



Proposed changes to BT's regulatory financial reporting framework

Consultation

Closing Date for Responses: 23 June 2005

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Section 1

Summary

Scope of this document

1.1 This document sets out Ofcom's proposals to amend some of BT's regulatory financial reporting and audit requirements as set out in "The regulatory financial reporting obligations on BT and Kingston Communications" issued in July 2004 (the "2004 Statement"). These are expected to take effect in relation to the year ended 31 March 2005.

Summary of proposals

1.2 The proposals fall into four categories:

- the introduction of a significant new layer of regulatory financial information provided to Ofcom by BT;
- the enhancement of certain aspects of the 2004 Statement as it relates to BT;
- certain "housekeeping" amendments to the 2004 Statement as it relates to BT; and
- a limited relaxation on the reporting and audit requirements set out in the 2004 Statement in recognition of the new layer of information being made available by BT to Ofcom.

1.3 These proposals are being made following detailed and constructive discussions with BT and with BT's regulatory auditor, PricewaterhouseCoopers LLP ("PwC") within the tri-partite regime that was put in place by the 2004 Statement.

A new layer of regulatory financial reporting

1.4 The primary focus of the 2004 Statement was to establish an ex ante financial reporting regime in compliance with the five EC Communications Directives. In summary this regime requires BT to demonstrate its compliance with cost-orientation and non-discrimination obligations and to have an appropriate regulatory financial reporting system to support the information requirements of the regulator in setting and monitoring the effectiveness of price controls.

1.5 Ofcom's operational use of regulatory financial information covers a variety of purposes such as investigating allegations of margin squeeze or of other potentially anti-competitive behaviour and for setting policy. For these purposes the regulatory financial statements prepared by BT have been less relevant, often because they have been prepared and audited at a less granular level than is required for the purposes of an investigation to ensure compliance with ex ante conditions. The information requirements have therefore typically been met by an iterative process of information requests which is slow and can give rise to misunderstandings

1.6 Ofcom believes that it would be infeasible and disproportionate to attempt to revise the 2004 Statement such that financial information received was capable of dealing with any investigation or policy review. Instead Ofcom has agreed with BT that BT will supply a complete set of financial data from its regulatory accounting systems, such that profit and loss accounts and balance sheets for product groups (as set out

in BT's product and service catalogues) can be re-created and analysed down to summary cost codes. Ofcom understands that a similar data set is used in the scoping of the external regulatory audit.

Enhancements

- 1.7 At the time of the 2004 Statement, one aspect of the reporting regime was continuing to be developed. The network component list sets out the building blocks that are used to compile the detailed financial statements and is a key element to the ability to demonstrate non-discrimination and cost orientation. This list has continued to be enhanced in collaboration with BT, with particular focus since the date of the 2004 Statement on the copper access network. Ofcom therefore proposes to update the network component list to reflect this work and to continue to work with BT to address other existing and emerging areas where greater transparency is required.

Housekeeping amendments

- 1.8 In the course of working through with BT the detailed application of the 2004 Statement, a number of practical implementation issues have been identified requiring modifications to current Directions. These include the degree to which, in the first year of application, comparative information can be restated and covered by the audit opinion without disproportionate cost. Ofcom also proposes other amendments to rationalise the form and content of the reported financial statements to take account of materiality issues and improved presentation.

Relaxation of obligations

- 1.9 The 2004 Statement was set in the context of no other ex ante financial information being available to Ofcom. As such the degree of granularity of financial reporting and of the level of audit was set so as to achieve the highest proportionate level of assurance over the relevant products and markets. The introduction of the new layer of financial reporting allows Ofcom to reassess those proportionality considerations.
- 1.10 As a result Ofcom is proposing to relax a number of obligations by reducing the audit and publication requirement of certain statements. That proposal would be made on the basis that the new arrangements form an effective and more efficient alternative to the current arrangements. Ofcom will gauge whether this has been the case when the new arrangements are fully implemented.

Existing powers to gather information are unaffected

- 1.11 The information BT will provide may be used for a variety of regulatory purposes for which Ofcom might also elect to use its formal powers in relation to information gathering under, for example, the Communications Act. Nothing in these arrangements constitutes a waiver or commitment not to use those powers in any particular case or policy review.

Proposed changes do not affect Kingston

- 1.12 Ofcom is not currently reviewing Kingston Communication Ltd's ("KCL") regulatory financial obligations as there has been no practical or implementation issues raised relating to the detailed application of KCL's obligations requiring formal amendments to the 2004 Statement. KCL's obligations also reflect and are proportional to its size and complexity relative to BT.

Conclusion

- 1.13 Ofcom is encouraged by the spirit of co-operation it has received from BT in looking at better ways of allowing Ofcom to perform its role. Taken together these proposals are expected to create a significant step forward in financial transparency while at the same time addressing BT's concerns relating to the incremental cost burden of regulatory financial reporting. If successfully implemented Ofcom will consider further areas for improvement.

Section 2

Introduction

The regulatory regime

- 2.1 The current regulatory framework for electronic communications networks and services entered into force on 25 July 2003. The framework is designed to create harmonised regulation across Europe and is aimed at reducing entry barriers and fostering prospects for effective competition to the benefit of consumers. The basis for the current regulatory framework is five EC Communications Directives:
- Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services (the "Framework Directive");
 - Directive 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities (the "Access Directive");
 - Directive 2002/20/EC on the authorisation of electronic communications networks and services (the "Authorisation Directive");
 - Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services (the "Universal Service Directive") and;
 - Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector (the "Privacy Directive").
- 2.2 The Framework Directive provides the overall structure for the current regulatory regime and sets out fundamental rules and objectives which read across all the new directives. The Authorisation Directive establishes a new system whereby any person will be generally authorised to provide electronic communications services and/or networks without prior approval. The general authorisation replaced the former licensing regime. The Universal Service Directive defines a basic set of services that must be provided to end-users. The Access Directive sets out the terms on which providers may access each others' networks and services with a view to providing publicly available electronic communications services. These four Directives were implemented in the UK on 25 July 2003. This was achieved via the Communications Act 2003 (the "Act"). The fifth Directive on Privacy establishes users' rights with regard to the privacy of their communications. This Directive was adopted slightly later than the other four Directives and was implemented by regulations which came into force on 11 December 2003.
- 2.3 The Act provides for functions, powers and duties to be carried out by Ofcom which include, inter alia, functions, powers and duties flowing from the first four EC Communications Directives referred to above.

Powers that Ofcom holds under the Act

- 2.4 The Act identifies three types of regulatory financial reporting obligations that Ofcom can impose on dominant providers. These are:
- wholesale cost accounting;
 - retail cost accounting; and

- accounting separation.
- 2.5 These obligations were described in some detail in paragraphs 2.16 to 2.19 of the 2004 Statement and will not be described again here.
- 2.6 It should be noted that the powers to impose these regulatory financial reporting obligations are subject to certain limitations.

Communication Act tests

- 2.7 As discussed in paragraph 2.6 Ofcom's powers are subject to certain limitations in that Ofcom must satisfy certain tests.

Tests that must be met

- 2.8 Section 3 of the Act sets out the general duties of Ofcom. Ofcom is required by this section to carry out its functions in line with these duties.
- 2.9 Section 4 of the Act requires Ofcom to act in accordance with the six European Community requirements of Article 8 of the Framework Directive for regulation. In summary these requirements are to:
- promote competition in the provision of electronic communications networks and services, associated facilities and the supply of directories;
 - contribute to the development of the European internal market;
 - promote the interests of all persons who are citizens of the European Union;
 - not favour one form of or means of providing electronic communications networks or services, i.e. to be technologically neutral;
 - to encourage the provision of network access and service interoperability for the purpose of securing:
 - efficient and sustainable competition; and
 - the maximum benefit for customers of communications providers;
 - encourage compliance with certain standards in order to facilitate service interoperability and secure freedom of choice for the customers of communications providers.
- 2.10 Section 49 of the Act require Ofcom to ensure that any condition it sets or direction it gives 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.
- 2.11 In paragraphs 4.88 to 4.91 of the 2004 Statement Ofcom set out how it had complied with these and other tests. Ofcom is now proposing amendments to certain directions under the conditions which are already in place.

The need for new regulatory financial reporting information

- 2.12 Regulatory financial information is fundamental to the economic regulation of the electronic communications sector and in particular to many of the decisions of Ofcom.
- 2.13 The need for regulatory financial reporting information was discussed in detail in paragraphs 2.22 to 2.26 of the 2004 Statement and will not be repeated here. However it is important to stress that such financial information needs to be provided in a timely manner, be of high quality, prepared to high standards and be relevant to the task at hand.
- 2.14 To this end the supply by BT of a complete set of financial data such that profit and loss accounts and the mean capital employed statements for a product group (the most detailed level of cost analysis prepared by BT) can be re-created and analysed down to summary cost category codes, will greatly assist Ofcom in, for example, planning and carrying out its initial analysis on investigations and policy projects, and monitoring the effectiveness of price controls.
- 2.15 In addition, certain enhancements to current obligations (such as the revision of the Component List) will improve the quality and transparency available to Ofcom, the industry and stakeholders.

