



# Monitoring compliance with charge controls

Statement

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## Section 1

# Summary

- 1.1 This document sets out our proposals for effective monitoring of compliance with charge controls.
- 1.2 An associated document, the Charge Control Compliance Standard (the Standard), sets out the detailed requirements for implementation of these proposals. It is being published<sup>1</sup> alongside this statement.

## Background

- 1.3 Charge controls provide a remedy to protect consumers and promote competition in markets which are not operating effectively by imposing a maximum price that can be charged by communication providers (the “Regulatees”) who are found to have Significant Market Power (“SMP”).
- 1.4 Charge controls are an essential part of the regulatory framework. Setting charge controls requires a substantial commitment of resource both by stakeholders and by us. The revenues covered by charge controls are also significant, for example: in the case of Mobile Call Termination (MCT), revenues in 2006 were estimated to be around £2.5 billion<sup>2</sup>. The methodology for monitoring compliance with charge controls should reflect the importance of the controls.
- 1.5 To date, we have relied on annual returns prepared by the Regulatees (the ‘Ofcom Data Submission’) as evidence that the controls are being properly implemented. There is currently no requirement for independent verification of this information. Therefore our confidence in this data is limited to the assurance provided by basic checks on these submissions.
- 1.6 Over time, charge controls have increased in number and complexity. Both trends have imposed limitations on our ability and that of the Regulatees’ customers to check that the Regulatees are complying with the charge controls.
- 1.7 As a result, we considered:
  - Whether the existing procedures for monitoring compliance remain effective.
  - How it may be possible to obtain better assurance over the implementation of controls.
- 1.8 A benchmarking study commissioned by us and conducted by Deloitte & Touche LLP (Deloitte)<sup>3</sup>, suggested that more extensive assurance is commonplace in other UK regulated industries and internationally.
- 1.9 We developed proposals which were published in a consultation document on 11<sup>th</sup> September (‘the Consultation’)<sup>4</sup>. The Consultation explained why the current

<sup>1</sup> Published at [www.ofcom.org.uk/telecoms/netw\\_intercon\\_index/standard](http://www.ofcom.org.uk/telecoms/netw_intercon_index/standard)

<sup>2</sup> [http://www.ofcom.org.uk/consult/condocs/mobile\\_call\\_term/statement/statement.pdf](http://www.ofcom.org.uk/consult/condocs/mobile_call_term/statement/statement.pdf)

Paragraph 2.17, page 7.

<sup>3</sup> <http://www.ofcom.org.uk/consult/condocs/compliance/compliance.pdf> Annex 8

<sup>4</sup> <http://www.ofcom.org.uk/consult/condocs/compliance/compliance.pdf>

framework for monitoring compliance no longer provides us with enough confidence that the Regulatees are properly applying the charge controls. It proposed:

- a set of general principles to use when considering the monitoring of all future charge controls; and
- an amendment to the SMP condition for the wholesale mobile voice call termination (MCT) control.

## Responses to the Consultation

- 1.10 Eight responses were received to the Consultation. The respondents were BT, O2, Orange, Scottish and Southern Energy, T-mobile, UKCTA, Vodafone, and a confidential respondent. Respondents broadly agreed that more monitoring was needed. But some, in particular those subject to charge controls, disagreed with us on how best to achieve this.
- 1.11 Importantly, buyers of charge-controlled services were supportive of the proposals; UKCTA argued for more extensive information and assurance requirements than we had suggested, as they felt that the proposals did not go far enough.
- 1.12 As a result of discussions with the Regulatees during this consultation process, a number of other issues also became apparent that highlighted the need for robust reporting and monitoring processes. The biggest issue was confusion amongst some of the mobile network operators (MNOs) as to the classification of minutes covered by the control.

## Conclusions

- 1.13 We have carefully considered all the responses to the Consultation in respect of the proposed general principles to consider for all future charge controls.
- 1.14 We have also met with several Regulatees to discuss the proposals as part of the informal consultation on the Standard. From these discussions we have gained considerable insight into the practical issues facing the Regulatees in implementing our proposals.
- 1.15 Taking all of this into account, our judgment remains that the current process no longer delivers the necessary level of confidence that the Regulatees have complied with their charge controls. Therefore, for all future charge controls where compliance is measured in relation to a weighted average charge, we intend to require that:
- A Data submission (the Ofcom Data Submission) is presented to us, providing information similar to that provided in the current returns. The submission will be prepared in accordance with the Standard which is being published alongside this statement;
  - An Independent Assurance Report will provide 'reasonable assurance' under ISAE 3000<sup>5</sup> regarding the Published Information Summary<sup>6</sup> and the transparency

<sup>5</sup> International Standard on Assurance Engagements 3000.

[http://www.ifac.org/Members/Source\\_Files/Auditing\\_Related\\_Services/2007\\_Handbook/2007\\_A270\\_I\\_SAE\\_3000.pdf](http://www.ifac.org/Members/Source_Files/Auditing_Related_Services/2007_Handbook/2007_A270_I_SAE_3000.pdf)

<sup>6</sup> This is non-confidential version of the Ofcom data submission.

of the Statement of Methodology<sup>7</sup>. The details are laid out in the Standard.

- The Regulatee will publish Independent Assurance Report, a non confidential version of the Ofcom Data Submission (called the Published Information Summary) and the Statement of Methodology. The Regulatee will also publish a statement of responsibility signed on behalf of the Board of Directors of the Regulatee. Collectively these documents comprise the 'Charge Control Compliance Report'.
- 1.16 These general principles will be used as a starting point for our approach to compliance monitoring under future reviews. Compliance regimes will be adopted, where justified on a case-by-case basis, via new or modified SMP conditions.
- 1.17 MCT is the first market where we have developed specific requirements from these general principles. The current MCT control came into effect on 1 April 2007. The amended charge control conditions are set out in Annex 2.
- 1.18 Where charging structures have been simplified (e.g. in the case of an MNO charging a single 24 hour rate) all the procedures required to demonstrate compliance still apply. We believe that the costs of demonstrating compliance would be low in such situations. We also believe that there are benefits to keeping the same compliance requirements in these cases.
- 1.19 We recognise the special practical difficulty of introducing the proposals part way through the current year and have relaxed the requirement to obtain an Independent Assurance Report for the year to March 2008.

## Next steps

- 1.20 The general principles can only be implemented within individual charge controls following a market review, charge control review or charge control condition modification. Therefore, as future market reviews are undertaken, the principles will be implemented, on a case-by-case basis, where needed. The next market review is the Business Connectivity market review. The proposals will be reflected in the draft conditions included in the consultation which will be published shortly.
- 1.21 For the MCT control, the new procedures will be effective for the first year of the control (1 April 2007 to 31 March 2008). Regulatees will need to submit their Ofcom Data Submission and Charge Control Compliance Report (excluding the Independent Assurance Report) to us by 30 June 2008. The first Charge Control Compliance Report should be published no later than 29 July 2008.

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<sup>7</sup> The aim of the Statement of Methodology is to give buyers a good understanding of all of the material assumptions, judgements and methodologies used to prepare the Published Information Summary.

## Section 2

# Introduction

## The regulatory framework

- 2.1 The regulatory framework for electronic communications networks and services is based on the EC Communications Directives (the “Directives”). The Directives were implemented into UK law principally by the 2003 Communications Act (the “Act”). The Directives require us to carry out reviews of competition in communications markets to ensure that regulation remains appropriate in the light of changing market conditions.
- 2.2 Each market review has three parts:
  - a definition of the relevant market or markets;
  - an assessment of competition in each market, in particular whether any companies have Significant Market Power (SMP) in a given market; and
  - an assessment of the appropriate regulatory obligations which should be imposed where there has been a finding of SMP.
- 2.3 Charge controls are one type of regulatory obligation that may be imposed by us where there has been a finding of SMP. Following a market review, the terms of a charge control are set out within the SMP conditions. Procedures for monitoring compliance (where they exist) are also set out within the SMP conditions.
- 2.4 Once set, SMP conditions usually remain in place until the next market review. SMP conditions may be modified or revoked only if either a new market review has been carried out or if, during the intervening period, there has been no material change within the relevant product or service market in the intervening period.
- 2.5 We can set SMP conditions that limit the amount that an SMP communications provider (the Regulatee) can charge for regulated products and services. These are often in the form of a charge ceiling, fixed for a period of time or in the form of an RPI+/-X control. In the case of an RPI+/-X control, the maximum charge increase in any year is limited to the rate of inflation (RPI) plus or minus ‘X’.
- 2.6 There are essentially two types of charge control:
  - Controls which apply to an individual product or service: and
  - Controls which can apply across a basket of different products or service.
- 2.7 RPI+/-X charge controls may take the form of: overall basket charge caps (baskets) or simple individual charge caps. Historically, we have not actively monitored compliance with simple charge caps that apply to individual products or services. In these cases, since prices are usually transparent, we rely on buyers to detect a breach and to complain to us. We can do a simple check on prices to monitor compliance, if required. The proposals considered in this consultation are not intended to apply to simple individual charge caps.

- 2.8 A basket contains a number of products or services (which are usually charged at different prices depending on the time of day). Compliance with the charge control is measured in terms of a weighted average charge across the products or services within the basket. This gives the Regulatee some flexibility to set prices of the individual elements within the basket, so long as the weighted average charge remains compliant. The degree of latitude available to a Regulatee in setting prices within the basket is determined by the weight that a particular product or service has within the basket. Prices are usually weighted by either volumes or revenues.
- 2.9 One drawback of this flexibility is that buyers are unable to detect breaches because they cannot reconcile the prices that they pay to the weighted average charge. These types of control therefore require some form of active compliance monitoring by us.
- 2.10 We currently receive annual returns spreadsheets (called Ofcom Data Submissions) from the relevant Communications Providers (the Regulatees), which contain the information for us to assess compliance. These submissions typically contain prices by time of day and corresponding volumes or revenues as set out in the relevant SMP conditions. We are able to perform only basic checks on this data.

## The Consultation

- 2.11 As set out in the Consultation, charge controls are an essential part of the regulatory framework. Setting charge controls requires a substantial commitment of resources both by stakeholders and by us. The revenues covered by charge controls are also significant. In the case of MCT, termination revenues are estimated at around £2.5 billion<sup>8</sup>. We consider that the methodology for monitoring compliance with charge controls should reflect the importance of the controls and be consistent with the current market and regulatory environment.
- 2.12 The Consultation also set out our view that the current monitoring process no longer delivers sufficient confidence that Regulatees have complied with the controls. The reasons we reached this view include the following:
- the number and complexity of basket charge controls has increased significantly over time. Due to this complexity, individual buyers are frequently unable, themselves, to check compliance with the charge controls;
  - there has been a general problem with the timeliness of and some particular issues with the quality of Ofcom Data Submissions that we receive for monitoring compliance; and
  - there is evidence, supported by a benchmarking exercise conducted by Deloitte<sup>9</sup>, that more extensive assurance and compliance monitoring is commonplace in other UK regulated industries and internationally.
- 2.13 Other concerns expressed in the Consultation included:
- the lack of independent audit/assurance or a statement from a Director of the Regulatee confirming the accuracy of the information;
  - the need for transparency and assurance to be provided to buyers, which could be delivered by some form of publication;

<sup>8</sup> [http://www.ofcom.org.uk/consult/condocs/mobile\\_call\\_term/statement/statement.pdf](http://www.ofcom.org.uk/consult/condocs/mobile_call_term/statement/statement.pdf)

<sup>9</sup> Paragraphs 2.3.2 and 2.3.3 of the Deloitte report (Annex 8)



- the lack of any standardisation or consistency of formats, between controls and between Regulatees.
- 2.14 Discussions with the Regulatees during this consultation process brought out issues which highlighted the need for robust reporting and monitoring processes. The scope for ambiguity over how controls should be interpreted also became apparent during this consultation. This reinforces our view that independent scrutiny is needed.
- 2.15 We received eight responses to the Consultation. The non-confidential responses are published on our website<sup>10</sup> and the names of respondents are listed in Annex 1. This statement summarises the Consultation and the responses. This statement does not address issues raised in responses where those issues are outside the scope of, or irrelevant to, the assessment.
- 2.16 In particular it does not specifically include responses on the informal consultation on the Standard although our final proposals and conclusions reflect this process. It sets out the principles to be considered in monitoring charge controls going forward. It also establishes a new compliance regime for MCT through modified charge control conditions.

