financial Statements.
- 5.48 In any case, as indicated above, the Regulatory Accounting Guidelines will clarify which aspects of our regulatory decisions should be adopted in the preparation of the Regulatory Financial Statements.

**Reviewing the Regulatory Accounting Guidelines**

- 5.49 The Regulatory Accounting Guidelines will be updated over time in part to reflect regulatory decisions and policy developments. Developing and maintaining the Regulatory Accounting Guidelines is therefore an important exercise requiring significant time and resource commitment. We will consult on changes to the Regulatory Accounting Guidelines as appropriate.
- 5.50 Development of the Regulatory Accounting Guidelines may require a review of BT’s existing regulatory accounting methodology, such as the cost allocation rules. It may result in setting some new rules.

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<sup>155</sup> Belonging either to the Wholesale or Retail Residual parts of the Reported Business.

- 5.51 We consider that by drafting new Regulatory Accounting Guidelines, we can add clarity, where required by updating sections as the document evolves.
- 5.52 We will set the Regulatory Accounting Guidelines by reference to the Regulatory Accounting Principles. BT will then be responsible for implementing the changes. To do so, we expect BT will need to update the documents that describe BT's Regulatory Financial Reporting. We propose that these documents, the Accounting Methodology Documents (formerly the Secondary Accounting Documents), should remain BT's responsibility. In Section 6 we also make proposals that we consider should enable BT to produce a simplified more transparent version of its Secondary Accounting Documents that will become the Accounting Methodology Documents.

### **Summary of proposals and legal tests**

- 5.53 In summary, we propose to amend the regulatory reporting obligations on BT so that:
- BT's Regulatory Financial Reporting must comply with the Regulatory Accounting Guidelines as directed by Ofcom. The Regulatory Accounting Guidelines will in particular set out how BT should implement Ofcom's regulatory decisions in its Regulatory Financial Reporting.
  - BT must give precedence to the Regulatory Accounting Guidelines over the Regulatory Accounting Principles; and
  - BT must prepare the Regulatory Financial Statements on a RAV basis.
- 5.54 These amendments will be implemented in the SMP conditions.
- 5.55 We have considered our proposals about the Regulatory Accounting Guidelines against the tests set out in S.47(2) of the Act and have concluded that they are:
- Objectively justifiable because establishing Regulatory Accounting Principles alone is not sufficient to ensure Regulatory Financial Reporting is free and is seen to be free from bias and is consistent with regulatory decisions. The Regulatory Accounting Guidelines will establish further detail and will also provide BT with clarity as to the implementation of the "consistency with regulatory decisions" principle.
  - Not unduly discriminatory because KCOM is the only other SMP provider which has regulatory accounting obligations, but we have not at present established the need for such regulation. We will however keep under review whether any of the changes that we are proposing may be appropriate to apply to KCOM in due course.
  - Proportionate because our proposals, in conjunction with our other proposals which see us taking a greater role in establishing the basis of preparation of the Regulatory Financial Statements, are no more than is required to ensure an absence of bias and consistency with regulatory decisions. While we are establishing Regulatory Accounting Guidelines, as well as Regulatory Accounting Principles and implementing a change control process, BT retains an important role in determining the basis of preparation of the Regulatory Financial Statements, and can continue to put through changes where this is in line with the Regulatory Accounting Principles and Regulatory Accounting Guidelines.

- Transparent because it is clear that the intention of our proposals is to ensure we take a greater role in the basis of preparation of the Regulatory Financial Statements to ensure an absence of bias and consistency with regulatory decisions.

## **Maintaining greater control over the basis of preparation**

- 5.56 While responsibility for the preparation and accuracy of BT's regulatory financial data will remain with BT we will take greater control over the basis of preparation.
- 5.57 BT will be responsible for updating the Accounting Methodology Documents that describe BT's regulatory financial reporting (as currently set out in its Secondary Accounting Documents). We propose that BT must, however, ensure that the Accounting Methodology Documents, are consistent with the Regulatory Accounting Principles and Regulatory Accounting Guidelines.
- 5.58 As further explained in Section 6, we propose some additional changes, in particular to the Transparency Direction, which will clarify to BT what level of detail we expect the Accounting Methodology Documents to enter into.
- 5.59 Going forwards there are three aspects through which we will take greater control over the basis of preparation:
- Review of the allocation bases
  - Review of the asset valuation methodology; and
  - Introduction of a change control and error notification process.

## **Review of allocation bases**

- 5.60 In the 2012 Consultation we proposed that we should identify and review the most significant allocation bases, as currently described in BT's Secondary Accounting Documents, and propose changes where appropriate as and when regulatory decisions are made.
- 5.61 We considered two options: either to review and revise only the most significant allocation rules in a one-off review alongside the Regulatory Accounting Principles; or to review and revise allocation rules as and when regulatory decisions are made.
- 5.62 We noted that both options would address stakeholder concerns that BT selects the most favourable allocation rules and help ensure that the Regulatory Financial Statements are aligned to regulatory decisions.
- 5.63 We proposed the second option due to the risk that we may not be best placed to choose the most appropriate bases. We also did not consider that a full review of the rules on a bottom up basis would be appropriate or practicable. Further, we thought that even if we were to only review and approve the current set of rules, this would be a large exercise that carries a risk of making a decision based on incomplete information and not considering all the consequences across all regulated products.
- 5.64 BT agreed that it would be beneficial for us to identify and review the most significant allocation bases and said that such a review would provide regulatory certainty in advance of charge controls and investigations. They had the following observations:

- we should refrain from specifying detailed methodologies and any increased involvement should be proportionate;
- we need to clearly define ‘most significant’. BT proposed 5% of market costs or revenues, modified for smaller markets;
- we should make clear our intention to use such methodologies in our regulatory decision making and that any future deviation from allocation bases would be clearly reasoned;
- a clear appeal process would need to be specified, as well as what methodology to use when an appeal is pending;
- any methodology changes should be imposed no later than the third quarter of the reporting year in order for BT to meet the Regulatory Financial Statements publication deadline; and
- The impact on the audit opinion should be considered if auditors do not agree that the methodology proposed by us conforms to the regulatory principles and applicable law.<sup>156</sup>

5.65 Other stakeholders made the following points:

- UKCTA said that their preferred approach would be for an independent third party to set the basis of preparation of the Regulatory Financial Statements although an acceptable compromise would be if we regularly reviewed the principles following relevant regulatory statements.
- UKCTA also expressed a reservation over our “ability and willingness to conduct the necessary in-depth review” noting that we would need to commit significant resources.<sup>157</sup>
- TTG said that we must determine rather than review allocation rules and “start from a blank sheet of paper.”<sup>158</sup> TTG emphasised that BT’s allocation methodologies should be considered as only one option and not afforded a special status.
- TTG said it was unclear what would be the purpose of reviewing both the Regulatory Accounting Principles and the allocation rules. TTG said that if we set major allocation rules, this would render the Regulatory Accounting Principles redundant in respect of these cost categories. TTG noted that they would still be relevant for minor cost categories.
- TTG would like to understand how decisions arising from “Ofcom investigations, CC/CAT judgements, future charge controls” will be implemented in the charge controls and in the Regulatory Financial Statements.<sup>159</sup>
- CWW welcomed our proposals to review key attribution decisions and saw this as a significant step forward.

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<sup>156</sup> BT, 2012 Consultation response, page 20, paragraph 111.

<sup>157</sup> UKCTA, 2012 Consultation response, page 16, paragraph 81.

<sup>158</sup> TTG, 2012 Consultation response, page 9, paragraph 40.

<sup>159</sup> TTG, 2012 Consultation response, page 11, paragraph 50.

- CWW thought that for us to do this job properly a significant amount of resource and expertise will be required. CWW considered that we do not have sufficient resources and would seek assurances that additional expert resourcing will be available.
  - CWW would like to see all significant attribution decisions reviewed in an orderly fashion at the outset to eradicate bias and said that they would welcome a timetable.
  - CWW also believed that we should engage “with stakeholders on some of the material attribution decisions, providing visibility of our work and giving Ofcom a sound frame of reference.”<sup>160</sup>
- 5.66 We consider that we are in a better position to do the review than a third party. A third party is unlikely to be familiar with BT’s Regulatory Financial Statements or regulatory accounting systems, as well as the purpose of the Regulatory Financial Statements.
- 5.67 Taking account of stakeholder responses and the changes to the allocation bases in the 2012/13 Regulatory Financial Statements (as described in BT’s October 2013 Reconciliation Report) we consider that it may be appropriate for Ofcom to consider BT’s Detailed Attribution Methodology in more detail to identify and assess the most significant allocation bases. This would be considered as part of an assessment of BT’s financial information for the purpose of modelling charge controls. Any outcome of such review would be consulted on in the course of the market review and be reflected in the Regulatory Accounting Guidelines.
- 5.68 This would be a significant piece of work and we consider that such a review would need to be conducted in the context of the framework that will be provided by the new Regulatory Accounting Principles and Regulatory Accounting Guidelines.

## **Review of Asset Valuation Methodology**

- 5.69 In its response to the 2012 Consultation UKCTA stated that it would prefer to move to a process where BT is not solely responsible for valuing its assets. They suggested that the valuation could be overseen by an independent body or at the very least we could test how BT applies the Regulatory Accounting Principles in practice. CWW said that “BT should not have sole responsibility for determining the basis on which its assets are valued”<sup>161</sup> and would like to see some independent oversight, with us being alerted to any material revaluation plans early on.
- 5.70 Following the 2012 Consultation (and as explained in more detail in Section 2.1 of its 2013 Regulatory Financial Statements), BT revised the basis for deriving its CCA valuation of its copper and duct assets, from an absolute basis to an approach based on actual spend, indexed using RPI. We consider that this methodology significantly reduces the extent to which the valuation is subject to changes in BT’s assumptions over time. Therefore, for the time being at least, we do not intend to propose specific requirements relating to the way BT should value its assets (providing that it complies with the Regulatory Accounting Principles and Regulatory Accounting Guidelines).

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<sup>160</sup> CWW, 2012 Consultation response, page 8, paragraph 4.8.

<sup>161</sup> CWW, 2012 Consultation response, page 20.

## Change Control and error notification

- 5.71 Our proposal on change control builds on 2012 Consultation proposal. In the 2012 Consultation we proposed that BT should notify us in advance of proposed changes to accounting methodologies, sufficiently far in advance to allow a review of the proposals.
- 5.72 UKCTA welcomed our proposals saying that “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 the publication of the RFS.”<sup>162</sup> EE also said that the proposals to “require BT to provide advance notice of significant changes to Ofcom, in time for Ofcom to challenge and understand such challenges is also crucial.”<sup>163</sup>
- 5.73 BT noted that it already discusses methodology changes with us “but agree that this could be done earlier in the process”<sup>164</sup> and went on to explain that such discussions should be proportionate and proposed a threshold of “5% of market costs or revenues of a reported market, modified to a more appropriate figure for smaller markets.”<sup>165</sup> BT also said that it would need sufficient time and a process to challenge proposals.
- 5.74 We propose that we should introduce a change control and error notification process. The proposed change control and error notification process has two purposes:
- To increase transparency about the changes BT makes to the way it prepares its Regulatory Financial Statements and the errors that it decides to correct.
  - To allow us to understand the consequences of the proposed changes and errors at an early stage, and be able to intervene to stop proposed changes before they are made.
- 5.75 We now propose that BT must notify us about all proposed material changes in the way it intends to prepare its Regulatory Financial Statements by 30 November for the Regulatory Financial Statement to be published in the following July. Any material change to cost allocations will be subject to this process. In practice, we expect that, in most cases, the notifications will be for one of two types of changes: changes to allocation methodologies; and changes to the source data it uses to determine the allocations.
- 5.76 The notification of changes must include the reason for change and an evaluation of the financial impact for each proposed change based on the previous year’s Regulatory Financial Statements. The evaluation must include the value of all the figures affected by the proposed change on both the old and proposed basis. The changes must be justified by reference to the Regulatory Accounting Principles. BT will need to demonstrate that the change makes a methodology more reflective of one or more principles. For example, a change could make a cost allocation more cost causal or more accurate. We propose a template for change control in Annex 13.

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<sup>162</sup> UKCTA, 2012 Consultation response, page 17, proposal 1d.

<sup>163</sup> EE, 2012 Consultation response, page 7, Section 5.

<sup>164</sup> BT, 2012 Consultation response, page 22, paragraph 112.

<sup>165</sup> BT, 2012 Consultation response, page 23, paragraph 113.

- 5.77 In terms of materiality, we propose to include the following guidance, that is consistent with the materiality threshold which is currently part of BT's obligations, in the Regulatory Accounting Guidelines when first published:

**Material change**

A change in any element of the Regulatory Financial Reporting is material if the resultant percentage change (be it positive or negative) in any figure in the Regulatory Financial Statements exceeds 5%.

The resultant percentage change in the figures shall be calculated by taking the value of the affected figures before the change in the Regulatory Financial Reporting is applied, and subtracting from it, the value of the same item after the change in the Regulatory Financial Reporting is applied, and then dividing this result by the former value.

- 5.78 We will require notification where cost allocation changes are made in a year, which either individually or when in aggregate when grouped with similar changes cumulatively exceed the 5% materiality threshold. Where this happens we will require that each individual change be notified.
- 5.79 If implemented, change control requirements will come into effect for the 2014/15 Regulatory Financial Statement. Under these requirements, BT will not need our approval to apply changes to its Regulatory Financial Reporting. However, if we determine that a change proposed by BT does not comply with the Regulatory Accounting Principles or the Regulatory Accounting Guidelines, then we will have the right to veto the change. In such case, we will inform BT of our decision by 31 January of the relevant financial year.
- 5.80 As part of the process BT must publish the data supplied to us under the change control process on their website at the same time as the information is given to us. We consider that this will provide transparency to stakeholders and provide further context for them to understand the Regulatory Financial Statements. We will not however formally consult on whether we will reject any change.
- 5.81 BT's regulatory auditors will be required to report whether BT has notified us of all the material changes it will apply to the Regulatory Financial Statements by 31st December of the relevant financial year.
- 5.82 We also propose that BT must set out in the annual reconciliation report, with an accompanying assurance report from their regulatory auditors, the impact of all material changes it has applied to the Regulatory Financial Statements for the financial year.
- 5.83 We also propose a separate notification process for any material mathematical or input errors that BT may become aware of while preparing the Regulatory Financial Statements or at any other time. It's important for BT to notify us as soon as possible when it decides that a mathematical or input error needs correcting because the Regulatory Financial Statements are often used as a starting point for projects such as charge controls and investigations. It is important that the financial data that we use is as accurate as possible. Where an error is material, it may also mean that previously published Regulatory Financial Statements do not provide meaningful

information and therefore requires restatement. We propose to use the same materiality threshold for errors (5%) as we have set out for changes.

- 5.84 BT will have an obligation to make sure that the Regulatory Financial Statements are free from error under the Accuracy principle that we are introducing. However, given the complexity of BT's business, mathematical input errors may arise from time to time. We therefore propose that where BT decides to correct a material error, the correction of which would affect the upcoming Regulatory Financial Statements or the Regulatory Financial Statements of the previous financial year, BT must notify us within 30 calendar days of BT deciding that the error needs correction. The notification will include a description of the error, an explanation of how the error was discovered, the reason for the error, the expected impact on the Regulatory Financial Statements for each affected market and service and what steps BT intends to take to correct the error. We propose a template for change control in Annex 13. The same materiality threshold as for change control will apply to error notification. The impact of the error for each affected market and service is measured as the difference in the numbers which were reported in the previous financial year, and the numbers that would have been reported had the error been corrected in the previous financial year (or such error not been made).
- 5.85 As part of the process BT must publish the data supplied to us under the error notification process on their website at the same time as the information is given to us. We consider that this will provide transparency to stakeholders and provide further context for them to understand the Regulatory Financial Statements.
- 5.86 BT must set out in the annual reconciliation report, with an accompanying assurance report from their regulatory auditors, the impact of all material errors that it decides to correct in the financial year.

### **Summary of proposals and legal tests**

- 5.87 In summary, we propose to amend the regulatory reporting obligations on BT so that:
- BT must notify material changes to cost allocations to Ofcom by 30 November of the relevant financial year. The notification must include the reason, the impact and a justification by reference to the Regulatory Accounting Principles. The notification must be published on BT's website at the same time. By 31 of December of the relevant financial year, BT must obtain an opinion confirming that it has notified us of all material changes. If Ofcom informs BT by 31 January of the relevant financial year that any of the changes should not be made, BT must comply with such notification.
  - BT must notify material errors within 30 days of a decision to correct the error. The notification must include a description of the error, explain how the error was discovered, the reason for the error, the expected impact on the RFS for each affected market and service and what steps BT intends to take to correct the error.
  - BT must publish a reconciliation report, setting out the impact of all material changes to cost allocation and all error corrections. BT must secure an opinion confirming that it has correctly calculated the impact of the changes and error corrections.
- 5.88 These amendments will be implemented in the SMP Conditions.

5.89 We have considered our proposals to take greater control over the basis of preparation against the tests set out in S.47(2) of the Act and have concluded that they are:

- Objectively justifiable because it is necessary for there to be visibility in relation to changes to the basis of preparation of the Regulatory Financial Statements both for us and for other stakeholders in order for us to maintain greater control over the basis of preparation of the Regulatory Financial Statements.
- Not unduly discriminatory because KCOM is the only other SMP provider which has regulatory accounting obligations, but we have not at present established the need for such regulation. We will however keep under review whether any of the changes that we are proposing may be appropriate to apply to KCOM in due course.
- Proportionate because our proposals are no more than is required to ensure we maintain greater control over the basis of preparation of the Regulatory Financial Statements. While we are establishing a change control process, BT will retain the ability to implement changes where this is necessary and in line with the Regulatory Accounting Principles and Regulatory Accounting Guidelines.
- Transparent because it is clear that the intention of our proposals is to ensure that we maintain control over the basis of preparation of the Regulatory Financial Statements.

## **Conclusion and summary of our proposals**

5.90 In this section we have made proposals that seek to address gaps that we identified in Section 4. Our proposals seek to ensure that:

- Our involvement in setting the basis of preparation increases, and BT no longer has the level of control over the basis of preparation that it currently enjoys.
- Published Regulatory Financial Statements are aligned with regulatory decisions.
- There is greater transparency about the basis of preparation.

### **Our proposals about the Regulatory Accounting Principles**

Proposal

- 5.1 We will replace the existing Regulatory Accounting Principles with new Regulatory Accounting Principles. Such principles will include, in particular, a new “consistency with regulatory decisions” principle.
- 5.2 The new Regulatory Accounting Principles will come into effect immediately and will apply to the 2014/15 Regulatory Financial Statements.
- 5.3 BT’s Regulatory Financial Reporting must comply with the new Regulatory Accounting Principles.

## **Our proposals about the Regulatory Accounting Guidelines**

### Proposal

- 5.4 We will review the BT Primary Accounting Documents to ensure that they are consistent with the revised Regulatory Accounting Principles and any recent regulatory decisions to date. In redrafting, the Primary Accounting Documents will become the Regulatory Accounting Guidelines.
- 5.5 We will no longer require BT to produce and publish a Primary Accounting Document with effect from 2014/15 financial year.
- 5.6 BT's Regulatory Financial Reporting must comply with the Regulatory Accounting Guidelines.
- 5.7 The Regulatory Accounting Guidelines will evolve over time to reflect policy including outcomes of charge controls and investigations as well as discrete policy initiatives. They will, in particular, be amended to reflect our regulatory decisions, and as such create consistency between our decisions and BT's reporting.
- 5.8 BT must prepare the Regulatory Financial Statements on a RAV basis.

## **Our proposals to maintain greater control over the basis of preparation**

### Proposal

- 5.9 BT must notify any proposed material changes to cost allocations (together with impact) by 30 November and publish any notification on its website. The notification will include an evaluation of the financial impact for each proposed change based on the previous year's Regulatory Financial Statements. The evaluation must include the value of all the figures affected by the proposed change on both the old and proposed basis. BT's regulatory auditors will be required to report whether BT has notified us of all the material changes it will apply to the Regulatory Financial Statements for the relevant financial year by 31 December.
- 5.10 We will not approve any proposed changes that are notified but may block any proposed change. If this is the case, we will notify BT by 31 January of the relevant financial year.
- 5.11 We will not consult on any proposed changes that are notified or on any Ofcom course of action.
- 5.12 BT must publish the impact of all material changes in an annual reconciliation report with an accompanying assurance report from their regulatory auditors, alongside the Regulatory Financial Statements.
- 5.13 BT must notify any material error within 30 days of deciding to correct the error (together with impact) and publish the notified error on its website. The impact of the error for each affected market and service is measured as the difference in the numbers which were reported in the previous financial year, and the numbers that would have been reported had the error been corrected in the previous

financial year (or such error not been made).