The need for further amendments to existing Directions

- 2.16 Although Ofcom stresses the need for good quality financial information from dominant providers, it is also aware of the need for such information requirements not to create an unnecessary and disproportionate burden either to the providers or users of such information.
- 2.17 To this end Ofcom is proposing some amendments and relaxations to BT's financial reporting obligations as set out in the 2004 Statement.

Proposed changes do not affect Kingston

- 2.18 Ofcom is not currently reviewing Kingston Communication Ltd's ("KCL") regulatory financial obligations as there has been no practical or implementation issues raised relating to the detailed application of KCL's obligations requiring formal amendments to the 2004 Statement. KCL's obligations also reflect and are proportional to its size and complexity relative to BT.

Cost benefit analysis

- 2.19 Ofcom conducted a cost benefit analysis of the financial reporting obligations in paragraphs 2.27 to 2.30 of the 2004 Statement. Ofcom, at the time, recognised that one of the primary purposes of regulatory financial reporting obligations is to prevent the occurrence of anti-competitive practices and many of the benefits can be difficult to quantify. The benefits for the industry at large, Ofcom and BT respectively are discussed in the paragraphs below.

Benefits to the industry and citizen-consumers

- 2.20 Ofcom believes the benefits of having a rigorous and effective regulatory financial reporting regime will accrue to all parts of the industry:
- non-dominant communications providers have assurance that Ofcom has information to monitor and if necessary enforce obligations for non discrimination, cost-orientation, etc;
 - non-dominant communications providers have greater assurance that prices charged to them by dominant providers are cost-oriented and/or nondiscriminatory enabling them to produce business plans and compete more effectively;
 - disputes and investigations will be resolved more quickly, efficiently and on the basis of more reliable information;
 - competition in the UK communications sector is protected and supported providing benefits for the UK economy as a whole; and
 - citizen/consumers are protected from excessive prices in retail SMP markets.

Benefits to BT

- 2.21 As noted in paragraph 2.28 of the 2004 Statement BT estimates that it incurs incremental compliance costs (including external audit) of £7m annually. BT has also commented that the implementation of all of the various changes and additional reporting required by the 2004 Statement as compared to the previous reporting regime would add to this cost.
- 2.22 These additional costs would arise in respect of audit fees and in preparation time, which together BT estimates would be significant and certainly in excess of £1m. Further, the time required to compile the financial statements themselves would considerably extend the timetable for preparation and audit. As a result of the amendments proposed in this consultation, BT has noted that no such additional costs would be incurred and that, in addition, savings should be achievable for the 2005/06 reporting cycle when the impact of the proposals can be fully planned for as part of the preparation process.

Structure of this document

- 2.23 This consultation document is structured in four main sections:
- Section 3 discusses the introduction of a significant new layer of regulatory financial information;
 - Section 4 discusses enhancements which affect Direction 1;
 - Section 5 discusses amendments and relaxation of reporting obligations which affect Direction 3; and
 - Section 6 discusses amendments and relaxation of reporting obligations which affect Direction 4.

Section 3

A new layer of regulatory financial reporting

Introduction

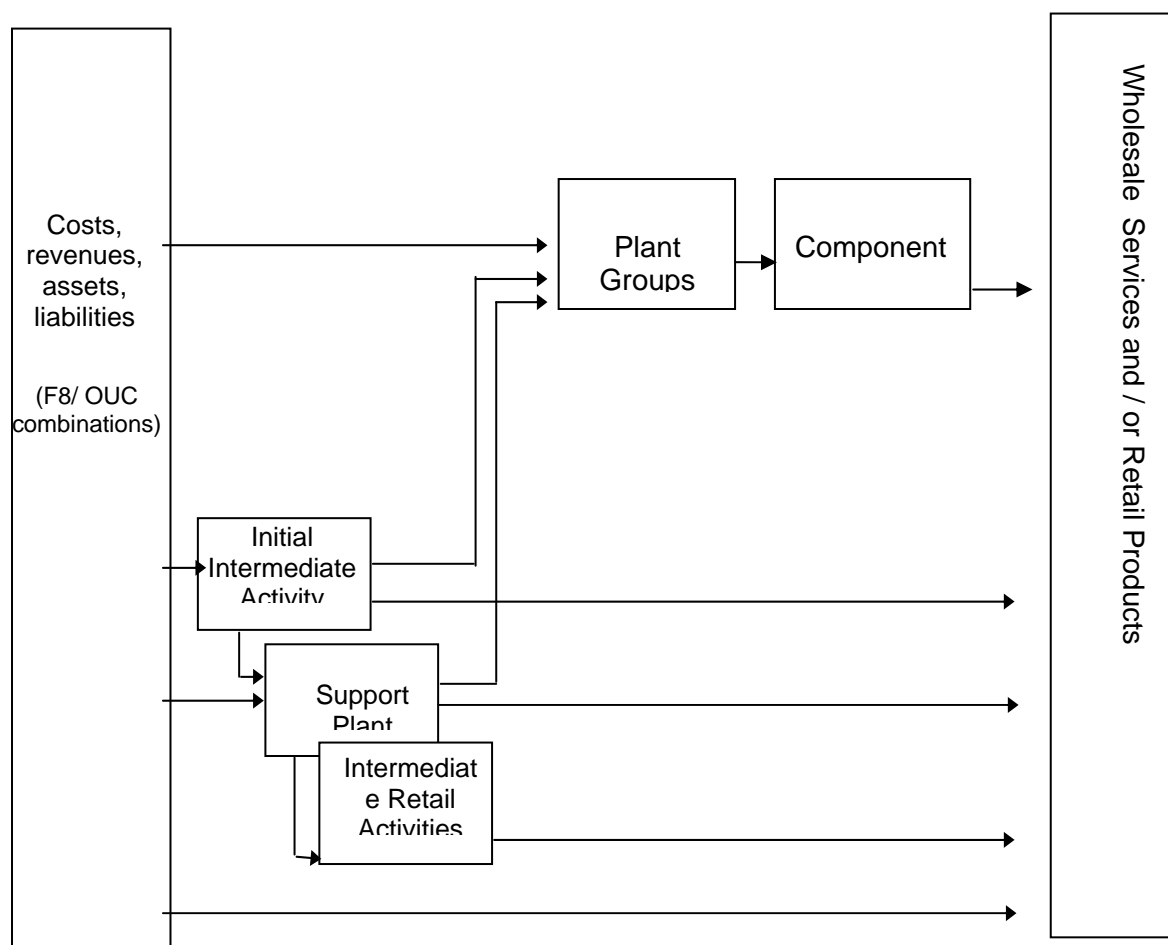
- 3.1 The primary focus of the 2004 Statement was to establish an ex ante financial reporting regime in compliance with the five EC Communications Directives. Ofcom's operational use of regulatory financial information however covers a variety of purposes such as investigating allegations of margin squeeze or of other potentially anti-competitive behaviour and for setting policy. The regulatory financial statements prepared by BT have been less relevant for such investigations, often because they have been prepared and audited to a lower level of granularity than is required for the purposes of an investigation. The information requirements have therefore typically been met by an iterative process of information requests which can be inefficient and may require supplementary validation processes.
- 3.2 Ofcom has now agreed with BT that BT will supply a complete set of financial data from its regulatory accounting systems, such that profit and loss accounts and balance sheets for product groups (as set out in BT's product and service catalogues) can be re-created and analysed down to summary cost codes. Ofcom understands that a similar data set is used to determine the coverage of the external audit.
- 3.3 Ofcom is also investigating other improvements to BT's financial regulatory information and will be consulting on these in due course.

What is the proposal?

- 3.4 To facilitate the external audit, BT prepares a "data file" that shows how the general ledger records flow through the regulatory Fully Allocated Cost ("FAC") costing system into individual product groups and components. This file includes the detailed path of all revenues, costs, assets and liabilities (including current cost accounting adjustments) through the BT costing models from starting cost group (F8 code) to final product group or network component. There are also several other sources of information which form elements of the regulatory reporting regime already imposed on BT available to help us interpret the detailed information. Examples include:
- the Detailed Attribution Methods ("DAM") which describes the individual stages of the cost cascade, referencing the attribution bases for individual activities and plant groups at each stage;
 - the wholesale and retail catalogues which describe the services and products in each of the SMP markets subject to regulatory reporting; and
 - the published regulatory financial statements which contain usage factors for each regulated wholesale service.

An example of how this works in practice is shown in Figure 1 below.