### Structure of this Statement

- 2.17 The responses received from stakeholder and our conclusions are set out in this statement as follows:
- Section 3 considers responses on whether we need to change the current monitoring processes.
  - Section 4 considers responses to our overall approach of devising a more effective compliance regime.
  - Section 5 considers responses on information content.
  - Section 6 considers responses on assurance reporting.
  - Section 7 considers responses to the publication requirement.
  - Section 8 considers responses to the Standard.
  - Section 9 considers responses relating to the implementation of our proposals.
  - Section 10 sets out our decisions on the proposals, after having taken into account the responses.

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<sup>10</sup> <http://www.ofcom.org.uk/consult/condocs/compliance/responses/>

## Section 3

# The need for change

## Introduction

- 3.1 In the Consultation, we invited views as to whether, as a general principle, additional measures were required to ensure that charge control compliance submissions were properly prepared and independently verified.
- 3.2 Several respondents disagreed with our assessment that the current monitoring system is inadequate. However, buyers not subject to charge control conditions were much more supportive of the proposals. UKCTA argued for even more extensive information and assurance requirements than we had proposed, as they felt we had not gone far enough.
- 3.3 For the reasons set out in this section, our judgment remains that the current process no longer delivers the necessary level of confidence that the Regulatees have complied with the charge controls.

## Responses to the Consultation

- 3.4 Vodafone, BT, T-mobile and the confidential respondent said we had failed either to establish why the current system was in need of change particularly as we had yet to report any material breaches.
- 3.5 Specifically in relation to MCT, Vodafone and O2 asserted that buyers have been able to monitor the control themselves, by checking the prices that they pay to published prices.
- 3.6 BT was against any assurance requirement as a general principle. A number of respondents, in dismissing the proposals as a whole, stressed that independent scrutiny was not required. None of these respondents put forward alternative proposals that provided for increased assurance, although several respondents suggested information gathering under section 135 of the Act (see paras 4.9 and 4.21-4.23) as an alternative.
- 3.7 BT and the confidential respondent questioned the timing of the introduction of the new procedures in general. They were expecting fewer charge controls to be in place going forward, as the regulatory burden fell with increased competition.
- 3.8 Specifically, for MCT, T-mobile, Vodafone and the confidential respondent objected to the proposal to introduce these requirements for the year to March 2008. They argued that Independent Accountants would be unable to verify the operation of internal controls over volume reporting for the preceding year. (Prior year volumes are used for weighting prices in the calculation of the average interconnection charge (AIC)). This is because they would not have had the opportunity to carry out their work on volumes during the preceding year, if they were engaged only now.
- 3.9 The confidential respondent noted that the Consultation did not take account of an appeal against the SMP findings of the MCT Market Review<sup>11</sup>. They argued that if successful, the Mobile Network Operators (MNOs) would incur significant

<sup>11</sup> <http://www.catribunal.org.uk/documents/Sum1083Hutch010607.pdf>

unnecessary costs implementing the new regime.

- 3.10 These respondents made the suggestion that our proposals should either be abandoned, suspended or delayed for at least a year to allow for the various factors.

### Ofcom's view

- 3.11 On the general principles, those respondents who accepted our justification of the need for independent verification agreed with the information asymmetry point made in the Consultation. Regulatees have a very detailed understanding of their own business and how it relates to the industry and the regulation, which we cannot hope to achieve from outside.
- 3.12 The fact that we have not exposed 'material breaches' to date does not demonstrate that the current process is adequate. The problem is that it is not possible to say with confidence that there have not been material breaches, only that none have been detected. Given the lack of visibility on the traffic volumes, the risk of an undetected breach is a real one.
- 3.13 The blending disputes earlier this year<sup>12</sup> indicated that buyers (including most of the MNOs) had concerns over the call termination rates they paid, albeit in terms of how unregulated 3G rates were blended with regulated 2G rates.
- 3.14 On MCT, the consultation process highlighted buyer concerns. Firstly the response from UKCTA, (whose members buy MCT but do not sell it) stated: "The inability to monitor compliance with mobile charge controls has caused problems recently. In 2005 Vodafone started the practice of 3G blending (including a higher cost for the proportion of traffic that terminated on 3G handsets) and this went unnoticed by customers because they had no visibility of the typical traffic profile"<sup>13</sup>.
- 3.15 Secondly, in relation to MCT, we found there was scope for ambiguity over how controls should be interpreted which reinforced our view of the need for independent scrutiny.
- 3.16 We do not agree with Vodafone that buyers could check compliance by comparing the prices that they pay to published prices. Buyers under the previous charge control would only have seen published prices and not the volume proportions. They would therefore be unable to re-perform the weighted average charge calculation for themselves.
- 3.17 As a general principle, we believe that where information asymmetry exists, independent audit or assurance is a powerful tool to increase the regulator's confidence in the data provided.
- 3.18 Statutory financial statements produced by most large UK companies are required by the Companies Act to be audited by Independent Accountants. This allows stakeholders, and in particular shareholders who own the company but delegate the running of it to the Board of Directors, to be confident that the financial position of the company is fairly reflected in the statutory accounts.
- 3.19 The requirement for independent scrutiny through independent audit is well established in the financial world, and is becoming increasingly common in other

<sup>12</sup> [http://www.ofcom.org.uk/bulletins/comp\\_bull\\_index/comp\\_bull\\_ccases/closed\\_all/cw\\_942/](http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ccases/closed_all/cw_942/)  
<sup>13</sup> <http://www.ofcom.org.uk/consult/condocs/compliance/responses/ukcta.pdf>

spheres of government and commerce (value for money, health service, environmental) where information asymmetry exists. As noted above, none of the respondents put forward alternative proposals to deal with information asymmetry.

- 3.20 As a general principle, we have a bias against regulation and would like to see fewer charge controls in the future. However, even if BT's expectation of fewer charge controls holds true, we still should ensure we have a robust but proportionate monitoring regime for those that remain.
- 3.21 In terms of MCT, the current charge control has become less complex due to the removal of the weights adjustment factor and the incorporation of 3G volumes into the charge control. This however is against the general trend. We believe that a consistent approach to compliance across charge controls is desirable because it provides clarity to Regulatees and will build confidence with buyers.
- 3.22 We have considered the respondents views about introducing the new procedures during the first year of the current control. Recognising the practical difficulties of carrying out independent assurance for the first year, we do not require the MNOs to obtain an Independent Assurance Report in the year to March 2008. In practice, this does mean that the MNOs will still need to produce and publish the rest of the Compliance Report.

## Summary

- 3.23 We consider that additional measures are required to ensure that compliance information is properly prepared and independently verified. One of the main difficulties that a regulator faces is information asymmetry (i.e. the lack of a detailed understanding of a Regulatee's business). Independent assurance is a powerful tool to increase the regulator's confidence in the data provided.
- 3.24 The lack of 'material breaches' being discovered does not mean that the current process is adequate. Buyers are currently unable to check the calculation themselves. There is ambiguity amongst MNOs as to how the charge control should be interpreted.
- 3.25 We recognise the practical difficulties of independent assurance for the first year and no longer require it for 2008.

## Section 4

# Devising a more effective compliance regime

## Introduction

- 4.1 The Consultation identified three key elements of a monitoring framework as follows:
- the information content of returns;
  - the assurance over the integrity of the information contained in returns; and
  - the transparency provided through publication.
- 4.2 The Consultation made a series of proposals in respect of each element. Our initial conclusions were set out as follows:
- The information currently contained in the Ofcom Data Submission should continue to be supplied (see section 5 below);
  - the necessary level of assurance is best provided in the form of an Independent Assurance Report under ISAE 3000 (see section 6 below); and
  - A limited subset of the Ofcom Data Submission should be published (known as the 'Published Information Summary'). It should contain enough information to enable an informed buyer to check that published prices correspond to the weighted average charge set out in the relevant condition (see section 7 below). Alongside this, an Independent Assurance Report, a Directors' Statement of Responsibilities and a Statement of Methodology should be also published.
- 4.3 The Consultation asked stakeholders whether they agreed that, when taken as a whole, these proposals would provide for effective charge control compliance monitoring and good regulation.

## Responses to the Consultation

- 4.4 BT argued that our general principles are too tightly defined because of the need to implement them for MCT. As a result the principles constrain future analysis by setting minimum standards which may not be right for other charge controls.
- 4.5 Vodafone and O2, conversely, argued that by widening the Consultation to cover all charge controls, rather than just MCT, we have not focused enough on the specifics of the MCT charge control. Vodafone also questioned the need for consistency between charge controls.
- 4.6 Vodafone suggested that the Deloitte benchmarking is defective by looking wider than MCT. They argue that this approach resulted in general principles that lead to proposals that are not proportionate or specific to the MCT charge control. O2 broadly agree with Vodafone, arguing against a "one size fits all" approach.

- 4.7 Vodafone and O2 did not think that we discussed the specifics of the MCT charge control properly. In particular we did not acknowledge the simplicity of the information required to check compliance, and the fact that some Regulatees have recently been exercising their ability to charge a single 24 hour rate. This, they argued, eliminates the requirement for the volumetric information to be independently verified. Orange and T-mobile also made this point. A number of Regulatees also argued that there may be circumstances where the simplicity of the charging structure lessens the procedures required to demonstrate compliance.
- 4.8 Two of the respondents questioned our ability to introduce the proposals to MCT. Vodafone argue that the Consultation is legally defective as the power to impose monitoring requirements is not specifically mentioned under section 78 of the Act. The confidential respondent suggested that the fact that the MCT statement had been appealed meant that the market had materially changed.
- 4.9 Vodafone, O2 and the confidential respondent felt that in formulating the general principles we either did not properly examine the possible use of our existing powers to gather information under section 135 of the Act or that this possibility was discussed in an unsatisfactory manner in the Deloitte report.
- 4.10 Several respondents, for different reasons, were opposed to what they saw as our “regulatory withdrawal”. As a general principle, T-mobile felt that it was for us to ensure consumers are confident that compliance with is being adequately monitored. They felt that regulation should be enforced by us undertaking the work ourselves. By encouraging consumers (buyers) to check regulation for themselves through publication, they felt that we were transferring responsibility for monitoring regulatory compliance to the buyers.
- 4.11 UKCTA on the other hand were happy with the idea they could check compliance for themselves. But felt that as we have a greater level of insight into the activities of the Regulatees we should remain closely involved.

### Ofcom's views

- 4.12 The keys points identified in the responses might be summarised as follows:
- Developing specific MCT proposals from general principles
  - Specific application to ‘simple’ 24 hour MCT charges
  - Legal powers
  - Consideration of Section 135 powers
  - Regulatory withdrawal

These points are considered below in turn.

### Developing specific MCT proposals from general principles

- 4.13 In order to provide a consistent approach and regulatory certainty to Regulatees, we gave the Consultation a broad scope. This allowed us to show Regulatees our intended general approach to compliance in the future. The Consultation clearly states that the proposals, at this stage, apply only to MCT (per para 6.4 of the Consultation) and the draft SMP conditions only relate to MCT.

- 4.14 Whilst we would like to replicate where possible the remedies used in MCT, when we review other charge controls, we recognise that they must fit the charge control in question. This particularly applies to proportionality (following a regulatory impact assessment). The requirements may be reduced (or increased) accordingly.
- 4.15 We see consistency as important, as we believe that buyers who purchase several charge control products would benefit from seeing a familiar approach. It helps them to understand the process and helps build their confidence.
- 4.16 We believe that it was right to take a strategic and holistic approach to monitoring charge control compliance. We agree that Deloitte, in looking for improvements to the process, were correct to look further than the narrow area of mobile termination. A narrower approach would have yielded, in our opinion, too restricted<sup>14</sup> a range of options.

### Specific application to ‘simple’ 24 hour MCT charges

- 4.17 We believe that the costs of demonstrating compliance would be low in a “simple” situation, whereby an MNO charged a single 24 hour rate for the whole of the charge control year. In particular, our accounting advisors, Deloitte, have advised us that, in such circumstances, the assurance work that was necessary could be substantially reduced. The costs of independent assurance would therefore be low.
- 4.18 There are three main reasons why we consider that our compliance requirements should continue to apply in such situations:
- There is a benefit in buyers knowing that charge controls come with a consistent level of monitoring in all situations. This will generate confidence that our regulatory remedies are being effectively applied.
  - Within a charge control, changes can be made to prices by the Regulatees at any point during the relevant year, for example in response to external events. Regulatees therefore cannot be certain that their situation is “simple” until they reach the end of the year. There is a risk that Regulatees may relax their compliance procedures earlier in the year, in anticipation of achieving a “simple” situation for the whole year. This could lead to information not being collected or retained, that would later be needed to demonstrate compliance. We are concerned that any signalling of a potential relaxation could lead to this failure.
  - Even where Regulatees claim that a situation is “simple”, there may be some complex and hidden assumptions made by the Regulatees, which lie behind a “simple” approach. Because of our limited knowledge of Regulatees and their businesses (information asymmetry) we may not be best placed to appreciate or be aware of such possibilities. There is therefore a benefit, in such circumstances, from the additional scrutiny and transparency brought about as a result of our assurance requirements.