- 5.14 BT must publish the impact of all material errors that it decides to correct in an annual reconciliation report alongside the Regulatory Financial Statements.

### **Consultation questions**

*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.*

*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.*

## Section 6

# Reports

## Introduction

- 6.1 In this section we set out how we propose to change the way in which the Regulatory Financial Statements are presented and the extent to which information is published. In developing our proposals we have sought to address those areas where improvements could be made to the current Regulatory Financial Reporting arrangements that we identified in Section 4. Our proposals should help stakeholders gain the reasonable confidence that they need about BT's compliance with obligations. At the same time our proposals will lead to a reduction in the overall amount and detail of information that BT is required to publish.
- 6.2 We explained in Section 2 that we use the term Regulatory Financial Statements to describe the annual Regulatory Financial Statements, prepared to a defined framework and methodology. Regulatory Financial Statements, therefore, include both the published and unpublished statements.
- 6.3 In making our proposals we have considered the balance that needs to be struck between ensuring that stakeholders have access to the correct level of information for it to be relevant and the need to ensure that the requirements that we impose are proportionate. We have also considered the concerns expressed by BT about the publication of what it considers to be commercially confidential information.
- 6.4 We make proposals in three broad themes for reporting:
- *Ensuring that Published Regulatory Financial Statements provide relevant information.* The Published Regulatory Financial Statements must be able to answer the right questions, in the right way and at the right time.
  - *Improving the presentation of the basis of preparation.* The basis of preparation should be transparent and understood by users of the Published Regulatory Financial Statements. The Accounting Methodology Documents must be clear and easy for stakeholders to use.
  - *Ensuring that the Published Regulatory Financial Statements provide the appropriate level of detail.* We should only require BT to publish information to the level that is proportionate. Stakeholders should not expect information to be published that goes beyond the purposes that we have identified in Section 3.
- 6.5 We also make proposals about how we receive the confidential information that we need as follows:
- *Ensuring we have access to the information that we need.* We need financial information to be able to regulate effectively. In Section 3 we explained that this includes more information than can or should be included in the Published Regulatory Financial Statements. We need this information to fulfil our regulatory duties.

## **Ensuring the Published Regulatory Financial Statements provide relevant information**

- 6.6 In Section 5 we have set out our proposals to take greater control of the basis of preparation. These proposals will ensure that the Published Regulatory Financial Statements are prepared in line with our assumptions rather than BT's, making them more relevant.
- 6.7 In this section, we consider how the appropriate information might be provided clearly.

### **Understanding BT's financial performance**

- 6.8 As explained in Section 4, to assess our effectiveness at forecasting costs for the purpose of setting charge controls, we may need information that could be commercially sensitive to BT. The information should not be included in the Published Regulatory Financial Statements.
- 6.9 We consider that users of the Published Regulatory Financial Statements should be able to gain a reasonable understanding about the impact of regulation on BT and its ability to recover costs. As explained in Section 3, we consider that this means that information should be, as far as possible, consistent with the basis of our regulatory decisions. In theory this would mean reflecting any 'pricing adjustments' as well as following the general approach to valuing assets (e.g. on the RAV basis) and allocating costs. As explained in Section 3, these "price adjustments" might include adjusting the asset value to reflect a steady state valuation or recovering costs of one activity from a different service. However, as explained in Section 4, we do not consider it appropriate to require BT to model the impact of recent price adjustments such as steady state valuation adjustments as this would require BT to make difficult judgements about how it thinks we might deal with these costs on an ongoing basis.
- 6.10 However, we recognise that this means that differences may remain between the reported view of BT's financial performance and the way we might interpret the data in the context of regulatory decisions. We have explained in Section 3 that we do not regulate the returns that BT can make but we consider that stakeholders should be able to interpret the returns that BT does make, in part to inform their view on what this might mean if and when we need to make further regulatory decisions. As explained in Section 4, there remains a risk that stakeholders may still not understand or potentially misinterpret the reported returns.
- 6.11 We are therefore keen to receive views on if and how stakeholders can be given a better understanding of BT's financial performance from a regulatory perspective.

### **Transparent reporting of Equivalence of Input costs**

- 6.12 In Section 3 we concluded that monitoring BT compliance with EOI obligations required in the Undertakings should not be a specific objective for the Published Regulatory Financial Statements. However we should ensure that where there is a product which is subject to SMP regulation, it should continue to be reported as required under BT's Regulatory Financial Reporting obligations, even where that product also needs to be provided on an EOI basis under the Undertakings.
- 6.13 In Section 4 we explained that BT had been reporting inputs which BT needed to provide on an EOI basis under the Undertakings in a way that we consider is less

transparent than other inputs into other products subject to SMP regulation. We believe, and propose, that BT should disclose all inputs on the same basis, whether they need to be provided on an EOI basis under the Undertakings or not.

- 6.14 This would provide more transparency of year on year movements of inputs BT needs to provide on an EOI basis under the Undertakings into regulated products where they are published within the Regulatory Financial Statements. BT will only be required to report EOI at the same level that they are regulated. As BT is required to publish the price of all products that BT is required to provide on an EOI basis under the Undertakings, this information will not be confidential.
- 6.15 We have set out in Annex 10 the proformas that we intend to direct BT to follow for EOI reporting in the WBA market.

### **Explaining year-on-year changes and their causes**

- 6.16 Our proposals to take greater control of the basis of preparation in Section 5 include the imposition of a change control and error notification process, which should reduce the scope for changes and restatements. Nevertheless changes will still be appropriate from time to time and the need for restatements will remain. It is important that stakeholders understand the reason for changes and restatements and their impacts.
- 6.17 We consider that the requirement for BT to produce and publish an annual reconciliation report should be formalised. Condition OA5f currently provides us with the ability to require that BT “deliver to us a report detailing any changes in the Accounting Documents, any Process and any other methodology which caused any figure presented on any one of the Regulatory Financial Statements to change by more than 5% from the figure that would have been presented had such a change not been made. Any such report shall include details sufficient to render transparent such changes in accordance with any relevant direction Ofcom may make from time to time”<sup>166</sup>
- 6.18 We propose that this should be replaced by a new requirement for a similar report to be published alongside the Published Regulatory Financial Statements every year. As we explain in Section 5, the report will also include the impacts of any material errors or material changes in cost allocations.
- 6.19 BT must also obtain a report from their regulatory auditors confirming that the report includes all the errors and changes in methodology that occurred during the year and that the impacts of the errors and changes in methodology have been correctly calculated, that is for each and every error or change identified, the difference between the number after the error had been corrected or methodology implemented and the uncorrected number or the pre methodology change number is consistent with the explanation BT published explaining the error or change in methodology. This regulatory auditor’s report must be published as part of the reconciliation report.

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<sup>166</sup> The regulatory financial reporting obligations on BT and Kingston Communications Accounting separation and cost accounting: Final statement and notification 22 July 2004.  
[http://stakeholders.ofcom.org.uk/consultations/fin\\_reporting/?a=0](http://stakeholders.ofcom.org.uk/consultations/fin_reporting/?a=0)

## **Providing reasonable confidence that BT is complying with its regulatory obligations**

- 6.20 In Section 3, we concluded that providing other stakeholders with reasonable confidence that BT has complied with its regulatory obligations is a key purpose of the Published Regulatory Financial Statements. We noted that stakeholders other than BT consider that they need to understand the way in which the products and services that they buy are captured in the Published Regulatory Financial Statements.
- 6.21 In Section 4 we noted that stakeholders are unable to see whether BT has complied with some of its charge control obligations in part because they are not able to map the products that they buy to charge control baskets.
- 6.22 We propose that BT should publish more detailed compliance information in the form of a non-confidential version of the compliance statement that it provides to us. Publication of a non-confidential compliance statement will provide assurance about BT's compliance with charge controls. Although 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.
- 6.23 In Annex 10 we set out the proposed format and content of the non-confidential Compliance Statement for the WBA and Fixed Access markets. The proposed statement will list, on a price list basis, every product within the basket (split internal and external will provide assurance about non-discrimination), price movements (internal and external) in the year, basket relevant revenue and actual basket yields. The relevant basket revenues must reconcile to those published in the Regulatory Financial Statements.

## **Providing information in an easily usable format**

- 6.24 As we explained in Section 3, stakeholders should be able to access information in a form that is convenient and easy to use. In the 2012 consultation we proposed that BT should publish the Regulatory Financial Statements in spreadsheet form. As part of our 2012/13 annual update, we directed BT to do so. In 2013, BT embedded spreadsheets in its Published Regulatory Financial Statements. As we explained in Section 4, this has been welcomed by stakeholders.

## **Summary of proposals and legal tests**

- 6.25 In summary, we propose to amend the Regulatory Financial Reporting obligations on BT so that:
- Where products which are subject to EOI regulation are also covered by SMP regulation, BT must report such products at the same level as products which are covered by SMP regulation but not by EOI regulation.
  - BT must report information in relation to compliance with charge controls.
- 6.26 These amendments will be implemented by way of direction.
- 6.27 We have considered our proposals against the tests set out in S.49(2) of the Act and have concluded that they are:

- Objectively justifiable because the Regulatory Financial Statements do not currently contain sufficient detail in relation to EOI reporting and in relation to BT's compliance with charge controls. The proposed changes will ensure that the Published Regulatory Financial Statements will provide stakeholders with relevant information.
- Not unduly discriminatory because KCOM is the only other SMP provider which has regulatory accounting obligations, but we have not at present established the need for such regulation. In any case, KCOM is not subject to any charge controls or EOI regulation.
- Proportionate because the changes are no more than is required to ensure that published Regulatory Financial Statements provide relevant information.
- Transparent because it is clear that the intention of our proposed changes is to ensure that the Regulatory Financial Statements provide relevant information.

## Improving the presentation of the basis of preparation

- 6.28 In Section 3 we explained that the basis of preparation of the Published Regulatory Financial Statements should be understood by users of the reports. This means that the Accounting Methodology Documents that are to replace the Secondary Accounting Documentation should be clear and easy for stakeholders to use.
- 6.29 In Section 4 we noted that stakeholders find aspects of BT's Secondary Accounting Documents difficult to understand. We also explained that BT's existing regulatory accounting system may be contributing to a lack of transparency of the basis of preparation. However, we accept that the Transparency Direction<sup>167</sup> and Direction 5, relating to the form of the fairly presented in accordance with (FPIA) opinion may have contributed to the current level of detail (and size and complexity) of the Secondary Accounting Documents.
- 6.30 The Transparency Direction specifies the level of transparency required to be met by BT for the purposes of preparing and maintaining the accounting records, Accounting Documents and Regulatory Financial Statements in respect of wholesale cost accounting, accounting separation and retail cost accounting. We have set out the Transparency Direction as it currently reads together with our proposed changes as follows:

“BT shall ensure that any data information, description, material or explanatory document prepared under Conditions OA1 to OA34 in respect of accounting and other methods used in the preparation of the accounting records and Regulatory Financial Statements shall be sufficiently transparent and prepared such that a suitably informed reader can gain a ~~detailed~~ clear understanding of such data, information, description, material or explanatory document, and, if necessary, the overall structure of BT's financial and information systems from which regulatory accounting data is derived and in particular the sequence of the processing and 'cascade' effect of the intermediate cost centres; gain a detailed clear understanding of all the material, methodologies and drivers

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<sup>167</sup> The regulatory financial reporting obligations on BT and Kingston Communications Accounting separation and cost accounting: Final statement and notification 22 July 2004.  
[http://stakeholders.ofcom.org.uk/consultations/fin\\_reporting/?a=0](http://stakeholders.ofcom.org.uk/consultations/fin_reporting/?a=0)

(e.g. systems, Processes and procedures) applied in the preparation of regulatory accounting data; ~~and make their own judgement as to the reasonableness of these methodologies and driver data and any changes to them. [...]~~

- 6.31 BT believes the effect of the current wording is that it is required to explain the allocation rules as applied at every stage in the allocation process. This results in difficult to follow explanations, particularly where a large number of reallocations take place. The revisions which we propose should clarify that we do not expect BT to explain allocation rules at every stage in the allocation process but that it should provide a summary narrative focusing on key cost drivers.
- 6.32 We propose to revise the requirements of the Transparency Direction as shown above, replacing the word “detailed” with “clear”. We also propose to remove the wording “make their own judgement as to the reasonableness of these methodologies and driver data and any changes to them”.
- 6.33 Direction 5, relating to the form of the FPIA opinion includes the requirement for BT’s auditors to give an opinion on whether the Secondary Accounting Documents are appropriate to implement the Primary Accounting Documents. We propose to remove this requirement, which will provide BT with further scope to provide less complex Accounting Methodology Documents.
- 6.34 Direction 6, relating to the form of the PPIA opinion, includes the requirement for BT’s auditor to give an opinion on whether, having reviewed the Accounting Documents, nothing has come to his attention that would lead him to conclude that the Secondary Accounting Documents are unreasonable in the context of the Primary Accounting Documents. We also propose to remove this requirement.
- 6.35 We expect that our proposals will have most impact on how BT drafts its Detailed Attribution Methodology document. This document provides a description of the rules for allocation and attribution. We note that in addition to changes as a consequence of the amendments to directions as described above, the first new Detailed Attribution Methodology document will also reflect the new Regulatory Accounting Principles, the Regulatory Accounting Guidelines and any changes as a consequence of BT’s move to a new regulatory accounting system.
- 6.36 We will work with BT to deliver a Detailed Attribution Methodology document that is more accessible to users. We expect that the new document will no longer include the internal description of sector allocations contained in hundreds of embedded pages of spreadsheets as this type of detail is a function of the document’s purpose as an internal reference manual and contains no information of use to users outside of BT. However, we would expect that the document explains the allocation of cost components to products and services alongside the relevant usage factors. The current documents stops at the cost component level. We would welcome stakeholder views about what information they would wish to see in the new document.
- 6.37 BT may also decide it is necessary to update its Detailed Valuation Methodology Document and the Long Run Incremental Cost Model: Relationships and Parameters Model Document. BT should ensure that they remain up to date and consistent with our proposed Regulatory Accounting Principles and Guidelines.
- 6.38 We expect that BT would still need to produce and maintain a detailed internal accounting manual or other information that is similar in nature to the existing

Detailed Attribution Methodology. This would include the allocation rules needed for its own internal control purposes. We will continue to need access to this BT information in order to understand how BT's attribution methodology works in detail. The need for Ofcom to access this information will not impose any additional burden on BT.

## Summary of proposals and legal tests

- 6.39 In summary, we propose to amend the regulatory reporting obligations on BT so that BT needs to comply with less burdensome transparency requirements, in particular by amending the Transparency Direction and the Direction relation to the form of the FPIA audit opinion.
- 6.40 These amendments will be implemented by way of direction.
- 6.41 We have considered our proposals against the tests set out in S.49(2) of the Act and have concluded that they are:
- Objectively justifiable because the Secondary Accounting Documents currently prepared by BT are difficult to understand. The proposed changes to the directions seek to clarify that BT should be providing less detailed, but clearer Accounting Methodology Documents.
  - Not unduly discriminatory because KCOM is the only other SMP provider which has regulatory accounting obligations, but we have not at present established the need for such regulation. In any case, KCOM's Secondary Accounting Documents do not exhibit the same level of complexity as BT's.
  - Proportionate because the changes are no more than is required to ensure that presentation of the basis of preparation is clear for users, and they reduce the regulatory burden on BT.
  - Transparent because it is clear that the intention of our proposed changes is to ensure that presentation of the basis of preparation is clear for users.

## Ensuring that the Published Regulatory Financial Statements provide the appropriate level of detail.

- 6.42 As we have explained in Section 3, we should only require BT to publish information where required by objectives of Regulatory Financial Reporting.
- 6.43 Stakeholders should not expect information to be published that goes beyond the purposes that we have identified. Before requiring information to be published we must consider the extent to which its publication would be proportionate.
- 6.44 In Section 4 we noted that BT is currently required to publish information, including detailed service analysis and FAC cost information, at the component cost level based on usage factors for aggregations of products where the financial importance of the individual products is low. We concluded that Regulatory Financial Reporting should follow policy and should explicitly be linked to SMP conditions.
- 6.45 In the recent Narrowband Charge Control<sup>168</sup> published in September, we considered what sort of regulatory reporting would be required and would be

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<sup>168</sup> <http://stakeholders.ofcom.org.uk/consultations/nmr-13/>

proportionate, in order to support the remedies being put in place by the market review. We set this out more comprehensively than in the past and explained the reasons for the accounting obligations, in terms of the remedies that they were supporting and the purposes of regulatory reporting. Through our consultation, stakeholders were able to consider the appropriateness of the reporting, in the context of the market review and the specific remedies that it was supporting. CPs had the opportunity to comment on whether the reporting was sufficient and BT could comment on whether it was proportionate.

- 6.46 We will in each market review continue to consider the necessary reporting requirements in conjunction with the other SMP obligations.
- 6.47 We propose that the volume and revenue information within the Published Regulatory Financial Statements must reconcile with the non-confidential charge control compliance basket submissions. This will enable CPs to trace the products they buy all the way through to the Published Regulated Financial Statements. This will provide reasonable confidence to stakeholders about BT's compliance with charge controls. We set out in Annex 10 what these schedules would look like for the current WBA markets and the proposed Fixed Access markets charge controls.
- 6.48 We explained in the 2012 Consultation that responses from stakeholders explaining how they use the Published Regulatory Financial Statements indicated that the following statements are rarely used:
- the Network Activity Statement;<sup>169</sup>
  - the Network Services Reconciliation;<sup>170</sup> and
  - the Attribution of Wholesale Current Cost and Mean Capital Employed.<sup>171</sup>
- 6.49 To aid our decision making we invited stakeholders to explain if and how they have used these statements. Only one stakeholder, CWW, provided a response, explaining that the Network Activity Statement "is vital" given that the information provided is not available elsewhere allowing an understanding of the drivers of individual service costs.<sup>172</sup> CWW also consider that the Attribution of Wholesale Current Cost and Mean Capital Employed "is useful, helping to provide an overall picture across a range of regulated markets."<sup>173</sup> CWW consider that both should be retained although they saw less need for reconciliation statements.
- 6.50 In light of CWW's response, we have further considered stakeholders' use of the Network Activity Statement and the Attribution of Wholesale Current Cost and Mean Capital Employed statement. We now believe that we should, at least in the short term, retain these two statements. However we welcome further submissions from stakeholders about the degree to which they are useful and may reassess this in the future.
- 6.51 Subject to further responses we therefore propose to retain the Network Activity Statement and the Attribution of Wholesale Current Cost and Mean Capital

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<sup>169</sup> 2012 Published Regulatory Financial Statements, Appendix 1.1, pages 95 to 100.

<sup>170</sup> 2012 Published Regulatory Financial Statements, Appendix 1.3, pages 115 to 120.

<sup>171</sup> 2012 Published Regulatory Financial Statements, Section 6, pages 21 to 27.

<sup>172</sup> CWW, response to the 2012 Consultation, page 16, paragraph 5.15.12.

<sup>173</sup> CWW, response to the 2012 Consultation, page 15, paragraph 5.15.7.

Employed statement and to remove the requirement to publish the Network Services Reconciliation statement, which we will still receive as an AFI.

## Summary of proposals and legal tests

6.52 In summary, we propose to amend the regulatory reporting obligations on BT so that

- BT must report volume and revenue information so as to reconcile with the charge control compliance reports; and
- BT must no longer publish the Network Services Reconciliation statement.

6.53 These amendments will be implemented by way of direction.

6.54 We have considered our proposals to ensure that the Published Regulatory Financial Statements provide the appropriate level of detail against the tests set out in S.49(2) of the Act and have concluded that they are:

- Objectively justifiable because, in relation to the reconciliation of volume and revenue with the charge control compliance statements, it provides CPs with reasonable assurance that BT is complying with its charge controls and, in relation to the Network Services Reconciliation statement, we should not require BT to publish more than is necessary in light of its other SMP obligations.
- Not unduly discriminatory because KCOM is the only other SMP provider which has regulatory accounting obligations, but we have not at present established the need for such regulation. In any case, KCOM is not subject to charge controls
- Proportionate because the changes are no more than is required to ensure that published Regulatory Financial Statements provide the appropriate level of detail.
- Transparent because it is clear that the intention of our proposed changes is to ensure that the Regulatory Financial Statements provide the appropriate level of detail.