Figure 1
Processing levels that can be interrogated through the data file (cost basis is Current Cost Accounting ("CCA") Fully Allocated Costs ("FAC"))



3.5 The data file is a simple parsed text file showing the value attributed to each cost item against a particular product group or component. By importing this data into a powerful database tool it will be possible to manipulate and report on the data at different levels in the costing structure.

3.6 Ofcom and BT are continuing to discuss the precise form and content of the data file and the nature of the audit assurance to be provided on the file.

Advantages

3.7 There are a number of advantages associated with the provision of this additional layer of information where Ofcom will have:

- access to the same financial information as BT's auditors use to determine their audit samples which can then be used, for example, to support the initial planning and analysis required for an investigation or policy project;
- the necessary information on a timely-basis, in the required formats and of good quality; and

- access to full BT costing system data which will help Ofcom analyse and assess the objectivity and rationale of BT's costing.

Amendments to Directions and Annexes

- 3.8 BT currently has no legal obligation to provide this additional layer of regulatory financial information as part of the 2004 Statement. Ofcom therefore propose to amend Annex 42 to Direction 4 and ensure that this information is established as an Additional Financial Information (AFI) BT has to provide Ofcom under the SMP reporting obligations (see Section 6 for more details).

Section 4

Proposals affecting Direction 1

Introduction

- 4.1 Direction 1 operates in conjunction with BT's SMP regulatory reporting conditions in so far as they relate to wholesale markets. The Annex to Direction 1 specifies a list of components, currently 70 in number, against which BT must report its costs for each of its wholesale markets subject to a regulatory financial reporting remedy.
- 4.2 In finalising the new regulatory reporting framework for BT, Ofcom signalled that it would be necessary for it to carry out a rigorous review¹ of BT's network components and that further updates would be needed to the list of components on a regular basis².
- 4.3 'Network components' is the term used to describe the various assets (or groups of assets) and activities that make up the wholesale inputs that are consumed or used in the provision of regulated wholesale services. The scope of any individual component will also include any associated operating activities undertaken in the provision of these wholesale inputs.
- 4.4 Ofcom has imposed one or more remedies for each economic market in which it found BT to have SMP. These remedies often include cost orientation and non-discrimination obligations operating at individual service and product level. In order that an informed assessment can be made as to whether BT is complying with these obligations in respect of wholesale services it is necessary to have some mechanism for monitoring compliance. Network components are essential to demonstrating compliance with both cost orientation and non-discrimination obligations as they:
- enable costs to be objectively attributed to services on a causal basis;
 - facilitate transparency of the costing process; and
 - avoid the risk of elements not required by the purchaser being bundled into services.
- 4.5 As a result of review work already completed Ofcom is proposing a revised list which, among other things, recognises improvements to the previously directed list in respect of BT's copper access network. These proposals would enable BT to demonstrate with significantly enhanced transparency within its 2004/05 regulatory financial statements whether:
- its regulated copper-based access products such as WLR and LLU are cost-orientated; and
 - such services have been costed at the component level on an equivalent basis to related services.

¹ http://www.ofcom.org.uk/consult/condocs/fin_reporting/financial_rep/financial_rep.pdf, para 7.35.

² http://www.ofcom.org.uk/consult/condocs/fin_reporting/fin_report_statement/finance_report.pdf, para 3.27.

- 4.6 Ofcom recognises that the process of updating and amending component lists is ongoing as technologies and regulatory obligations change. For example it is envisaged that the component list will require changes resulting from BT's implementation of next generation networks over the next few years. We will continue to work closely with BT on its network component list this year with the aim of proposing further improvements in advance of the 2005/06 reporting year.

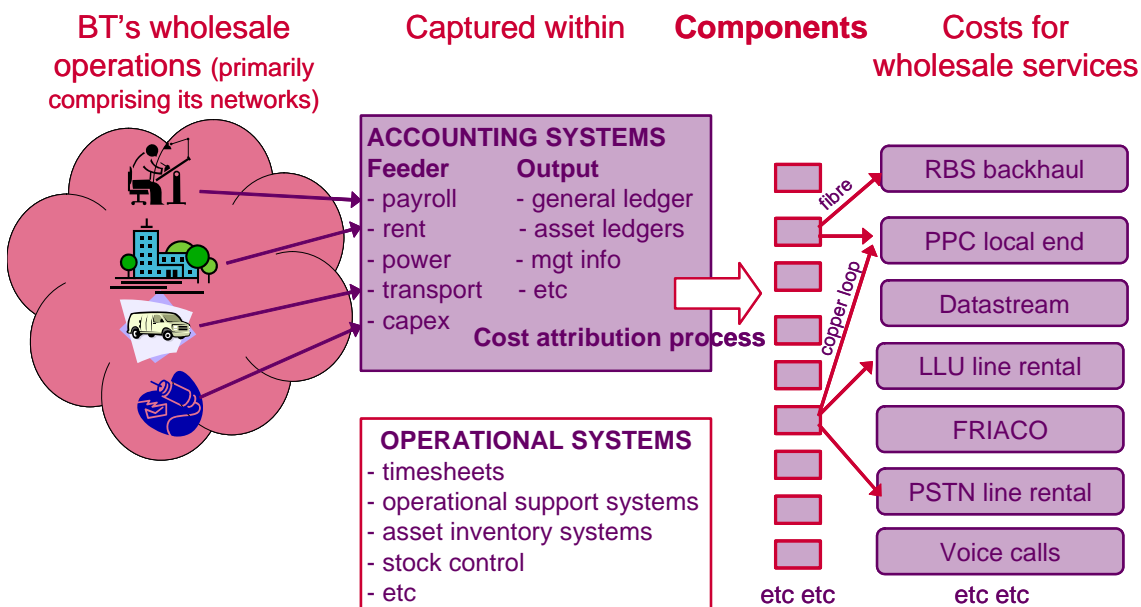
Background

- 4.7 BT utilises, amongst other things, a number of different technologies, platforms and infrastructures in providing a range of wholesale services. Elements of these technologies, platforms and infrastructures are used in the provision of any one service, with many of the same elements being used in the provision of different services.
- 4.8 In view of the nature of the complex interrelationships between these technologies, platforms and infrastructures there needs to be a mechanism which both allows Ofcom to assess whether or not BT is objectively demonstrating compliance with its non-discrimination and cost orientation obligations and other operators to be confident that they are not being compelled to purchase elements of service they do not require. Network components, appropriately defined and costed, provide the base for that mechanism.
- 4.9 The first list of network components was agreed between Oftel and BT in 1995 as part of the introduction of a CCA regulatory reporting framework for BT. The scope of regulatory reporting extended to the whole of BT's activities with BT's Network Business, the regulatory business construct which captured all of BT's wholesale telecoms operations, comprising the directed list of network components. The primary focus at the time was on identifying the components necessary for BT to demonstrate transparently whether its price controlled network charge control services were cost-orientated and, where required, priced on an equivalent basis. Less attention was given at the time to components in respect of BT's other wholesale telecoms services.
- 4.10 Since 1995 the scope of regulated wholesale services has extended considerably (to include, for example, partial private circuits ("PPCs"), local loop unbundling ("LLU") and wholesale line rental ("WLR")). BT did update the list of components against which it reported in its regulatory financial statements during this time to take account of some of these regulatory and technical changes but Ofcom believes that these changes are not sufficient to comply fully with its obligations.
- 4.11 As a result the directed list and the list of components against which BT in practice reported in its regulatory financial statements were not necessarily able to fulfil their primary objective in respect of these newly mandated wholesale services. In particular BT developed many service specific 'components' which did not transparently show whether services were costed objectively vis a vis other similar services and whether the basis on which BT provided wholesale services to its downstream activities for regulatory reporting purposes was equivalent at the component level to the prices paid by BT's competitors for the same or similar services. The review of the component list has taken into account additional detail available from BT's systems and processes in relation to its copper access network.

Network Components and their key characteristics

- 4.12 Network components provide the basis which allows BT to breakdown the cost of its wholesale operations into a number of elements which then allows it to cost its regulated services in a transparently objective and cost-causal way.
- 4.13 BT provides wholesale services, both regulated and non-regulated, over a number of core and access networks, for example, its copper access network and its PSTN core transmission network. Each individual network may support a number of different wholesale services and, furthermore, individual services provided to a particular customer may be conveyed on more than one network. The distinct physical and logical networks themselves typically draw on common elements such as transmission fibre and equipment for a core network and copper loops and network terminating equipment for an access network. It is this layer of analysis, below that of individual wholesale services, which network components are designed to represent.
- 4.14 Figure 2 shows how financial accounting systems, together with relevant operational information, can be combined to identify the costs of network components. The illustration also shows at a very high level how costs for local access components flow to a number of different regulated, and potentially unregulated, wholesale services on the basis of usage.
- 4.15 BT incurs, for example, payroll costs in respect of maintenance personnel, capital expenditure to lay new duct and cables, accommodation costs to house network equipment and transport costs when maintaining its networks. These costs are captured within its accounting systems. Using additional information obtained from its operational systems, for example timesheets for maintenance personnel and asset inventory systems in respect of its capital assets, it is possible for BT to attribute all relevant costs to, say, copper loop components. As a result the cost of a copper loop can be then attributed to all relevant services in a transparent manner.