### Legal powers

- 4.19 In our view, obligations relating to the monitoring of compliance are ancillary to the existence of the charge control mechanism itself. We are not seeking to extend the

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<sup>14</sup> In Sweden, for example, there are no monitoring requirements. This is because their MNOs do not have the same pricing flexibility as MNOs in the UK. Swedish MNOs have to publish a single 24 hour rate set by the regulator.



substantive scope of the charge control regulation, but only to secure that we can effectively perform our duties where a price control has been found to be necessary.

- 4.20 We also do not consider that the existence of an appeal itself constitutes a material change to a market. In particular, the MCT statement continues to be in force and has not been suspended as a result of the appeals.

### **Consideration of section 135 powers**

- 4.21 When formulating the general principles, we considered the use of section 135 at an early stage of the analysis, and discussed this with Deloitte. Section 135 allows us to request financial information from Regulatees. In the case of MCT, as the information is produced specifically for charge controls only on an 'informal basis', we would have no powers to compel the MNOs to produce it in a required format under Section 135. As Vodafone point out in its response, Regulatees face financial sanctions not exceeding £50,000 if they are found to have contravened the request for information.
- 4.22 The compliance monitoring regime is a preventive ex-ante approach. By requiring that information be collected and assessed anyway (and not just when we issue a section 135 request), we are seeking to minimise the risk of non-compliance. Additionally, the ex-ante approach provides greater transparency than an ex-post approach.
- 4.23 Even if section 135 were used, Regulatees can only be required to provide information that already exists. Section 135 does not give us the power to require that, when originated, the information provided meets specific standards or to obtain external assurance on that content. In this crucial respect, we would gain no significant incremental assurance except the limited deterrent of sanctions on those providing the information. The use of section 135 would not allow us, therefore, to tackle the information asymmetry problem. It would also lead to a much higher regulatory burden through the requirement to operate many annual investigative processes.

### **Regulatory withdrawal**

- 4.24 Our Regulatory Principles<sup>15</sup> require us to operate with a bias against intervention. In the case of MCT, as Vodafone point out, the consumers are wholesale operators who - given the right information - can police regulation for themselves. The problem is that for MCT, where the regulated rate is a weighted average charge, buyers do not have visibility of the volumes used to determine compliance. Some communication providers may know what volumes they terminate (if they are MNOs) and this might give them a feel for whether there were a compliance problem. However, as UKCTA set out in their response, there could not be certainty on compliance.
- 4.25 In fact, UKCTA were concerned that even with the level of disclosure presented in the Consultation, they would not be in a position to fully understand compliance. Therefore they wished to see us retain a role in compliance. We agree with this point. The information asymmetry that UKCTA is faced with is shared by us. We have addressed that in this statement.

<sup>15</sup> <http://www.ofcom.org.uk/about/sdrp/>



## Summary

### Devising general principles

- 4.26 We do not think that any of the arguments for maintaining the status quo are compelling. We intend to implement the general principles proposed in the consultation, wherever they remain relevant and proportional.
- 4.27 In summary, the general principles are:
- Information content, similar to that already provided in the current returns from Regulatees, will continue to be submitted to us. This will be the Ofcom Data Submission. It will be prepared in accordance with the Standard set by us and the Statement of Methodology provided by the Regulatee explaining how the submission has been prepared.
  - An Independent Accountant will provide a 'reasonable assurance report' (in accordance with ISAE 3000) on the Ofcom Data Submission and the Statement of Methodology.
  - The Regulatee will publish a "Charge Control Compliance Report" consisting of: the Independent Assurance Report, the Published Information Summary, the Statement of Methodology and a statement of responsibility signed by the Directors of the Regulatee.

### Application to MCT

- 4.28 We have applied the general principles to MCT in a way that we consider to be relevant and proportional.

## Section 5

# Information content

## Introduction

5.1 In the Consultation we set out proposals for:

- The Ofcom Data Submission - the annual return prepared by the Regulatees as evidence that the controls are being properly implemented.
- The Statement of Methodology (formerly termed the Supporting Documentation in the Consultation) – which describes how the information provided by the Regulatees was prepared.

## Ofcom Data Submission

- 5.2 The granularity of information currently received is sufficient. The Consultation proposed that an information format in line with what Regulatees currently provide would continue to be used to check compliance. Currently these submissions are supplied to us on a confidential basis, as the Regulatees believe that they contain confidential business information. Section 7 addresses the issue as to whether any of the information should be published and if so, how much.
- 5.3 We dismissed the use of regulatory accounts as overly intrusive and costly. Whilst they are used for price control monitoring purposes in Italy and France, we concluded that they were disproportionate if introduced solely for charge control monitoring. We asked whether preparing the Ofcom Data Submission would involve extra cost for Regulatees.

## Statement of Methodology

- 5.4 In the Consultation we proposed that Regulatees prepare a Statement of Methodology. The Statement of Methodology should give buyers a good understanding of all of the material assumptions, judgements and methodologies used to prepare the information submitted.
- 5.5 The reader of the Statement of Methodology should also be able to gain a clear understanding of the overall structure of the information systems, from which the information is prepared. In particular, the sequence and nature of processing by any intermediate systems. The Statement of Methodology should address the process of preparing the information from the initial source of the relevant data.
- 5.6 We proposed that Regulatees produce the Statement of Methodology according to the principles laid out in a separately published Standard. We did not ask any specific questions on the Statement of Methodology.

## Responses to the Consultation

- 5.7 Of the respondents that answered the question, about whether preparing the Ofcom Data Submission would involve extra costs, most were either unclear what the burden would be or felt that there was an increased burden.

- 5.8 Scottish and Southern Energy questioned why we needed the monthly information set out in the Ofcom Data Submission. BT felt that a tightly defined Standard would result in an increased data requirement. UKTCA on the other hand suggested that we should move the other way and that we were too quick to dismiss regulatory accounts as a potential solution.
- 5.9 In respect of the proposals as they relate to MCT, Vodafone, whilst commenting generally that the proposals were costly and unnecessary, alleged that we had been misleading in our description of the use of regulatory accounts for charge control monitoring in France and Italy. They argued that this was a by-product of the regulatory accounts process, not the objective.
- 5.10 On the general principle of requiring a Statement of Methodology, Vodafone and Scottish and Southern Energy believed that what we were asking for was overly prescriptive. In particular, they objected to the requirements to have in place and document internal controls. The need to document how volumes could be traced back to the “ultimate source” was deemed overly bureaucratic. In BT’s opinion, the level of detail proposed for the documentation was too granular. It needed to reflect the regulatory issue, which was compliance with the charge control. T Mobile did not see the need for a detailed audit of controls.

## Ofcom’s view

### Ofcom Data Submission

- 5.11 We were surprised by the responses. Regulatees already produce Ofcom Data Submissions. The incremental cost of producing further information for publication is covered in section 7.
- 5.12 We have started to build a dataset from the Ofcom Data Submissions that allow us to identify trends in traffic movement. This information also helps us to increase our understanding of the market. By continuing to provide this information to us and the Independent Accountants, potential compliance issues that span more than one year can be identified.
- 5.13 As we clearly stated in paragraph 3.5 of the Consultation, we believe that across the charge controls, current informational requirements are adequate and therefore we do not agree with BT’s concern that they would increase. As noted in para 4.14 the general principles can only be implemented for individual charge controls as part of a market review. Regulatees will have an opportunity to express their opinions through the relevant consultations.
- 5.14 As set out in paragraph 5.3 above, we believe that the intrusion and cost of implementing a regulatory accounts solution, solely for charge control compliance purposes, is disproportionate. We have therefore dismissed this option.

### Statement of Methodology

- 5.15 As a result of the informal consultation, the Standard has been developed and refined in conjunction with Stakeholders and the ICAEW. It gives Regulatees responsibility to judge how much documentation should be provided and to what extent data can be aggregated within any summary. We specify transparency criteria (see paragraph 3.9 of the Standard) for the Statement of Methodology and the minimum content (see paragraph 3.12 of the Standard), and we explain the factors

that would influence our decisions (see the materiality section of the Standard at paragraphs 4.8 and 4.9).

## Summary

- 5.16 As explained above, we will require the MNOs (and other Regulatees for future controls) to produce an Ofcom Data Submission similar to that which they already produce<sup>16</sup>.
- 5.17 We have not received any compelling arguments as to why the informational requirement for monitoring compliance should be lower or higher than our proposals. We will therefore continue to seek the current level of information.
- 5.18 For price controls arising in the future, the information submitted may look different from that shown in the Standard, depending on the specific nature of the charge control.

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<sup>16</sup> Proformas for the information to be submitted are provided in the in the Standard

## Section 6

# Assurance reporting

## Introduction

- 6.1 In the Consultation, we set out our view that providing assurance through independent verification is the best way to tackle the information asymmetry problem. We also explained our view that options that do not introduce independent scrutiny will fail to provide sufficient assurance. These included 'light touch' forms of assurance reporting such as retaining the status quo or relying solely on a Directors' statement. Independent reporting from an Independent Accountant is therefore a basic requirement in any future monitoring process.
- 6.2 The Consultation set out a range of standards, published by the International Federation of Accountants that provide several alternative levels of assurance that could be provided by an Independent Accountant<sup>17</sup>:
- Agreed upon procedures – ISRS 4400<sup>18</sup>
  - Assurance Engagements – ISAE 3000<sup>19</sup>
    - "Limited assurance engagement"
    - "Reasonable assurance engagement"
  - Audit – SAS 700 (ISA 700)<sup>20</sup>
    - "Properly Prepared in accordance with..." and
    - "Properly Prepared in accordance with..." plus "Fairly Present".
- 6.3 These alternatives were described in the Consultation and are explained in Annex 4 to this statement
- 6.4 In the Consultation we stated that the reasonable assurance engagement, as set out in ISAE 3000, provides the right level of assurance. Whether there is value in communicating the independent assurance report to buyers, such as through publication, is discussed in section 7. ISAE 3000 would be compatible with publication if that were desired.
- 6.5 In the Consultation we explained our reservations about the applicability of ISAE 3000 to charge control compliance. It is not yet a tried and tested standard (it was only introduced in 2005). This, combined with the lack of guidance in the ISAE 3000 standard (particularly between a "reasonable" and "limited" report) led to concerns that implementation might result in inconsistent approaches being followed by different firms of Independent Accountants across different Regulatees.

<sup>17</sup> <http://www.ifac.org/>

<sup>18</sup> As set out in the International Standard on Assurance Engagements (ISAE 4400) [http://www.ifac.org/Members/Source\\_Files/Auditing\\_Related\\_Services/2007\\_Handbook/2007\\_A280\\_I\\_SRS\\_4400.pdf](http://www.ifac.org/Members/Source_Files/Auditing_Related_Services/2007_Handbook/2007_A280_I_SRS_4400.pdf)

<sup>19</sup> <http://www.icap.org.pk/Circulars/circulars2006/ISAE3000.pdf>

<sup>20</sup> <http://www.frc.org.uk/images/uploaded/documents/ACFAB4.pdf>

- 6.6 We did however invite respondents' views on the relative merits of ISAE 3000 and "properly prepared" under ISA 700, and on the proposed form of audit report or assurance report. We also asked whether a signed statement from a Director provided additional assurance.

## Responses to the Consultation

- 6.7 The responses on the general principle of independent scrutiny, as a concept, are covered in section 3. On the question of the merits of ISA 700 versus ISAE 3000, we received a number of helpful and informative responses. Of those who responded, four preferred the use of ISAE 3000 to ISA 700. The exception was Scottish and Southern Energy who suggested ISA 700 for the early years followed by a move to "Agreed upon procedures" at a future date.
- 6.8 The respondents who favoured ISAE 3000 pointed out that ISA 700 is designed primarily for the statutory audit of historical financial statements, whereas ISAE 3000 is designed for assurance engagements on everything not covered by ISA 700. ISA 700 was not developed for compliance information and such information is more appropriately covered by ISAE 3000. Therefore there was no need for the modification (the dropping of the "fairly presents" part of the ISA 700 Audit opinion) that we had proposed.
- 6.9 On the general principle of the wording of the audit/assurance report, three respondents agreed that the proposed wording provided sufficient assurance, one respondent disagreed.
- 6.10 As a general principle, T-mobile and the confidential respondent felt that if an audit or assurance report were required, no additional assurance could be gained from a directors' statement. It was therefore an unnecessary duplication of effort.

