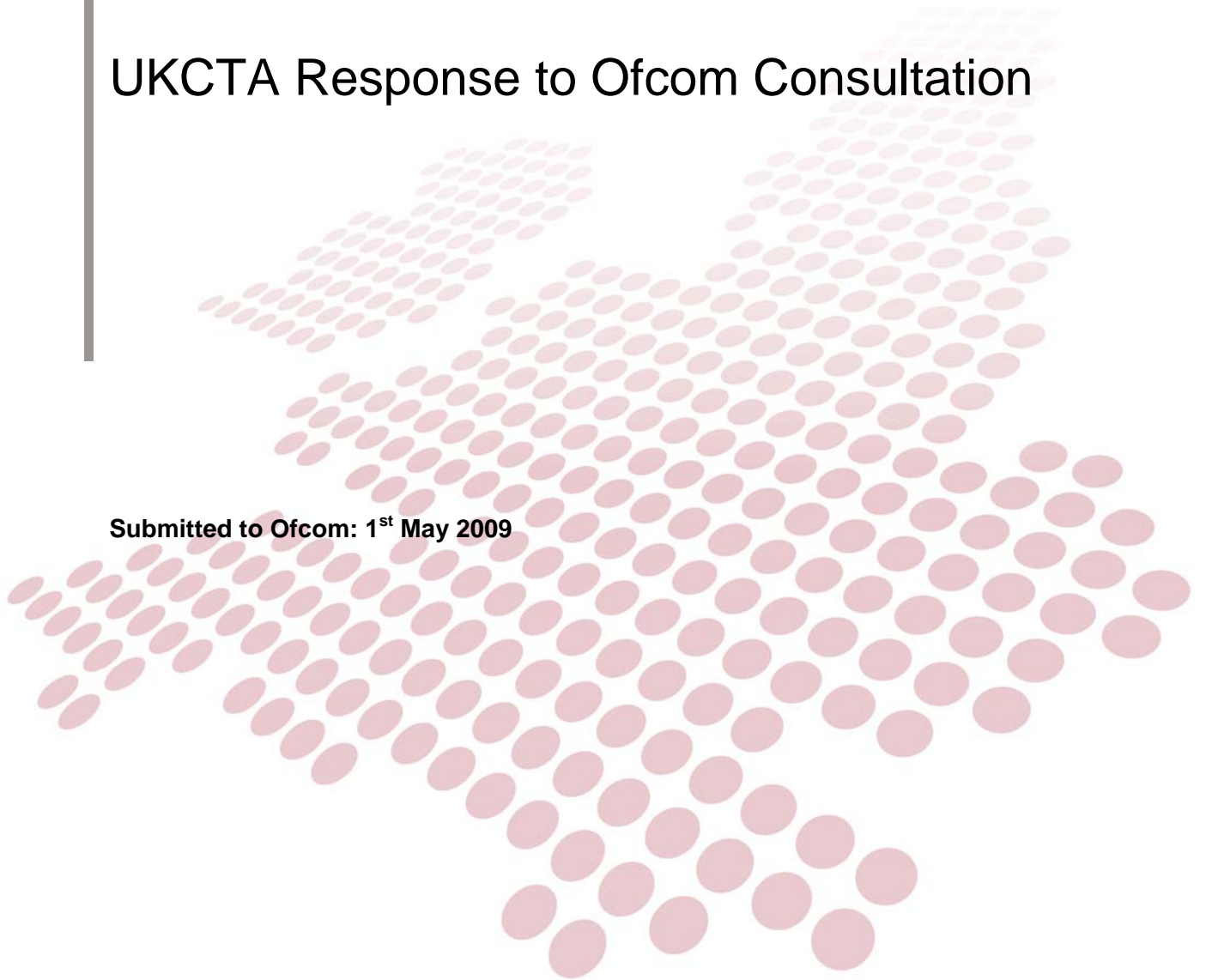


Changes to BT and KCOM's regulatory financial reporting

2008/09 update

UKCTA Response to Ofcom Consultation

Submitted to Ofcom: 1st May 2009



UKCTA is a trade association promoting the interests of competitive fixed-line telecommunications companies competing against BT, as well as each other, in the residential and business markets. Its role is to develop and promote the interests of its members to Ofcom and the Government. Details of membership of UKCTA can be found at www.ukcta.com.