Figure 2: Costing of services via network components



- 4.16 When components have been clearly identified the next stage is to prepare total operating costs, mean capital employed and associated volumes for each one. Figure 3 shows an example based on BT's latest set of regulatory financial statements³ relating to its PSTN call conveyance network components. In this example the local exchange concentrator component has total CCA operating costs of £146m and mean capital employed of £419m. A rate of return of 13.5% has been applied to the mean capital employed to derive capital costs for the year of £57m (= 13.5% times £419m). These operating costs (£146m) and capital costs (£57m) are added together to derive total costs of £203m. In summary BT supplied 395,497 million minutes worth of local exchange concentrator activity at a cost of £203m in 2003/04. From this information it is possible to derive unit costs for each component.

Figure 3: Total component costs and volumes

BT Network

STATEMENT OF COSTS ON A CURRENT COST BASIS

for the year ended 31 March 2004

Network components	HCA operating costs £m	CCA net adjs £m	Total CCA operating costs £m	CCA mean capital employed £m	Applicable rate of return on capital %	Capital costs £m	Total of operating & capital costs £m	Volumes million minutes	Average cost per minute pence
Local exchange concentrator	160	(14)	146	419	13.5	57	203	395,497	0.051
Local exchange processor	192	(13)	179	473	13.5	64	243	389,915	0.063
Main exchange switching	105	21	126	186	13.5	25	151	235,788	0.064
Remote - local transmission link	55	(3)	52	101	13.5	14	66	311,882	0.021
Remote - local transmission length	50	3	53	378	13.5	51	104	549,955	0.019
Local - tandem transmission link	33	(1)	32	66	13.5	9	41	168,799	0.024
Local - tandem transmission length	20	-	20	150	13.5	20	40	634,643	0.006
Inter - tandem transmission link	25	-	25	56	13.5	8	33	68,686	0.046
Inter - tandem transmission length	17	-	17	123	13.5	17	34	919,587	0.004
Product management, policy & planning	28	-	28	28	13.5	4	32	277,971	0.011

- 4.17 The unit costs for each network component can then be used to cost (including a return on capital employed) BT's regulated wholesale services in an objective and transparent manner, with any differences in the extent to which individual services might consume any particular component being explained by usage factors. A worked illustration of this principle is given in Figure 4 below and an example based on information disclosed in BT's regulatory financial statements³ in Figure 5.

³ See information on Ofcom's use of audited regulatory financial information, and the duty of care of the auditor, at http://www.ofcom.org.uk/consultations/past/fin_reporting/pwc_.doc.

Figure 4: Costing individual services using components

Components	C ₁	C ₂	C ₃	C ₄	C ₅	C ₆	Total cost
Unit cost	5	10	3	8	5	20	
Usage factors							
Service 1	1.0	1.0	1.0	1.0	1.0	1.0	51
Service 2	1.0	1.0	1.0	1.0	1.0	-	31
Service 3	1.0	2.0	1.0	1.0	0.8	-	40
Service 4	-	-	1.0	1.0	2.0	-	21
Service 5	1.0	-	-	2.0	-	-	21

4.18 In Figure 4 the top line of figures provides the unit costs for each component ascertained by dividing total costs by total volumes for that component. Below this is given all the usage factors relevant to each service. For example service 4 uses 1.0 unit of component 3, 1.0 unit of component 4 and 2.0 units of component 5. To calculate the total service cost for service 4 we multiply the unit cost of each relevant component by its respective usage factor. Thus the total cost for service 4 would be 21 (i.e. 1.0 times unit cost of 3, 1.0 times unit cost of 8 and 2.0 times the unit cost of 5).

Figure 5: Practical example of costing regulated services

Statements of costs and charges for Standard Services
for the year ended 31 March 2004

	Local exchange concentrator	Local exchange processor	Remote - local transmission link	Remote - local transmission length	Emergency services	Floor	CCA fully allocated costs	Ceiling	Average charge for the year
Component floor 24 hour	0.035	0.060	0.019	0.013	0.004				
Fully allocated cost 24 hour	0.051	0.063	0.021	0.019	0.006				
Component ceiling 24 hour	0.078	0.096	0.035	0.067	0.010				
	ppm	ppm	ppm	ppm per 10km	ppm		ppm		ppm
	Usage Factors								
Call Termination Basket Call Termination Local Exchange Segment	1.000	1.000	0.783	1.324		0.128	0.155	0.289	0.201
Call Origination Basket Call Originating Local Exchange Segment	1.000	1.000	0.783	1.324	1.000	0.132	0.161	0.299	0.192

4.19 Figure 5 demonstrates how two similar but distinct services, wholesale PSTN call termination local exchange segment and call originating local exchange segment, are costed on an objective basis using network components and usage factors. For call

termination local exchange segment the three measures of component unit costs (A) are multiplied by the relevant usage factor (B) component by component to arrive at the same three measures of total component cost (C) for each regulated service. The provision of the average charge prevailing over the same period (D) allows an informed first order assessment to be made as to whether BT had been complying with its cost-orientation obligation over this period.

Network component identification principles

4.20 Ofcom has set out the approach described in paragraphs 4.12 to 4.19 in a set of network component principles or characteristics to guide the identification of the entire set of BT's network components at any particular time. Ofcom's current thinking on what these principles should be is as set out in the table below.

Table 1: Network component identification principles

Principle	Description of principle	Further comments
Granularity	Components should be specified at a level that allows utilisation of the same type of assets, groups of assets or activities by a number of different services to be identified.	This enables use of the same type of assets and activities by a number of different services to be made transparent.
Inclusion of all relevant costs	Components should include within their scope all assets, liabilities and activities directly and indirectly incurred in their supply.	For example as would be identified as a result of an activity-based costing ("ABC") exercise.
Unbundling	Components should be identified at a sufficiently granular level to exclude assets and activities not required in the provision of services utilising that component.	This supports the principle that purchasers of wholesale services should not be required to pay for elements of service they do not require.
Single objective cost driver	Components should have a single objective cost driver, a volume measure, which is used to attribute component costs onward to all relevant services on a consistent and causal basis. Such volume measures should be meaningful, measurable and capable of	The single objective cost driver used to drive component costs to services will not necessarily be the same as the drivers used to attribute costs to components in the first place as individual cost activities (e.g. accommodation) will be driven to components on the basis of that individual cost activity's driver (e.g. space

Principle	Description of principle	Further comments
	<p>being independently verified.</p>	<p>occupied).</p> <p>A common onward volume measure is not by itself a sufficient condition to amalgamate two or more components where the separate components are utilised by different services in such a way that cannot be handled by the appropriate application of usage factors.</p>
<p>Transparency of component utilisation through application of 'usage factors'</p>	<p>The varying extent to which a particular service may consume an individual network component should be indicated by the application of usage factors rather than the creation of separate components.</p> <p>Such usage factors should be meaningful, measurable and capable of being independently verified.</p>	
<p>Capability objectively to demonstrate equivalence of costing</p>	<p>Where two services are similar but not the same (as may be the case where, for example, one service is internally provided to downstream activities and the other to external parties) the difference(s) between the two services should be solely demonstrated through the application of usage factors to the appropriate components.</p>	<p>This principle supports the concept of 'equivalence' between SMP operators such as BT and other operators as it allows BT to demonstrate transparently and objectively that it has costed wholesale services sold to external parties on the same basis as the wholesale services provided to its own downstream activities.</p>
<p>Capability to demonstrate objective costing where there are variations in pricing structure</p>	<p>The same set of components should be capable of demonstrating compliance with regulatory obligations when there is more than one pricing structure for individual services.</p>	<p>This principle is designed to address the scenario where, for example, there are different permutations in the balance between up-front and ongoing charges in place for a particular service. For example with PPCs Altnets are required to pay up-front for capital</p>

Principle	Description of principle	Further comments
		equipment deployed at end-user premises whilst the 'rentals' basis of BT's equivalent transfer charges does not allow the reader to see whether BT is costing (and transfer pricing) these services to itself on an equivalent basis.
Specific regulatory need	Where there is a specific regulatory need to isolate the costs of certain activities (for example to facilitate a particular cost recovery treatment to be applied) a component should be created to capture the associated costs.	Examples of such requirements in the past have been LLU and CPS set up costs and Product Management, Policy and Planning ("PPP").
Practicality/proportionality	It should be practicable and proportionate to attribute relevant costs to all identified components and subsequently onwardly drive the attributed component costs to all relevant services in an objective manner.	It should be practical and proportionate to report both the profit and loss account costs and statement of mean capital employed in respect of each identified component.
Materiality	Separate components need not be identified where the inclusion of these assets or activities within other components would not materially affect the demonstration of compliance by SMP operators (including BT) of their regulatory obligations.	Materiality is the final test of whether a component should be identified. While the principles as described above should maximise the usefulness of the network components identified in demonstrating BT's compliance with its cost-orientation and non-discrimination obligations, the materiality principle asks whether each individual component so identified is of such significance to be required to demonstrate that compliance.