## Ofcom's view

- 6.11 Taking into consideration responses on the question of ISA 700 versus ISAE 3000 and following further work carried out by Deloitte, we have decided to follow the framework as set out under ISAE 3000. We agree with respondents that ISAE 3000 is the more appropriate standard. We note that the respondents (who are also buyers) did not share our concerns about users not understanding ISAE 3000 or its relatively recent introduction.
- 6.12 A proforma assurance report for MCT is set out in the Standard. It has been revised to reflect the comments from the informal consultation. In particular, The Institute of Chartered Accountants in England and Wales (ICAEW) was consulted in November 2007 by OFCOM on the assurance framework contained within the Standard and provided comments on the proposals after discussion with the member firms that might be undertaking these engagements for the first year of assurance.
- 6.13 The Directors' Statement of Responsibilities is required for two reasons:
- It is an integral part of the independent assurance framework
  - It provides additional assurance for little extra cost.
- 6.14 The directors' statement distinguishes the responsibility of the directors to prepare the information, from the responsibility of the Independent Accountant to check the information and provide an assurance report on it. The Independent Accountant

might require a directors' statement in order to be able to report. It could then base its assurance work, including testing, around the statement. The assurance report may refer to the directors' statement in the section dealing with the responsibilities of the Regulatee and the Independent Accountant. The directors' statement is therefore a key part of the independent assurance framework.

- 6.15 The directors' statement provides additional assurance because the directors are confirming that they have prepared compliance information according to the requirements. Such a statement may also increase the importance that the Regulatee places upon preparing correctly compiled compliance information.

### Summary

- 6.16 We accepted the arguments made by respondents on their preference for ISAE 3000 over ISA 700 and have modified the proposals accordingly. The Standard contains a proforma assurance report for MCT that has been discussed with the ICAEW.
- 6.17 The directors' statement is an integral part of the independent assurance framework and provides additional assurance for little extra cost.

## Section 7

# Publication requirement

## Introduction

- 7.1 In the Consultation we identified three publication options: no publication, publication but with no information summary and publication with a summary of the information provided to us. Currently there is no requirement for publication.

## No publication

- 7.2 As explained in the Consultation, we consider that the current requirement for Regulatees to provide confidential data submissions to us, does not deliver adequate transparency.

## Publication without the information summary

- 7.3 The Consultation also discussed a more transparent option where we would receive the Ofcom Data Submission and the Independent Assurance Report in private. We would still require the Regulatee to publish a statement, but it would exclude the information to check compliance. In the Consultation we envisaged this as a published statement, by a director of the company, that would set out the Regulatees' responsibility in relation to compliance. This would be accompanied by the assurance report of the Independent Accountants confirming the results of their engagement.
- 7.4 In the Consultation we were concerned that it might not be possible to publish the Independent Assurance Report without the underlying data, since the report could be taken out of context. This has been confirmed since the end of the Consultation. Since this option does not allow buyers to see for themselves, at first hand, an independent assurance report confirming compliance, we have dismissed it.

## Publication of summary information

- 7.5 The most transparent option. The Consultation proposed that a subset of the Ofcom Data Submission (that excluded the additional underlying information) called the Published Information Summary would be more suitable for publication. The Published Information Summary would provide sufficient data granularity to allow buyers to undertake the essential calculations as set out in the relevant charge control conditions.
- 7.6 The Consultation proposed that alongside the Published Information Summary, the director's statement and the Independent Accountants report should also be published. By providing real transparency, the Published Information Summary increases assurance in a cost effective manner.
- 7.7 The Consultation also explained that we consider that publication puts additional discipline on Regulatees and increases accountability, by enabling buyers to scrutinise the compliance output. Publication places a degree of reputational risk on both the Regulatee and the Independent Accountants. In the Consultation we recognised that publication can cause commercial harm in some circumstances but felt this would not be the case for the Published Information Summary.



- 7.8 The Consultation asked for views as to whether the publication proposals improved transparency and provided sufficient assurance to buyers. We also asked whether publication of the Published Information Summary enabled a reasonably well-informed buyer to check charge control compliance.

## Responses to the Consultation

- 7.9 Respondents were generally in favour of the principle that some publication should be required. The majority however felt that the Published Information Summary went too far. On the other hand, UKCTA felt it was a key part of the process and we should review what is published in two years time to see whether any more information is needed.
- 7.10 T-mobile believed we misinterpreted our transparency objective. Specifically they argued that it is for us to make our process transparent, not for the MNOs to disclose information. They added that if an audit or assurance requirement is necessary, it is our job is to ensure Independent Accountants are competent.
- 7.11 One respondent suggested that we should publish summary information on whether Regulatees had complied.
- 7.12 T-mobile and Scottish and Southern Energy questioned, as a general principle, what additional benefit there is for buyers if Ofcom and the Independent Accountants had verified that the control had been met. BT and Vodafone were unclear as to why buyers would be required to check compliance for themselves if we had done it already.
- 7.13 Vodafone felt that an Ofcom statement on compliance would provide more assurance than relying on the Published Information Summary and associated reports from the Regulatee and Independent Accountant.
- 7.14 T-mobile felt the publication of the audit or assurance report increased the cost and burden on the Regulatees. They argued that it is for us to ensure that consumers are confident that regulation is appropriate and enforced, not for consumer to undertake regulation for themselves.
- 7.15 Several respondents argued that it was too intrusive to require a Regulatee to publish the Statement of Methodology. They argued that publication would give useful information on internal controls to competitors. BT felt that by requiring Regulatees to publish internal controls procedures, we were going further than the requirements of Sarbanes-Oxley.
- 7.16 As part of a confidential response, one of the respondents set out two scenarios where commercial harm would result to MNOs from publication of the limited data set. These were:
- Potential for disruptive targeted retail offerings. If a competitor Communication Provider became aware that an MNO's network traffic was particularly heavy in, say, the evening, it would be possible for them to devise a price plan that incentivised its customers to call that MNO at this time of day. This would force the terminating MNO to increase investment in its network.
  - Information on customer profiles. The concern here is that the traffic weights would give additional information about customer profiles which could be used to

target particular network customers through specific retail offerings i.e. to design a retail offering that would be more attractive to those customers.

- 7.17 Vodafone pointed out that as compliance can only be assessed retrospectively, publication of out of date information is of no use to operators. We agree with this point, insofar as it relates to operators' commercial strategies, but we do believe that publication will have value in demonstrating compliance.

### **Ofcom's view**

- 7.18 The keys points identified in the responses might be summarised as follows:

- General principle of transparency
- Benefits of publication
- Level of detail being published
- Incremental cost of the Published Information Summary
- Publication of the Statement of Methodology
- Commercial harm to MNOs

These points are considered below.

### **General Principle of transparency**

- 7.19 The Act specifically provides for the possibility of SMP conditions requiring the publication of information in order to secure transparency (s87(6)(b)).

### **Benefits of publication**

- 7.20 Publication gives greater incentive to the Regulatee and Independent Accountant to ensure the figures in the submission are correct and facilitates checking by third parties which gives them confidence in the system and enables them to spot compliance issues.
- 7.21 There are two benefits from the publication of a fuller set of information by Regulatees. Firstly, they publish the independent assurance report in full. This would clearly carry the authority of the Independent Accountant and would better build confidence than a summary by us.
- 7.22 Secondly, there is a degree of reputational risk for both the Regulatee and Independent Accountant in publishing compliance information. We believe that this will significantly enhance the quality of such compliance information.

### **Level of detail being published**

- 7.23 The assurance engagement is designed to address the fundamental information asymmetry between the Regulatee, on the one hand, and buyers and Ofcom on the other. We want buyers to be able to satisfy themselves that charge controls are being complied with – and publication of data is critical to achieving this.
- 7.24 UKCTA, who represent some of the fixed line operators, were supportive of the need

to publish. They suggested that the default position should be for all the information to be published, with exceptions having to be justified. They felt that the Published Information Summary would allow them to make a first-line test of non-compliance, although recognising we may have to carry out more complex checks.

- 7.25 The Published Information Summary needs to contain sufficient information for a buyer or reader to check compliance (see paragraph 4.2 of the Consultation). We agree with Vodafone that only volume proportions rather than absolute volumes are required, for each period of the year during which there was a particular price. We have revised the Published Information Summary proforma in the Standard to reflect this.

### **Incremental cost of the Published Information Summary**

- 7.26 The costs of producing the Published Information Summary are minimal. It requires no more than the extraction of a subset of this data into a separate spreadsheet (the example in the Consultation took less than an hour). We remain of the view that the incremental cost of this obligation is minimal.

### **Publication of the Statement of Methodology**

- 7.27 The Statement of Methodology would be presented alongside the Published Information Summary as part of a single document called the Charge Control Compliance Report.
- 7.28 This follows the model of financial statements, where the basis of preparation is explained in the notes to the accounts, which sit alongside the profit and loss account, balance sheet and cash flow and forms an integral part of the financial statements. Similarly, the Directors' Statement of Responsibilities and the Independent Assurance Report also form part of this document.
- 7.29 We propose publication of the Statement of Methodology because we believe that this will help to increase the confidence of buyers that the Regulatees are complying with the control. If they can see the methods and data sources that are being used in the calculation, they can be more confident that the regime is effective. The response received from UKCTA on the informal consultation on the Standard confirmed the importance of a Statement of Methodology for buyers.
- 7.30 Since we have removed the requirement to document internal controls, the publication of the statement of methodology will no longer disclose such information.

### **Commercial harm to the MNOs**

- 7.31 Commercial harm is most likely to arise where, for example, the information published allows rivals to target the firm's customers, anticipate its prices or copy innovative service features. We do not believe this is likely to arise from any requirement, in the case of the MNOs, to publish prior year termination traffic weights.
- 7.32 Although these may provide some information on customer profiles, the profiles would relate to calls received rather than calls made or retail services purchased from the Regulatee by its retail customers. The limited data would be an average for all fixed and mobile calls, rather than specific to an individual Regulatee, and would be published in the form of time of day weightings rather than the underlying volumes.

- 7.33 In response to the two scenarios presented in confidence, no evidence was provided that the first one, that “Potential for disruptive targeted retail offerings”, would be a rational or even a feasible strategy for the competing communication provider. Indeed, it would presumably require the originator to reduce its own retail prices while continuing to pay the MNO's termination charges which could also be adjusted within the overall ceiling. It seems at least possible that this would benefit the terminating MNO whilst being unprofitable for the originating communication provider.
- 7.34 The second scenario was again asserted without supporting evidence. It seems doubtful since the information content of prior year termination traffic weights, relevant to current year retail customer profiles, is low. Even if MNOs could use the data in the way suggested, their rivals could make a competitive response, given that similar information would be available about all MNOs.
- 7.35 In our opinion, harm to competition is most likely to arise where publication enables operators to agree on the prices that they set and hence raise them above the competitive level. We do not believe this to be a significant risk in the case of the MNOs.
- 7.36 The charge control itself would prevent any increase in charges for termination on MNOs' own network. Whilst there may be some linkage between termination revenues and competition in the retail mobile market, we do not believe that publication of the Published Information Summary would lead to any reduction in competition in the retail mobile market.

## Summary

- 7.37 The response by UKCTA, whose members are buyers of charge controlled products and services, strongly supports our publication proposals. UKCTA see a clear requirement for publication and a direct benefit to buyers. The arguments put forward against publication on the grounds of commercial harm are weak.
- 7.38 We do however take on board the sensitivities of the MNOs on the specifics of their publication requirement. We have modified our proposals to ensure only the weights, rather than actual volumes are published.
- 7.39 The Statement of Methodology is key to readers' understanding of the Published Information Summary. Its publication will be important in increasing the confidence of buyers. We have reduced the scope of the Statement of Methodology to focus on what is needed for effective monitoring of compliance.