## Future provision of information to Ofcom

6.55 In Section 3 we explained that we need information in addition to that which is included in the Published Regulatory Financial Statements. In Section 4 we explained that access to data to inform regulatory decision making could be improved.

6.56 In Section 8 we explain that BT's ongoing development of a new regulatory accounting system is intended to result in a more capable and flexible system. We understand that it will have an improved reporting and analysis capability.

6.57 Our aim is to work with BT during the development and implementation of its regulatory accounting system to develop more efficient means of obtaining the information that we require. We hope that the outcome of this work will be to reduce the need for elements of the AFI including the need for BT to provide the flat file. However, we will not propose that any necessary AFI requirements are removed until we have a better understanding of how we can access the information we need. This will not be until after the new regulatory accounting system is operational.

- 6.58 While we have set out some options for changes that might lead to a more efficient process once BT's new regulatory accounting system has been implemented, for the time being we do not propose changes to the current arrangements.

### **On demand reporting**

- 6.59 Should BT be able to demonstrate that it is able to provide certain standard reports and analysis to us 'on-demand', in a timely manner (say, within five working days) there might be scope to reduce the amount of information that BT provides to us annually.
- 6.60 On-demand reporting would be likely to reduce the annual reporting requirements on BT. It could, for example, reduce the need for the Data Extract Tool and therefore BT's provision of the flat file. On demand reporting would also be likely to reduce the burden imposed by formal information requests by standardising the form of required information and therefore shortening the time period for their provision. It may also reduce the number of requests that are necessary.
- 6.61 In order to implement on demand reporting, we would expect to work with BT to understand and agree how BT's new regulatory accounting system might provide the required information on a timely basis. This might include us creating a set of 'standard' reports that make clear the analysis and explanations that BT's systems would need to be capable of fulfilling within a short period.

### **Scenario reporting**

- 6.62 We use the term 'scenario reporting' to refer to the modelling of the impact on the costs of services and markets of alternative allocation bases. We understand that BT's existing regulatory accounting system is not capable of scenario reporting.
- 6.63 From time to time it may be necessary for us to consider the likely impact of alternative cost allocations or asset valuations. This may arise, for example in the context of charge controls or investigations when we are considering the costs that are relevant to a particular service. The need to consider the impact of alternative cost allocations may also arise in the context of any review of cost allocations.
- 6.64 Scenario reporting also becomes more important given the increased role that we propose to have in the basis of preparation and in the setting of some of BT's cost allocation rules. In particular, scenario reporting will help BT to provide the information required as part of the change control and error notification process that we have proposed in Section 5.

## **Conclusion and summary of our proposals**

- 6.65 In this section we have made proposals that seek to address gaps that we identified in Section 4. Our proposals seek to ensure that:
- Published Regulatory Financial Statements provide stakeholders with the information required to be relevant.
  - The presentation of the basis of preparation is improved for users of the Published Regulatory Financial Statements.

- The Published Regulatory Financial Statements provide the appropriate level of detail; are proportionate and have regard to legitimate concerns of commercial confidentiality.
- We have access to the information that we need.

6.66 In Section 5, we discussed our proposal to require BT to produce and publish a reconciliation report on an annual basis, including a report from the regulatory auditors on the completeness and accuracy of the reconciliation report.

6.67 We also highlighted that we already implemented our proposal, as formulated in the 2012 Consultation, to require BT to publish the Regulatory Financial Statements in spreadsheet format

6.68 The proposals about reporting we additionally make in this section are as follows:

### **Ensuring the Published Regulatory Financial Statements provides relevant information.**

#### Proposal

- 6.1 Where products which are subject to EOI regulation are also covered by SMP regulation, BT must report such products at the same level as products which are covered by SMP regulation but not by EOI regulation.
- 6.2 BT must publish non confidential compliance statements. This will result in a significant increase in published information while imposing minimal burdens.

### **Improving the presentation of the basis of preparation**

#### Proposal

- 6.3 We will amend the regulatory reporting obligations on BT so that BT needs to comply with less burdensome transparency requirements, in particular by amending the Transparency Direction and the Direction relation to the form of the FPIA audit opinion.

### **Ensuring that the Published Regulatory Financial Statements provide the appropriate level of detail**

#### Proposal

- 6.4 BT must report volume and revenue information so as to reconcile with the charge control compliance reports.
- 6.5 BT must no longer publish the Network Services Reconciliation statement.

## Consultation questions

*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.*

*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.*

*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?*

## Section 7

# Audit and Review

## Introduction

- 7.1 In Section 4, we recognised that stakeholders other than BT had lost confidence in the audit. We consider that the problems identified by stakeholders reflect their concerns regarding BT's level of control over the basis of preparation, a lack of transparency about the basis of preparation, and the way that data is reported. The audit alone cannot be relied upon to address these concerns.
- 7.2 We have set out how we propose to address the way data is prepared in Section 5. We have also made proposals about changes to increase the transparency of BT's accounting documentation, and about the way data is reported in Section 6.
- 7.3 In the 2012 Consultation, we considered the concept of "Controls" as a key element of the reporting framework and suggested that this covered the way by which data reports and systems are reviewed and enforced.
- 7.4 In this section, we focus on the review of the data and reports and consider the extent to which the way the data and reports are reviewed should be changed.

## Proposed changes relating to audit and review

- 7.5 We do not propose any significant changes to the current regulatory audit arrangements. However, we do propose that the Published Regulatory Financial statements should be signed-off by a Director for and on behalf of BT's Board of Directors as a means of increasing BT's internal scrutiny of the data and reports.

## No significant changes to the audit requirements

- 7.6 We understand that some stakeholders consider that there may be some scope for changes to audit requirements even if the options are as CWW noted "limited".<sup>174</sup> Given our assessment of the root causes of stakeholders' concerns we do not consider that CWW's suggestion that we seek "expert accounting advice on what is possible and realistic"<sup>175</sup> to be necessary.
- 7.7 The purpose of the regulatory audit cannot be to prevent errors or changes to methodologies. However, it should be expected to detect material errors and identify clearly inappropriate changes to methodologies. As we explain in Section 4, there have been a number of restatements, changes in methodologies and corrections of errors in recent years that have led to an erosion of stakeholder confidence.
- 7.8 We recognise the limitations that an audit has as a single tool for detecting errors. Nevertheless we would expect that the audit of the Regulatory Financial Statements should detect errors such as the typographical error in the Attribution of Wholesale Current Cost Mean Capital Employed statement that we described in Section 4.
- 7.9 At this stage, we remain of the view that we set out in the 2012 Consultation, that while any arrangements whereby the audit was conducted by someone other than

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<sup>174</sup> CWW, 2012 Consultation response, page 11, paragraph 4.19.

<sup>175</sup> CWW, 2012 Consultation response, page 11, paragraph 4.20.

the statutory auditor might improve CPs perception of the independence of the auditor it could increase audit fees without delivering a more effective audit. We also consider that the current auditor has a good understanding of BT's regulatory accounting systems which will be useful during the transition to the new regulatory accounting system.

- 7.10 In the event that, at some point in the future, we do consider it appropriate for the auditor to be changed, we have adequate powers to require this change should it become necessary. Specifically, Condition OA12 states that the Regulatory Auditor appointed by BT must be satisfactory to us at all times. Condition OA 13 allows us to require BT to appoint an Alternative Regulatory Auditor if, in our opinion, the existing Regulatory Auditor is unsatisfactory.<sup>176</sup>
- 7.11 Therefore we do not consider that we need to change the current arrangements regarding the audit.
- 7.12 In the 2012 Consultation, we also considered the scope and format of the audit opinion. We noted that the auditors provide opinions on the Regulatory Financial Statements as a whole and on some of the individual markets (as required by us). We invited views on whether opinions on the Regulatory Financial Statements as a whole would be sufficient, or whether we should also require audit opinions at a product level.
- 7.13 BT responded, saying that "any move to a more detailed level of audit e.g. below the market level or an extension of the requirement for a "fairly presents" opinion would be disproportionate to the intended purpose of such requirements, the benefits received and, in certain instances, as has been the case in the past, may be impracticable and lead to qualifications of the auditor's opinions."<sup>177</sup>
- 7.14 Other stakeholders explained that they wanted a more detailed audit. CWW said that "the audit should be more comprehensive."<sup>178</sup> UKCTA explained that they remain "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."<sup>179</sup>
- 7.15 As explained above, we have considered data (Section 5), reports (Section 6) and BT's systems (Section 8) and believe that the changes proposed in those sections will give users of the Regulatory Financial Statements reasonable confidence about the numbers presented, and subsequently audited.
- 7.16 In light of the above, we do not consider that there is a compelling case to move away from the current audit arrangements. Given the changes that we propose in Section 5 about the basis of preparation and in Section 6 on reports, our view is that it would be disproportionate to require audit to the product level. We therefore propose that we will still require audit opinions at the market level and the specific requirements for FPIA and PPIA opinions will continue to be determined by us.
- 7.17 We have however proposed updating Direction 5 on FPIA opinions (Annex 11) and Direction 6 on PPIA opinions (Annex 12) to reflect our proposals to take control of the

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<sup>176</sup> The regulatory financial reporting obligations on BT and Kingston Communications. Final statement and notification. 22 July 2004.

[http://stakeholders.ofcom.org.uk/binaries/consultations/fin\\_reporting/statement/finance\\_report.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/fin_reporting/statement/finance_report.pdf)

<sup>177</sup> BT, 2012 Consultation response, page 9, paragraph 38.

<sup>178</sup> CWW, 2012 Consultation response, page 18, question 3.3.

<sup>179</sup> UKCTA, 2012 Consultation response, page 9, question 3.3.

Regulatory Accounting principles and Regulatory Accounting guidelines as well as new requirements for BT to replace the Secondary Accounting Documents with new Accounting Methodology Documents.

### **Regulatory Financial statements should be signed at board level**

- 7.18 In the 2012 Consultation we considered whether it would be appropriate to require the Published Regulatory Financial Statements to be signed by a Director for and on behalf of BT's Board of Directors.
- Stakeholders other than BT agreed that a higher level of sign-off should take place for the Regulatory Financial Statements.
  - BT argued that their "existing practice of signature by non-Directors has not led to any problems and we follow strict internal processes in preparing and reviewing the financial statements prior to signature."<sup>180</sup>
- 7.19 In our view requiring sign-off of the Regulatory Financial Statements by a Director for and on behalf of BT's Board of Directors will help to provide confidence by confirming that BT's Directors have given Regulatory Financial Reporting adequate attention.
- 7.20 Although regulatory reporting is not (unlike statutory reporting) governed directly by the Companies Act 2006, we believe that the Regulatory Financial Statements should adopt best practice in acknowledging the responsibilities of the Directors regarding their preparation. BT's 2012/13 consolidated financial statements were approved by the Board of Directors, reflecting the requirements under the Companies Act 2006 Section 419 and in this case were signed by the Chairman, Chief Executive and Group Finance Director.
- 7.21 Sign-off by a Director for and on behalf of BT's Board of Directors would also be consistent with other elements of the regulatory audit framework. A Director currently signs off the regulatory audit engagement letter for and on behalf of BT's Board of Directors and receives a copy of the "duty of care" letter from the auditors to us. Sign-off by a director for and on behalf of BT's Board of Directors would therefore be consistent with these other elements of Regulatory Financial Reporting, bringing it into line with the requirements for statutory reporting.
- 7.22 Our proposal is that a Director must sign-off the Regulatory Financial Statements for and on behalf of BT's Board of Directors with effect from the 2013/14 Regulatory Financial Statements onwards.

### **Changes linked to other proposals in this document**

- 7.23 We have set out three proposals in this consultation that would benefit from some form of third party review.

#### Change control and error notification

- 7.24 We propose in Section 5 a change control and error notification process. BT will be required to notify to us about proposed material changes and material errors that it decides need correction.

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<sup>180</sup> BT, 2012 Consultation response, page 34, paragraph 190.

- 7.25 We propose that the regulatory auditors must report whether BT has notified us all material methodology changes that have been reflected in the latest Regulatory Financial Statement.

### Reconciliation Report

- 7.26 We propose in Section 6 that BT must publish an annual reconciliation report to show the cause and effect of all proposed material methodology changes during the financial year which we have not blocked. It will also show any material errors that BT has decided to correct.
- 7.27 We propose that the regulatory auditors must report whether BT has included and correctly calculated the impact of all the changed material methodologies and all material errors included in the report.

### The transition to a new system

- 7.28 In Section 8, we propose a systems reconciliation report between the numbers generated by BT's current regulatory accounting system (which it calls ASPIRE) and its proposed new system. We will require BT to provide us with a report that explains and accounts for differences that arise between the results produced by ASIRE and its proposed new system for the 2013/14 Regulatory Financial Statements.
- 7.29 We propose that assurance must be provided that:
- The two sets of results being compared have been properly extracted from ASPIRE and the new system.
  - The explanations given by BT for the differences, if any, are reasonable. We expect the assurance opinion to be similar to FPIA given the judgement involved.

### **Other assurance proposals**

- 7.30 We also propose two minor changes that will formalise existing practice.

### Formalising the requirement for BT to arrange ad-hoc assignments

- 7.31 Audit and assurance is an important verification tool available to us in ad hoc situations outside the annual regulatory audit. These ad hoc assignments may be carried out by BT's regulatory auditors or by other providers of assurance, including consultants.
- 7.32 Examples of their use include:
- Analysys Mason's 2008 investigation into PPC volumes restatement/ change in methodology for counting volumes.<sup>181</sup>
  - BDO's 2010 report on NTS bad debt and billing.<sup>182</sup>

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<sup>181</sup> Ofcom, *Draft Determination to resolve disputes between each of Cable & Wireless, THUS, Global Crossing, Verizon, Virgin Media and COLT and BT regarding BT's charges for partial private circuits* [http://stakeholders.ofcom.org.uk/consultations/draft\\_deter\\_ppc/summary](http://stakeholders.ofcom.org.uk/consultations/draft_deter_ppc/summary)

- 7.33 We will continue to commission ad hoc audit and assurance in future, as and when the need arises and it would be proportionate to do so. In many cases, it will be appropriate for BT to bear the cost of such engagements, however it will depend upon the circumstances.
- 7.34 We propose to formalise our powers to require ad hoc assurance reports, as well as “agreed upon procedures” engagements via an additional SMP condition. BT must arrange and pay for third party assurance for these as required.

### **Summary of proposals and legal tests**

- 7.35 In summary, we propose to amend the regulatory reporting obligations on BT so that
- A Director of BT must sign off the RFS for and on behalf of BT’s Board of Directors
  - BT must arrange for assurance reports where so directed by Ofcom
- 7.36 These amendments will be implemented in the SMP conditions.
- 7.37 We have considered our proposals about audit and review against the tests set out in S.47(2) of the Act and have concluded that they are:
- Objectively justifiable because signature by a BT Director will ensure that the Regulatory Financial Statements get the necessary attention within BT.
  - Not unduly discriminatory because KCOM is the only other SMP provider which has regulatory accounting obligations, but we have not at present established the need for such regulation.
  - Proportionate because the changes are no more than is required to ensure that there is an appropriate level of assurance.
  - Transparent because it is clear that the intention of our proposed changes is to ensure that there is an appropriate level of assurance.

### **Conclusion and summary of our proposals**

- 7.38 In this section we do not propose significant changes to the current audit arrangements.
- 7.39 In previous sections, we have made a range of proposals which will impact on the audit reports we require BT to obtain. In particular, we propose in Sections, 5, 6 and 8 that:
- BT’s regulatory auditors must report whether BT has notified all material methodological changes to us.
  - 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.

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<sup>182</sup> BDO, *NTS Retail Uplift And PRS Bad Debt Surcharge Charge Control Project Final*, January 2011 <http://stakeholders.ofcom.org.uk/consultations/nts-retail-uplift/>

- BT's regulatory auditors must report whether the results of the ASPIRE and new regulatory accounting system have been properly extracted and that explanations for any difference are reasonable.

7.40 The proposals about controls we additionally make in this section are as follows:

#### Proposal

- 7.1 A Director must sign-off the regulatory accounts for and on behalf of BT's Board of Directors.
- 7.2 BT must arrange and pay for third party assurance in relation to ad hoc assignments as we require.

## Consultation questions

*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.*

*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.*

## Section 8

# Transition to a new regulatory accounting system

## Introduction

- 8.1 The regulatory accounting systems that BT uses to produce Regulatory Financial reporting information have developed over time, evolving to meet the changing regulatory context. We explained in Section 4 that the main regulatory accounting system that BT uses is the called ASPIRE. This is used to produce FAC data. A subsidiary LRIC model draws on the ASPIRE FAC data. Additionally, BT provides a data file (the 'flat file') which allows Ofcom to interrogate BT data.
- 8.2 In the 2012 Consultation we provided details about BT's existing regulatory accounting systems and identified some issues around the current systems. We said that they "appear to be complicated, require a significant amount of manual intervention, lack transparency and are difficult and time consuming to modify. We also understand that it is difficult to model the effects of potential modifications to the bases of preparation".<sup>183</sup>
- 8.3 In this section we provide an update on BT's proposal to deliver a new regulatory accounting system and set out our proposals to ensure we continue to have visibility of how the transition to the new regulatory accounting system is managed in order to prevent the transition itself causing differences in the figures included in the Regulatory Financial Statements.
- 8.4 The introduction of BT's new regulatory accounting system is expected to address many of the issues we identified in the 2012 Consultation. This section provides an update on how the new regulatory accounting system is being implemented.
- 8.5 In the 2012 Consultation we made proposals in relation to the visibility of the introduction of BT's new regulatory accounting system. The proposals were intended to capture our objective to collaborate with BT to implement a new regulatory accounting system and manage the transition to any replacement regulatory accounting system. This section provides new proposals that take account of BT's quicker than expected progress in implementing its proposed new regulatory accounting system.

## Update on BT's new regulatory accounting system

- 8.6 Since the 2012 Consultation, BT has explained to us its proposal to replace the existing ASPIRE system with a new system. BT has told us that whereas ASPIRE is made complex by having over 200 offline interlinked cost attribution models,<sup>184</sup> the objective of its proposed new regulatory accounting system is to integrate these attribution models into one unified regulatory accounting system on a new platform. The intention is that its proposed new regulatory accounting system will be more flexible than ASPIRE and able to more easily support new requirements and methodologies in future. A unified regulatory accounting system should make it

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<sup>183</sup> 2012 Consultation, paragraph 5.225.

<sup>184</sup> 2012 Consultation, paragraph 4.111.

quicker to produce reports and analysis, and allow scenario analysis to take place, for example calculating the impact on services of alternative allocation bases.

- 8.7 BT has told us that the focus of its proposed new regulatory accounting system is on the replacement of ASPIRE, the system that produces FAC data in the Regulatory Financial Statements. At this stage, the proposed new regulatory accounting will not incorporate the BT LRIC model. Instead, outputs from the proposed new regulatory accounting system will feed into the BT LRIC model in the same way that outputs from ASPIRE currently feed into it.

## Timetable

- 8.8 BT's current plan is as follows:

- The 2013/14 Regulatory Financial Statements will be the last produced using ASPIRE.
- Following publication of the 2013/14 Regulatory Financial Statements, the proposed new regulatory accounting system will be tested to ensure it produces results for 2013/14 that are consistent with ASPIRE.
- The proposed new regulatory accounting system will 'go live' around December 2014, subject to satisfactory testing.
- The 2014/15 Regulatory Financial Statements will be produced using the proposed new regulatory accounting system.

- 8.9 This timetable represents a significant shortening of the period to complete the development of the proposed new regulatory accounting system. In the 2012 Consultation we said that BT thought it may be 2015/16 at the earliest before a replacement regulatory accounting system could be capable of producing the Regulatory Financial Statements<sup>185</sup>.