- 4.21 It is conceivable that conflicts may occasionally arise in applying these principles. In such circumstances a trade-off will need to be found that still enables the purpose of network components to be met. Should such conflicts occur Ofcom will apply these principles in such a way to identify components which, in its view, enable BT to demonstrate most effectively its compliance with its cost orientation and non-discrimination obligations.
- 4.22 Ofcom intends to apply these principles in future component reviews with BT so as to identify a comprehensive and consistent set of network components supporting all of those regulated wholesale services provided by BT subject to financial reporting obligations.

Question 1: Has Ofcom characterised the network component identification principles appropriately? Are there any other principles or considerations that are relevant when identifying components which enable BT to effectively demonstrate compliance with its regulatory obligations?

Proposed changes to the network component list and rationale

Introduction

- 4.23 Ofcom has been in discussion with BT since the 2004 Statement to develop a revised list of components. A series of principles or characteristics has been developed as set out in paragraph 4.20 to guide component identification. The focus in this time has been on developing a set of components for BT's copper access network for two reasons. Firstly, it is by far the most financially significant element of BT's network operations for which only minimal component breakdown has in the past been prepared or published. Secondly, BT's local copper access network has been the subject of intense regulatory interest over the past year both in connection with specific wholesale service markets (e.g. WLR) and more general assessments of the role of that network as a long-term source of market power within the TSR. This makes increased transparency in this area of costing highly relevant.
- 4.24 Ofcom has made other changes in recognition of the fact that the proposals as originally put to Ofcom by BT represent an improvement on the existing list. Many of these components will require further review in the coming year to ensure that the relevant component identification principles have been appropriately met.
- 4.25 Annex A to the proposed direction set out in Annex 4 sets out the complete proposed list of components, separately identifying additions and deletions from the previous directed list. Annex 5 provides the link, in respect of additions to the component list, to descriptions either already contained in the latest Detailed Attribution Methods⁴ or fresh descriptions as provided to Ofcom by BT (see Annex 6). These descriptions should assist readers to evaluate our proposals as they should contain further detail as to what assets and activities each component comprises.

4

<http://www.btplc.com/Thegroup/Regulatoryinformation/Financialstatements/PDF2004/DAM/dam2004.pdf>

Copper access network and related services

- 4.26 The revised components relating to the copper local access network are:
- E-side copper (capital);
 - E-side copper (current);
 - D-side copper (capital);
 - D-side copper (current);
 - Local exchange general frames (capital);
 - Local exchange general frames (current);
 - Dropwire (capital) including PSTN NTE; and
 - Pair gain.
- 4.27 In using the terms 'capital' and 'current' Ofcom is maintaining BT's choice of terminology to distinguish between the 'capital' assets (e.g. the copper loop itself) and associated support activities (such as accommodation) associated with provision of copper loop itself and 'current' activities, such as preventive and reactive maintenance, which are incurred on an ongoing basis. The reason for creating two separate components in these circumstances is that the cost drivers for attributing costs to individual services may well be different between the two. For example no E-side or D-side copper (capital) component costs are attributed to shared local loops but copper (current) costs, additional to those required to provide PSTN services, are.
- 4.28 All these new components listed at 4.26 will replace component 21 ("copper access lines") on the existing directed list in the 2004 Statement. Ofcom believes these new components in particular will allow BT to demonstrate the objectivity of the attribution of its copper component costs to all the individual regulated services reliant on them with a significantly enhanced degree of transparency than has previously been the case.
- 4.29 The dropwire component also includes the network terminating equipment (NTE) relating to PSTN services. Ofcom observes that dropwires are required to provide a number of services, not just PSTN services. However BT claims that the incorporation of PSTN NTEs within this component, a small element of the overall cost, does not materially affect its compliance with its cost-orientation and non-discrimination obligations. In consequence Ofcom is proposing to delete component 23 'network terminating equipment (not elsewhere identified) for copper lines' from the current list.
- 4.30 Ofcom is also proposing to delete component 47 'passive optical network' on similar grounds. BT has informed Ofcom that these assets /activities, a relatively small cost element of its access network, will be reflected with D-side copper components on materiality grounds. BT states that the operating costs (including depreciation) of these types of assets for the year ending 31 March 2004 were £17 million.
- 4.31 In addition to the generic copper access network components listed at 4.26 Ofcom proposes several more service (or a narrow range of services) specific related components relating to services utilising BT's copper access network as follows:

- Business PSTN drop maintenance;
 - Residential PSTN drop maintenance; and
 - PSTN line cards.
- 4.32 The above components replace component 46 in the current list 'PSTN (analogue) specific'. Ofcom recognises that the underlying activities associated with maintaining a business PSTN drop are likely to share much in common with residential PSTN drop. BT has informed Ofcom that it captures maintenance activities for residential customers separately from business customers at source via timesheets. Ofcom therefore believes that there is a good case to maintain this granularity at the component level.
- 4.33 In respect of ISDN services Ofcom proposes the following components replacing components 48 'ISDN 2 specific' and 49 ISDN 30 specific:
- ISDN2 line cards;
 - ISDN2 NTE / other;
 - ISDN2 drop (maintenance); and
 - ISDN 30 (line cards / maintenance).
- 4.34 In respect of testing the copper local loop Ofcom proposes to replace component 55 'copper loop line information & testing' with:
- PSTN line test equipment; and
 - Test access management system (TAMS).
- The former component relates exclusively to the testing of PSTN services whilst the latter is also used to test unbundled local loops.
- 4.35 Ofcom is also proposing to re-title component 68 'xDSL specific' as DSLAM (capital / maintenance) to be consistent with other terminology.
- 4.36 Ofcom expects BT to be able to cost all relevant services (e.g. PSTN, ISDN, unbundled local loops) utilising its copper access network regardless of whether they are supplied to external parties or exclusively to itself using these components in its 2004/05 regulatory financial statements.

LLU specific components

- 4.37 Ofcom is proposing to remove the current set of components which were created to capture the non-local loop specific assets and activities associated with the provision of, among other services, services utilising fully unbundled and shared local loops. Ofcom currently believes that these cost elements would be better handled by relying on the objectivity of the costing process in attributing costs to network components in the first place. For example electricity is a cost element reflected within most, if not all, components. Electricity should therefore be attributed to all relevant components on a cost-causal, objective and transparent basis. Electricity costs would be effectively attributed to services via its inclusion within components utilised by regulated services. The affected components are:
- 56. Copper cabling within exchange buildings;
 - 57. Copper cabling from within exchange buildings to outside;

- 58. Operational buildings – electricity;
 - 59. Operational buildings – space;
 - 60. Operational buildings – other;
 - 61. Operational buildings – modifications (including for co-location);
 - 62. Bespoke network build – copper; and
 - 63. Bespoke network rearrangement – copper.
- 4.38 In place of the components proposed to be deleted as set out in paragraph 4.37 Ofcom is proposing a number of components to capture those LLU activities which are not specifically related to the loop itself. Ofcom regards these new components as an initial position and that it expects them to be subject to further development in the coming year to ensure any cost elements common to a wider range of services than unbundled local loops are identified.
- Local loop unbundling system set up;
 - Local loop unbundling connection activities;
 - Local loop unbundling room build activities;
 - Local loop unbundling hostel activities;
 - Local loop unbundling tie cables; and
 - Shared local loop unbundling (SMPF) connection activities.

