



**Directions for Regulatory Financial Reporting
Consultation**

TalkTalk response

Non-confidential

January 2015

1 Summary

- 1.1 TalkTalk is pleased to respond to this consultation on Directions for Regulatory Financial Reporting. We broadly agree with most of Ofcom's proposals – they will start to improve the usefulness of BT's regulatory financial reports which will in time flow through to more effective regulation and better outcomes for consumers.
- 1.2 These improvements are long overdue. It is important that Ofcom presses ahead expeditiously with these changes as well as other changes to the manner in which the financial reports are prepared, audited and presented (such as the review of all key allocations used to prepare the RFS).

2 Adjusted Financial Performance

- 2.1 We agree with the proposal to require BT to publish Adjusted Financial Performance (“AFP”) schedules that include most of the adjustments to BT's revenues/costs that Ofcom use in deriving the revenues/costs used to set charge controls. This will improve transparency and allow stakeholders to understand the actual return BT is making compared to the target return (i.e. cost of capital).
- 2.2 We have the following comments on the proposed AFP schedules:
- Ideally all adjustments should be included in the AFP so that the AFP reflects Ofcom's view of costs. Adjustments should *not* be made only by exception
 - In the case where an adjustment is excluded from the AFP (e.g. 2011/12 allocation bases) there should be a clear indication how stakeholders can make the appropriate adjustment themselves.
 - Schedule 1 of AFP should provide the estimated impacts on revenue and CCA operating costs (as well as the impacts on return and ROCE).
 - Schedule 1 of AFP should provide the impact of each adjustment (on revenue, CCA operating costs, return and ROCE) on each market (as was provided in the impacts of changed cost allocations in the 2012/13 RFS¹)
 - Schedule 1 of AFP may need to evolve from its first iteration. It is not clear from the template whether the level of information (e.g. description of the adjustments) will be sufficiently clear and therefore Ofcom should ensure it has the powers to amend the schedule if this is required to provide an appropriate level of transparency
 - It would be useful for Ofcom to explain in generic terms why actual ROCE might diverge from ‘allowed’ return (e.g. cost of capital). This could perhaps be done in the statement

¹ see section 4.1 of Report requested by Ofcom describing certain changes to the Accounting Documents for the year ended 31 March 2013 and illustrating the resulting differences to the Current Cost Financial Statements had those changes not applied (3 October 2013)
<http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2013/ReportrequestedbyOfcomfortheyearended31March2013.pdf>

3 Adjustments to BT's reported financial data

- 3.1 For the adjustments that are included in RFS it would be preferable if these changes were corrected in BT's underlying FAC allocations rather than being corrected *ex post*. For instance, in respect of DSLAM capital / maintenance it would be better than this cost category is correctly classified and correctly allocated in the FAC allocations rather than the FAC allocations incorrectly allocating the costs and then the costs being corrected afterwards. Similarly, the TAM depreciation rate should be set to 7 years (not 5). Embedding these changes/corrections in the underlying assumptions should result in more robust allocations, less risk of errors and will avoid any concern of the order in which adjustments are made.
- 3.2 It would be useful for Ofcom to lay out general principles for judging whether adjustments made in charge controls should be:
- Included in the regulatory financial statements;
 - Included in the ADP; or,
 - Not included.
- 3.3 There should be a record (within BT's reporting) of which adjustments have been included in the RFS (and which in the AFP).
- 3.4 In respect of specific adjustments we have the following comments:
- It is not clear how Ofcom should determine the NGA related Cumulo costs (Annex 5: Part 2: §1.6.1)
 - It is not appropriate to allocate copper current costs, drop maintenance and DSLAM capital maintenance (which includes SFI costs) based on usage factors that reflect care levels since some of these costs are not incurred in response to a fault repair activity

4 VULA reporting

- 4.1 We strongly agree with Ofcom that VULA reporting is important. As Ofcom explain in §5.3 the key tenet underlying its decision not to impose a VULA charge control was that VULA prices were indirectly constrained by other products (e.g. Virgin). If this was shown not to be the case then the reason for not imposing a VULA charge control would be significantly undermined.
- 4.2 Therefore, it is important for Ofcom and stakeholders to be able to identify whether VULA prices are constrained – one strong indicator of this is whether prices are in excess of costs. Therefore reporting of prices/revenue and costs is critical.
- 4.3 Reporting of this data will also be very important to provide a robust evidence base for setting a charge control – if Ofcom considers that a charge control should be imposed in the next FAMR.

4.4 In terms of the specific reporting requirements we have the following comments:

- We do not consider that this information is in any way confidential. Given BT's position of SMP it is unclear how disclosure of it could commercially advantage other players
- Average price and cost data should be provided split by the following categories:
 - GEA (FTTC) rentals
 - GEA (FTTC) connections (i.e. first time connection to GEA)
 - GEA (FTTC) GEA-GEA migration
- GEA (FTTH) should be reported separately from GEA (FTTC) categories. Similarly if GEA (FTTdp) is developed this should be reported separately
- Subsidies (i.e. BDUK) should be shown separately (as a negative cost)
- Some data should be provided on the key assumptions used to derive the costs such as depreciation rates, allocation of duct cost (as between GEA/VULA and LLU/WLR)

5 Electricity reporting

5.1 We agree with the need to provide transparency. We do not consider that information about BT's average electricity costs is that commercially confidential for two reasons.

- First, prices for electricity are publicly available and, as a commodity product, BT will have little ability to negotiate better than market rates
- Second, BT's average electricity cost will be an average of many different supply contracts (e.g. a mix of spot purchases, 3 month in advance, 6 months in advance etc). Therefore, it would not be possible to identify from BT's average electricity costs the amount they paid for a particular contract

5.2 However, if BT is unwilling to provide cost information to allow stakeholders to confirm whether it has complied with the basis of charges obligations then another method of confirming compliance is essential. One possibility is that Ofcom makes a statement that BT has complied with its obligation following the publication of BT's RFS. Without this stakeholders can have no transparency or confidence as to whether BT has complied with its regulatory obligations. A result of this might be a complaint to Ofcom in order to ascertain whether BT has complied.

5.3 Ofcom proposes that BT shall provide details of the cost attribution to electricity charges in the DAM. As Ofcom itself recognises the current DAM is close to useless. It is essential that the information in relation to electricity is a substantial improvement on the information currently provided in the DAM.

6 Other

- 6.1 BT, in Appendix 2 of its 2014/15 RFS², presents Price Control Statements which seem intended to show whether BT complies with charge controls/price caps on various products. However, for most products/baskets, there is not sufficient data to judge whether BT complied. For example, it shows the 'controlling %' but not the actual % change in price (in some cases it just says 'Cap met'). Ofcom should require BT to present a full set of data that demonstrates compliance with each and every charge control.

2

http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2014/Current_Cost_Financial_Statement_2014.pdf