## Managing the transition to the proposed new regulatory accounting system

- 8.10 We welcome BT's decision to develop a new regulatory accounting system. Creating a more unified regulatory accounting system should lead to a number of benefits. For example we would expect the move to a new regulatory accounting system to result in:

- **Fewer errors.** We said in the 2012 Consultation that a series of errors in recent years had led to a loss of confidence in the Regulatory Financial Statements.<sup>186</sup> A unified regulatory accounting system will minimise the need for manual intervention and reduce the number of offline allocation models which should reduce the scope for mathematical or input errors to arise. The actual process of developing a new regulatory accounting system may also identify errors that require correction.
- **Faster turnaround of analysis.** The new regulatory accounting system should enable regulatory financial information to be produced quicker with less effort

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<sup>185</sup> 2012 Consultation, paragraph 5.235.

<sup>186</sup> 2012 Consultation, paragraph 1.10.

from BT staff. While this will allow BT to focus more on the analysis of its regulatory financial data, it should also allow it to respond quicker to our requests for information and analysis.

- **Better functionality.** In particular, BT has told us that it will be possible to calculate the impact of changes in allocation bases on services and markets and undertake what if-type analysis. This could support our intention in Section 6 to require BT to produce scenario analysis at a future date and remove the requirement for the flat file.
- **Future flexibility.** A redeveloped regulatory accounting system should enable the allocation bases to be amended in future relatively easily.

8.11 We consider, however, that the transition to a new regulatory accounting system requires certain safeguards to be put in place. This is to ensure that its introduction does not cause material changes to the numbers that would have been reported in the Regulatory Financial Statements under ASPIRE, or at least that those changes are explained and understood.

8.12 In response to our proposals in the 2012 Consultation:

- BT agreed to the collaborative approach of improving their cost accounting systems. BT explained that its new regulatory accounting system would be designed to deliver initially “identical results as the previous system” and where results were different to ASPIRE they would “provide a detailed explanation and reconciliations to the previous system.”<sup>187</sup> BT considered that the transition period would be covered by the annual audit process.<sup>188</sup>
- BT stressed that its cost accounting systems were its own “responsibility provided they are appropriate to meet its Regulatory Financial Reporting and other SMP obligations”<sup>189</sup> and they were unwilling to share detailed documentation or regulatory accounting system specifications with stakeholders. It saw “no role for stakeholders in assessing or contributing to model developments, assumptions or underlying structures.”<sup>190</sup>
- Other stakeholders considered that we “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”<sup>191</sup>, scrutinising both the implementation and outputs of a new regulatory accounting system.
- Stakeholders also made suggestions on implementation. For example CWW said that “it is inevitable that some numbers will change and a parallel run of 2 years would be needed to provide a stable period of transition.”<sup>192</sup>

8.13 We have considered the comments received in response to the 2012 Consultation and developed proposals that continue with the collaborative approach and ensure that the introduction of the new regulatory accounting systems’ results in outputs consistent with ASPIRE. Where differences between the new regulatory accounting

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<sup>187</sup> BT, 2012 Consultation response, page 4, paragraph 195.

<sup>188</sup> BT, 2012 Consultation response, page 4, paragraph 207.

<sup>189</sup> BT, 2012 Consultation response, page 4, paragraph 11.

<sup>190</sup> BT, 2012 Consultation response, page 4, paragraphs 205.

<sup>191</sup> UKCTA, 2012 Consultation response, page 25, question 5.15.

<sup>192</sup> CWW, 2012 Consultation response, page 24, question 5.15

system and ASPIRE do emerge, BT will reconcile them and where the differences are material, we may require BT to prepare the Regulatory Financial Statements on a basis consistent with ASPIRE.

### **Continuing with the collaborative approach**

- 8.14 BT has kept us informed about its progress in developing its new regulatory accounting system and has said it will continue to do so. We have met with BT's regulatory finance team as well as the consultants designing and building the new regulatory accounting system. These meetings have worked well to date. BT has shared and discussed its plans with us. We are confident that these informal arrangements will continue. Going forward we intend to meet BT to discuss progress on the new regulatory accounting system every two months or so.
- 8.15 Although we recognise BT's cooperation to date, we nevertheless consider that it would be helpful to formalise these arrangements. This is because there are likely to be future developments to BT's regulatory accounting systems about which we need to be informed. For example, the BT LRIC model is not currently within the scope of the new regulatory accounting system and is likely to be developed at some point in the future. We need to be kept informed about such developments to ensure that the impact on the Regulatory Financial Statements can be assessed.
- 8.16 We therefore propose that where BT develops or replaces any of its regulatory accounting systems, it must keep us informed about its progress against milestones at the design, build, test and implementation stages of development. The frequency and content of these progress updates will be agreed between BT and us. We consider that this proposal formalises the existing informal arrangements that work well currently.
- 8.17 This proposal will be implemented with immediate effect when we make our decision.

### **Comparability of financial output**

- 8.18 The introduction of a new regulatory accounting system has the potential to give rise to changes that are the direct result of the use of a different regulatory accounting system to produce the Regulatory Financial Statements. This is potentially a concern since we do not consider it would be appropriate for the financial data appearing in the Regulatory Financial Statements to be different simply because a new regulatory accounting system was used to produce it. Any differences that did arise would need to be explained and accounted for.
- 8.19 BT has told us that it is designing the new regulatory accounting system to replicate the output of ASPIRE.<sup>193</sup> This is supported by its consultation response where it said that any new regulatory accounting system will deliver identical results compared to the previous regulatory accounting system.<sup>194</sup> However, in practice, it may be difficult to achieve exactly the same results in the new regulatory accounting system as in ASPIRE for two reasons:
- First, testing the new regulatory accounting system against ASPIRE may reveal mathematical or input errors in ASPIRE. We would expect ASPIRE to be corrected, as is currently the case when BT discovers such errors. If any errors

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<sup>193</sup> BT told us that the new system will initially be a system upgrade and that the new system will not introduce any methodology changes.

<sup>194</sup> BT, response to 2012 Consultation, page 35, paragraph 195.

were material, we would expect the Published Regulatory Financial Statements to be restated. Such differences, if they arose, would therefore be capable of being disclosed and reconciled.

- Second, the new regulatory accounting system may process data in a different way which could lead to differences from ASPIRE. For example, we understand ASPIRE needs to be run several times to produce a set of results due to the way feedback loops work. The new regulatory accounting system will not necessarily run in the same way. It is possible that this could lead to differences between the results generated from the two regulatory accounting systems.

8.20 Although it may be difficult to ensure the new regulatory accounting system produces exactly the same results as ASPIRE, we consider that it is important that the new regulatory accounting system does not introduce material changes to the numbers previously reported by ASPIRE.

8.21 We propose that BT must ensure, to the best of its ability, that the financial data produced by the new regulatory accounting system is the same as that produced by ASPIRE. This proposal will be implemented with immediate effect when we make our decision.

### **Systems reconciliation report between ASPIRE and the new regulatory accounting system**

8.22 Despite BT's best efforts, we recognise that there may be differences between the outputs of ASPIRE and the new regulatory accounting system. Such differences need to be explained by BT and understood by us and potentially other stakeholders.

8.23 We therefore propose that BT must produce and provide to us a report that explains and accounts for any differences between the outputs of the new regulatory accounting system and ASPIRE in relation to the 2013/14 Regulatory Financial Statements ("systems reconciliation report"). The report is to be provided to us by 31 December 2014. The report must be accompanied by an assurance statement by a third party confirming that the numbers used in the report have been properly extracted from ASPIRE and the new regulatory accounting system. We may require all or part of this report to be published. This proposal will be implemented with immediate effect when we make our decision.

### **Preparation of the 2014/15 Regulatory Financial Statements**

8.24 In the event that the systems reconciliation report reveals that the new regulatory accounting system produces results that are significantly different from ASPIRE BT must, where we require it to do so, provide a further assurance statement and prepare the 2014/15 Regulatory Financial Statements on a basis consistent with ASPIRE.

8.25 Specifically, where the systems reconciliation report indicates that any number published in the 2013/14 Regulatory Financial Statements under ASPIRE would be more than 1% different using the new system, BT must do the following, where we require it to do so:

- provide an assurance statement by an independent third party confirming that the explanations given by BT for any differences are a reasonable representation of the underlying cause.

- prepare the 2014/15 Regulatory Financial Statements on a basis consistent with how the 2013/14 Regulatory Financial Statements were prepared under ASPIRE. We could require this where there are a number of significant differences between the new system and ASPIRE or where we consider BT has not sufficiently explained those differences.
- 8.26 This proposal will be implemented with immediate effect when we make our decision in spring 2014.
- 8.27 We note that in Section 5 we set a materiality level of 5%. Given that the new regulatory accounting system should not lead to significantly different results to ASPIRE, we consider a materiality threshold of 5% would be too great, and that 1% would be more appropriate. A 1% threshold recognises that it may be difficult to ensure that the outputs from the new regulatory accounting system are exactly the same as the outputs from ASPIRE, while guarding against an outcome where many regulated services saw their costs increase significantly due solely to a system change.
- 8.28 We consider that the proposals set out above respond to CPs concerns that any replacement regulatory accounting system would lead to unexplained changes in financial data, or that any changes would not be transparent.

### **Summary of proposals and legal tests**

- 8.29 In summary, we propose to amend the regulatory reporting obligations on BT so that
- Where BT develops or replaces any of its regulatory accounting systems, it must keep us informed about its progress against milestones at the design, build, test and implementation stages of development.
  - BT must ensure, to the best of its ability, that the financial data produced by the new regulatory accounting system is the same as that produced by the old regulatory accounting system.
  - BT must produce and provide to us a report that explains and accounts for any differences between the outputs of the new regulatory accounting system and the old regulatory accounting system. The report must be accompanied by an assurance statement by an independent third party confirming that the numbers used in the report have been properly extracted from old regulatory accounting system and the new regulatory accounting system. We may require all or part of this report to be published.
  - In the event that the systems reconciliation report reveals that the new regulatory accounting system produces results that are significantly different from the old regulatory accounting system, BT must, where we require it to do so, provide a further assurance statement and prepare the Regulatory Financial Statements on a basis consistent with the old regulatory accounting system.
- 8.30 These amendments will be implemented in the SMP conditions.
- 8.31 We have considered our proposals to manage the transition to a new BT system against the tests set out in S.47(2) of the Act and have concluded that they are:

- Objectively justifiable because our proposals will ensure that we remain engaged with BT's plans for a new system and that Stakeholders and Ofcom understand any differences resulting from the transition.
- Not unduly discriminatory because KCOM is the only other SMP provider which has regulatory accounting obligations, but we have not at present established the need for such regulation.
- Proportionate because the changes are no more than is required to ensure that Ofcom remains engaged with BT's plans for a new system and that Stakeholders and Ofcom understand any differences resulting from the transition.
- Transparent because it is clear that the intention of our proposed changes is to ensure that Ofcom remains engaged with BT's plans for a new system and that Stakeholders and Ofcom understand any differences resulting from the transition.

## Conclusion and summary of our proposals

8.32 In this section we made proposals about managing the transition to BT's proposed new regulatory accounting system.

8.33 In summary our proposals about managing the transition are:

### Proposal

- 8.1 Where BT develops or replaces any of its regulatory accounting systems, it must keep us informed about its progress against milestones at the design, build, test and implementation stages of development.
- 8.2 We propose that BT must ensure, to the best of its ability, that the financial data produced by the new regulatory accounting system is the same as that produced by ASPIRE.
- 8.3 BT must produce and provide to us a report that explains and accounts for any differences between the outputs of the new regulatory accounting system and ASPIRE in relation to the 2013/14 Regulatory Financial Statements ("systems reconciliation report").
- 8.4 BT must, where we require it to do so provide a report from its regulatory auditors confirming that the explanations given by BT for any differences are a reasonable representation of the underlying cause.
- 8.5 BT must where we require it to do so prepare the 2014/15 Regulatory Financial Statements on a basis consistent with how the 2013/14 Regulatory Financial Statements were prepared under ASPIRE

## Consultation questions

*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.*

*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.*

## Section 9

# Implementing the new framework

## Introduction

- 9.1 In this section we set out our proposed timeline for implementing our proposals.
- 9.2 We will put in place the key elements of the framework immediately when we make our decision. By taking ownership of the Regulatory Accounting Principles, reviewing BT's Primary Accounting Documents and introducing change control we will both address the level of control that BT currently has over the basis of preparation and introduce transparency about changes to material changes to allocation methodologies.
- 9.3 We do not expect that BT will be able to amend its processes in time for these proposed changes to be reflected in the 2013/14 Regulatory Financial Statements. The 2014/15 Regulatory Financial Statements will, therefore, be the first to be published consistent with the new Regulatory Accounting Principles, subject to change control, and to be consistent with the Regulatory Accounting Guidelines.
- 9.4 In 2013 we required BT to publish a reconciliation report with its Regulatory Financial Statements. This change which will be formalised with effect from the 2013/14 Regulatory Financial Statement onwards. We have already implemented the requirement for BT to publish Regulatory Financial Statements in spreadsheet format alongside its pdf format Regulatory Financial Statement. These changes will, together with changes to the structure of reports, further aid transparency and increase confidence.
- 9.5 Full implementation of our proposals will take more time. Some elements such as development of the Regulatory Accounting Guidelines may be the subject of future consultations. Other elements of the framework may well be dependent on the outcome of separate policy projects.
- 9.6 As our reporting framework evolves BT will need to ensure that its accounting systems and processes can deliver these requirements.

## A proposed implementation timeline

- 9.7 We consider that the following timeline provides an appropriate period for BT to ensure that it is able to meet the requirements while managing the transition from its existing regulatory accounting systems. We expect to be consulting on proposed changes to Regulatory Accounting Guidelines throughout this timetable.

**Table 2: Proposed timeline for implementing key changes to the reporting framework**

<b>When:</b>	<b>Key deliverables:</b>
<b>2013/14 – The year to March 2014; Regulatory Financial Statement published July 2014</b>	<ul style="list-style-type: none"> <li>• Reconciliation reports to be produced and published annually.</li> <li>• Ofcom begins to review BT's Primary Accounting Documents</li> <li>• Regulatory Financial Statement signed off by a Director for and on behalf of BT's Board.</li> <li>• Regulatory Financial Statement published in line with current arrangements e.g. CCA basis.</li> <li>• Final year ASPIRE is used to prepare the Regulatory Financial Statement.</li> </ul>
<b>2014/15 – The year to March 2015; Regulatory Financial Statement published July 2015</b>	<ul style="list-style-type: none"> <li>• Regulatory Financial Reporting in line with new Regulatory Accounting Principles.</li> <li>• BT notifies Ofcom and publishes any proposed material changes to allocation methodology by November 2014.</li> <li>• BT notifies Ofcom and publishes any material errors within 30 days of decision to correct.</li> <li>• Regulatory Financial Statement prepared on a RAV basis.</li> <li>• Published Regulatory Financial Statement includes Compliance Statements for relevant markets.</li> <li>• BT's new regulatory accounting system used to prepare the Regulatory Financial Statements.</li> <li>• BT must provide a reconciliation report between new system outputs and ASPIRE by 31 December 2014 together with assurance statement.</li> </ul>
<b>2015/16 – The year to March 2016; Regulatory Financial Statement published July 2016</b>	<ul style="list-style-type: none"> <li>• As above (no systems reconciliation report required)</li> </ul>
<b>2016/17 – The year to March 2017; Regulatory Financial Statement published July 2017</b>	<ul style="list-style-type: none"> <li>• BT completes update of its Accounting Methodology Documents in line with Ofcom's Regulatory Accounting Principles and Regulatory Accounting Guidelines.</li> </ul>

## **Application of the changes to markets with SMP**

9.8 As we have explained in Section 2, the regulatory reporting obligations are SMP obligations which we can only impose in markets where BT has SMP. We propose to formally implement changes to relevant markets as they are reviewed in the course of a market review. As part of this document, we are consulting on introducing these changes in relation to those markets considered in the Wholesale Broadband Access (WBA) markets and Fixed Access markets and we expect to make a decision in relation to the proposals formulated in this document alongside our decisions in relation to those markets (due to conclude in Spring 2014).

- 9.9 In relation to the markets which are considered as part of the Business Connectivity Market Review and the Narrowband Market Review, we intend to implement the revised framework for Regulatory Reporting at the next round of those market reviews (due to conclude in 2016).
- 9.10 However, to preserve the integrity and consistency of the regulatory accounting system, we consider that the changes we are proposing should be implemented for regulatory accounting as a whole (including for example, reporting of markets considered as part of the Narrowband Market Review and the Business Connectivity Market Review). Our objective is that BT should therefore apply one set of accounting rules across all markets.
- 9.11 We will therefore work with BT to determine how best to implement any changes that we decide to impose in the WBA and Fixed Access Markets in all other markets that are subject to regulatory accounting obligations, if necessary on a voluntary basis in the short term, until the relevant market reviews are completed.
- 9.12 Our proposal is that:
- We publish our decision to implement our proposed changes alongside our decisions on the market reviews for Wholesale Broadband Access, and Fixed Access markets.<sup>195</sup> These are due to be published in spring 2014.
  - The new arrangements will apply to the Wholesale Broadband Access, and Fixed Access markets but take effect as set out in the timeline that we have described in table 2.
  - BT will align its Regulatory Financial Reporting including production and publication of Regulatory Financial Statements for the Business Connectivity and Narrowband markets in a manner that is consistent with requirements for Wholesale Broadband Access, and Fixed Access markets.
  - Ofcom will consult on and formally introduce requirements for Regulatory Financial Reporting in the form that we propose (if implemented) for the remaining markets alongside decisions about SMP in Business Connectivity (scheduled for March 2016) and Narrowband (scheduled for September 2016) markets.
- 9.13 Before implementing any changes to SMP conditions Ofcom must notify the European Commission providing it with the opportunity to comment on our proposals. We propose to do this in spring 2014. We will then consider any responses received and make any necessary changes before publishing our final decision.
- 9.14 Reporting must be consistent with our regulatory decisions. This means that the framework and its components, in particular the Regulatory Accounting Guidelines, will need to continue to evolve over time. As regulatory policy changes and decisions are made the reporting regime will evolve to follow these changes. Some of the changes to, for example the Regulatory Accounting Guidelines, may require specific consultations. Others changes will be introduced as the result of specific policy initiatives, market reviews and charge controls.

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<sup>195</sup> These markets are composed of the Local Loop Unbundled (LLU) and Wholesale Line Rental (WLR) markets.

- 9.15 Successful implementation will depend on the co-operation of BT. BT's systems and processes will need to change. BT's ASPIRE system must be able to change in the short term. In the longer term BT's new accounting system must be capable of complying with the new framework from the system's implementation. It must also be flexible enough to evolve as the Regulatory Financial Reporting requirements evolve.

## Consultation questions

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

*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?*

## Section 10

# Simplification of conditions

## Simplification of conditions

- 10.1 We explained in Section 1 that the current framework for BT's Regulatory Financial Reporting was first implemented in 2004 and that the use of financial data has evolved. This evolution has been driven by technology changes and changes in regulation, with an increased focus on detailed costing data.
- 10.2 The changes that we have proposed in the preceding sections will require the modification of SMP services conditions and directions that were first implemented in Ofcom's July 2004 statement "The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification". Save in their application, these conditions have remained unchanged.
- 10.3 We have taken the opportunity presented by this review of Regulatory Financial Reporting to consider whether the SMP services conditions could be simplified in order to bring greater transparency and increased understanding of the obligations that are imposed on BT.
- 10.4 We have as a result included within the proposed modifications of conditions set out in Annex 6 proposals that are intended to deliver simpler and clearer conditions. Our proposed changes are as follows:

- i) Removal of the consistency requirement in condition OA9 as set out at Annex 2 of the July 2004 Statement

The requirement for BT's Regulatory Financial Statements to be consistent as a whole and from one period to another remains. However, in this consultation we are proposing that this principle be part of the Regulatory Accounting Principles, and there is therefore no need for that to be repeated here.

- ii) Removal of condition OA10 as set out at Annex 2 of the July 2004 Statement

We now consider that there is no need for us to set out what actions BT needs to undertake in order for it to be able to obtain an audit opinion (although the requirement to obtain such audit opinion does, of course, remain). We are therefore proposing to remove this requirement.

- iii) Removal of conditions OA17 to OA20 as set out at Annex 2 of the July 2004 Statement

As part of our proposals set out in this consultation, we are proposing new requirements in relation to Accounting Methodology Documents. These replace former conditions OA17-OA21, which relate to the Primary and Secondary Accounting Documents.