## Section 8

# The Standard

## Introduction

- 8.1 The Charge Control Compliance Standard (the Standard) sets out the detailed requirements for preparation of the information and the documentation needed to demonstrate compliance with the relevant charge controls. It identifies how our proposals should be implemented.
- 8.2 In order to develop the Standard we:
- Outlined the aims and content of the Standard in the Consultation
  - Refined the Standard through discussions with Regulatees and an informal consultation
  - Consulted the Institute of Chartered Accountants in England and Wales (ICAEW).
- 8.3 In the Consultation (paragraphs 4.8, 6.1 and 6.2), we explained our plan to draft a Standard and to consult informally with Regulatees on it, prior to publishing it along with this statement. During the consultation period we worked with Regulatees to develop the Standard, sharing two working drafts with them. We also received advice from our accounting advisors, Deloitte. Following the end of the consultation period on our proposals, we carried out a four week informal consultation on the Standard during November 2007.
- 8.4 We consulted the ICAEW in November on the assurance framework contained within the Standard. It provided comments on the proposals, after discussion with the member firms who might be undertaking these engagements for the first year.
- 8.5 The proposals set out below take into account feedback received during the informal consultation.
- 8.6 In particular we have recognised stakeholder concerns over the requirements originally proposed by us, that internal controls should be documented and published. Our primary focus is on the result (i.e. the Published Information Summary) rather than on the controls over the data that is used to populate the Published Information Summary. We recognise that full assurance could be gained over the Published Information Summary by directly checking data back to the supporting evidence (substantive tests), rather than needing to test the operation of controls over the collection of such data (compliance tests).
- 8.7 We will publish the Standard and review it from time to time. It will be revised to cover new charge controls, as and when they arise.

## Responses to the Consultation

- 8.8 As the Standard was subject to a separate informal consultation, we asked no specific questions. Orange and Vodafone (referring to early working drafts of the Standard that they had reviewed in their responses) commented on the fact that work on the Standard was being carried out in parallel with the Consultation. They believed that the Standard assumed that there should be independent verification of

the Published Information Summary, whereas discussion was continuing on this in the Consultation. They therefore argued that this is evidence that we had already made up our mind on the outcome of the consultation. Orange also complained that the Consultation had been rushed due to the six-week consultation period.

- 8.9 The confidential respondent felt that as a general principle, the Consultation did not adequately define materiality, which we proposed as a key part of the Standard.

## Ofcom View

- 8.10 We believed that it would be helpful to split the broader issues on compliance monitoring from the detailed technical implementation issues. By working on them in parallel, we felt that we could effectively facilitate responses in both areas. If proposals from the Consultation had been modified or abandoned, the associated work on the Standard would have also been abandoned. We have remained open-minded and accepted an operational risk of potentially wasted effort. However, parallel running allowed us to advance the project more quickly, leaving more time for MNOs to implement any new requirements.
- 8.11 The Consultation was not predetermined: we openly considered the issues and commissioned Deloitte to prepare a full range of options. In the Consultation, we considered that the current processes were deficient and a combination of assurance, information and publication requirements were proposed. The Consultation considered a number of options and then focused on some clearly defined proposals with a more limited range of options. We have modified the proposals on the basis of responses.
- 8.12 The reasons for the six-week consultation were set out in Annex 2 paragraph A 2.5 of the Consultation. In addition, the MNOs (who wished to engage with us) and BT were given sight of the proposals in June. We received no formal request during the consultation period for an extension.
- 8.13 In the final version of the Standard, we have provided more information about materiality. We give examples of both quantitative and qualitative factors that would influence our decisions. Our discussions with the major audit firms which might be involved did not indicate any confusion as to how to set materiality. However, materiality will rightly vary depending on the circumstances of each Regulatee. It is the responsibility of Independent Accountants to set materiality for assurance according to their professional judgement. In the Standard, we also refer to the professional guidance on materiality.

## Summary

- 8.14 With input from the ICAEW, assurance/ audit firms who might be involved, Regulatees and our advisors, we have developed a Standard that we believe gives clear and workable directions as to how to implement the proposals.

## Section 9

# Implementation

9.1 The Consultation raised a number of questions relating to the introduction of our proposals, in particular:

- Should the Regulatee select and pay the Independent Accountant?
- Should Ofcom enter into a modified form of tripartite agreement with the Regulatee and Independent Accountant?

## Responses to the Consultation

- 9.2 Most respondents agreed that, in the case of an audit or assurance requirement, it should be the Regulatee who selects and pays the Independent Accountant. BT, however, asked if it might be more appropriate for us to bear the audit or assurance costs in the case of a tri-partite engagement. They felt that each situation for each charge control needed to be looked at separately and that we had underestimated the costs.
- 9.3 The confidential respondent felt that our power to require the Regulatees to remove their Independent Accountant was too wide-ranging and that we should define the circumstances for removal more tightly.
- 9.4 Specifically on MCT, the confidential respondent felt that MNOs should not be required to pay for the audit/assurance engagement because there was no allowance for them to recover the costs under the charge control.
- 9.5 Two respondents (T-mobile and UKCTA) agreed that as a general principle, a modified tri-partite agreement was appropriate. Other respondents either made no comment or did not answer the question.

## Ofcom's view

- 9.6 Each time a new charge control arises, we will consider the costs and benefits of our proposals for monitoring compliance with that control. Our cost estimates are an upper limit and were provided by our advisors, Deloitte. Regulatees may control a significant element of the compliance costs. For example, having good systems, controls and documentation could result in lower costs of demonstrating compliance for both the Regulatee and the Independent Accountant. The form of engagement letter used (e.g. tri-partite or bi-partite) is independent of who pays the fees.
- 9.7 As a general principle, we do not consider that the costs of demonstrating compliance with regulation should automatically be borne solely by those whom it is designed to protect.
- 9.8 In relation to MCT specifically, we have used our six principles of costs recovery<sup>21</sup> to determine that, on balance, the MNOs should bear the costs of compliance. In particular the principles of practicality, cost causation and cost minimisation apply:

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<sup>21</sup> The Six Principles of Cost Recovery were developed originally by Ofcom in the context of number portability  
[http://www.ofcom.org.uk/static/archive/ofcom/publications/1995\\_98/competition/cps298.htm](http://www.ofcom.org.uk/static/archive/ofcom/publications/1995_98/competition/cps298.htm)



- Practicality. The cost of the assurance engagement is likely to be less than £150k per MNO. Recovering this across an average MNO MCT revenues of £500m would result in a 0.05% increase in charges which would be not material in the context of the MCT cost modelling. As the MCT charge control has been set and we are in the first relevant year it would not be practical to re-set the charge control to recover this level of cost.
- Cost causation. The requirement for an assurance engagement on the MNOs is a result of the information asymmetry buyers face. If the MNO were able to demonstrate compliance in an open and transparent way (i.e. through the use of a single 24 hour rate) then the cost of the assurance requirement would be vastly reduced.
- Cost minimisation. If the MNO pays for the assurance engagement, it has the incentive to achieve efficiency savings through commercial negotiation and/or by improving the systems, controls and documentation, thereby reducing the overall compliance costs.

- 9.9 We have reviewed the wording of our power to require a Regulatee to remove their Independent Accountant but we do not believe that it should be worded any more narrowly (SMP Condition MA6.7). However, we point out that we would only expect to use this power in exceptional circumstances and we would need to justify their removal.
- 9.10 Since the Consultation was published, we have considered more closely the options under the ICAEW (Institute of Chartered Accountants in England and Wales) Technical release Audit 05/03<sup>22</sup>. We believe that a bi-partite agreement with an accompanying written notice, under Appendices D and E respectively of the technical release, best suits our circumstances. The accompanying written notice would still establish the duty of care between the Independent Accountant and Ofcom.
- 9.11 This arrangement is slightly less intrusive for the Regulatee than a tri-partite arrangement. Additionally, this option avoids the need for us to sign the entire engagement contract. (Some Regulatees may have a separate engagement contract for the compliance assurance work whereas others may have a single contract that covers all the assurance work by the Independent Accountant: compliance, statutory audit and anything else).

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<sup>22</sup> "Reporting to Regulators of Regulated Entities"  
<http://www.icaew.co.uk/publicassets/00/00/05/85/0000058576.PDF>



## Implementation and timetable

### Implementation of the general principles

- 9.12 As and when new charge controls arise or are reviewed in the future, they will be introduced/modified via SMP Conditions, as part of the related market review. The current timetable is:

<b>Market Review</b>	<b>Expected review (consultation publication)</b>
Business Connectivity	December 2007
WLR and LLU	2008
NTS retail uplift	2009
NCC	2009

### Implementation for MCT

- 9.13 By 30<sup>th</sup> June, 2008, the MNOs will need to deliver to us: the Published Information Summary, Statement of Methodology and the directors' Statement. The Independent Assurance Report is not required for the first year of the MCT. We intend to hold a workshop with the Regulatees after publication of this statement, in order to help them implement the new procedures.
- 9.14 We consulted The Institute of Chartered Accountants in England and Wales in November 2007, on the assurance framework contained within the Standard and provided comments on the proposals, after discussion with the member firms who might be undertaking these engagements for the first year of independent assurance.
- 9.15 We believe that we have shared our proposals with Regulatees and other interested parties and that we are helping with implementation. In the Consultation we asked whether we were doing enough to help stakeholders implement the proposed procedures.

## Responses to the Consultation

- 9.16 The majority of respondents either did not comment or were unclear as to exactly what we were doing to help stakeholders implement the proposals.

### Ofcom's view

- 9.17 We have listened to Regulatees as part of the consultation process and we have revised our proposals accordingly. In particular:
- the Standard has been developed to assist Regulatees and their Independent Accountants with the implementation of our proposals;
  - we have worked with BT and the MNOs who wished to engage with us, when drafting the Standard, in order to ensure that it is a workable document for them to implement; and
  - we intend to hold a workshop with the Regulatees and their Independent Accountants, after publication of this statement. We will be able to explain further

our aims and our thinking behind the detail of the proposals and in particular the Standard. Regulatees and their Independent Accountants will be able to ask any questions that they have about implementation.

Finally, we have significantly revised our proposals by delaying the introduction of the requirement for an Independent Assurance Report by one year, for the MCT. This recognises concerns expressed by MNOs about the practicality of introducing a requirement now, to verify volumes from the historical year 2006/2007.

## Section 10

# Conclusion

## General Proposals

10.1 For all future charge controls where compliance is measured in relation to a weighted average charge:

- Information content similar to that already provided in the current returns will continue to be submitted to us. The submission will be prepared in accordance with the Standard which is being published alongside this statement.
- An Independent Assurance Report will provide 'reasonable assurance' under ISAE 3000<sup>23</sup> regarding the Published Information Summary and the transparency of the Statement of Methodology.
- The Regulatee will publish the Independent Assurance Report, Published Information Summary and the Statement of Methodology. It will also publish a Directors' Statement of Responsibility signed on behalf of the Board of Directors of the Regulatee. Together, these documents are termed the 'Charge Control Compliance Report'.

10.2 We consider that the new charge control regime meets the attributes of good regulation:

- **Intervention and intrusion** – It keeps the obligations to the minimum necessary to achieve a sufficient level of compliance monitoring.
- **Transparency** – Publication of key documents ensures the ability of buyers to engage in the process.
- **Cost effectiveness** – The cost of the obligations will not place an unreasonable burden on Regulatees.

## MCT Specific Proposals

10.3 The new procedures will be applied to the MCT control first. The MCT Statement was published on 27 March 2007<sup>24</sup>.

10.4 We have considered all of the consultation responses in full and as a result of the consultation process we have modified the conditions presented in the Consultation. The amendments to that condition are set out in Annex 2. The modified condition implements the general proposals set out in paragraph 4.27. The key changes from the draft published in the Consultation are:

- ISAE 3000 is adopted as the assurance framework rather than ISA 700.
- Assurance Reporting will not be required for the relevant year to March 2008.

<sup>23</sup> International Standard on Assurance Engagements 3000.

[http://www.ifac.org/Members/Source\\_Files/Auditing\\_Related\\_Services/2007\\_Handbook/2007\\_A270\\_1\\_SAE\\_3000.pdf](http://www.ifac.org/Members/Source_Files/Auditing_Related_Services/2007_Handbook/2007_A270_1_SAE_3000.pdf)

<sup>24</sup> [http://www.ofcom.org.uk/consult/condocs/mobile\\_call\\_term/statement/statement.pdf](http://www.ofcom.org.uk/consult/condocs/mobile_call_term/statement/statement.pdf)

- The requirement to document internal controls in the Statement of Methodology has been removed.

