

CHANGES TO BT & KCOM'S REGULATORY FINANCIAL REPORTING - 08/09 UPDATE

Cable&Wireless

1ST MAY 2009

1. Introduction

Cable&Wireless is a major provider of communication solutions to enterprises in the United Kingdom. We aim to provide great value and great service to all our customers; however we remain reliant on products from BT and Openreach to give our customers the end to end experience they demand.

Regulatory Accounting is one of the vital building blocks of the regulatory regime. Without it we'd have no way to judge if BT had met its regulatory obligations in relation to cost orientation or charge control compliance. We always welcome any initiatives that improve the usefulness of the accounts themselves so we broadly welcome the proposal put forward by Ofcom in this consultation.

Confidence in the regulatory accounting process has been severely dented by BT's restatement of prior years revenues and a great deal of work needs to be done to help restore confidence and to that end we look forward to working with Ofcom in the forthcoming clean sheet review of the UK regulatory accounting regime.

A radical overhaul of the regime is now required to help drive improvements in the quality of the regulatory accounting output produced and bring about changes to create the right kind of culture around the preparation of the accounts, ensuring that the individuals responsible for allocating costs and producing the numbers aren't influenced by the needs of BT's businesses or the objectives of its shareholders. The creation of this culture alongside a more robust assurance approach will help to deliver more transparent and useable output that will make a real difference, bringing benefits to the entire industry and ultimately end users and consumers.

We'll wait until the summer consultation to give our comprehensive views on what we think the best outcome looks like for the UK regulatory accounting regime, but we remain happy to work with Ofcom through all the stages of the consultation process. The remainder of this response will focus upon those issues specifically raised by Ofcom in the current consultation, as a founding member of UKCTA we fully support the views expressed in the UKCTA response so we'll try where possible not repeat what has already been said, instead we'll focus on the issues we see as the most important.

2. Matching of costs and revenues

We agree with Ofcom that failure to match costs and revenues in the RFS is a significant barrier to their usability. This has been a particular problem in the Business Connectivity markets and in LLU co-mingling but is also an issue elsewhere. One consequence of the existing situation is that in future returns may look low due to the continued reporting of costs without associated revenues, when in fact the revenue to cover the cost has already been collected.

It is important to ensure sufficient transparency of this issue in the RFS while still ensuring that a meaningful reconciliation between the statutory and regulatory accounts can be made. We think Ofcom's option 1 strikes the best balance between providing the reader with meaningful information without requiring more significant changes to BT's accounting policies.

3. Consistent reporting of RFS units against BT price lists

We fully support the proposal to require BT to take a consistent approach between the unit costs used in the Regulatory Financial Statements and the Carrier Price list. For too long users of the accounts have had to deal with conflicting information which has hindered the usability of the data.

4. Requirement to publish the reconciliation with the General Ledger

The existence of a reconciliation statement between the General Ledger and the Regulatory Accounts is fundamental. Without this information users will be left in the dark when it comes to understanding the numbers in the regulatory financial statements. As a key user of the accounts we need to see this information and we are extremely disappointed that Ofcom aren't proposing to let us see it.

BT has raised confidentiality concerns but we do not believe they are material as our expectation is only to see the information at the same level of granularity as that already published. As we see it there are two sources of information, the P x Q currently used for all internal and external revenues in the RFS which is an approximation and, for external sales only, the revenues recorded by BT

from actual sales. In the past there have been differences between the two, and we believe those differences are important and we'd expect that the actual billed revenue is more reliable than the P x Q calculation. Therefore we are concerned by the thought that the very fact that the billed revenue may be more accurate could be a reason for it to be commercially confidential.

Where there are genuine confidentiality concerns then the appropriate information should be removed, otherwise this level of detail should be published in full. Cable&Wireless and other RFS users have a key role to play in ensuring that the accounts are robust and we will be hindered if this reconciliation data isn't disclosed to us. Ofcom don't have the resources to spot every potential anomaly in the data and other pairs of expert eyes are critical if BT output is to be properly scrutinised and thus avoid any future restatements.

5. BT's continued discretion over cost allocation: LUS Costs within Openreach

It is clear to us that BT retains far too much discretion when it comes to allocating costs. The scope for cost allocation that favours BT is only going to widen as services are deregulated. We therefore need to take action in the forthcoming review to change the incentives around allocation methodologies and the preparation of the accounts to prevent BT favouring its own business. We fully support Ofcom's approach in dealing with this particular case, however the fact remains that BT still retains a significant amount of discretion which allows them to apportion costs in a way that is sympathetic to their own business. A longer term solution to this wider issue of incentives is still required.