This response is focused upon BT's regulatory accounting obligations. KCOM is a member of UKCTA and as such UKCTA will not be commenting on any of the changes proposed for the Hull area. Any individual UKCTA members who wish to comment on the changes for Hull are free to do so in their own responses.

Introduction

The regulatory financial statements are the cornerstone of the telecommunications regulatory regime in the United Kingdom. They provide a first order test that BT has complied with their most important SMP obligations and they enable other Communications Providers to investigate areas where they have concerns. The availability of high quality regulatory accounts is now more important than ever and even in cases where deregulation has occurred at a geographic or product level, BT's regulatory accounting output has an important role to play in any future ex-post investigations, providing verification and an obvious source to sanity check data in cases where assets and resources can be shared between regulated and unregulated services.

UKCTA is keen supporter of any Ofcom initiative to improve the quality of BT's regulatory reporting; however it is apparent that confidence in the regulatory accounting process for UK telecoms is at an all time low following BT's unprecedented restatement of prior year numbers. The restatement occurred with no prior warning, this is despite the fact that BT's regulatory accounts were signed off by an independent auditor and Ofcom had access to far more information than is actually published.

The circumstances of the restatement are also a cause for concern as it is evident that BT only took the action to restate its accounts when it was about to be investigated by Ofcom for alleged overcharging. If confidence is to be restored we need BT to take its regulatory accounting obligations seriously and devote sufficient resource to being able to properly fulfil its obligations in this area. It is our belief that Regulatory Accounting hasn't been given a high enough priority within BT and as a result it has suffered from a lack of investment in the resources required to gather accurate information.

We therefore welcome Ofcom's proposal to conduct a "clean sheet" reassessment of the regulatory reporting framework for BT. We will work with Ofcom to help shape that framework as UKCTA members are uniquely placed to comment on the many shortcomings of the current system and are able to propose improvements that will benefit the entire industry and ultimately UK Consumers and Business users. What is clear at this stage is that a radical change is required to both the format of the regulatory statements and the culture, values and incentives of the organisation preparing the accounts. We look forward with interest to the publication of the consultation in the summer.

The remainder of this response will focus on some of the issues highlighted in the current consultation.

Cost Matching

We welcome Ofcom's recognition of the fact that the existence of non-matched items presents the RFS user community with considerable problems when trying to make practical use of the accounts. Given the primary purpose of the accounts is to help provide the transparency required to assist users in determining if BT has met its regulatory obligations it would be unsatisfactory if the current arrangement was to continue.

We acknowledge the difficulties BT feel they are presented with in making any changes to the status quo but feel that under investment in the regulatory accounts over the years has contributed to the problem. It is telling that this issue is only being rectified through the formal regulatory process. It would have been far better had BT brought this obvious shortcoming to the attention of stakeholders and Ofcom so that a solution could have been found in a collaborative way, however the current framework provides BT with no incentive to make the regulatory accounts easy to follow, indeed quite the opposite is true.

In respect of the options presented we believe that the solution that delivers the most usable and straightforward regulatory accounting information should be selected. With this regard we believe that Option 1 gives user with the most intelligible set of Regulatory Financial Statements.

Consistent reporting of RFS units against BT price lists

We believe Ofcom's proposal to ensure consistent treatment for each service unit reported in the RFS and Carrier Price list is long overdue. The current situation where Carrier List Price list entries and the RFS units don't reconcile is unsatisfactory and detracts from the usability of the accounts. It also presents problems when BT is pricing services near the boundaries of compliance. UKCTA therefore fully supports this Ofcom initiative to ensure price units are consistent with the regulatory financial statements.