### No material change test on MCT

10.5 As set out in the Consultation, in March 2007, we published the statement on mobile call termination<sup>25</sup>. It concluded that each MNO has SMP in wholesale mobile voice termination. The market definition has not changed because it remains the case that there is an absence of demand or supply side substitutes for termination on each MNO network. Given the market definition, MNOs continue to have 100% market share in their relevant markets. Therefore it is our view that there has been no material change to the product markets or to the SMP findings since the publication of the statement. Therefore as there has been no material change since the Statement, we may amend the relevant SMP condition.

### Communications Act tests on MCT

10.6 We consider that the condition amendment (Annex 2) meets the tests set out in the Communications Act.

10.7 We considered our duties under section 3 and all the Community requirements set out in section 4 of the Act. For the reasons set out above we believe that its decision meets these requirements. In particular, the amendments to the condition are aimed at promoting competition and securing efficient and sustainable competition for the maximum benefit of consumers by ensuring that the charges for mobile call termination are at the level set out in conditions MA3 and MA4.

10.8 As set out under 47(1) of the Act, in modifying a condition, we must be satisfied that the test set out under 47(2) has been met. The test is that the modification is:

- objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
- not unduly discriminatory against particular persons or against a particular description of persons;
- proportionate to what it is intended to achieve; and
- transparent in relation to what it is intended to achieve.

10.9 By reference to the these tests, we consider that the amendment is:

- objectively justifiable, as it requires the MNOs to put in place procedures that ensure we are able to assess their compliance with their SMP conditions in an effective manner;
- proportionate, since the information content remains at the present level. The documentation requirements add little incremental cost to Regulatees who should have already documented their processes for other reasons. The incremental cost of the assurance engagement is proportionate considering the revenues covered under the charge control. We have modified our proposals as described above at 10.4;

<sup>25</sup> [http://www.ofcom.org.uk/consult/condocs/mobile\\_call\\_term/statement/statement.pdf](http://www.ofcom.org.uk/consult/condocs/mobile_call_term/statement/statement.pdf)

- not unduly discriminatory, as only the MNOs are able to supply MCT. In due course the requirements will be extended to all charge controls where appropriate; and
- transparent, in that the proposals and the reasoning behind them are set out in this document.

## Conclusion

10.10 We have set out measures to achieve effective monitoring for all future charge controls that involve a weighted average:

- The information to be submitted to us remains largely unchanged.
- An Independent Assurance Report will be required over the Published Information Summary and the Statement of Methodology.
- The Regulatee will publish the Charge Control Compliance Report, consisting of: the Published Information Summary, the Directors' Statement of Responsibility, the Independent Assurance Report and the Statement of Methodology.

10.11 The first charge control to which we are applying these new proposals is the MCT. After considering the responses to the Consultation, we have developed specific proposals for the MCT.

10.12 In order to put our proposals into effect for the MCT, via a modification of the SMP Conditions, we need to satisfy certain tests. We have satisfied both the no material change test and the Communications Act tests.

## Annex 1

# Responses to the Consultation

A1.1 Responses to the Consultation were received from:

- BT
- Orange
- T-mobile
- Scottish and Southern Energy
- Vodafone
- O2
- UKCTA
- 1 anonymous response (not published)

A1.2 Non-confidential responses are published on our website:

<http://www.ofcom.org.uk/consult/condocs/l>

## Annex 2

# Notification – Modification of Mobile Call Termination SMP Services Conditions

## Notification under sections 48(1) and 86 of the Communications Act 2003

### Proposals for the modification of SMP services conditions in relation to mobile call termination for the purposes of monitoring price controls

#### WHEREAS:

(A) OFCOM issued a notification pursuant to sections 48(2) and 86 of the Act setting out their proposals for the modification of SMP services conditions in relation to mobile call termination on 11 September 2007 (the “Notification”).

(B) A copy of the Notification was sent to the Secretary of State in accordance with section 50(1)(a) of the Act, and to the European Commission and to the regulatory authorities of every other member state in accordance with section 50(3) of the Act.

(C) In the Notification and accompanying explanatory statement, OFCOM invited representations about the proposals made by 23 October 2007.

(D) By virtue of section 48(5) of the Act, OFCOM may give effect to any proposals to modify SMP services conditions as set out in the Notification, with or without modification, where:

i. they have considered every representation about the proposals made to them within the period specified in the First Notification; and

ii. they have had regard to every international obligation of the United Kingdom (if any) which has been notified to them for this purpose by the Secretary of State;

(E) OFCOM received eight responses to the Notification and have considered every such representation made to them in respect of the proposals set out in the Notification and the accompanying explanatory statement; and the Secretary of State has not notified OFCOM of any international obligation of the United Kingdom for this purpose;

#### THEREFORE:

1. OFCOM makes in accordance with sections 48(1) and 86 of the Act the following modifications to an SMP services condition which was set by reference to market power determinations in relation to markets in which OFCOM are satisfied there has been no material change since those determinations were proposed or made.

2. The measures contained in this notification are further to the market power determinations made in notifications under section 79 of the Act by OFCOM on 27 March 2007 whereby H3G, O2, Orange, T-Mobile and Vodafone were determined to have significant market

power in product markets in effect as a result of those notifications.

3. As a result of, amongst other things, the market power determinations referred to in paragraph 2 above, H3G, O2, Orange, T-Mobile and Vodafone have been subjected to a number of SMP services conditions, including SMP services conditions imposing price controls. OFCOM are modifying these SMP services conditions by adding new provisions concerning the monitoring of compliance with price controls as set out in the Schedule to this Notification.

4. The effect of, and OFCOM's reasons for making, the modifications referred to in paragraph 3 above are set out in the accompanying explanatory statement.

5. OFCOM consider that the proposals referred to in paragraph 3 above comply with the requirements of sections 45 to 50 and sections 78 to 92 of the Act, as appropriate and relevant to each of the modifications.

6. In making the modifications set out in this notification, OFCOM have considered and acted in accordance with their general duties in section 3 of the Act and the six Community requirements in section 4 of the Act.

7. Copies of this notification and the accompanying explanatory statement have been sent to the Secretary of State in accordance with section 50(1)(a), and to the European Commission and the regulatory authorities of every other Member State in accordance with section 50(3) of the Act.

8. In this notification:

“Act” means the Communications Act 2003;

“H3G” means Hutchison 3G (UK) Limited (registered company number 3885486) including any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 736 of the Companies Act 1985, as amended by the Companies Act 1989 (or any subsequent amendment or replacement Act);

“the Notification” means the notification referred to in paragraph A of this notification;

“O2” means O2 Limited (registered company number 1743099) including any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 736 of the Companies Act 1985, as amended by the Companies Act 1989 (or any subsequent amendment or replacement Act);

“Orange” means Orange Personal Communications Services Ltd (registered company number 2178917) including any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 736 of the Companies Act 1985, as amended by the Companies Act 1989 (or any subsequent amendment or replacement Act);

“T-Mobile” means T Mobile Limited (registered company number 2382161) including any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 736 of the Companies Act 1985, as amended by the Companies Act 1989 (or any subsequent amendment or replacement Act);

“United Kingdom” has the meaning given to it in the Interpretation Act 1978 (c. 30); and

“Vodafone” means Vodafone Limited (registered company number 1471587) including any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as



defined by section 736 of the Companies Act 1985, as amended by the Companies Act 1989 (or any subsequent amendment or replacement Act).

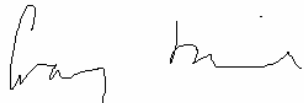
9. Except insofar as the context otherwise requires, words or expressions shall have the meaning assigned to them in this notification and otherwise any word or expression shall have the same meaning as it has in the Act.

10. For the purpose of interpreting this notification:

(a) headings and titles shall be disregarded; and

(b) the Interpretation Act 1878 (c. 30) shall apply as if this Notification were an Act of Parliament.

11. The Schedule to this notification shall form part of this notification.



Craig Lonie

DIRECTOR OF COMPETITION FINANCE

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

18 December 2007

## Schedule

SMP services condition MA6 shall be added as follows:

### **Condition MA6 – Monitoring compliance with Conditions MA3 and MA4**

**MA6.1** The Dominant Provider shall at all times ensure that its procedures, systems and processes for recording and analysing terminated traffic volumes covered by Conditions MA3 and MA4 are compliant with the Charge Control Compliance Standard.

**MA6.2** The Dominant Provider shall prepare and maintain documentation (the “Statement of Methodology”) containing a detailed and complete description of the procedures, systems and processes for preparing the information contained in the Published Information Summary and the Ofcom Data Submission in accordance with the Charge Control Compliance Standard.

**MA6.3** The Dominant Provider shall, in respect of each Relevant Year:

- (a) maintain the Statement of Methodology in accordance with this Condition and the Charge Control Compliance Standard;
- (b) prepare the Published Information Summary in accordance with this Condition, the Charge Control Compliance Standard and the Statement of Methodology;
- (c) prepare a Directors’ Statement of Responsibilities in accordance with the Charge Control Compliance Standard;
- (d) except in the first Relevant Year, procure an Independent Assurance Report with an Assurance Conclusion stating whether the Published Information Summary demonstrates compliance with the Charge Control Compliance Standard and the Statement of Methodology in all material respects; and
- (e) prepare the Ofcom Data Submission in accordance with this Condition, the Charge Control Compliance Standard and the Statement of Methodology.

The outputs of steps (a) to (d) above shall be contained in one document, termed the Charge Control Compliance Report.

**MA6.4** The Dominant Provider shall:

- (a) deliver to Ofcom within 90 days of the end of each Relevant Year copies of the Published Information Summary, Ofcom Data Submission, Statement of Methodology, Independent Assurance Report (except for the first Relevant Year) and Directors’ Statement of Responsibilities;
- (b) publish the Published Information Summary, Statement of Methodology, Independent Assurance Report (except for the first Relevant Year) and Directors’ Statement of Responsibilities within 120 days of the end of each Relevant Year, together with any written statement made by Ofcom and provided to the Dominant Provider commenting on the Published Information Summary and Statement of Methodology.

**MA6.5** The Dominant Provider shall

- (a) ensure that a bi-partite written engagement contract is made with the Independent

Accountant including provisions acknowledging the acceptance by the Independent Accountant that, in forming and/or expressing any Assurance Conclusion pursuant to this Condition, the Independent Accountant shall owe a duty of care to Ofcom (but not directly or indirectly to any other third party) in respect of its assurance work, Independent Assurance Report and Assurance Conclusion, consistent with the Institute of Chartered Accountants in England and Wales guidance, as further described in the Charge Control Compliance Standard.

(b) use its best endeavours to obtain from the Independent Accountant any further explanation and clarification of any Assurance Conclusion and any other information in respect of the matters which are the subject of that Assurance Conclusion as Ofcom shall require.

**MA6.6** The Independent Accountant that the Dominant Provider from time to time appoints shall at all times be satisfactory to Ofcom having regard to such reasonable matters as Ofcom considers appropriate. The Dominant Provider shall notify Ofcom in writing of the Independent Accountant appointed to secure compliance with this Condition before the Independent Accountant carries out any work for that purpose. The Dominant Provider shall notify Ofcom of any proposed change of Independent Accountant at least 28 days before effect is given to that change.

**MA6.7** In the event that the Independent Accountant is in the opinion of Ofcom unsatisfactory, the Dominant Provider shall appoint and instruct an Alternative Independent Accountant that is at all times satisfactory to Ofcom having regard to such reasonable matters as Ofcom considers appropriate. The Dominant Provider shall ensure that the Alternative Independent Accountant:

(a) carries out such on going duties as are required to secure compliance with this Condition;

(b) carries out work or further work, in addition to that performed by the former Independent Accountant, in relation to such matters connected to compliance with this Condition as are of concern to Ofcom; and/or

(c) re-performs work previously performed by the former Independent Accountant in relation to such matters connected to compliance with this Condition as are of concern to Ofcom.

**MA6.8** Where Ofcom have reasonable grounds to believe that any or all of the Independent Assurance Report, Published Information Summary, Ofcom Data Submission or Statement of Methodology are deficient, the Dominant Provider shall, where directed by Ofcom:

(a) amend and restate the relevant document in order to remedy the deficiencies identified by Ofcom;

(b) secure in accordance with any relevant direction of Ofcom under this Condition the expression of an Assurance Conclusion on the restated documents;

(c) deliver to Ofcom the restated documents and corresponding Independent Assurance Report; and

(e) publish the restated documents and corresponding Independent Assurance Report as directed by Ofcom.