Connection activities

- 4.39 The current list of components does not specifically recognise the existence of components in respect of those activities associated with setting up service for individual customers. These typically one-off activities are quite different in nature, and therefore have different associated cost drivers, to assets and activities associated with the ongoing provision of service. In recognition of this omission Ofcom is proposing to include in the new list a number of connection activity components. These proposals reflect BT's current practice of distinguishing between those activities needed to provide wholesale services to third parties (i.e. 'external' components) and those provided to its downstream activities (i.e. 'internal' components).
- 4.40 Ofcom recognises that there are many connection activities which are common across broad ranges of service as well as being common between externally provided services and internally provided services. For example the activity of maintaining 'routing and records' is needed in the provision of PSTN, ISDN and LLU services and regardless of whether the wholesale service is provided to an external party or to a retail customer of BT. As a result Ofcom is intending to re-examine these components in the new financial year to establish whether a more generic set of connection activity components should be developed.
- 4.41 The proposed new connection and related activity components are:
- Internal PSTN business connection activities;
 - Internal PSTN residential connection activities;
 - Internal ISDN30 connection activities;

- Internal ISDN2 business connection activities;
- Internal ISDN2 residential connection activities;
- ADSL connection activities;
- SDSL connection activities;
- External ISDN2 conversion activities;
- External PSTN connection activities;
- External PSTN transfer activities;
- Internal PSTN takeovers activities;
- Internal ISDN2 takeover activities;
- Service provider gateway (capital / maintenance);
- External ISDN2 connection activities;
- External ISDN2 transfer activities;
- Internal ISDN30 takeover activities;
- External ISDN30 connection activities; and
- External ISDN30 transfer activities.

Selling, general and administration ("SG & A") expenses

4.42 BT has identified that there are a number of activities which are associated with the provision of wholesale service to other communication providers (OCPs) which are in addition to the provision of the underlying network service. Such activities would typically include billing and wholesale customer care. BT will largely avoid the need to incur such costs by virtue of it being a vertically integrated operator but it maintains that there are some activities associated with the wholesale/retail interface for itself. As a result Ofcom is proposing to include the following components within the new list:

- External wholesale line rental ("WLR") SG & A;
- Internal WLR SG & A;
- External partial private circuits ("PPC") SG & A;
- Internal PPC SG & A; and
- Other SG & A.

4.43 These new components will replace the following components currently within the list:

- 64. Product management, policy & planning for narrowband access services;
- 66. Product management, policy & planning for partial private circuits; and
- 69. Product management, policy & planning for xDSL interconnect services.

In proposing these changes Ofcom's view is that the term 'selling, general and administration' is a better description of the activities involved than PPP as the latter is a separately regulated service with its own specific meaning, distinct from the more general scope of SG & A activities.

- 4.44 Ofcom is aware that BT might not be able to identify single onward common volume measures and usage factors to attribute component costs to individual services in all cases. Its past practice has been to attribute these type of costs on the basis of a percentage of the total component cost attributable to individual services based on survey data. Ofcom intends to review further these components in the coming year to ensure that the component identification principles as set out in paragraph 4.20 are closely adhered to.

FRIACO ports

- 4.45 BT has indicated to Ofcom that for 2004/05 it wishes to identify FRIACO ports as a component separately from the local exchange switching component. Ofcom is proposing this additional component but regards this proposal as subject to further development as it believes that it may be more appropriate to identify all ports as a separate component. This practice would allow the cost of ports to be transparently and objectively attributed to all services using ports, not just FRIACO services.

ATM specific components

- 4.46 Ofcom is proposing to adopt the components, and the terminology, which BT has captured within its regulatory accounting system in the past for these sorts of asset/activities on the grounds that they are in essence the same, or more granular than, the existing directed components.

- ATM customer interface 2mb;
- ATM customer interface 34mb;
- ATM customer interface > 155mb;
- ATM network interface; and
- ATM network switching.

- 4.47 As a result of proposing the components in 4.46 Ofcom is proposing to delete the following components from the list:

- 39. ATM switches;
- 40. Third party facing ATM tributary cards by size; and
- 41. Network facing ATM tributary cards by size.

Other components

- 4.48 At this stage Ofcom is not proposing to revise any other components included in the list other than those discussed in the section (paragraphs 4.23 through to 4.47). These components will be subject to review and potential replacement in the coming year as Ofcom considers the degree to which the proposed list adheres to the network component identification principles and takes account of technological developments.

Other aspects to network components and links to other Ofcom work

Reference offers

- 4.49 One of the remedies that Ofcom can impose on an SMP operator is the requirement to provide reference offers in relation both to wholesale services which are sold to

external parties and equivalent services which are provided internally in a different manner than supplied to third parties. The reference offer conditions themselves specify their content which may include the 'amount applied to' each network component together with the relevant usage factors for each service offered in the market, whether that service is provided to external parties or provided internally. This provision is intended to make transparent any differences in approach taken to the pricing of regulated wholesale services by BT at the individual network components level. It can therefore aid the monitoring of non-discrimination obligations where these obligations apply at the network component level.

Implementation and next steps

- 4.50 Ofcom expects BT to reflect the new components relating to the copper access network in its 2004/2005 regulatory financial statements. This should significantly improve the quality of regulatory reporting in relation to many high profile wholesale services delivered over its copper network. BT will therefore be able to demonstrate its compliance with its applicable cost orientation and non-discrimination obligations for these services in a much more transparent way compared against the 2003/04 reporting period.
- 4.51 Work will continue through 2005/06 in collaboration with BT to enhance the list in other areas such as core transmission with the intention of developing one consistent set of components covering all relevant regulated services (e.g. PPCs, wholesale broadband access, PSTN). We also plan to identify the appropriate components for local access services which are delivered over fibre as well as conducting a comprehensive review of service connection activities.

How the legal tests are met

- 4.52 Ofcom has set out in Section 2 the legal tests that have to be met regarding the imposition of regulatory financial reporting conditions on BT.

Section 3 and 4 duties

- 4.53 As part of the EU market review process Ofcom imposed wholesale cost accounting and accounting separation obligations (conditions and directions) on BT in specific identified markets as appropriate remedies to its SMP in these markets. The relevant individual market reviews have already assessed whether these regulatory accounting obligations met the tests outlined in Sections 3 and 4 of the Communications Act. The proposed changes to Direction 1 are designed to enable BT to more effectively fulfil the purpose for which these particular obligations were imposed (i.e. demonstrate cost orientation and non-discrimination). In consequence Ofcom believes the proposed amendments to Direction 1 meet the tests in Sections 3 and 4.

Section 49 duties

- 4.54 Ofcom considers that specific proposals set out in this section, that is changes to the list of network components, in Annex A to Direction 1, meet the tests included in Section 49 of the Act of being objectively justifiable, proportionate, transparent and not unduly discriminatory.

Justifiable

- 4.55 Ofcom considers that the list of components amended for these proposed changes are necessary for Ofcom to effectively monitor and enforce compliance of BT's obligations for non-discrimination, cost-orientation, cost recovery and price controls. The proposed changes will enable Ofcom to more effectively monitor compliance with these obligations.

Proportionate

- 4.56 Ofcom considers that the proposed changes to the list are proportionate because they are no more than is necessary for securing the purpose for which network components have been identified.

- 4.57 That is the changes are essential to:

- enable costs to be objectively attributed to regulated wholesale services on a causal basis;
- facilitate transparency of that costing process; and
- avoid the risk of elements not required by the purchasers being bundled into regulated wholesale services.

Transparency

- 4.58 Ofcom considers these proposals are transparent because we have set out our network component identification principles we propose to apply in paragraphs 4.20 to 4.22, and the detail of the proposed changes and associated detailed reasoning in paragraphs 4.23 to 4.47. Furthermore Ofcom is consulting on both the identification principles and the resulting proposed changes.

Not unduly discriminatory

- 4.59 BT and KCL are the only communications providers in the fixed communications market to have SMP in multiple markets and therefore can be treated as a class of communications provider. As a consequence of having SMP in multiple markets they are the only providers in respect of which Ofcom stipulates a list of network components. Ofcom is not currently reviewing KCL's list of network components as concerns about the composition of BT's current list have the potential to impact telecommunications markets much more significantly whereas KCL's current list of 8 components relates entirely to call conveyance services in the Kingston area. Ofcom therefore does not consider its current review of BT's network component list is unduly discriminatory against it vis a vis Kingston.

Section 5

Proposals affecting Direction 3

Introduction

5.1 This section will describe the following amendments Ofcom is proposing to Direction 3.

Amendment	Type of amendments	Paragraph reference
Changes to audit opinion	Housekeeping	5.2 to 5.7
Proposed additional publication of statements	Housekeeping	5.10 to 5.11
Proposed removal of statements from publication	Housekeeping	5.12 to 5.13
Proposed aggregation of statements	Relaxation	5.14 to 5.18
Proposed deletion of statements	Relaxation	5.19 to 5.23

Changes to audit opinion

Introduction

5.2 Ofcom considers that an effective and rigorous external audit is necessary for raising confidence in the robustness of regulatory financial information. The provision of an unqualified audit opinion provides Ofcom with a degree of reassurance about the reliability of the regulatory financial information when making decisions based on it.

5.3 In the 2004 Statement, Ofcom identified two levels of audit opinion, to be applied to the financial statements: fairly presented in accordance with ("FPIA") and properly prepared in accordance with ("PPIA").

5.4 Direction 3 of the 2004 Statement, directed that regulatory financial statements at market level and above are audited to FPIA standard and regulatory financial statements below that level are audited to PPIA standard.