Getting information on Geographic Markets

The advent of geographic deregulation for BT products represents a significant challenge for Ofcom, both in terms of regulatory reporting and future investigations and enforcement. If accounting separation obligations fall away as services are deregulated the regulatory accounts will start to resemble a block of Swiss cheese. Unless BT has the correct incentives then common costs which are shared between regulated and deregulated products may be unfairly attributed against just the regulated products. Such arrangements are unlikely to come to the attention of either

stakeholders or Ofcom unless a more suitable way is found to tackle the challenge that deregulation brings. The investigations team at Ofcom will also face a step increase in the complexity level of future investigations and given the length of time taken to complete some of the investigations which have occurred since Ofcom's inception we feel the Investigation Team in its current form is ill placed to cope. If Ofcom is to rely on ex-post remedies then the industry needs to have the confidence in Ofcom's ability as a competition authority and this must start with Ofcom's ability to gain access to reliable cost data.

While we welcome Ofcom's proposed approach to assume national costs even in broadband market three we believe a much longer term approach to this issue is required. We hope this issue can be addressed in a more strategic way in Ofcom's summer 'clean sheet' consultation.

Requirement to publish the reconciliation with the General Ledger

We are very disappointed that Ofcom have not proposed that BT publish the reconciliation statement which shows the difference between the total revenue in the General Ledger and the calculated service by service revenue for the each of the markets covered by the replicability review. Stakeholders need to see this information. By not requiring this information to be published Ofcom are limiting the value of the regulatory financial statements and significantly reducing the benefit of it being prepared in the first place, as only BT and Ofcom will know why the numbers in the RFS are deficient / inaccurate.

We view the publication of this information as necessary for BT to meet its obligation for accounting separation. With confidence in the regulatory accounting process so low and Ofcom not having been in a position previously to identify any issues early to prevent inaccurate and subsequently restated accounts being published, we are not able to place our trust in Ofcom to perform this task our behalf. Stakeholders require sight of this information. As these are SMP products we don't think confidentiality concerns are relevant. Even if BT has very specific confidentially concerns (and

Ofcom subsequently adjudge these concerns to be valid) then any sensitive information could be redacted from the published version of the reconciliation.

LUS Costs within Openreach

Despite the numerous improvements made to the regulatory financial reports over recent years, BT still retain a significant amount of discretion which allows them to apportion costs in a way that is sympathetic to their own business. The case of LUS costs is a clear example where BT has deliberately set out to manipulate the RFS to ensure that Openreach's costs are artificially inflated, while at the same time reducing the cost base for non-regulated services. It is only through Ofcom dialogue with BT and questions raised by industry stakeholders that these issues ever come to light. These examples erode confidence in the regulatory accounting process and leave us wondering how many other similar practices go undetected within BT's RFS allocations.

In many cases the numbers may be small when viewed in the context of individual cost lines at aggregate level, but cumulatively these can add up to a great deal of money. We hope that in the forthcoming "clean sheet" consultation Ofcom will begin to start addressing the cultural and incentive distortions that exist within BT that contribute to this problem. In the meantime we endorse Ofcom's proposals to require BT to remove the costs of the low user scheme from the Openreach entity as reported in the RFS.

Regulatory Reporting for New Services

We note with concern the issue whereby BT are not required to report separately for new products even when the revenue and associated costs is expected to be above the £10M material threshold in any given year. It is not acceptable for BT to fail to report separately for these often important and fast growing products just because they haven't implemented the correct reporting mechanism.

BT is well aware both of the forecast revenue for any given product in any particular year and its regulatory accounting obligations. BT should take action to ensure that the regulatory accounting process within BT is linked in the product launch cycle to ensure separate costs are captured from day one. UKCTA would ask Ofcom to rigorously enforce the separate reporting obligation for any new product where the costs and associated revenue in any given year exceed £10M. Where BT misses the deadline to include separate reporting for inclusion in the RFS, they should be required to publish a separate, comprehensive standalone report for the product within 60 days. With new services being introduced every few months it is important that BT takes its obligations seriously.