- iv) Removal of condition OA21 as set out at Annex 2 of the July 2004 Statement

The proposals set out in this consultation are aimed at giving us a greater role in determining how BT should prepare its Regulatory Financial Statements. In

addition, we propose a Regulatory Accounting Principle which requires consistency with regulatory decisions, with specific guidance as to how to apply this principle to be set out in the Regulatory Accounting Guidelines. Condition OA21, which relates to the up-dating of systems, accounting documents and form and content of the Regulatory Financial Statements to ensure consistency with certain regulatory decisions, will therefore no longer add anything.

- v) Removal of conditions OA23, OA24 and OA32 as set out at Annex 2 of the July 2004 Statement

These conditions specify various requirements in relation to the accounting records. We have retained the majority of the requirements of these conditions, however have simplified their drafting.

- vi) Removal of conditions OA26, OA27 and OA28 as set out at Annex 2 of the July 2004 Statement

The requirement on BT to prepare a wholesale catalogue remains. However we have simplified the drafting of such requirement.

- vii) Removal of conditions OA29, OA30 and OA31

The requirement for BT to prepare a retail catalogue was removed several years ago<sup>196</sup>. The proposed removal of these conditions aligns the SMP conditions with that position.

- 10.5 In addition, we also propose to remove some of the terminology used in the conditions as set out at Annex 2 of the July 2004 Statement (e.g. Disaggregated Activities, Accounting Separation Activities) and replace it with terminology which is more aligned with that used in the course of our market reviews. This change in terminology does not, however change BT's reporting requirements.

## Directions to be retained

- 10.6 As part of this consultation, we are proposing a new transparency direction, a new "form of FPIA direction" and a new "form of PPIA direction". Other directions set out in the Statement of July 2004 (and subsequently amended) will be retained as if they were made under the proposed new SMP conditions. This is the case in relation to the direction specifying network components, the direction setting out requirements for the preparation, audit and delivery of the Regulatory Financial Statements, and the direction setting out requirements for the form and content of the Regulatory Financial Statements. The latter two directions will in addition be amended to implement the proposals set out in this consultation.

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<sup>196</sup> Changes to BT and KCOM's regulatory and financial reporting 2009/10 update, Explanatory statement and notification, statement of 4 June 2010  
<http://stakeholders.ofcom.org.uk/binaries/consultations/btregs10/statement/statement.pdf>

## Annex 1

# Responding to this consultation

## How to respond

- A1.1 Ofcom invites written views and comments on the issues raised in this document, to be made **by 5pm on 14 February 2014**.
- A1.2 Ofcom strongly prefers to receive responses using the online web form at <http://stakeholders.ofcom.org.uk/consultations/bt-transparency/howtorespond/form>, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 3), to indicate whether or not there are confidentiality issues. This response coversheet is incorporated into the online web form questionnaire.
- A1.3 For larger consultation responses - particularly those with supporting charts, tables or other data - please email [gary.carey@ofcom.org.uk](mailto:gary.carey@ofcom.org.uk) attaching your response in Microsoft Word format, together with a consultation response coversheet.
- A1.4 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.
- Gary Carey  
Floor 4  
Competition Finance  
Riverside House  
2A Southwark Bridge Road  
London SE1 9HA
- Fax: 020 7783 4103
- A1.5 Note that we do not need a hard copy in addition to an electronic version. Ofcom will acknowledge receipt of responses if they are submitted using the online web form but not otherwise.
- A1.6 It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at Annex 4. It would also help if you can explain why you hold your views and how Ofcom's proposals would impact on you.

## Further information

- A1.7 If you want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Gary Carey on 020 7783 4393.

## Confidentiality

- A1.8 We believe it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, [www.ofcom.org.uk](http://www.ofcom.org.uk), ideally on receipt. If you think your response should be kept confidential, can you please specify what part or whether

all of your response should be kept confidential, and specify why. Please also place such parts in a separate annex.

- A1.9 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and will try to respect this. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A1.10 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom 's approach on intellectual property rights is explained further on its website at <http://www.ofcom.org.uk/about/accoun/disclaimer/>

## Next steps

- A1.11 Following the end of the consultation period, Ofcom intends to publish a statement in spring 2014.
- A1.12 Please note that you can register to receive free mail updates alerting you to the publications of relevant Ofcom documents. For more details please see: [http://www.ofcom.org.uk/static/subscribe/select\\_list.htm](http://www.ofcom.org.uk/static/subscribe/select_list.htm)

## Ofcom's consultation processes

- A1.13 Ofcom seeks to ensure that responding to a consultation is easy as possible. For more information please see our consultation principles in Annex 2.
- A1.14 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at [consult@ofcom.org.uk](mailto:consult@ofcom.org.uk) . We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, who are less likely to give their opinions through a formal consultation.
- A1.15 If you would like to discuss these issues or Ofcom 's consultation processes more generally you can alternatively contact Vicki Nash, Director Scotland, who is Ofcom's consultation champion:

Vicki Nash  
Ofcom  
Sutherland House  
149 St. Vincent Street  
Glasgow G2 5NW

Tel: 0141 229 7401

Fax: 0141 229 7433

Email [vicki.nash@ofcom.org.uk](mailto:vicki.nash@ofcom.org.uk)

## Annex 2

# Ofcom's consultation principles

A2.1 Ofcom has published the following seven principles that it will follow for each public written consultation:

### Before the consultation

A2.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

### During the consultation

A2.3 We will be clear about who we are consulting, why, on what questions and for how long.

A2.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened Plain English Guide for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.

A2.5 We will consult for up to 10 weeks depending on the potential impact of our proposals.

A2.6 A person within Ofcom will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. Ofcom's 'Consultation Champion' will also be the main person to contact with views on the way we run our consultations.

A2.7 If we are not able to follow one of these principles, we will explain why.

### After the consultation

A2.8 We think it is important for everyone interested in an issue to see the views of others during a consultation. We would usually publish all the responses we have received on our website. In our statement, we will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

## Annex 3

# Consultation response cover sheet

- A3.1 In the interests of transparency and good regulatory practice, we will publish all consultation responses in full on our website, [www.ofcom.org.uk](http://www.ofcom.org.uk).
- A3.2 We have produced a coversheet for responses (see below) and would be very grateful if you could send one with your response (this is incorporated into the online web form if you respond in this way). This will speed up our processing of responses, and help to maintain confidentiality where appropriate.
- A3.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their coversheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.
- A3.4 We strongly prefer to receive responses via the online web form which incorporates the coversheet. If you are responding via email, post or fax you can download an electronic copy of this coversheet in Word or RTF format from the 'Consultations' section of our website at [www.ofcom.org.uk/consult/](http://www.ofcom.org.uk/consult/).
- A3.5 Please put any parts of your response you consider should be kept confidential in a separate annex to your response and include your reasons why this part of your response should not be published. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only, so that we don't have to edit your response.

## Cover sheet for response to an Ofcom consultation

### BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

### CONFIDENTIALITY

Please tick below what part of your response you consider is confidential, giving your reasons why

Nothing	<input type="checkbox"/>	Name/contact details/job title	<input type="checkbox"/>
Whole response	<input type="checkbox"/>	Organisation	<input type="checkbox"/>
Part of the response	<input type="checkbox"/>	If there is no separate annex, which parts?	

If you want part of your response, your name or your organisation not to be published, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

### DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response that Ofcom can publish. However, in supplying this response, I understand that Ofcom may need to publish all responses, including those which are marked as confidential, in order to meet legal obligations. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name

Signed (if hard copy)

## Annex 4

# Consultation questions

## Sub heading

### A4.1 Questions requiring Responses by 5pm on 14 February 2014

*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?*

*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?*

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

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

*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.*

*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.*

*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.*

*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.*

*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?*

*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.*

*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.*

*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.*

*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.*

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

*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?*

## Annex 5

# Glossary

- A5.1 **Additional Financial Statements (AFS) and Additional Financial Information (AFI):** Consist of additional financial reporting by BT to Ofcom on a confidential basis.
- A5.2 **ASPIRE:** BT's Accounting Separation System used to produce fully allocated costs (FAC) according to the Regulatory Financial Reporting structure of markets, services, products and components.
- A5.3 **CAT:** Competition Appeal Tribunal
- A5.4 **CC:** Competition Commission
- A5.5 **CFI:** Call for Inputs
- A5.6 **Charge control:** A control which sets the maximum price that a communication provider can charge for a particular product or service. Most charge controls are imposed for a defined period.
- A5.7 **Common costs:** Costs which are shared by all the services supplied by a firm.
- A5.8 **Communications Act or "the Act":** Communications Act 2003
- A5.9 **Cost orientation:** The principle that the price charged for the provision of a service should reflect the underlying costs incurred in providing that service.
- A5.10 **CP:** Communications provider.
- A5.11 **Current cost accounting (CCA):** An accounting convention, where assets are valued and depreciated according to their current replacement cost whilst maintaining the operating or financial capital of the business entity.
- A5.12 **DLRIC:** Distributed long run incremental cost. A cost measure that is equal to the LRIC of a service plus a share of the common costs.
- A5.13 **DSAC:** Distributed standalone cost. An accounting approach estimated by adding to the DLRIC a proportionate share of the inter-increment common costs. Rather than all common costs shared by a service being allocated to the service under consideration, the common costs are instead allocated amongst all the services that share the network increment.
- A5.14 **Data File (Flat File):** BT Regulatory Financial Reporting information provided annually on a confidential basis to Ofcom.
- A5.15 **Data Extraction Tool (DET):** The DET is an Ofcom tool that allows Ofcom to access financial reporting information provided in confidence by BT in the form of the Flat File.
- A5.16 **Equivalence of Input (EOI):** The concept established by the undertakings in which BT provides, in respect of a particular product or service, the same product or service to all CPs (including BT) on the same timescales, terms and conditions

(including price and service levels) by means of the same systems and processes, and includes the provision to all CPs (including BT) of the same commercial information about such products, services, systems and processes.

- A5.17 **Fully Allocated Cost (FAC):** An accounting approach under which all the costs of the company are distributed between its various products and services. The fully allocated cost of a product or service may therefore include some common costs that are not directly attributable to the service.
- A5.18 **Information requests:** Under statutory information gathering powers, we can request a wide range of information, subject to limitations such as proportionality. We would typically use these on an ad hoc basis, to supplement information already available through Regulatory Financial Reporting. Uses include: to support investigations, to assess market power and to set regulatory obligations.
- A5.19 **KCOM:** KCOM Group PLC, formerly Kingston Communications
- A5.20 **Long Run Incremental Cost (LRIC):** A measure of the change in total costs of the firm that arises from a discrete increment in output in the long run.
- A5.21 **LLU:** Local Loop unbundling allows CPs to physically control (or share control) of BT's existing copper lines between the local exchanges and the customer premises.
- A5.22 **Market summary statements:** For example, see 2011 RFS, "Market summary" at the top of page 37, Section 7.3, comprising two rows of data for 2011 and 2010. However, by market summary statement, we exclude "Note1: Comparison of average internal and external charges with each other and with FAC", provided below the summary on the same page (this sets out the reporting at a service level including unit costs etc.)
- A5.23 **Openreach:** A BT group business offering communications providers products and services that are linked to BT's nationwide local access network.
- A5.24 **Primary Accounting Documents (PAD):** The PAD set out the Regulatory Accounting Principles, the attribution methods, the transfer charge system methodology, accounting policies (including the principles of calculation of fixed assets) and the LRIC methodology.
- A5.25 **Published Financial Statements or published RFS:** These terms refer to only the subset of the Regulatory Financial Statements that is published by the SMP operator.
- A5.26 **Regulatory Accounting Guidelines (RAG):** A complete set of guidelines for the preparation of BT's regulatory accounts.
- A5.27 **Regulatory Accounting Principles (RAP):** The RAP are a set of guiding principles with which BT's Regulatory Financial Reporting must comply
- A5.28 **Regulatory Asset Value (RAV):** the value ascribed by Ofcom to assets within the copper access network which were in existence prior to August 1997 (i.e. assets which were in existence prior to the change in valuation method from HCA to CCA).
- A5.29 **Regulatory Financial Reporting:** refers to the whole of the regulatory reporting methodology, systems and legal framework, as well as the Regulatory Financial Statements. The scope of this review therefore includes regulatory financial

reporting and the principles and methodologies under which the accounts are prepared.

- A5.30 **Regulatory Financial Statements:** describe the annual regulatory financial statements, prepared according to a defined framework and methodology. We use the term in this document to refer to both the published and unpublished statements. The unpublished financial statements are submitted to us confidentially.
- A5.31 **Secondary Accounting Documents (SAD):** The SAD comprises four main elements: the Detailed Attribution Methods (DAM), the Detailed Valuation Methodology (DVM), and the LRIC Relationships and Parameters (LRIC R&P).
- A5.32 **SMP:** Significant Market Power. SMP is determined by a market review which is conducted under the relevant provisions of the Communications Act 2003
- A5.33 **SMP conditions:** Regulatory conditions imposed on a specific CP that has been found to have significant market power in a market review conducted by Ofcom.
- A5.34 **Transparency Direction:** The Transparency Direction (Direction 2) imposes a transparency principle on BT in relation to the accounting documentation.
- A5.35 **WLA:** Wholesale local access
- A5.36 **WLR:** Wholesale line rental. Used by CPs (including BT) to provide narrowband telephony (but not broadband) using BT's network

# Proposals for SMP Conditions

## NOTIFICATION OF PROPOSALS UNDER SECTION 48A OF THE COMMUNICATIONS ACT 2003

### Proposals for setting SMP services conditions in relation to BT under section 45 of the Communications Act 2003 (the “Act”)

#### Background

1. On 22 July 2004, Ofcom published the regulatory statement “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” (the “July 2004 Statement”)<sup>197</sup>. At Annex 2 of that statement, Ofcom imposed regulatory financial reporting requirements on BT and Kingston Communications in markets in which BT and Kingston Communications had been found to have significant market power in previously concluded market reviews.
2. On 16 December 2004, Ofcom published a statement entitled “Review of the wholesale local access market - Identification and analysis of markets, determination of market power and setting of SMP conditions, Explanatory statement and notification” (the “December 2004 Statement”)<sup>198</sup>. At Annex 1 of that statement, Ofcom imposed SMP services conditions, including regulatory accounting conditions, on BT and Kingston Communications in relation to wholesale local access services.
3. The July 2004 Statement and the December 2004 Statement were subsequently amended by:
  - The regulatory statement “Review of wholesale international services markets – Explanatory Statement and Notification on market identification and market power determinations” of 7 July 2006<sup>199</sup>
  - The regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 16 August 2006<sup>200</sup>
  - The regulatory statement “Review of the wholesale broadband access markets – Final explanatory statement and notification” of 21 May 2008<sup>201</sup>
  - The regulatory statement “Business Connectivity Market Review – Review of the retail leased lines, wholesale symmetric broadband origination and wholesale trunk segments markets” of 8 December 2008<sup>202</sup>

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<sup>197</sup> [http://stakeholders.ofcom.org.uk/binaries/consultations/fin\\_reporting/statement/finance\\_report.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/fin_reporting/statement/finance_report.pdf)

<sup>198</sup> <http://stakeholders.ofcom.org.uk/binaries/consultations/rwlam/statement/rwlam161204.pdf>

<sup>199</sup> <http://stakeholders.ofcom.org.uk/binaries/consultations/wsidd/statement/statement.pdf>

<sup>200</sup> [http://stakeholders.ofcom.org.uk/binaries/consultations/reg\\_bt/statement/statement.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/reg_bt/statement/statement.pdf)

<sup>201</sup> <http://stakeholders.ofcom.org.uk/binaries/consultations/wbamr07/statement/statement.pdf>

<sup>202</sup> <http://stakeholders.ofcom.org.uk/binaries/consultations/bcmr08/summary/bcmr08.pdf>

- The regulatory statement “Changes to BT’s and KCOM’s 2008/09 regulatory financial statements” of 15 June 2009<sup>203</sup>
  - The regulatory statement “Fixed Narrowband Retail Services Markets – Identification of markets and determination of market power” of 15 September 2009<sup>204</sup>
  - The regulatory statement “Review of the fixed narrowband services wholesale markets – Statement on the markets, market power determinations and remedies including further consultation” of 15 September 2009<sup>205</sup>
  - The regulatory statement “Review of the fixed narrowband services wholesale markets – Further statement on wholesale transit markets and remedies in the wholesale call termination market” of 5 February 2010<sup>206</sup>
  - The regulatory statement “Review of retail and wholesale ISDN30 markets – Statement on the markets, market power determinations and remedies” of 20 August 2010<sup>207</sup>
  - The regulatory statement “Review of the wholesale local access market – Statement on market definition, market power determinations and remedies” of 7 October 2010<sup>208</sup>
  - The regulatory statement “Review of the wholesale fixed analogue exchange lines markets – Statement on market definition, market power determinations and remedies” of 20 December 2010<sup>209</sup>
  - The regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2010/11 update – Explanatory statement and notification” of 2 June 2011<sup>210</sup>
  - The regulatory statement “Business Connectivity Market Review – Review of retail leased lines, wholesale symmetric broadband origination and wholesale trunk segments” of 28 March 2013<sup>211</sup>
  - The regulatory statement “Review of the fixed narrowband services markets – final statement on the proposed markets, market power determinations and remedies” of 26 September 2013<sup>212</sup>
4. In the statements identified in paragraph 3, Ofcom set regulatory accounting SMP conditions as set out in the July 2004 Statement in relation to markets which Ofcom identified and in relation to which Ofcom made market power determinations in the relevant market reviews.

<sup>203</sup> [http://stakeholders.ofcom.org.uk/binaries/consultations/btkcom09/statement/btkcom\\_statement.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/btkcom09/statement/btkcom_statement.pdf)

<sup>204</sup> [http://stakeholders.ofcom.org.uk/binaries/consultations/retail\\_markets/statement/statement.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/retail_markets/statement/statement.pdf)

<sup>205</sup> [http://stakeholders.ofcom.org.uk/binaries/consultations/wnmr\\_statement\\_consultation/summary/main.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/wnmr_statement_consultation/summary/main.pdf)

<sup>206</sup> [http://stakeholders.ofcom.org.uk/binaries/consultations/wnmr\\_statement\\_consultation/statement/statement.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/wnmr_statement_consultation/statement/statement.pdf)

<sup>207</sup> <http://stakeholders.ofcom.org.uk/binaries/consultations/isdn30/statement/statement.pdf>

<sup>208</sup> [http://stakeholders.ofcom.org.uk/binaries/consultations/wla/statement/WLA\\_statement.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/wla/statement/WLA_statement.pdf)

<sup>209</sup> <http://stakeholders.ofcom.org.uk/binaries/consultations/review-wholesale-fixed-exchange/statement/statement.pdf>

<sup>210</sup> <http://stakeholders.ofcom.org.uk/binaries/consultations/bt-kcom-reporting/statement/statement.pdf>

<sup>211</sup> <http://stakeholders.ofcom.org.uk/consultations/business-connectivity-mr/final-statement/>

<sup>212</sup> [http://stakeholders.ofcom.org.uk/binaries/consultations/nmr-2013/statement/Final\\_Statement.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/nmr-2013/statement/Final_Statement.pdf)

5. On 3 July 2013, Ofcom published the consultation “Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30”<sup>213</sup>.
6. On 11 July 2013, Ofcom published the consultation “Review of the wholesale broadband access markets”<sup>214</sup>.
7. In the consultations identified in paragraphs 5 and 6 above, Ofcom proposed to apply regulatory accounting SMP conditions as set out in the July 2004 Statement to certain markets which Ofcom proposed to identify and in relation to which Ofcom proposed BT has significant market power. In particular, Ofcom proposed:
  - In the consultation of 3 July 2013, to apply to BT the SMP conditions OA1 to OA28, OA32 and OA33 as set out in Schedule 2 to Annex 2 to the July 2004 Statement, to the following proposed markets:
    - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
    - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area
    - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area
    - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area
  - In the consultation of 11 July 2013, to apply to BT the SMP conditions OA1 to OA28, OA32 and OA33 as set out in Schedule 2 to Annex 2 to the July 2004 Statement, to the following proposed market:
    - “Wholesale Broadband Access in Market A as defined in OFCOM’s Notification published on [date of publication of the final statement]”.
8. On 20 December 2013, Ofcom published the consultation “Regulatory Financial Reporting – A Review”. In this consultation, Ofcom proposes to amend the proposals set out in the consultation of 3 July 2013 and the consultation of 11 July 2013 in relation to regulatory accounting obligations of BT. In particular, Ofcom no longer proposes to apply to BT the regulatory accounting conditions set out in the July 2004 Statement to the markets identified in paragraph 7 above as set out in paragraphs 12 and 13 of the consultation of 3 July 2013 and as set out in paragraphs 13 and 14 of the consultation of 11 July 2013. Ofcom proposes no changes to the regulatory accounting SMP conditions which currently apply in all other markets.