**MA6.9** The Dominant Provider shall preserve records sufficient to provide an adequate

explanation of each Published Information Summary and Ofcom Data Submission for a period of six years from the date on which such submissions are delivered to Ofcom.

**MA6.10** Publication of information in Condition MA6.4 shall be effected by

- (a) placing a copy of the relevant information on any relevant website operated or controlled by the Dominant Provider; and
- (b) sending a copy of the relevant information to any person at that person's written request.

**MA6.11** In this Condition:

**“Alternative Independent Accountant”** means any Independent Accountant not for the time being appointed as the Dominant Provider's Independent Accountant;

**“Assurance Conclusion”** means the reasonable assurance conclusion section of an Independent Assurance Report as set out in International Standard on Assurance Engagements 3000

**“Charge Control Compliance Report”** means the single document containing the Directors' Statement of Responsibilities, the Independent Assurance Report, the Published Information Summary and the Statement of Methodology.

**“Charge Control Compliance Standard”** means the document issued from time to time by Ofcom which describes:

- (a) the minimum requirements of the Dominant Provider's procedures, systems and processes for recording and analysing terminated traffic volumes covered by Conditions MA3 and MA4
- (b) the minimum requirements for the documentation describing the procedures, systems and processes used for preparing the information contained in the Published Information Summary and the Ofcom Data Submission;
- (c) the minimum requirements for the preparation of the Published Information Summaries and Ofcom Data Submissions
- (d) the Directors' Statement of Responsibilities
- (e) the minimum requirements for the Independent Assurance Report
- (f) any other relevant requirements, including definitions of terms and proforma documents for the Published Information Summaries, Ofcom Data Submissions and Independent Assurance Reports.

**“Directors' Statement of Responsibilities”** means a written statement, approved by the Dominant Provider's main Board and signed on their behalf by an Executive Director who sits on the main Board, that states the responsibilities of the directors who sit on the main Board in relation to ensuring compliance with condition MA3 and MA4 and preparing the Published Information Summary and Statement of Methodology in accordance with this Condition.

**“Independent Accountant”** means any Independent Accountant eligible for appointment as

the Dominant Provider's auditor under the Companies Act 1985 as amended by the Companies Act 1989 (or any subsequent amendment or replacement Act) for the time being appointed by the Dominant Provider

**"Independent Assurance Report"** means a report providing a reasonable assurance conclusion made by an Independent Accountant in accordance with International Standard on Assurance Engagements 3000

**"Ofcom Data Submission"** means a submission containing, in addition to the information in the Published Information Summary, prices and volumes by Charging Period on a monthly basis in the form described in the Charge Control Compliance Standard;

**"Published Information Summary"** means a submission demonstrating compliance in respect of Condition MA3.1 and MA4.1 in the form described in the Charge Control Compliance Standard;

**"Statement of Methodology"** has the meaning described in Condition MA 6.2.

## Annex 3

# Impact assessment

## Introduction

- A3.1 The analysis presented in this Annex represents an impact assessment, as defined in section 7 of the Communications Act 2003 (the Act).
- A3.2 This section contains an impact assessment of the revised conditions contained in Annex 2 relating to compliance with the charge controls on mobile network operators (MNOs) designated with SMP in wholesale mobile voice call termination. This is not an impact assessment of the charge controls themselves, which were already discussed in the statement published by us in March 2007<sup>26</sup>.
- A3.3 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 our activities. However, as a matter of policy we are committed to carrying out and publishing 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:  
[http://www.ofcom.org.uk/consult/policy\\_making/guidelines.pdf](http://www.ofcom.org.uk/consult/policy_making/guidelines.pdf)

## The citizen and/or consumer interest

- A3.4 Charge controls have been imposed on SMP providers to ensure that the wholesale services supplied by them are not provided at excessively high prices affecting competition in downstream markets. In monitoring compliance with the charge controls, however, our check on prior year volume weights is not adequate as we lack the information to verify these weights. This information asymmetry can mean that there is a risk that operators' compliance is not being monitored effectively, leaving consumers with the risk of higher prices. Although no significant breaches have been discovered, the levels of errors, late returns and disputes have increased. Monitoring compliance with charge controls is necessary to ensure that consumers can benefit from regulation.
- A3.5 The amendments made in this document ensure that we can receive assurance that the MNOs are complying with the charge control. It will also provide for purchasers of wholesale services are to be able to reconcile the prices they pay to the average weighted charge, and assure themselves that they benefit from the regulation imposed on them. In competitive markets these benefits are likely to flow to consumers as well.

## Ofcom's policy objective

- A3.6 Our objective is to ensure that an effective monitoring regime is in place to ensure compliance with the charge controls, particularly as it has become increasingly evident that charge control monitoring has not kept up with the increasing diversity

<sup>26</sup> [http://www.ofcom.org.uk/consult/condocs/mobile\\_call\\_term/statement/statement.pdf](http://www.ofcom.org.uk/consult/condocs/mobile_call_term/statement/statement.pdf)

and complexity of the charge controls being introduced.

### Analysis of the options considered

- A3.7 Currently, we receive spreadsheet returns from Regulatees to demonstrate compliance with each price and charge control. There is no requirement for audit. The form and content of such returns varies from operator to operator and there is no standardisation or requirement for consistency, either between one year and the next or between Regulatees.
- A3.8 We can only perform only basic checks on this information, and breaches may take longer to detect. The consequence of this is that, given the significant level of revenues from mobile call termination (in the case of MCT, termination revenues are estimated at around £2.5 billion<sup>27</sup>), even a small departure from compliance can mean that mobile customers are overcharged a significant amount.
- A3.9 The amended condition achieves our aim of providing greater assurance of compliance and providing transparency regarding the operation of the charge controls. In the Consultation different options were considered for: the level of assurance, information provision to us and the level of disclosure of that information.
- Five options identified by the Deloitte report were considered for effective monitoring through levels of assurance; (a) “agreed upon procedures”, (b) “limited assurance engagement report”, (c) “reasonable assurance engagement report”, (d) “properly prepared in accordance with” and (e) “fairly present”. The audit and assurance options differed in the level of assurance that would be provided and the amount of information that needed to be provided.
  - Two options were identified for the provision of information; (a) Ofcom Data Submission, and (b) Published Information Summary. The options differed in the volume of information that Regulatees need to provide for assurance.
  - Three options were identified for transparency and disclosure; (a) no publication of any information, (b) publication with no numbers, and (c) publication with numbers. The three options differed in the level of disclosure that will be required by MNOs.

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<sup>27</sup> [http://www.ofcom.org.uk/consult/condocs/mobile\\_call\\_term/statement/statement.pdf](http://www.ofcom.org.uk/consult/condocs/mobile_call_term/statement/statement.pdf)  
Paragraph 2.17, page 7.

A3.10 The tables below discuss the benefits and costs/ risks of all the above options.

### Option Assessment - levels of assurance opinion

Option	Benefits	Risks/Costs
<p>"Agreed upon procedures"</p> <p>- An Auditor is able to perform mechanical tests against our checklist.</p>	<ul style="list-style-type: none"> <li>• Independent assessment of compliance.</li> <li>• Limited level of assurance achieved over and above the current situation.</li> </ul>	<ul style="list-style-type: none"> <li>• Information asymmetry means benefits may not be achievable as we may not be able to specify details of the tests accurately.</li> <li>• Auditor only tests the letter and not spirit of compliance; does not use professional judgement in reporting compliance.</li> <li>• Costs likely to be significantly less than £150,000 per annum to operate.</li> </ul>
<p>"Limited assurance engagement report"</p> <p>- Based on a negative statement.</p> <p>- Enables the Independent Accountant to conclude that nothing has come to the Independent Accountant's attention that would cause the Independent Accountant to believe that the operator had not complied with the charge control. The Independent Accountant would need to obtain sufficient and appropriate evidence to form such a conclusion.</p>	<ul style="list-style-type: none"> <li>• The risk of problems not being detected, because of poorly designed tests, is reduced versus the above.</li> <li>• Provides us with knowledge of when breaches of compliance may be taking place.</li> <li>• Designed specifically for assignments other than historical financial statements, of which monitoring compliance is one type.</li> </ul>	<ul style="list-style-type: none"> <li>• Does not provide us with the confidence it is seeking from the new regime.</li> <li>• ISAE 3000 does not provide much information to differentiate sufficiently between the level of work in a reasonable and limited assurance report.</li> <li>• Imposes costs and interventionist because of the level of assurance required, but costs likely to be less than £150k for an average MNO.</li> </ul>



Option (cont.)	Benefits (cont.)	Risks/Costs (cont.)
<p>“Reasonable assurance” engagement report</p> <ul style="list-style-type: none"> <li>- We set a Standard. Operators will prepare a Statement of Methodology codifying the procedures to be followed.</li> <li>- Auditor obtains sufficient and appropriate evidence, assesses risks of misstatement, developing responses to provide a positive conclusion.</li> </ul>	<ul style="list-style-type: none"> <li>• The risk of a problem being missed is lower than the limited assurance engagement above.</li> <li>• Positive conclusion possible because there are clearly linked procedures on compliance (the Standard and Statement of Methodology)</li> <li>• Close proximity of the regulatee’s books and records allows a better assurance than if we were to undertake assurance.</li> <li>• The Standard directs Independent Accountants on areas to focus; Auditor has the proximity to assess the effectiveness of the Statement of Methodology.</li> <li>• Auditor uses their professional judgement to opine on the submission</li> <li>• Process reports on the spirit of compliance.</li> <li>• ISAE 3000 designed specifically for assignments other than historical financial statements, such as compliance reporting.</li> </ul>	<ul style="list-style-type: none"> <li>• ISAE 3000 does not provide much information to differentiate sufficiently between the level of work in a reasonable and limited assurance report.</li> <li>• Imposes costs and interventionist because of the level of assurance required, but costs still likely to be less than £150k for an average MNO</li> </ul>
<p>“Properly prepared in accordance with”</p> <ul style="list-style-type: none"> <li>- We set a Standard. Operators will prepare a Statement of Methodology codifying the procedures to be followed.</li> <li>- Auditor checks Statement of Methodology against the Standard. Then it checks that the submission is in accordance with Statement of Methodology.</li> </ul>	<ul style="list-style-type: none"> <li>• The Standard directs Independent Accountants on areas to focus; Auditor has the proximity to assess the effectiveness of the Statement of Methodology.</li> <li>• Auditor uses their professional judgement to opine on the submission</li> <li>• Process reports on the spirit of compliance.</li> </ul>	<ul style="list-style-type: none"> <li>• Could be perceived by Regulatees as too intrusive and burdensome; however this is mitigated by the fact that as purchasers from each other they have a greater degree of assurance regarding compliance.</li> <li>• Costs likely to be less than £150,000.</li> <li>• ISA 700 designed primarily for historical financial statements.</li> </ul>

Option (cont.)	Benefits (cont.)	Risks/Costs (cont.)
<p>“Fairly present”</p> <p>- Similar to “properly prepared in accordance with”, but where the Auditor can use their own judgement in making the assessment of compliance. In particular an Auditor can apply a “fairly present override” to state in their opinion the full statutory or regulatory statements are ‘compliant’ for the purposes of charge control compliance even where there are significant departures from the Standard.</p>	<ul style="list-style-type: none"> <li>Potentially the highest level of assurance possible</li> </ul>	<ul style="list-style-type: none"> <li>The ‘true and fair’ override puts too much judgement in the hands of the Independent Accountants and may risk the regulation being inappropriately assessed.</li> <li>Can only be used on full statutory or full regulatory financial statements. These are significantly more costly to produce and audit than Published Information Summaries, particularly for the MNOs.</li> <li>ISA 700 designed primarily for historical financial statements</li> </ul>

### Option Assessment – Information

Option	Benefits	Risks/Costs
Ofcom Data Submission	<ul style="list-style-type: none"> <li>We will receive the detailed data necessary for monitoring charge control compliance.</li> <li>As Regulatees already produce an un-audited Ofcom Data Submission, this option will not require additional resources.</li> </ul>	<ul style="list-style-type: none"> <li>Operators may perceive a risk in providing a level of information that may potentially be published.</li> </ul>
Published Information Summary	<ul style="list-style-type: none"> <li>Can potentially be published</li> </ul>	<ul style="list-style-type: none"> <li>Further information may be required to deal with disputes or concerns</li> </ul>