Proposed changes and rationale

5.5 The reporting matrix, contained in Annexes A to C of Direction 3 of the 2004 Statement, set out that the following annex should be accompanied by an FPIA audit opinion:

- Annex 40 Market network services reconciliation statement (NCR FA)

5.6 However, this statement reports information which is below market level and this proposal seeks to change the level of audit opinion for this annex to PPIA. This not

only brings the audit opinion on the statements in line with the intention of the 2004 Statement, but will reduce the audit burden, while still maintaining an appropriate level of audit assurance.

Amendments to Direction and Annexes

- 5.7 Specific amendments made to Direction 3 in respect of changes to the audit opinion are shown in Annex A to Annex 7 at the end of this document (Annex A to Direction 3).

Changes to publication

Introduction

- 5.8 The 2004 Statement included a reporting matrix setting out the financial statements to be produced for the relevant SMP markets, identifying those statements which would be made available to both stakeholders and Ofcom, and those to Ofcom only.
- 5.9 Ofcom is proposing amendments to this reporting matrix as discussed in the paragraphs below.

Proposed additional publication of statements and rationale

- 5.10 It is proposed that the following statements be included in the published set of statements:
- Annex 34 - Statements of costs and charges for internal and external wholesale services (SoCC Ext); and
 - Annex 35 - Statements of costs and charges for internal only wholesale services (SoCC Int).
- 5.11 These are important financial statements, which are intended to demonstrate compliance with cost orientation obligations, and to demonstrate there is no undue discrimination, in the treatment of those services provided by BT, which are consumed by both internal and external customers

Proposed removal of statements from publication and rationale

- 5.12 It is proposed that the following statements are not included within the published set of statements:
- Annex 36 – BT Network Consolidated Profitability and Mean Capital Employed Statement by Wholesale Service; and
 - Annex 40 – Market Network Reconciliation statement.
- 5.13 The 2004 Statement, set out that published primary financial statements should be at market level and above. These two statements, which will be provided to Ofcom, contain information which is at service level (i.e. below market level) and it was not intended that they should be published outside of Ofcom.

Proposed aggregation of statements and rationale

- 5.14 The review of the Fixed Narrowband Retail Services Market, set out that Residential IDD category B calls, should have cost accounting obligations imposed, on a route by route basis.
- 5.15 At the time, 121 routes were identified. However, Ofcom is now aware that many of these routes have very low traffic volumes and low revenues
- 5.16 Ofcom considers that it would be disproportionate for this level and volume of information to be published, in the context of the low level of activity involved.
- 5.17 The proposal is to produce consolidated Profit and Loss and Mean Capital Employed statements, which will aggregate all of the Category B routes.
- 5.18 BT would still maintain the capability to prepare information by individual route, and this information could be made available to Ofcom if required.

Proposed deletion of statements and rationale

- 5.19 In the 2004 Statement, the reporting matrix set out the regulatory financial statements which required preparation and publication.
- 5.20 The matrix included a summary profit and loss, and mean capital employed statement, for each of the market review consultation documents, e.g. Review of fixed geographic call termination markets.
- 5.21 The proposal is to remove the obligations which set out that the following market review level statements should be provided:
- Annex 7 Wholesale summary narrowband P&L statement;
 - Annex 8 Wholesale summary narrowband MCE statement;
 - Annex 17 Retail summary narrowband statement P&L statement; and
 - Annex 18 Retail summary narrowband statement MCE statement.
- 5.22 Ofcom is of the opinion that these are not meaningful consolidations, as it is simply a grouping of markets that appeared in a market review document. The market reviews sought to follow the new regulatory framework, by identifying markets that may have similar characteristics.
- 5.23 The reporting matrix already contains statements which set out totals by market and a consolidated total statement, for all wholesale and retail markets, which have Cost Accounting or Accounting Separation obligations. Ofcom considers that these statements provide a more meaningful and sufficient level of consolidation.

Amendments to Direction and Annexes

- 5.24 Specific amendments made to Direction 3 in respect of changes to publication are shown in Annex A to Annex 7 at the end of this document (Annex A to Direction 3).

Question 2: Do stakeholders have any comments in respect of the amendments proposed to Direction 3?

How the legal tests are met

5.25 Ofcom has set out in Section 2 the legal tests that have to be met regarding the imposition of regulatory financial reporting conditions on BT.

Section 3 and 4 duties

5.26 As part of the EU market review process, Ofcom imposed wholesale and retail cost accounting and accounting separation obligations (conditions and directions) on BT in specific markets; as appropriate remedies to its SMP in these markets. The individual market reviews have already assessed whether the proposals to impose these obligations meet the tests outlined in Sections 3 and 4 of the Communications Act. Ofcom considers that the amendments contained within this section do not affect either the essence or intentions contained within the market reviews (i.e. the demonstration of cost orientation and non-discrimination) and as a result, considers that the proposed amendments continue to meet the tests set out in Sections 3 and 4 of the Act.

Section 49 duties

5.27 Ofcom considers that specific proposals set out in this section, that is changes to the audit opinion and changes to publication, meet the tests included in Section 49 of the Act of being objectively justifiable, proportionate, transparent and not unduly discriminatory.

Justifiable

5.28 Ofcom considers that the amendments proposed in this section are objectively justifiable because the maintenance of accounting systems; preparation, audit, delivery and publication of regulatory financial statement; transparent accounting documentation; and reasonable amendment powers are necessary for Ofcom to effectively monitor and enforce compliance of BT'S obligations for non-discrimination, cost-orientation, cost recovery and price controls.

Proportionate

5.29 Ofcom considers that the proposed changes in this section are proportionate because they are no more than is necessary for securing the following objectives:

- the obligations regarding the audit of regulatory financial statements are proportionate because they are no more than Ofcom considers necessary for ensuring that an appropriate level of assurance is provided regarding the regulatory financial statements; and
- the obligations to prepare, deliver and publish regulatory financial statements are proportionate because the level of information is no more than Ofcom considers necessary for Ofcom to monitor and enforce obligations for non-discrimination, cost orientation, cost recovery and price controls.

Transparency

- 5.30 Ofcom considers the proposals included in this section are transparent as they are being consulted upon, and responses to this consultation will be transparently taken into account.

Not unduly discriminatory

- 5.31 Ofcom considers that the amendments proposed in this section are not unduly discriminatory as the only other dominant provider with SMP in multiple markets, is KCL; who already has a lesser level of regulatory reporting, than BT.

Section 6

Proposals affecting Direction 4

Introduction

6.1 This section will describe the following amendments Ofcom is proposing to Direction 4.

Amendment	Type of amendments	Paragraph reference
Merging of low value services	Relaxation	6.2 to 6.11
Changes to denomination of reports	Relaxation	6.12 to 6.20
Sector analysis	Housekeeping	6.21 to 6.30
Comparatives	Housekeeping	6.31 to 6.46
AFIs	Relaxation	6.47 to 6.53
Reporting of revenue discounts	Housekeeping	6.54 to 6.59

Merging of low value services

Introduction

- 6.2 Depending on the view taken, BT provides hundreds if not thousands of products and services. Even for some basic services there may be many variants taking account of levels of service, bandwidth, burst rates, etc. BT's regulatory costing process for products and services does not attribute costs to the lowest level of granularity but defines a set of product groups that make the process manageable as well as producing meaningful information that can be subject to audit.
- 6.3 BT's products and services are mapped into SMP markets and these will be disclosed in separate wholesale and retail catalogues when the regulatory Financial Statements are published.
- 6.4 However, the reporting matrix within Annexes A, B & C of Direction 3, of the 2004 Statement, did not set out or attempt to identify each individual service within each market, but either referred to 'wholesale service A', 'wholesale service B' as example services, or included some illustrative services, for each market.
- 6.5 Since the publication of the original statement, Ofcom has reviewed BT's proposed list of services, for all markets, for which financial statements are to be produced.
- 6.6 This proposal is not a change to a Direction, but now seeks to clarify some of the detailed requirements for reporting of products and service under SMP.

Proposed changes and rationale

- 6.7 BT's has provided Ofcom with a list identifying all wholesale services within SMP markets. If BT reported on the full list, then each of the services would require the production of profit & loss, mean capital employed and related service statements.
- 6.8 Within this list, BT has identified some "low value services", with low revenue and operating costs (typically below £10m pa), and is proposing that these are merged within similar product families. For example, connection services may be merged with rental services for the same 'low value' product set
- 6.9 Reporting at this (service) level is to Ofcom only, so this proposal does not change the regulatory Financial Statements published in the public domain; and services with values at a material level would still be reported.
- 6.10 This proposal will simplify the preparation process, reduce the audit burden and help avoid undue emphasis or excessive analysis effort on immaterial activities. BT will however retain data at service level and make this available to Ofcom using, for example, the additional layer of regulatory financial information (see Section 3). This proposal only applies therefore to the presentation of the regulatory Financial Statements themselves and BT's cost attribution processes will retain the capability to generate information for all service and product groups.