### **Proposals to set SMP services conditions**

9. Ofcom is proposing to set the SMP services conditions set out in Schedule 2 to this Notification to the markets set out in Schedule 1 to this Notification.
10. Ofcom is further proposing that Directions as set out in Schedule 3 to this Notification, given under the SMP conditions as set out in the July 2004 Statement and the December 2004 Statement, shall, in relation to the markets identified in paragraph 7 above,

<sup>213</sup> <http://stakeholders.ofcom.org.uk/consultations/fixed-access-market-reviews/>

<sup>214</sup> <http://stakeholders.ofcom.org.uk/consultations/review-wba-markets/>

continue to have force as if they were given under the conditions set out in Schedule 2 to this Notification, and shall be read accordingly.

11. The effect of, and Ofcom's reasons for making the proposal to set the SMP services conditions set out in Schedule 2 to this Notification are set out in the consultation document accompanying this Notification.

### **Proposals to apply SMP services conditions**

12. Except where otherwise stated in paragraph 13 below, Ofcom is proposing to set the SMP services conditions referred to in paragraph 9 above from the date of the notification under section 48(1) of the Act adopting the proposals set out in this Notification. For the purpose of clarity, such conditions will have effect from the Financial Year 2014-15 in relation to the Regulatory Financial Statements to be published by 31 July 2015.
13. Ofcom is proposing that the following conditions will have effect for the Financial Year 2013-14, in relation to the Regulatory Financial Statements to be published by 31 July 2014:
  - Condition 5(f), but not the requirement to obtain an Assurance Assignment on the reconciliation report; and
  - Condition 6(a).

### **Proposals to revoke SMP services conditions**

14. Ofcom is proposing that the conditions set out at Annex 2 of the July 2004 Statement, as amended, be revoked from the date of the notification under section 48(1) of the Act adopting the proposals set out in this Notification, but only insofar as such SMP services conditions apply to the markets set out in Schedule 1 to this Notification. For the purpose of clarity, such conditions will continue to have effect, in relation to the markets set out in Schedule 1 to this Notification, for the Financial Year 2013-14, in relation to the Regulatory Financial Statements to be published by 31 July 2014.

### **Ofcom's duties and legal tests**

15. Ofcom considers that the proposed SMP conditions referred to in paragraph 9 above comply with the requirements of section 45 to 47, 87 and 88 of the Act, as appropriate and relevant to each such SMP condition.
16. In making the proposals referred to in this Notification, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act and the six Community requirements in section 4 of the Act.

### **Making representations**

17. Representations may be made to Ofcom about any of the proposals set out in this Notification and the accompanying consultation document by no later than 14 February 2014.
18. Copies of this Notification and the accompanying consultation document have been sent to the Secretary of State in accordance with section 48(C)(1) of the Act.

## **Interpretation**

19. Except as otherwise defined in paragraph 20 of this Notification, words or expressions used shall have the same meaning as they have been ascribed in the Act.

20. In this Notification

- “BT” means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006.
- “Assurance Assignment”, “Financial Year” and “Regulatory Financial Statements” will be defined as in Schedule 2 to this Notification.

## **Signed**

**David Brown**

**Director of Competition Finance, Ofcom**

**A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002**

**20 December 2013**

**[draft] Schedule 1 – Application**

The SMP conditions in Schedule 2 shall apply to BT in each of the relevant markets and technical areas listed in column 1 of Table 1 below from the date specified in column 2 of Table 1 below to the extent specified in column 3 of Table 1 below.

<b>Relevant market</b>	<b>Date</b>	<b>Applicable SMP conditions</b>
1. The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area	[date of publication of the final statement]	1 to 32
2. Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area	As above	1 to 32
3. Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area	As above	1 to 32
4. Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area	As above	1 to 32
5. Wholesale Broadband Access in Market A as defined in OFCOM's Notification published on [date of publication of the final statement]	As above	1 to 32

## **[draft] Schedule 2 – SMP Conditions**

### **Part 1: Definitions and Interpretation of these conditions**

1. These conditions shall apply to the markets and technical areas as described in Schedule 1 of this Notification under sections 45 and 87 of the Communications Act 2003.
2. For the purpose of interpreting these conditions the following definitions shall apply:

‘Accounting Methodology Documents’ means the documentation maintained by BT setting out the policies, methodologies, systems, processes and procedures for deriving or calculating costs, revenues, assets and liabilities in accordance with the Regulatory Accounting Principles and the Regulatory Accounting Guidelines.

‘Accounting Separation System’ means the totality of all apparatus, systems, data, procedures and activities which BT uses or holds for use to determine the costs, revenues, assets and liabilities to be attributed to an activity, and the extent to which such costs, revenues, assets and liabilities are to be attributed to such activity;

‘Accounting Standards’ means the accounting standards by reference to which BT are required to prepare the Statutory Financial Statements;

‘Allocation Methodology’ means the practices used by BT to attribute, allocate or apportion revenue (including appropriate Transfer Charges), costs (including appropriate Transfer Charges), assets and liabilities to activities or, insofar as those activities have been aggregated into Wholesale Segments or Retail Segments in a given Market or Technical Area (as applicable), to each Wholesale Segment or Retail Segment;

‘Alternative Regulatory Auditor’ means any Auditor not for the time being appointed as BT’s Regulatory Auditor;

‘Assurance Assignment’ means an engagement carried out in accordance with international standard (ISRS 4400) by the Regulatory Auditor or other independent third party to perform agreed-upon procedures and to report the findings of the agreed-upon-procedures to Ofcom and/or publish the report if required by Ofcom.

‘Auditor’ means any auditor which could be appointed as BT’s auditor in accordance with the requirements of the Companies Act 2006;

‘BT’ means British Telecommunications plc, whose registered company number is 1800000, and any British Telecommunications plc subsidiary or holding company, or any subsidiary of that holding company, all as defined by Section 1159 of the Companies Act 2006;

‘Cost Accounting System’ means the totality of all apparatus, systems, data, procedures and activities which BT uses or holds for use to determine the costs, revenues, assets and liabilities to be attributed to an activity, and the extent to which such costs, revenues, assets and liabilities are to be attributed to an activity;

‘Cost Allocation’ means the application of Allocation Methodologies to spread Source Data to a Cost Centre, product or service;

‘Cost Centre’ means a business or organisational unit that is responsible for the costs that it incurs;

'Current Year Figures' means, in relation to any set of Financial Statements, the amounts relating to the Financial Year to which the accounts relate;

'External Wholesale Services' means services supplied or offered to any Communications Provider other than BT;

'Financial Year' means a financial year of BT in respect of which annual statutory accounts are required to be (or to have been) prepared and audited in accordance with the requirements of the Companies Act 2006;

'GAAP' (Generally Accepted Accounting Practice(s)) means United Kingdom or international (as appropriate) conventions, rules and procedures that define currently accepted accounting practice (including, for the avoidance of doubt, not only broad guidelines of general application but also any detailed practices and procedures);

'ICAEW Guidance' means the technical release titled "Reporting to Regulators of Regulated Entities: Audit 05/03" issued by the Audit and Assurance Faculty of the Institute of Chartered Accountants in England & Wales in October 2003;

'Internal Wholesale Services' means services equivalent to the External Wholesale Services which, in the absence of horizontal or vertical integration, could be supplied within BT;

'Market' means the market to which these conditions apply in accordance with Schedule 1 of this notification;

'Error' means a deviation from accuracy or correctness;

'Network Component' means an element of the network that is used to provide Wholesale Services, and, to the extent they are used in the Market or Technical Area (as applicable), specified in a direction given by Ofcom from time to time for the purposes of these conditions;

'Network Services' means those groups of Network Components used directly (or which in the absence of horizontal or vertical integration would be used directly) in the course of supplying Wholesale Services;

'Prior Year Comparatives' means, in relation to any set of Financial Statements, the amounts relating to the Financial Year immediately preceding the Financial Year to which the accounts relate, re-evaluated if necessary to ensure that such figures are comparable to the Current Year Figures;

'Process' means the series of inter-related activities or actions to obtain, record or hold data or information or to carry out any operation or set of operations on the data or information, including:

- i. organisation, storage, adaptation, or alteration of the data or information;
- ii. retrieval, consultation, computation or use of the data or information;
- iii. disclosure of the data or information by transmission, dissemination, or otherwise making available; or

- iv. alignment, combination, blocking, erasing or destruction of the data or information;

'Product' means any product or service comprised in a Market or Technical Area to which these conditions apply in accordance with Schedule 1 of this notification;

'Regulatory Accounting Principles' means the principles as directed by Ofcom from time to time for the purpose of these conditions;

'Regulatory Accounting Guidelines' means documentation setting out at a high level the policies, methodologies, systems, processes and procedures for deriving or calculating costs, revenues, assets and liabilities;

'Regulatory Accounting System' means the set of computerised and manual accounting methods, procedures, Processes and controls established to determine and attribute the costs, revenues, assets and liabilities and summarize, interpret, and present the resultant financial data in accurate and timely manner;

'Regulatory Auditor' means the Auditor for the time being appointed by BT in accordance with these conditions;

'Regulatory Financial Statement' means any financial statement in respect of a Financial Year prepared or required to be prepared by BT in accordance with these conditions;

'Relevant Financial Year' means the Financial Year in relation to which any given set of Regulatory Financial Statements are required;

'Retail Activities' means any activities wholly and exclusively carried out (or which in the absence of horizontal or vertical integration would wholly and exclusively be carried out) in the course of supplying Retail Products and any activities wholly and exclusively carried out in the course of such activities, excluding those activities which are Wholesale Services;

'Retail Products' means services used by or offered to any End Users (including BT);

'Retail Segments' means groups of Retail Products;

'Retail Support Activities' means any activities carried out directly or indirectly (or which in the absence of horizontal or vertical integration would be carried out directly or indirectly) in the course of supplying Retail Products and any activities directly or indirectly carried out in the course of such activities, excluding those activities which are Retail Activities or Wholesale Services;

'Statutory Auditor' means the Auditor for the time being appointed by BT in accordance with the requirements of the Companies Act 2006;

'Statutory Financial Statements' means any annual account required to be prepared by BT in accordance with the requirements of the Companies Act 2006;

'Source Data' means the primary source extracted from a database, dataset, spreadsheet or hard-coded data that is gathered, sampled, calculated or estimated and input into the Regulatory Accounting System;

'Technical Area' means the technical area to which these conditions apply in accordance with Schedule 1 of this notification;

'Transfer Charge' means the charge or price that is applied, or deemed to be applied, by BT to itself for the use or provision of an activity or group of activities. For the avoidance of doubt, such activities or group of activities include, amongst other things, products and services provided from, to or within the Market or Technical Area (as applicable) and the use of Network Components in the Market or Technical Area (as applicable);

'Wholesale Catalogue' means the documentation required to be produced by BT under Condition 29;

'Wholesale Segments' means groups of Wholesale Services;

'Wholesale Services' means services related to Network Access used by or offered to any Communications Provider (including BT).

3. Except insofar as the context otherwise requires, words or expressions shall have the meaning assigned to them and otherwise any word or expression shall have the same meaning as it has in the Act.
4. The Interpretation Act 1978 shall apply as if each of the conditions were an Act of Parliament.
5. Headings and titles shall be disregarded.

## **Part 2: Conditions**

### **General requirements**

1. Except in so far as Ofcom may consent otherwise in writing, BT shall act in the manner set out in these conditions.
2. Ofcom may from time to time make such directions as they consider appropriate in relation to BT's Cost Accounting System, Accounting Separation System and its obligations under these conditions.
3. BT shall comply with any direction Ofcom may make from time to time under these conditions.
4. For the purpose of these conditions, publication shall be effected by
  - a. placing a copy of the relevant information on any relevant website operated or controlled by BT; and
  - b. sending a copy of the relevant information to any person at that person's written request.

### **Requirements relating to the preparation, audit, delivery and publication of the Regulatory Financial Statements**

5. BT shall in respect of the Market, Technical Areas, Products and Network Services (as applicable) for each Financial Year:
  - a. prepare such Regulatory Financial Statements as directed by Ofcom from time to time in accordance with the Regulatory Accounting Principles, the Regulatory Accounting Guidelines and the Accounting Methodology Documents (the relevant Accounting Methodology Documents to be identified in the Regulatory Financial Statements by reference to their date);
  - b. secure the expression of an audit opinion upon the Regulatory Financial Statements as directed by Ofcom from time to time;
  - c. deliver to Ofcom the Regulatory Financial Statements and corresponding audit opinion in accordance with Condition 6(a);
  - d. publish the Regulatory Financial Statements and corresponding audit opinion as directed by Ofcom from time to time and in accordance with Condition 6(b) and (c); ensure that any Regulatory Financial Statement and corresponding audit opinion that it delivers to Ofcom and/or publishes are fit for such purpose (or purposes), if any, as notified by Ofcom in writing; and
  - e. publish a reconciliation report detailing each and every material change or material error as described in Conditions 18 to 21 below. The reconciliation report must detail the impact of the changes and errors on the figures presented in the Regulatory Financial Statements when compared with the figures that would have been presented had such change not been made or error not been corrected. BT must secure an Assurance Assignment on the reconciliation report. The Assurance Assignment must report whether the reconciliation report includes all material changes and errors as referred to in Conditions 18 to 21 below and whether the impact of such changes has been correctly calculated.

6. BT shall:
  - a. deliver to Ofcom copies of the Regulatory Financial Statements and any corresponding audit opinion, as well as the reconciliation report and Assurance Assignment in relation to the reconciliation report, each and all of which shall be in the form in which they are ultimately to be published, at least two weeks before they are required to be published. The Regulatory Financial Statements must be approved by the Board of Directors and signed on behalf of the Board by a Director of the Company;
  - b. publish the Regulatory Financial Statements and any corresponding audit opinion, as well as the reconciliation report and Assurance Assignment in relation to the reconciliation report within 4 months after the end of the period to which they relate; and
  - c. publish with the Regulatory Financial Statements any written statement made by Ofcom and provided to BT commenting on the data in, the notes to or the presentation of any or all of the Regulatory Financial Statements and/or the Accounting Methodology Documents.
7. BT shall make such amendments to the form and content of the Regulatory Financial Statements as are necessary to give effect fully to the requirements of these conditions. BT shall provide to Ofcom particulars of any such amendment, the reasons for it and its effect, when it delivers the Regulatory Financial Statements to Ofcom.
8. BT shall prepare all Regulatory Financial Statements, explanations or other information required by virtue of these conditions on a regulatory asset value adjusted current cost basis as directed by Ofcom from time to time and shall be capable of doing so in relation to any period. Such Regulatory Financial Statements, explanations or other information shall be, in the opinion of Ofcom, meaningfully reconcilable to the Statutory Financial Statements.
9. Each Regulatory Financial Statement shall include Prior Year Comparatives which shall be prepared on a basis consistent with Current Year Figures. BT may depart from this requirement in preparing the Regulatory Financial Statements for a Financial Year if there are reasons for doing so provided that the particulars of the departure, the reasons for it and its effect are stated in a note in the Regulatory Financial Statements in accordance with Accounting Standards and GAAP.

### **Requirements relating to audit of the Regulatory Financial Statements**

10. The Regulatory Auditor that BT from time to time appoints shall at all times be satisfactory to Ofcom having regard to such matters as Ofcom consider appropriate. BT shall notify Ofcom in writing of the Regulatory Auditor appointed to secure compliance with these conditions before the Regulatory Auditor carries out any work for that purpose. BT shall notify Ofcom of any proposed change of Regulatory Auditor 28 days before effect is given to that change.
11. In the event that the Regulatory Auditor is in the opinion of Ofcom unsatisfactory, BT shall appoint and instruct an Alternative Regulatory Auditor that is at all times satisfactory to Ofcom having regard to such matters as Ofcom consider appropriate. BT shall ensure that the Alternative Regulatory Auditor:
  - a. carries out such on going duties as are required to secure compliance with these conditions;

b. carries out work or further work, in addition to that performed by the Statutory Auditor and/or by the former Regulatory Auditor, in relation to such matters connected to compliance with these conditions as are of concern to Ofcom and notified to BT in writing; and/or

c. re-performs work previously performed by the Statutory Auditor and/or by the former Regulatory Auditor in relation to such matters connected to compliance with this Condition as are of concern to Ofcom and notified to BT in writing.

12. BT shall extend to the Alternative Regulatory Auditor such assistance and co-operation as would be extended to the Statutory Auditor and/or to the Regulatory Auditor and, to the extent similar assistance and co-operation may be required from the Statutory Auditor and/or from the former Regulatory Auditor, BT shall use its best endeavours to secure such assistance and co-operation.
13. BT's letter of engagement appointing the Regulatory Auditor shall include such provisions acknowledging the acceptance by the Regulatory Auditor of duties and responsibilities to Ofcom in respect of its audit work, audit report and audit opinion as are consistent with the ICAEW Guidance.
14. BT shall use its best endeavours to obtain from the Regulatory Auditor any further explanation and clarification of any audit opinion required under these conditions and any other information in respect of the matters which are the subject of that audit opinion as Ofcom shall require.
15. BT shall obtain such Assurance Assignments in relation to BT's obligations under these conditions as directed by Ofcom.

### **Requirements relating to the Accounting Methodology Documents**

16. BT must prepare, maintain and keep up-to date the Accounting Methodology Documents in accordance with
  - (i) these conditions;
  - (ii) the Regulatory Accounting Guidelines, as directed by Ofcom; and
  - (iii) the Regulatory Accounting Principles, as directed by Ofcom.

Where it appears to BT that any of these requirements conflict with each other in a particular case, BT must resolve such conflict by giving priority to them in the order in which they are set out above.

17. BT must deliver an up-to-date version of the Accounting Methodology Documents to Ofcom when it delivers the regulatory financial statements to Ofcom in accordance with Condition 6 above and publish such up-to-date version on or before the day of publication of the regulatory financial statements which have been prepared in accordance with such version.

### **Requirements relating to changes to Cost Allocations and the correction of Errors**

18. BT must publish and deliver to Ofcom a list of each and every change to Cost Allocations, including changes to Allocation Methodologies and Source Data, that is a material change, as directed by Ofcom, by 30 November of the Financial Year in which the Cost Allocation is to be changed. Such list must be accompanied by a description of

each of the changes, the reason for making each of the changes (including by reference to their compatibility with the Regulatory Accounting Principles), and the impact of each of the changes by setting out, for each change separately, the figures which were presented in the previous Financial Year alongside the figures that would have been presented had such change been made in the previous Financial Year.

19. BT must secure an Assurance Assignment to report whether BT has notified Ofcom of each and every material change as referred to in Condition 18 above by 31 December of the Financial Year in which the Cost Allocation is to be changed.
20. Where in Ofcom's opinion any change referred to in Condition 18 above does not comply with these conditions, the Regulatory Accounting Principles or the Regulatory Accounting Guidelines, and Ofcom notifies BT by 31 January of the Financial Year in which the change is to be made, that such change should not be made, BT will comply with such notification.
21. BT must publish and notify Ofcom of each and every Error which is a material Error, as directed by Ofcom, within 30 calendar days of BT deciding to correct the Error. Such publication and notification must be accompanied by a description of the Error, the circumstances of discovery of the Error, the reason for the Error, the impact of the Error for each affected Market and service by setting out the figures which were presented in the previous Financial Year alongside the figures that would have been presented in the previous Financial Year had such Error not been made, and the steps BT will take to correct the Error.