### Option Assessment – Publication

Option	Benefits	Risks/Costs
<p>No publication (status quo)</p> <p>- We receive the submission and reports in private.</p>	<ul style="list-style-type: none"> <li>We will be able to publicly report that Regulatees have complied with the regulation and that it continues to monitor compliance.</li> </ul>	<ul style="list-style-type: none"> <li>Lack of transparency regarding compliance – our objective of open and transparent regulation not met.</li> </ul>

Option (cont.)	Benefits (cont.)	Risks/Costs (cont.)
<p>Publication with no numbers</p> <ul style="list-style-type: none"> <li>- We receive the submission and reports in private but would require Regulatees to publish a statement on compliance. This would be signed by an Executive Director</li> </ul>	<ul style="list-style-type: none"> <li>• Director's sign-off would seek to confirm compliance and provide limited assurance regarding compliance, although not independent.</li> <li>• Operators may see benefits in not revealing complete information to third parties</li> </ul>	<ul style="list-style-type: none"> <li>• Directors' sign off does not provide independent verification.</li> <li>• Independent Accountants unlikely to allow the assurance report itself to be published without the underlying data.</li> <li>• The process remains essentially private without complete disclosure to third parties and buyers and hence does not completely meet the objective of openness and transparency</li> </ul>
<p>Publication with numbers</p> <ul style="list-style-type: none"> <li>- Providers would be required, as a minimum to provide information for a buyer to be able to reconcile published prices to the charge control price – this includes prices published in the charge control year and the time of day volume weights for the corresponding period in the preceding year.</li> </ul>	<ul style="list-style-type: none"> <li>• It disciplines the Regulatees to provide a correct Published Information Summary.</li> <li>• Increases the reputational risk of both the Independent Accountants and the operator.</li> <li>• Increases accountability as buyers can scrutinise the numbers.</li> <li>• Increases confidence as buyers see that charge controls are effective and increases the perception of assurance</li> <li>• The process is open and transparent</li> </ul>	<ul style="list-style-type: none"> <li>• Regulatees might be concerned that publishing information volumes weights can be commercially sensitive and risky. But the information published may not be commercially sensitive because:</li> <li>• the charge control regulation only requires information that is at least 15 months out of date</li> <li>• times of day profiles are an average of all fixed and mobile termination on the MNOs network and do not reveal time of day profiles for termination from any one operator.</li> <li>• it is unlikely that this level of aggregation could provide information significantly advantageous to other competitors</li> </ul>

## The Preferred option

- A3.11 Based on the above impact analysis of the different options, our view is independent verification through an assurance engagement in compliance monitoring is a basic requirement in any monitoring process, where a simple 24 hour charge is made for the whole of the relevant year.
- A3.12 We considered options for an assurance report and is of the view that the costs of this are not significant. The benefits however can be significant in that:
- they provide us with assurance that the charge control obligations are being complied with;
  - purchasers are able to reconcile the charges they pay with the obligation; and
  - monitoring in general will provide greater transparency to our remedies and will help in detecting breaches.
- A3.13 On balance, following responses to the Consultation, we found the Independent Assurance Report based on reasonable assurance, as set out in ISAE 3000 was most effective form of reporting. We will require the MNOs:
- i) To continue to submit the Ofcom Data Submission in line with timescales included in the charge control conditions.
  - ii) to provide at the same time, the Published Information Summary.
  - iii) To provide a level of assurance by requiring Independent Accountants to submit an Independent Assurance Report under ISAE 3000.
  - iv) To provide a Statement of Methodology setting out how the Published Information Summary was complied.
  - v) To require a statement on behalf of the Regulatee by a Board Director acknowledging responsibility for preparing the data presented on behalf of the Board for its completeness and accuracy.
  - vi) To also require regulatees to publish these documents (ii), (iii), (iv) and (v) on their website as the Charge Control Compliance Report.
- A3.14 This approach in (i) to (iv) above appears to be the most effective as it provides the required benefit of compliance with the spirit of the regulation without being unduly burdensome. We consider that in order to improve transparency and bring discipline to the process, Regulatees would have to publish certain data on day part charges and day part traffic weights to enable buyers to check compliance for themselves. This would best be achieved by a Published Information Summary should be provided since such a submission has the advantage of minimising any concerns that Regulatees might have with revelation of commercially sensitive information.
- A3.15 Below is a table showing the distribution of costs and benefits of the new requirements on the MNO.

## Expected distribution of costs and benefits

Option	Costs		Benefits	
	Operators	Consumers	Ofcom/buyers	Wider Consumers
Independent Assurance Report under ISAE 3000.	Incremental cost of audit. Likely to be significantly - less than £150k	Assurance costs potentially passed on through higher retail charges. Minimal in face of £13bn UK retail revenue.	Ofcom – Operate a more effective compliance monitoring regime.  Buyers (and potential buyers) of MCT - Confidence that they are paying regulated rate.	Benefits of more effective monitoring may be passed on in lower prices.
Information – Ofcom Data Submission and Published Information Summary.	None - information already produced	N/A	Ofcom – Allow Ofcom to understand how MNOs comply with their charge controls.	N/A
Publication with numbers.	Publication of a summary (Published Information Summary) reduces the possible costs arising from the disclosure of potentially commercially sensitive data.	N/A	Buyers (and potential buyers) of MCT - Confidence from seeing Independent Assurance Report, directors statement and re-performing calculations for themselves.	Confidence from seeing independent assurance report and directors statement. Can re-perform calculations for them. Publication of only a summary submission (Published Information Summary) also avoids risk of dampening competition, which could ultimately disadvantage consumers.

## Measurement of benefits

A3.16 By definition, we cannot say what the level of undetected breaches is at the moment. Also, the fact of putting in place our proposals may lead to a deterrence effect, making breaches less likely to occur. These two factors mean that it is difficult to specify a direct measurement of the benefits of our information and assurance proposals. But we can measure benefits of our publication proposals as below.

- A3.17 The benefits of publication will be measured by: the improvement in transparency resulting from publication of charge control information.

## Annex 4

# Assurance Standards

## Introduction

- A4.1 This annex explains in more detail the assurance standards considered in section 6 where we chose a “reasonable assurance” engagement under ISAE 3000, over the other options for independent assurance and audit.

## Agreed upon procedures (AUPs)

- A4.2 Whilst AUPs are the least costly, interventionist and intrusive form of independent verification, we did not propose them for three reasons. Firstly the information asymmetry that we experience, in relation to the Regulatees’ volumes, also extends to the systems and processes they use. The result is that we are not in a position to specify the detail of the testing to be undertaken in a set of AUPs.
- A4.3 Secondly, the Independent Accountants or auditors would not express an opinion on the results of the AUPs, nor on the appropriateness of the procedures. Instead, they mechanically perform tests as set out in the AUP and remain silent if the tests are incorrectly specified (a likely outcome if specified by us).
- A4.4 Thirdly, AUPs are not usually published because the reports are restricted to those parties that have agreed the procedures to be performed.

## Audit – Fairly presents

- A4.5 Fairly presents is at the other end of the assurance scale: it offers the highest level of assurance but also the most costly/ intrusive one. We suggested in the Consultation that a full regulatory audit on a “Properly prepared and fairly presents basis” following ISA 700 was also inappropriate.
- A4.6 ISA 700 audits are underpinned by concepts that have been established for a considerable time and are well understood by both Independent Accountants and users of audit reports.
- A4.7 The detailed mechanical checking of the numbers is performed by the Independent Accountant, whose close proximity to the Regulatee’s books and records make them best placed to perform this task. Independent Accountants are required to give an opinion using their professional judgement.
- A4.8 The “fairly presents” aspect of the report presents three problems. Firstly a “fairly presents” opinion is usually only applicable to full statutory or full regulatory accounts. A suitably qualified audit firm, would, therefore find it difficult to make a “fairly presents” statement on a Published Information Summary. This is because the opinion is usually only made on the Regulatee’s overall financial position and performance, indicating if there exists sufficient disclosure, reasonable detail to interpret the accounts, and an absence of bias. As discussed in para 5.3 we consider regulatory accounts disproportionate.
- A4.9 Secondly a “fairly presents” opinion requires the Independent Accountant to extend their judgement to whether the information in the regulatory accounts provides adequate disclosure. Importantly, it allows departures from the Standard if they are

justified and adequately explained. We feel that this degree of judgement is inappropriate in the context of compliance monitoring, where there should be consistency across the Regulatees.

- A4.10 Thirdly, following as a consequence of the first two points, more work is required in carrying out the audit. This would increase the audit cost<sup>28</sup>, and imply an increase in the level of intervention and intrusion for the Regulatee. These problems outweigh the benefits of a “fairly presents” audit and the option was not proposed in the Consultation.

### **Audit – properly prepared in accordance with**

- A4.11 A “properly prepared in accordance with report” relaxes the audit scope to exclude the “fairly presents” element of judgement or override. This was the preferred option put forward in the Consultation. We considered this option to be the most suitable, as it had the positive aspects of the ISA 700 backing, with the Independent Accountant doing the testing and using their judgement.

- A4.12 The advantages of “properly prepared” over AUPs and “Fairly presents” are:

- The Independent Accountant is required to exercise their professional judgement on the Published Information Summary. This is missing from AUPs.
- The Independent Accountant provides an opinion on whether a Published Information Summary has been “properly prepared” in accordance with a proposed Standard and Statement of Methodology (termed Supporting Documentation in the Consultation). This avoids imposing a regulatory accounting requirement of the “Fairly presents” opinion.
- The incremental cost for a “properly prepared in accordance with ...” audit of a Published Information Summary will be significantly lower than a “Fairly presents” one.
- The Independent Accountant cannot apply the fairly presents override. Their opinion is restricted to whether the Published Information Summary prepared by the Regulatee has been “properly prepared in accordance with...”. Ofcom therefore retains responsibility for setting out the principles of compliance in the Standard.

- A4.13 In the Consultation, we gave our view that a “Properly prepared in accordance with...” approach would be better suited to our needs than an ISAE 3000 assurance engagement (see paragraph 4.3 of the Consultation). We felt that there would be more confidence in this reporting framework, as ISAE 3000 is relatively unknown and untried. But we asked respondents for their views.

### **Assurance Engagements**

- A4.14 Assurance engagements, as set out in ISAE 3000, are assignments carried out by Independent Accountants. They report a conclusion designed to enhance the degree of confidence in a particular subject matter (other than traditional audits of statutory financial statements) by reference to evaluation against defined criteria. There are two forms of assurance engagement: “limited” and “reasonable”.

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<sup>28</sup> Deloitte estimate a fairly present audit opinion on full regulatory accounts to be around £150k



## Limited Assurance Engagement

- A4.15 A limited assurance engagement would require the Independent Accountant to report on a negative basis<sup>29</sup> whether the Published Information Summary met the monitoring requirements. The level of work that the Independent Accountant would undertake would depend on the exact form of report required by us (in the Standard).
- A4.16 In our opinion, the negative language of the report does not provide the confidence that consumers (and in particular buyers and potential buyers) need from the new monitoring regime. They would not see a published statement that tells them whether or not Regulatees have complied with their charge controls.

## Reasonable Assurance Engagement

- A4.17 A reasonable assurance engagement requires the Independent Accountant to report on a positive basis whether the Published Information Summary meets the monitoring requirements. The amount of work required from the Independent Accountant would be dependent on the exact form of report required by us (in the Standard) but would involve more work than a limited report or AUPs.
- A4.18 As with “properly prepared”, we would retain responsibility, via the Standard, for setting out the principles to be applied by Regulatees in reporting compliance. The Regulatees would be responsible for preparing a “Statement of Methodology”, which would document how the general principles of the Standard were applied to the Regulatees’ own business and reporting.

## Summary

- A4.19 We chose a “reasonable assurance” engagement under ISAE 3000. This is because it gives us sufficient comfort that our compliance monitoring procedures have been followed, without being too intrusive or costly.
- A4.20 Assurance under ISAE 3000 works better than audit under ISA 700, because it fits better non-financial data, such as compliance reporting.
- A4.21 We do not have the necessary insight into Regulatees’ businesses to effectively design the procedures under “agreed upon procedures”.
- A4.22 A “fairly presents” audit, although being the strongest assurance standard, puts too much judgement in the hands of auditors and would be too costly/ intrusive.

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<sup>29</sup> E.g. “based on our work described in this report, nothing has come to our attention that causes us to believe that [the regulatee] has not complied with its charge control, in all material effects based on Ofcom’s charge control Standard”.