6. Point of Handover & Operator Assistance costs

We strongly object to any attempt to remove reporting for Point of Handover costs. These costs are material to our business as they are only levied on interconnected operators and anything that would reduce our understanding of how these costs are derived would have a detrimental impact on competition. We note that Ofcom are reviewing the future distribution of point of hand over costs as part of the leased lines charge control, so we would expect Ofcom to amend its regulatory accounting approach to adapt to the situation where BT was also making a contribution towards these costs.

A significant proportion of Operator Assistance costs are also borne by alternative providers through BT's NTS call origination charges (which include a cost based mark up for Operator Assistance). As we are compelled to contribute to these costs then we still require full visibility of how these costs are derived.

7. Adapting to Deregulation.

Deregulation presents a challenge to Ofcom as if accounting separation obligations fall away it becomes significantly harder to determine the true cost of the regulatory products that remain. BT will be presented with far more discretion over the way in which it allocates costs and based on the incentives that exist today it will have a tendency to allocate common costs towards those products that remain subject to regulation. This is true for products that are deregulated either by geography or by variant. Any future Ofcom investigations concerning these products will be harder to conduct as Ofcom will not have access to the same level of cost information. A wider debate is needed on this particular issue and we look forward to having that debate in the forthcoming clean sheet consultation.

Q & A

In the remainder of this response we respond to the specific questions posed in the consultation document.

Question 1: *Do you think change is required to match costs and revenues? If so which option do you think best meets our objectives and why:*

Option 1: BT prepares and discloses the adjustments necessary to match costs and revenues to show undistorted returns, MCE, FAC and LRIC numbers; or

Option 2: BT changes its regulatory accounting treatment so that costs and revenues are matched.

We would support the adoption of Option 1 as we believe this delivers the user the most useful output.

Question 2: *Do you agree with Ofcom's proposal for BT to separately identify and report the costs of OSPs, resilience and third party equipment charges?*

Yes. This information is required and BT should be separately identify costs relating to OSPs, resilience and third party equipment charges.

Question 3: *Do you agree with Ofcom's proposal for BT just to account for the point of handover costs in external local end service rentals?*

No. Cable&Wireless is concerned about the accuracy of those costs but in any case the allocation of those costs to local ends is not straightforward and the methodology for it has not been agreed. Instead BT should focus on ensuring that those costs are properly and accurately identified in the statement covering technical areas – point of handover.

Question 4: *Do you agree with Ofcom's proposal requiring BT to produce and publish online, details of the cost stacks underlying PPC services and technical areas?*

Yes, this information is vital if we are to make sense of the RFS in relation to PPCs and technical areas.

Question 5: *Do you agree with Ofcom's proposal to continue to require BT to produce the information to support the no undue discrimination and cost orientation obligations of the services covered by the business connectivity market review and that we formalise this reporting requirement?*

Yes, we fully support this Ofcom proposal and believe such information is vital if BT is to demonstrate compliance.

Question 6: *Do you agree with Ofcom's proposal that BT continues to provide an AFI that explains the difference between the revenue reported in the RFS compared to the revenue recognised in BT's general ledger for 2008/09 for the markets covered by the replicability review?*

Yes this information should be provided but it should also be published. Stakeholders need access to this information and by not publishing it Ofcom are limiting the value of the regulatory financial statements.

Question 7: *Do you agree with Ofcom's proposal that, as far as possible, for each service reported in the RFS the units should be consistent with the units by which that service is sold in BT's price list?*

Yes. The current situation makes life very difficult for users of the accounts. Consistency with the Carrier Price List is long overdue.

Question 8: *Do you agree with Ofcom's proposals for geographic reporting in the wholesale broadband access markets for BT?*

Yes. This solution is a pragmatic way of dealing with the issue in the short term, but a more strategic approach is required to deal with cost allocation between regulated and unregulated services which share common costs.

Question 9: *Do you agree with Ofcom's proposals for changes to reporting in the wholesale broadband access market for KCOM?*

Yes.

Question 10: *Do you agree with Ofcom's proposals for changes to reporting for BT as a result of the findings in the BCMR statement?*

Yes. Please refer to our response to question eight as the same issues apply in this instances where regulated and unregulated services share common costs.

Question 11: *Do you agree with Ofcom's proposals for changes to reporting for KCOM as a result of the findings in the BCMR statement?*

Yes.

Question 12: *Do you agree with BT's proposal and Ofcom's position with regards to removing reporting for the markets that account for less than £10m of revenue?*

We have concerns around any attempts to reduce cost transparency for Point of Handovers and Operator Assistance (where these costs are borne by interconnecting operators). Please see the main body of our response for further details

- End -