### **Requirements relating to the Regulatory Accounting System**

22. BT's Regulatory Accounting System must be able to produce the Regulatory Financial Statements as directed by Ofcom under Condition 5 in accordance with the Regulatory Accounting Principles, the Regulatory Accounting Guidelines and the Accounting Methodology Documents.
23. Where BT replaces the whole or part of its Regulatory Accounting System, or substantially modifies such Regulatory Accounting System, BT must:
  - (i) notify Ofcom in a timely manner of the replacement or modification, and, where so requested by Ofcom, inform Ofcom of progress towards completion and such other information as Ofcom may reasonably request.
  - (ii) ensure, to the best of its ability, that the replacement or modification does not cause the figures contained in the Regulatory Financial Statements to be different from the figures that would have been contained in the Regulatory Financial Statements had such Regulatory Financial Statements been prepared using the old or unmodified Regulatory Accounting System.
  - (iii) in relation to the first Financial Year for which the Regulatory Financial Statements are prepared using the new or modified Regulatory Accounting System, prepare a systems reconciliation report describing the differences between the Prior Year Comparatives that are contained in the Regulatory Financial Statements and the Prior Year Comparatives that would have been contained in the Regulatory Financial Statements had such Regulatory Financial Statements been prepared using the old or unmodified Regulatory Accounting System. Such report must be delivered to Ofcom by 31 January of the Financial Year for which the figures will be prepared using the new or modified system for the first time, and, if Ofcom so requires, be published.

- (iv) secure an Assurance Assignment to report whether the figures in the systems reconciliation report referred to in Condition 23(iii) above have been properly extracted from the new or modified Regulatory Accounting System and the old or unmodified Regulatory Accounting System respectively, and that the descriptions of the differences provided by BT are a reasonable representation of the underlying cause. BT shall deliver such report to Ofcom when it delivers the systems reconciliation report to Ofcom in accordance with Condition 22(iii) above.
- (v) where the systems reconciliation report referred to in Condition 23(iii) above indicates that the replacement or modification causes the figures contained in the Regulatory Financial Statements to be more than 1% more or less than the figures that would have been contained in the Regulatory Financial Statements had such Regulatory Financial Statements been prepared using the old or unmodified Regulatory Accounting System, prepare, if so notified by Ofcom, the Regulatory Financial Statements on a basis consistent with the old or unmodified Regulatory Accounting System.

### **Requirements relating to deficiencies in the Regulatory Financial Statements and the Accounting Methodology Documents**

24. Where Ofcom have reasonable grounds to believe that any or all of the Regulatory Financial Statements and/or Accounting Methodology Documents are deficient, BT shall, where directed by Ofcom:
- a. amend the Accounting Methodology Documents in order to remedy the deficiencies identified by Ofcom;
  - b. restate the Regulatory Financial Statements identified by Ofcom as requiring restatement in accordance with the Accounting Methodology Documents which have, where necessary, been amended pursuant to subparagraph (a);
  - c. secure in accordance with any relevant direction of Ofcom under this Condition the expression of an audit opinion on the restated Regulatory Financial Statements;
  - d. deliver to Ofcom the restated Regulatory Financial Statements and corresponding audit opinion; and
  - e. publish the restated Regulatory Financial Statements and corresponding audit opinion.

### **Requirements relating to the maintenance of sufficient accounting records**

25. BT shall maintain accounting records for a period of six years from the date on which each RFS is delivered to Ofcom.
26. BT shall maintain the accounting records in accordance with these conditions, the Regulatory Accounting Principles, the Regulatory Accounting Guidelines and the Accounting Methodology Documents.
27. BT shall maintain accounting records in a form which, on a historical cost basis and on a current cost basis:
- a. separately identifies each of the Markets, Technical Areas, Products, Network Components and Network Services;

- b. separately attributes the costs, revenues, assets and liabilities of each of the Markets, Technical Areas, Products, Network Components and Network Services; and
- c. shows and explains the transactions underlying each of the Markets, Technical Areas, Products, Network Components and Network Services.

28. BT shall maintain the accounting records so that they are sufficient

- a. to provide an adequate explanation of each Regulatory Financial Statement;
- b. to show that charges are non-discriminatory;
- c. to provide a complete justification of BT's charges for network access; and
- d. to provide a complete justification of BT's charges for the provision of services to End Users.

### **Requirement to facilitate on-demand reporting**

29. BT shall ensure that its Regulatory Accounting System and accounting records are sufficient to enable BT, at all times, to be capable of preparing in relation to any specified calendar month or months a financial statement in accordance with the Accounting Methodology Documents.

### **Requirements relating to the preparation and maintenance of a Wholesale Catalogue**

30. BT must prepare, maintain and keep up-to-date a Wholesale Catalogue. Such Wholesale Catalogue should separately identify and describe:

- a. Wholesale Services supplied externally;
- b. Wholesale Services supplied internally;
- c. Wholesale Services supplied both externally and internally; and
- d. Network Services and the extent to which these activities are used in the course of supplying Wholesale Services.

31. BT must deliver an up-to-date version of the Wholesale Catalogue to Ofcom when it delivers the Regulatory Financial Statements to Ofcom in accordance with Condition 6 above and publish such up-to-date version on or before the day of publication of the Regulatory Financial Statements which have been prepared in accordance with such version.

### **Requirements relating to the demonstration of non-discrimination**

32. BT shall ensure it is able to demonstrate that at any point in time:

- a. where a Network Service or combination of Network Services is used by BT in providing Internal Wholesale Services, the amount applied and incorporated in the

Transfer Charge for the Internal Wholesale Service in respect of the use of the Network Services is equivalent to the amount applied and incorporated for the use of the Network Services or combination of Network Services in the charge payable for an equivalent External Wholesale Service;

b. the same amount as applied and incorporated in the Transfer Charge for the Internal Wholesale Service in subparagraph (a) in respect of the use of the Network Services is applied to the Network Service or combination of Network Services whenever it is used by BT in providing that same Internal Wholesale Service; and

c. the same amount as applied and incorporated in the Transfer Charge for the equivalent External Wholesale Service in subparagraph (a) in respect of the use of the Network Services is applied to the Network Service or combination of Network Services whenever it is used by BT in providing that same External Wholesale Service;

d. the amount applied and incorporated in the Transfer Charge for the Internal Wholesale Service in subparagraph (a) in respect of the use of the Network Services shall be the cost of those Network Services unless the Network Service concerned is provided from a Market which is different from the Market which comprises the Internal Wholesale Service.

33. BT shall ensure it is able to demonstrate that at any point in time:

a. where a Retail Support Activity or combination of Retail Support Activities is used by BT in providing Retail Products, the same amount is applied and incorporated in the charge for the Retail Products whenever the Retail Support Activity or combination of Retail Support Activities is used by BT in the course of supplying Retail Products;

b. where a Wholesale Service or combination of Wholesale Services is used by BT in providing Retail Products, the same amount is applied and incorporated in the charge for the Retail Products whenever the Wholesale Service or combination of Wholesale Services is used by BT in the course of supplying Retail Products; and

c. the amount applied and incorporated in the charge for Retail Products in respect of the use of Wholesale Services shall be the Transfer Charge of those Wholesale Services unless no Transfer Charge exists in which event it shall be the cost of those Wholesale Services.

### **[draft] Schedule 3 – Directions**

The Directions listed below shall continue to have force as if they were given under the Conditions set out in Schedule 2 to this Notification, and shall be read accordingly.

(1) Direction 1 published at Annex 4 to the regulatory statement “The regulatory financial reporting obligations on BT and Kingston Communications – Final statement and notification – Accounting separation and cost accounting: final statement and notification” of 22 July 2004, as modified by:

- i) the Direction published at Annex 1 of the regulatory statement “Changes to BT’s regulatory financial reporting framework” of 31 August 2005;
- ii) the Direction published at Annex 1 of the regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 16 August 2006; and
- iii) the Direction published at Annex 3 of the regulatory statement “Changes to BT’s 2007/08 regulatory financial statements” of 26 June 2008,

specifying network components;

(2) Direction 3 published at Annex 4 to the regulatory statement “The regulatory financial reporting obligations on BT and Kingston Communications – Final statement and notification – Accounting separation and cost accounting: final statement and notification” of 22 July 2004, as modified by:

- i) the Direction published at Annex 2 of the regulatory statement “Changes to BT’s regulatory financial reporting framework” of 31 August 2005;
- ii) the Direction published at Annex 2 of the regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 16 August 2006;
- iii) the Direction published at Annex 4 of the regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 30 May 2007;
- iv) the Direction published at Annex 4 of the regulatory statement “Changes to BT’s 2007/08 regulatory financial statements” of 26 June 2008;
- v) the Direction published at Annex 4 of the regulatory statement “Changes to BT and KCOM’s regulatory financial reporting – 2008/09 update” of 15 June 2009;
- vi) the Direction published at Annex 3 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2009/10 update” of 4 June 2010; and
- vii) the Direction published at Annex 4 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2010/11 update” of 2 June 2011,

specifying requirements for the preparation, audit and delivery of Regulatory Financial Statements in respect of wholesale cost accounting, accounting separation and retail cost accounting;

(3) Direction 4 published at Annex 4 to the regulatory statement “The regulatory financial reporting obligations on BT and Kingston Communications – Final statement and notification – Accounting separation and cost accounting: final statement and notification” of 22 July 2004, as modified by:

- i) the Direction published at Annex 3 of the regulatory statement “Changes to BT’s regulatory financial reporting framework” of 31 August 2005;
- ii) the Direction published at Annex 3 of the regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 16 August 2006;
- iii) the Direction published at Annex 5 of the regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 30 May 2007;
- iv) the Direction published at Annex 5 of the regulatory statement “Changes to BT’s 2007/08 regulatory financial statements” of 26 June 2008;
- v) the Direction published at Annex 5 of the regulatory statement “Changes to BT and KCOM’s regulatory financial reporting – 2008/09 update” of 15 June 2009;
- vi) the Direction published at Annex 4 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2009/10 update” of 4 June 2010;
- vii) the Direction published at Annex 5 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2010/11 update” of 2 June 2011;
- viii) the Direction published at Annex 2 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2011/12 update” of 17 April 2012; and
- ix) the Direction published at Annex 1 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2012/13 update” of 25 April 2013,

specifying requirements for the form and content of Regulatory Financial Statements in respect of wholesale cost accounting, accounting separation and retail cost accounting;

- (4) The Direction published at Schedule 2 to Annex 2 to the regulatory statement “Review of the wholesale local access market – Identification and analysis of markets, determination of market power and setting of SMP conditions – Explanatory statement and notification” of 16 December 2004, as modified by:

- i) the Direction published at Annex 1 of the regulatory statement “Changes to BT’s regulatory financial reporting framework” of 31 August 2005;
- ii) the Direction published at Annex 1 of the regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 16 August 2006; and
- iii) the Direction published at Annex 3 of the regulatory statement “Changes to BT’s 2007/08 regulatory financial statements” of 26 June 2008,

specifying network components;

- (5) The Direction published at Schedule 4 to Annex 2 to the regulatory statement “Review of the wholesale local access market – Identification and analysis of markets, determination of market power and setting of SMP conditions – Explanatory statement and notification” of 16 December 2004, as modified by:

- i) the Direction published at Annex 2 of the regulatory statement “Changes to BT’s regulatory financial reporting framework” of 31 August 2005;

- ii) the Direction published at Annex 2 of the regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 16 August 2006;
- iii) the Direction published at Annex 4 of the regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 30 May 2007;
- iv) the Direction published at Annex 4 of the regulatory statement “Changes to BT’s 2007/08 regulatory financial statements” of 26 June 2008;
- v) the Direction published at Annex 4 of the regulatory statement “Changes to BT and KCOM’s regulatory financial reporting – 2008/09 update” of 15 June 2009; and
- vi) the Direction published at Annex 3 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2009/10 update” of 4 June 2010,

specifying requirements for the preparation, audit and delivery of Regulatory Financial Statements in respect of wholesale cost accounting, accounting separation and retail cost accounting; and

- (6) The Direction published at Schedule 5 to Annex 2 to the regulatory statement “Review of the wholesale local access market – Identification and analysis of markets, determination of market power and setting of SMP conditions – Explanatory statement and notification” of 16 December 2004, as modified by:

- i) the Direction published at Annex 3 of the regulatory statement “Changes to BT’s regulatory financial reporting framework” of 31 August 2005;
- ii) the Direction published at Annex 3 of the regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 16 August 2006;
- iii) the Direction published at Annex 5 of the regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 30 May 2007;
- iv) the Direction published at Annex 5 of the regulatory statement “Changes to BT’s 2007/08 regulatory financial statements” of 26 June 2008;
- v) the Direction published at Annex 5 of the regulatory statement “Changes to BT and KCOM’s regulatory financial reporting – 2008/09 update” of 15 June 2009;
- vi) the Direction published at Annex 4 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2009/10 update” of 4 June 2010;
- vii) the Direction published at Annex 5 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2010/11 update” of 2 June 2011; and
- viii) the Direction published at Annex 1 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2012/13 update” of 25 April 2013,

specifying requirements for the form and content of Regulatory Financial Statements in respect of wholesale cost accounting, accounting separation and retail cost accounting.

# Proposal for direction – Regulatory Accounting Principles

## Notification of proposal under sections 49 and 49A of the Communications Act 2003 and SMP Services Condition 2 specifying the Regulatory Accounting Principles

### Background

1. On 20 December 2013, Ofcom published a consultation entitled “Regulatory Financial Reporting – A Review” (the “December 2013 Consultation”), consulting on proposals to revoke the regulatory accounting obligations on BT set out in “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” and to set new regulatory accounting obligations on BT in relation to the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area
  - “Wholesale Broadband Access in Market A as defined in OFCOM’s Notification published on [date of publication of the final statement]”
2. Under proposed condition 2 of the regulatory accounting obligations set out at Annex 6 of the December 2013 Consultation, Ofcom may from time to time make such directions as they consider appropriate in relation to BT’s Cost Accounting System, Accounting Separation System and its obligations under the conditions.
3. This Notification relates to proposals to set out the Regulatory Accounting Principles with which BT is required to comply in preparing and maintaining the Regulatory Financial Statements, the Accounting Methodology Documents, the accounting records and the Regulatory Accounting System.

### Proposal to give direction

4. Ofcom is proposing to make the direction set out in the Schedule to this Notification.
5. The effect of and reasons for giving the proposed direction are set out in the accompanying consultation document.

## **Ofcom's duties and legal tests**

6. Ofcom considers that the proposed direction referred to in paragraph 4 complies with the requirements of section 49(2) of the Communications Act 2003 (the "Act").
7. In making the proposal referred to in paragraph 4, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act and the six community requirements in section 4 of the Act.

## **Making representations**

8. Representations may be made to Ofcom about the proposals set out in this Notification and the accompanying consultation document by no later than 14 February 2014.
9. In accordance with section 49C(1)(a) of the Act, a copy of the Notification, together with the Schedules, has been sent to the Secretary of State.

## **Interpretation**

10. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the Conditions set out in Annex 6 of the December 2013 Consultation and otherwise any word or expression shall have the same meaning as it has in the Act.

## **Signed**

**David Brown**

**Director of Competition Finance, Ofcom**

**A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002**

**20 December 2013**

## **Schedule**

### **Part 1: Definitions and Interpretation**

In this Schedule:

- a) 'Regulatory Financial Reporting' means the whole of the Regulatory Financial Statements, the Accounting Methodology Documents, the accounting records and the Regulatory Accounting System.

### **Part 2: Direction**

The Regulatory Accounting Principles which apply for the purposes of preparing and maintaining the Regulatory Financial Statements, the Accounting Methodology Documents, the accounting records and the Regulatory Accounting System are the following:

1.        **Completeness**

Regulatory Financial Reporting must encompass all revenues, costs, assets and liabilities of the Markets and Technical Areas, together with residual activities (including wholesale and retail).

2.        **Accuracy**

Regulatory Financial Reporting must maintain an adequate degree of accuracy, such that the information included in the Regulatory Financial Statements are free from material errors and double-counting. Materiality must be determined in accordance with the definition set out above.

3.        **Objectivity**

Each element of Regulatory Financial Reporting, so far as is possible, must take account of all the available financial and operational data that is relevant to that element.

Where an element of Regulatory Financial Reporting is based on assumptions, those assumptions must be justified and supported by all available relevant empirical data. The assumptions must not be formulated in a manner which unfairly benefits BT or any other operator or entity, or creates undue bias towards any part of BT's or any other operator's business or product.

4.        **Consistency with regulatory decisions**

Regulatory Financial Reporting must be consistent with OFCOM's regulatory decisions as set out in the Regulatory Accounting Guidelines.

5.        **Causality**

Regulatory Financial Reporting must ensure that:

- a) revenues (including revenues resulting from transfer charges);
- b) costs (including costs resulting from transfer charges);

- c) assets; and
- d) liabilities

are attributed in accordance with the activities which cause the revenues to be earned, or costs to be incurred, or the assets to be acquired, or liabilities to be incurred respectively.

6. Compliance with the statutory accounting standards

Regulatory Financial Reporting must comply with the accounting standards applied in BT's statutory accounts; with the exception of any departures as OFCOM may direct from time to time (including in the Regulatory Accounting Guidelines).

7. Consistency of the Regulatory Financial Statements as a whole and from one period to another

Regulatory Financial Reporting must be applied consistently in all the Regulatory Financial Statements relating to the same period.

Regulatory Financial Reporting must be applied consistently from one period to another.

All the changes in Regulatory Financial Reporting from one period to another must be justified by reference to the Regulatory Accounting Guidelines and the Regulatory Accounting Principles.

If there are material changes in Regulatory Financial Reporting from one period to another, BT must restate the previous period's Regulatory Financial Statements, applying the changes to the Regulatory Financial Statements for that period.

The Regulatory Accounting Principles must be applied to all material items of revenue, costs, assets and liabilities in the Regulatory Financial Statements, or material changes in those items. A material item of revenue, costs, assets or liabilities, or a material change in those items, is one which is reasonably expected by virtue of its magnitude or nature, to affect the views of any competent user of the Regulatory Financial Statements.

Where it appears to BT that any of the Regulatory Accounting Principles set out above conflict with each other in a particular case, BT must resolve such conflict by giving priority to them in the order in which they are set out above, with a previous principle taking precedence over a later principle.

## Proposal for direction – Transparency

**Notification of proposal under sections 49 and 49A of the Communications Act 2003 and SMP Services Condition 2 specifying the transparency requirements for the purposes of preparing and maintaining the accounting records, the Accounting Methodology Documents and Regulatory Financial Statements in respect of wholesale cost accounting, accounting separation and retail cost accounting**

### Background

1. On 20 December 2013, Ofcom published a consultation entitled “Regulatory Financial Reporting – A Review” (the “December 2013 Consultation”), consulting on proposals to revoke the regulatory accounting obligations on BT set out in “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” and to set new regulatory accounting obligations on BT in relation to the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area
  - “Wholesale Broadband Access in Market A as defined in OFCOM’s Notification published on [date of publication of the final statement]”
2. Under proposed condition 2 of the regulatory accounting obligations set out at Annex 6 of the December 2013 Consultation, Ofcom may from time to time make such directions as they consider appropriate in relation to BT’s Cost Accounting System, Accounting Separation System and its obligations under the conditions.
3. This Notification relates to proposals to specify the level of transparency required to be met by BT in preparing and maintaining the various documentation required by the regulatory accounting obligations set out at Annex 6 of the December 2013 Consultation.

### Proposal to give direction

4. Ofcom is proposing to make the direction set out in the Schedule to this Notification.
5. The effect of and reasons for giving the proposed direction are set out in the accompanying consultation document.

### **Ofcom's duties and legal tests**

6. Ofcom considers that the proposed direction referred to in paragraph 4 complies with the requirements of section 49(2) of the Communications Act 2003 (the "Act").
7. In making the proposal referred to in paragraph 4, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act and the six community requirements in section 4 of the Act.

### **Making representations**

8. Representations may be made to Ofcom about the proposals set out in this Notification and the accompanying consultation document by no later than 14 February 2014.
9. In accordance with section 49C(1)(a) of the Act, a copy of the Notification, together with the Schedules, has been sent to the Secretary of State.

### **Interpretation**

10. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the Conditions set out in Annex 6 of the December 2013 Consultation and otherwise any word or expression shall have the same meaning as it has in the Act.

### **Signed**

**David Brown**

**Director of Competition Finance, Ofcom**

**A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002**

**20 December 2013**

## **Schedule – Direction**

BT shall ensure that any data, information, description, material or explanatory document prepared under the Conditions set out at Annex 6 of the December 2013 Consultation in respect of accounting and other methods used in the preparation of the accounting records and Regulatory Financial Statements shall be sufficiently transparent and prepared such that a suitably informed reader can gain a clear understanding of such data, information, description, material or explanatory document, and, if necessary, the overall structure of BT's financial and information systems from which regulatory accounting data is derived and in particular the sequence of the processing and 'cascade' effect of the intermediate cost centres; and gain a clear understanding of all the material, methodologies and drivers (e.g. systems, Processes and procedures) applied in the preparation of regulatory accounting data.