We strongly object to any attempt to remove the reporting for Point of Handover costs (these are material charges and only levied on interconnected operators) and anything that would reduce our understanding of Operator Assistance costs, as a result of the NTS regime alternative providers are compelled to contribute to BT's Operator Assistance costs and full visibility of these costs is still required.

Q & A

In the following section, UKCTA responds to the specific questions (1 – 12) 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.

As stated above, in respect of the options presented we believe that the solution that delivers the most usable and straightforward regulatory accounting information should be selected. With this regard we believe that Option 1 gives users the most intelligible set of Regulatory Financial Statements.

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?

We support Ofcom's proposal to require BT to separately identify and report the costs of OSPs, resilience and third party equipment charges. Under investment by BT in the systems required to prepare the regulatory accounts is not an excuse for not producing this detail. BT should be required to take its regulatory accounting obligations seriously and produce this detail as part of the RFS.

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?

We have significant concerns over the accuracy of the cost information for points of handover and also the appropriateness of any allocation of that cost to all external local ends. Modern PPC in span handovers drive very little overhead whereas some legacy handovers installed as retail circuits may drive more significant overheads. As a result Ofcom should not ask BT to allocate point of handover costs to external local ends until an appropriate allocation method is defined. In the interim the most sensible approach is to ensure that the level of these costs is made clear within the technical area – point of handover statements.

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, we support Ofcom's proposal to require BT to produce and publish details of the cost stacks underlying PPC services and technical areas. This information is long overdue and while BT may protest that this information is difficult to extract, we don't believe Ofcom should be deterred from enforcing it. As an organisation we do not believe that BT have taken their regulatory accounting obligation seriously and have not given their production a sufficient level of priority. Their failure to invest in the necessary systems to capture this data with ease should not be rewarded and Ofcom should insist that BT devotes whatever resources are required to collecting and publishing this information.

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?

We believe Ofcom have not gone far enough as this information should not only be prepared it should also be published and made available to all stakeholders. Stakeholders need to see this information. By not requiring this information to be published Ofcom are limiting the value of the regulatory financial statements and significantly reducing the benefit of it being prepared in the first place, as only BT and Ofcom will know why the numbers in the RFS are deficient / inaccurate.

Even if BT has very specific confidentially concerns (and Ofcom subsequently adjudge these concerns to be valid) then any sensitive information could be redacted from the published version of the reconciliation.

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 where Carrier List Price list entries and the RFS units don't reconcile is unsatisfactory and detracts from the usability of the accounts. UKCTA therefore fully supports this Ofcom initiative to ensure price units are consistent with the regulatory financial statements.

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

We would support Ofcom's proposed approach as a way of dealing with the issue in the short term, however we believe a much longer term approach to this issue is required. We hope this issue can be addressed in a more strategic way in Ofcom's summer 'clean sheet' consultation.

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

Please refer to individual UKCTA members responses.

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?

We support the proposals set out by Ofcom, however where geographic deregulation has occurred and in cases where common resources are shared between regulated and unregulated products then this raises many new cost attribution questions for BT. As such we believe this issue is worthy of greater consideration and should be reviewed as part of Ofcom forthcoming 'clean sheet' review.

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?

Please refer to individual UKCTA members responses.

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 no objection to the removal of residential IDD or ISDN 2 reporting, however we have concerns relating to any attempt by BT to take out information relating to Point of Handover (as this cost is currently borne exclusively by interconnecting operators). We would also raise objections to any moves that reduced our understanding of how BT's operator assistance costs are derived. As a result of the NTS regime alternative providers are compelled to contribute to BT's Operator Assistance costs and full visibility of these costs is still required.

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