## Annex 9

# Proposal for modification to Direction 3 and the FA10 Preparation, audit and delivery Direction (BT)

## Notification of proposal under sections 49 and 49A of the Communications Act 2003 and SMP Services Condition OA2 and 2 modifying requirements in relation to the preparation, audit and delivery of the Regulatory Financial Statements

### Background

1. On 22 July 2004, Ofcom published a statement entitled “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” (the “July 2004 Statement”). At Annex 2 of this statement, Ofcom imposed SMP services conditions with respect to regulatory accounting on BT and Kingston Communications in markets in which BT and Kingston Communications had been found to have significant market power in previously concluded market reviews.
2. At Annex 4 of the July 2004 Statement, Ofcom published various directions for BT given under the SMP services conditions. These included a direction relating to the Preparation, audit, delivery and publication of the Regulatory Financial Statements (“Direction 3”).
3. On 16 December 2004, Ofcom published a statement entitled “Review of the wholesale local access market - Identification and analysis of markets, determination of market power and setting of SMP conditions, Explanatory statement and notification” (the “December 2004 Statement”). At Annex 1 of this statement, Ofcom imposed SMP services conditions, including regulatory accounting conditions, on BT and Kingston Communications in relation to wholesale local access services.
4. At Annex 2 of the December 2004 Statement, Ofcom published various directions for BT given under the SMP services conditions. These included a direction relating to the Preparation, audit, delivery and publication of the Regulatory Financial Statements (“The FA10 Preparation, audit and delivery Direction”).
5. Direction 3 and the FA10 Preparation, audit and delivery Direction were subsequently modified by:
  - i) the Direction published at Annex 2 of the regulatory statement “Changes to BT’s regulatory financial reporting framework” of 31 August 2005;
  - ii) the Direction published at Annex 2 of the regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 16 August 2006;
  - iii) the Direction published at Annex 4 of the regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 30 May 2007;

- iv) the Direction published at Annex 4 of the regulatory statement “Changes to BT’s 2007/08 regulatory financial statements” of 26 June 2008;
  - v) the Direction published at Annex 4 of the regulatory statement “Changes to BT and KCOM’s regulatory financial reporting – 2008/09 update” of 15 June 2009;
  - vi) the Direction published at Annex 3 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2009/10 update” of 4 June 2010; and
  - vii) the Direction published at Annex 4 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2010/11 update” of 2 June 2011.
6. On 7 October 2010, Ofcom published a statement entitled “Review of the wholesale local access market, Statement on market definition, market power determinations and remedies”. In this statement, Ofcom revoked the regulatory accounting conditions imposed on BT in the December 2004 Statement, imposed the regulatory accounting conditions imposed on BT in the July 2004 Statement, and determined that the directions given under the conditions set out in the December 2004 Statement, including the FA10 Preparation, audit and delivery Direction, would continue to have force as if they were given under the regulatory accounting conditions set out in the July 2004 Statement.
  7. On 20 December 2013, Ofcom published a consultation entitled “Regulatory Financial Reporting – A Review” (the “December 2013 Consultation”), consulting on proposals to revoke the regulatory accounting obligations on BT set out in the July 2004 Statement and to set new SMP services conditions with respect to regulatory accounting on BT in relation to the following markets:
    - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
    - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area
    - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area
    - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area
    - “Wholesale Broadband Access in Market A as defined in OFCOM’s Notification published on [date of publication of the final statement]”
  8. The December 2013 Consultation does not affect the regulatory accounting obligations on BT set out in the July 2004 Statement in relation to any other market.
  9. Ofcom further proposed that certain directions given under the SMP conditions as set out in the July 2004 Statement and the December 2004 Statement, including Direction 3 and the FA10 Preparation, audit and delivery Direction, would, in relation to the markets identified in paragraph 7, continue to have force as if they were given under the proposed SMP services conditions set out in the December 2013 Consultation.
  10. Under condition OA2 of the SMP conditions set out in the 2004 Statement and proposed condition 2 of the regulatory accounting obligations set out at Annex 6 of the December 2013 Consultation, Ofcom may from time to time make such directions as they consider appropriate in relation to BT’s Cost Accounting System, Accounting Separation System and its obligations under these conditions.

11. This notification relates to proposals to modify Direction 3 and the FA10 Preparation, audit and delivery Direction.

### **Proposal to give direction**

12. Ofcom is proposing to make the direction set out in the Schedule to this Notification.

13. The effect of and reasons for giving the proposed direction are set out in the accompanying consultation document.

### **Ofcom's duties and legal tests**

14. Ofcom considers that the proposed direction referred to in paragraph 12 complies with the requirements of section 49(2) of the Communications Act 2003 (the "Act").

15. In making the proposal referred to in paragraph 12, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act and the six community requirements in section 4 of the Act.

### **Making representations**

16. Representations may be made to Ofcom about the proposals set out in this Notification and the accompanying consultation document by no later than 14 February 2014.

17. In accordance with section 49C(1)(a) of the Act, a copy of the Notification, together with the Schedules, has been sent to the Secretary of State.

### **Interpretation**

18. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the Conditions set out in Annex 6 of the December 2013 Consultation and otherwise any word or expression shall have the same meaning as it has in the Act.

### **Signed**

**David Brown**

**Director of Competition Finance, Ofcom**

**A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002**

**20 December 2013**

## Schedule

The information set out in the Annex to Direction 3 and the FA10 Preparation, audit and delivery Direction are modified as shown in the document available by following the weblink below in that the words underlined are inserted and the words struck through are deleted.

<http://www.ofcom.org.uk/static/consultations/transparency/annex-matrix.xlsx>

# Proposal for modification to Direction 4 and the FA10 Form and content Direction (BT)

## Notification of proposal under sections 49 and 49A of the Communications Act 2003 and SMP Services Condition OA2 and 2 modifying requirements in relation to the form and content of the Regulatory Financial Statements

### Background

1. On 22 July 2004, Ofcom published a statement entitled “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” (the “July 2004 Statement”). At Annex 2 of this statement, Ofcom imposed SMP services conditions with respect to regulatory accounting on BT and Kingston Communications in markets in which BT and Kingston Communications had been found to have significant market power in previously concluded market reviews.
2. At Annex 4 of the July 2004 Statement, Ofcom published various directions for BT given under the SMP services conditions. These included a direction relating to the form and content of the Regulatory Financial Statements (“Direction 4”).
3. On 16 December 2004, Ofcom published a statement entitled “Review of the wholesale local access market - Identification and analysis of markets, determination of market power and setting of SMP conditions, Explanatory statement and notification” (the “December 2004 Statement”). At Annex 1 of this statement, Ofcom imposed SMP services conditions, including regulatory accounting conditions, on BT and Kingston Communications in relation to wholesale local access services.
4. At Annex 2 of the December 2004 Statement, Ofcom published various directions for BT given under the SMP service conditions. These included a direction relating to the form and content of the Regulatory Financial Statements (“The FA10 Form and content Direction”).
5. Direction 4 and the FA10 Form and content Direction for BT were subsequently modified by:
  - i) the Direction published at Annex 3 of the regulatory statement “Changes to BT’s regulatory financial reporting framework” of 31 August 2005;
  - ii) the Direction published at Annex 3 of the regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 16 August 2006;
  - iii) the Direction published at Annex 5 of the regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 30 May 2007;
  - iv) the Direction published at Annex 5 of the regulatory statement “Changes to BT’s 2007/08 regulatory financial statements” of 26 June 2008;

- v) the Direction published at Annex 5 of the regulatory statement “Changes to BT and KCOM’s regulatory financial reporting – 2008/09 update” of 15 June 2009;
- vi) the Direction published at Annex 4 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2009/10 update” of 4 June 2010;
- vii) the Direction published at Annex 5 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2010/11 update” of 2 June 2011;
- viii) the Direction published at Annex 2 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2011/12 update” of 17 April 2012; and
- ix) the Direction published at Annex 1 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2012/13 update” of 25 April 2013.
6. On 7 October 2010, Ofcom published a statement entitled “Review of the wholesale local access market, Statement on market definition, market power determinations and remedies”. In this statement, Ofcom revoked the regulatory accounting conditions imposed on BT in the December 2004 Statement, imposed the regulatory accounting conditions imposed on BT in the July 2004 Statement, and determined that the directions given under the conditions set out in the December 2004 Statement, including the FA10 Form and Content Direction, would continue to have force as if they were given under the regulatory accounting conditions set out in the July 2004 Statement.
7. On 20 December 2013, Ofcom published a consultation entitled “Regulatory Financial Reporting – A Review” (the “December 2013 Consultation”), consulting on proposals to revoke the regulatory accounting obligations on BT set out in the July 2004 Statement and to set new SMP services conditions with respect to regulatory accounting on BT in relation to the following markets:
- The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area
  - “Wholesale Broadband Access in Market A as defined in OFCOM’s Notification published on [date of publication of the final statement]”
8. The December 2013 Consultation does not affect the regulatory accounting obligations on BT set out in the July 2004 Statement in relation to any other market.
9. Ofcom further proposed that certain directions given under the SMP conditions as set out in the July 2004 Statement and the December 2004 Statement, including Direction 4 and the FA10 Form and content Direction, would, in relation to the markets identified in paragraph 7, continue to have force as if they were given under the proposed SMP services conditions set out in the December 2013 Consultation.

10. Under condition OA2 of the SMP conditions set out in the July 2004 Statement, and proposed condition 2 of the regulatory accounting obligations set out at Annex 6 of the December 2013 Consultation, Ofcom may from time to time make such directions as they consider appropriate in relation to BT's Cost Accounting System, Accounting Separation System and its obligations under these conditions.
11. This notification relates to proposals to modify Direction 4 and the FA10 Form and content Direction.

### **Proposal to give direction**

12. Ofcom is proposing to make the direction set out in the Schedule to this Notification.
13. The effect of and reasons for giving the proposed direction are set out in the accompanying consultation document.

### **Ofcom's duties and legal tests**

14. Ofcom considers that the proposed direction referred to in paragraph 12 complies with the requirements of section 49(2) of the Communications Act 2003 (the "Act").
15. In making the proposal referred to in paragraph 12, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act and the six Community requirements in section 4 of the Act.

### **Making representations**

16. Representations may be made to Ofcom about the proposals set out in this Notification and the accompanying consultation document by no later than 14 February 2014.
17. In accordance with section 49C(1)(a) of the Act, a copy of the Notification, together with the Schedules, has been sent to the Secretary of State.

### **Interpretation**

18. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the Conditions set out in Annex 6 of the December 2013 Consultation and otherwise any word or expression shall have the same meaning as it has in the Act.

**Signed**

**David Brown**

**Director of Competition Finance, Ofcom**

**A person duly authorised in accordance with paragraph 18 of the Schedule to the  
Office of Communications Act 2002**

**20 December 2013**

## Schedule

The form and content of the Regulatory Financial Statements set out in Direction 4 and the FA10 Form and content Direction and applying to the following markets:

- The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
- Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area
- Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area
- Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area
- “Wholesale Broadband Access in Market A as defined in OFCOM’s Notification published on [date of publication of the final statement]”

shall be modified as follows:

1. In Annex 11 to Direction 4 and the FA10 Form and content Direction  
as shown in the document available by following the weblink below in that the words underlined are inserted and the words struck through are deleted.  
<http://www.ofcom.org.uk/static/consultations/transparency/annex11.xlsx>
2. In Annex 12 to Direction 4 and the FA10 Form and content Direction  
as shown in the document available by following the weblink below in that the words underlined are inserted and the words struck through are deleted.  
<http://www.ofcom.org.uk/static/consultations/transparency/annex12.xlsx>
3. In Annex 16 to Direction 4 and the FA10 Form and content Direction  
as shown in the document available by following the weblink below in that the words underlined are inserted and the words struck through are deleted.  
<http://www.ofcom.org.uk/static/consultations/transparency/annex16.xlsx>
4. In Annex 24 to Direction 4 and the FA10 Form and content Direction  
as shown in the document available by following the weblink below in that the words underlined are inserted and the words struck through are deleted.  
<http://www.ofcom.org.uk/static/consultations/transparency/annex24.xlsx>
5. In Annex 25 to Direction 4 and the FA10 Form and content Direction  
as shown in the document available by following the weblink below in that the words underlined are inserted and the words struck through are deleted.  
<http://www.ofcom.org.uk/static/consultations/transparency/annex25.xlsx>

# Proposal for direction – Form of the FPIA opinion for Regulatory Financial Statements

**Notification of proposal under sections 49 and 49A of the Communications Act 2003 and SMP Services Condition 2 specifying requirements for the ‘FPIA’ audit of Regulatory Financial Statements in respect of wholesale cost accounting, accounting separation and retail cost accounting**

## Background

1. On 20 December 2013, Ofcom published a consultation entitled “Regulatory Financial Reporting – A Review” (the “December 2013 Consultation”), consulting on proposals to revoke the regulatory accounting obligations on BT set out in “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” and to set new regulatory accounting obligations on BT in relation to the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area
  - “Wholesale Broadband Access in Market A as defined in OFCOM’s Notification published on [date of publication of the final statement]”
2. Under proposed condition 2 of the regulatory accounting obligations set out at Annex 6 of the December 2013 Consultation, Ofcom may from time to time make such directions as they consider appropriate in relation to BT’s Cost Accounting System, Accounting Separation System and its obligations under the conditions.
3. This Notification relates to proposals to specify the level of audit which must be secured by BT in obtaining an audit to “fairly presents in accordance with” (“FPIA”) standards, where so required by Ofcom.

## Proposal to give direction

4. Ofcom is proposing to make the direction set out in the Schedule to this Notification.

5. The effect of and reasons for giving the proposed direction are set out in the accompanying consultation document.

### **Ofcom's duties and legal tests**

6. Ofcom considers that the proposed direction referred to in paragraph 4 complies with the requirements of section 49(2) of the Communications Act 2003 (the "Act").
7. In making the proposal referred to in paragraph 4, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act and the six community requirements in section 4 of the Act.

### **Making representations**

8. Representations may be made to Ofcom about the proposals set out in this Notification and the accompanying consultation document by no later than 14 February 2014.
9. In accordance with section 49C(1)(a) of the Act, a copy of the Notification, together with the Schedules, has been sent to the Secretary of State.

### **Interpretation**

10. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the Conditions set out in Annex 6 of the December 2013 Consultation and otherwise any word or expression shall have the same meaning as it has in the Act.

### **Signed**

**David Brown**

**Director of Competition Finance, Ofcom**

**A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002**

**20 December 2013**

## Schedule – Direction

Where BT is required to secure the expression of an audit opinion to FPIA standards upon any Regulatory Financial Statement, BT shall ensure that the Regulatory Auditor shall state whether in his opinion:

- (a) each Regulatory Financial Statement complies with the requirements of condition 5 set out in Annex 6 of the December 2013 Consultation;
- (b) each Regulatory Financial Statement fairly presents in accordance with the Regulatory Accounting Principles, the Regulatory Accounting Guidelines and the Accounting Methodology Documents:
  - (1) in the case of the profit and loss account and profit and loss reconciliation statements, the results in the relevant Market and/or Product (as appropriate) for the Relevant Financial Year and Prior Year Comparatives;
  - (2) in the case of the statement of mean capital employed and mean capital employed reconciliation statements, the mean capital employed in the relevant Market and/or Product (as appropriate) for the Relevant Financial Year and Prior Year Comparatives; and
  - (3) in the case of the other statements of revenues, costs, assets, liabilities and other quantities, the revenues, costs, assets, liabilities and other quantities incurred or employed in the relevant Market and/or Product (as appropriate) for the Relevant Financial Year and Prior Year Comparatives.

# Proposal for direction – Form of the PPIA opinion for Regulatory Financial Statements

## **Notification of proposal under sections 49 and 49A of the Communications Act 2003 and SMP Services Condition 2 specifying requirements for the ‘PPIA’ audit of Regulatory Financial Statements in respect of wholesale cost accounting, accounting separation and retail cost accounting**

### **Background**

1. On 20 December 2013, Ofcom published a consultation entitled “Regulatory Financial Reporting – A Review” (the “December 2013 Consultation”), consulting on proposals to revoke the regulatory accounting obligations on BT set out in “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” and to set new regulatory accounting obligations on BT in relation to the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area
  - “Wholesale Broadband Access in Market A as defined in OFCOM’s Notification published on [date of publication of the final statement]”
2. Under proposed condition 2 of the regulatory accounting obligations set out at Annex 6 of the December 2013 Consultation, Ofcom may from time to time make such directions as they consider appropriate in relation to BT’s Cost Accounting System, Accounting Separation System and its obligations under the conditions.
3. This Notification relates to proposals to specify the level of audit which must be secured by BT in obtaining an audit to “properly prepared in accordance with” (“PPIA”) standards, where so required by Ofcom.

### **Proposal to give direction**

4. Ofcom is proposing to make the direction set out in the Schedule to this Notification.
5. The effect of and reasons for giving the proposed direction are set out in the accompanying consultation document.

## **Ofcom's duties and legal tests**

6. Ofcom considers that the proposed direction referred to in paragraph 4 complies with the requirements of section 49(2) of the Communications Act 2003 (the "Act").
7. In making the proposal referred to in paragraph 4, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act and the six community requirements in section 4 of the Act.

## **Making representations**

8. Representations may be made to Ofcom about the proposals set out in this Notification and the accompanying consultation document by no later than 14 February 2014.
9. In accordance with section 49C(1)(a) of the Act, a copy of the Notification, together with the Schedules, has been sent to the Secretary of State.

## **Interpretation**

10. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the Conditions set out in Annex 6 of the December 2013 Consultation and otherwise any word or expression shall have the same meaning as it has in the Act.

## **Signed**

**David Brown**

**Director of Competition Finance, Ofcom**

**A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002**

**20 December 2013**

## **Schedule – Direction**

Where BT is required to secure the expression of an audit opinion to PPIA standards upon any Regulatory Financial Statement, BT shall ensure that the Regulatory Auditor shall state whether in his opinion:

- (a) each Regulatory Financial Statement complies with the requirements of condition 5 set out in Annex 6 of the December 2013 Consultation;
- (b) each Regulatory Financial Statement has been properly prepared in accordance with the Regulatory Accounting Principles, the Regulatory Accounting Guidelines, and the Accounting Methodology Documents, including the Prior Year Comparatives; and
- (c) anything has come to his attention that would lead him to conclude that the Regulatory Accounting Principles, the Regulatory Accounting Guidelines and the Accounting Methodology Documents have not been properly applied in the preparation of the relevant Regulatory Financial Statement, disclosing where practicable any adjustments he considers to be required in respect of any such matter.

## Annex 13

# Template for change control

<b>Title</b>	Short title for each change
<b>Type</b>	Select from: 1) Change in allocation basis; 2) change in valuation methodology; 3) change in source data; or 4) other
<b>Key driver for change</b>	State key driver based on Regulatory Accounting Principles (Select from: 1) more complete; 2) more accurate; 3) more objective; 4) more consistent with regulatory decisions; 5) more cost causal; 6) more compliant with statutory accounting standards; or 7) more consistent.
<b>Trigger for change</b>	Select from 1) BT judgement 2) Regulatory decision 3) changes in available evidence 4) other
<b>Description of change</b>	A short explanation of the new methodology and how it differs from the old methodology
<b>Effect of the change</b>	A description of the impact of the change in terms of the components most affected and the general impact of the change and the markets and services that are most affected by the changes
<b>Support for the change</b>	A detailed justification for the change and the evidence taken into account to support the change
<b>Key changes in accounting documents</b>	Set out key changes to accounting documents

## Annex 14

# Template for error notification

<b>Title</b>	Short title for each error
<b>Description of error</b>	A description of the error.
<b>Effect of the error</b>	Set out a description of the impact of the error for each affected market and service by setting out the figures which were presented in the previous financial year alongside the figures that would have been presented in the previous financial year had such error not been made.
<b>Explanation</b>	A description of the circumstances of how the error was discovered and the reason for the error.
<b>Steps to correct the error</b>	Set out the steps that will be taken to correct the error.