Amendments to Direction and Annexes

- 6.11 The detailed analysis of services at product group level is not something subject to the specific requirements of a Direction. It is important to note however that this relaxation allowing a grouping of services will reduce the resource burden on BT.

Changes to denomination of reports

Introduction

- 6.12 The Annexes to Direction 4 of the 2004 Statement, set out the form and content for each of the 42 financial statements to be provided, which not only included the format of, for example: the Profit and Loss, Mean Capital Employed; but specified the denomination of the statements.
- 6.13 The annexes specified that the new SMP statements should be reported in £k (pounds thousands). Whereas, previously BT reported its regulatory financial statements in £m (pounds millions).

Proposed changes and rationale

- 6.14 Ofcom has since had a great deal of discussion with BT and its auditors PwC, and agrees that a more meaningful and consistent reporting denomination should be £m.
- 6.15 BT argued reporting the regulatory financial statements in £k, would be inconsistent with its statutory annual reporting, which is reported in £m, as the same core data is used to support the reporting of both sets of statements.
- 6.16 It is argued that reporting at £k would not necessarily lead to improved disclosure or accuracy, in view of the scale of BT's activities and levels of materiality.

- 6.17 Reporting at £k would put a significant burden on the timetable for producing the statements and involve a substantial increase in resourcing and cost, for a relatively small marginal gain.
- 6.18 Ofcom will be able to access information with much greater granularity, as a result of the provision of the BT 'data file'. This facility will allow Ofcom to drill down to information at summary transaction level, providing a far greater level of analysis than previously experienced.
- 6.19 Therefore, considered against any marginal benefit that may be gained, and with Ofcom being able to access data at a far greater level of granularity, the proposal is to amend the reporting denomination of the financial statements, from £k to £m.

Amendments to Direction and Annexes

- 6.20 The actual amendments made to Direction 4 in respect of denomination to reports are shown in Annex A to Annex 8 of this document (Annex A to Direction 4). Not all changes are shown, however 4 examples are included based on the P&L and MCE statements for wholesale and retail markets.

Sector analysis

Introduction

- 6.21 The Annexes to Direction 4 of the 2004 Statement, set out the form and content for each of the 42 financial statements to be provided; which included the format of, for example: the Profit and Loss, Mean Capital Employed, and reconciliation statements.
- 6.22 A number of significant improvements were made to the form and content of the financial statements to be produced under the SMP conditions, which will increase understanding and interpretation of the statements. For example, the Operating expenditure applicable to a particular activity was previously shown as one number in the profit and loss account.
- 6.23 However, the new obligations set out, that each of the Profit and Loss statements should show all expenditure categories ("sectors") which exceed 10% of the total operating cost. This is for each market and service and covers both wholesale and retail markets.
- 6.24 Following a review of draft statements BT prepared under the new reporting format, using 2003/04 data, it was clear that BT maintains a large number of sectors that could potentially be analysed in the reporting of those expenditure categories, which constituted 10% or more of total operating cost of an activity.
- 6.25 This resulted in some inconsistency, on the type of expenditure identified and disparities between statements at a lower level, for example reporting of services; and those at a consolidated level e.g. market level.
- 6.26 This proposal seeks to bring a greater degree of consistency to the reporting and analysis of operating expenditure by market, for both Wholesale and Retail markets, while still providing greater granularity on operating expenditure.

Proposed changes and rationale

- 6.27 Ofcom is proposing a standard list of expenditure categories be used for the reporting of operating expenditure specific to all wholesale markets, and that a standard list of expenditure categories be used for the reporting of operating expenditure specific to all retail markets.
- 6.28 From a detailed review of draft financial statements in the new format, using 2004/05 data, Ofcom was able to identify the key expenditure activities which would give users of the information a better understanding of the main cost drivers, for both Wholesale and Retail activities.
- 6.29 Ofcom is committed to ensuring the granularity of the information provided is relevant, and will review the breakdown of expenditure, on an ongoing basis, to ensure its relevance.

Amendments to Direction and Annexes

- 6.30 The actual amendments made to Direction 4 in respect of sector analysis are shown in Annex A to Annex 8 of this document (Annex A to Direction 4) in the form of P&L and MCE statements for the wholesale and retail markets. Not all changes are shown, however examples are included based on the P&L statements for wholesale and retail markets.

Comparatives

Introduction

- 6.31 It is necessary to ensure that financial statements are prepared on a consistent and comparable basis, which means prior year comparative statements should be prepared, on a basis consistent to the current year figures.
- 6.32 2004/05 will be the first year statements are produced in the format set out under the SMP reporting obligations. As a result of this move to SMP reporting, Ofcom has subsequently identified some statements where it considers it is not practicable or proportionate for full comparative information to be produced.

Proposed changes and rationale

- 6.33 Ofcom is proposing that the following annex is not accompanied by a comparative statement for the year 2003/04:
- Annex 24 – Wholesale sales by market statement, external sales (published statement)
- 6.34 Ofcom recognises, that this particular analysis of external sales, by SMP Wholesale Market, was not prepared under the previous reporting regime, and would require a disproportionate amount of effort to obtain, while not necessarily providing a wholly meaningful comparative.
- 6.35 Therefore, for the 2004/05 reporting year only, the proposal is that no comparative information is provided for this Annex 24.

- 6.36 For the following statements, full comparative information is not proposed, however there will be partial or de facto comparative information, to assist in the interpretation of the 2004/05 statements:
- Annex 36 – Consolidated profitability and MCE statements by wholesale service (Ofcom only statement);
 - Annex 37 – Consolidated statement of costs on a current cost basis, network activity statement (published statement);
 - Annex 38 – Market statement of costs on a current cost basis, network activity statement (published statement);
 - Annex 39 – Consolidated network services reconciliation statement (published statement);
 - Annex 40 – Market network services reconciliation statement (Ofcom only statement); and
 - Annex 41 – Network component statement on incremental cost basis (reconciliation) (published statement).
- 6.37 In respect of Annex 36, BT did not capture this information in 2003/04 at a sufficiently disaggregated level, to be able to provide, in particular, comparative volume and profitability data, in line with the new SMP market and service structure.
- 6.38 BT has requested that for Annex 36, in 2004/05, information provided to Ofcom in 2003/04, under AFI 27 (of the schedules previously provided under Condition 78 of BT's Licence), is provided in place of a full comparator.
- 6.39 Ofcom considers, that as AFI 27 provides de facto comparative information at a summary level, it would be disproportionate to compel BT to provide a full comparative; when considered against the additional time and resource required to achieve this.
- 6.40 Therefore, Ofcom proposes that for 2004/05 only, BT uses the 2003/04 AFI 27 information as a comparator to Annex 36, and the statement contains a note to that effect, that it is not a full comparative.
- 6.41 Annexes 37 to 41 report on the new enhanced list of components (and subsequently services under SMP) for 2004/05. This will be a significantly different list to that used in 2003/04, including new components, more granular disclosure and the removal of redundant components.
- 6.42 As a defacto comparative, to be used in 2004/05 only, BT has requested it includes in the reported statements, the Network Statement of Cost for 2003/04, in place of a full comparative.
- 6.43 Ofcom is of the view that it would be a disproportionate burden for BT to produce full comparative information for 2003/04, which may impact on the reporting timetable, while not resulting in any quantifiable cost benefit.
- 6.44 Therefore, the proposal is for Annexes 37 to 41, comparative information is replaced by the Network Statements of Cost statement provided in 2003/04, with the statements containing a note to that effect.

- 6.45 Since certain of the comparative information for 2003/04 will not be a full comparative, as outlined above, BT has stated that it will not be able to procure the form of audit opinion in respect of the comparative information required by the 2004 Statement. Therefore, Ofcom is proposing that the audit requirement in respect of 2003/04 comparative information be amended to report only on the representation of the data supplied by BT. In the 2005/06 reporting year, a full comparative statement would be expected for each of the above statements.

Amendments to Direction and Annexes

- 6.46 The actual amendments made to Direction 4 in respect of comparatives are not specifically shown in an annex but are listed as amendments in the Schedule to Direction 4 in Annex 8 attached at the end of this document.

Additional Financial Information

Introduction

- 6.47 Annex 42 to Direction 4 set out the schedules of Additional Financial Information (AFI) to be provided under the new SMP reporting obligations. AFIs are un-audited schedules, which are provided to Ofcom in addition to the information provided in the audited statements.
- 6.48 Ofcom has now reviewed the relevance of each of the schedules, and in particular considered them against the audited information Ofcom will receive and the information available via the 'data file'.

Proposed changes and rationale

- 6.49 Ofcom is proposing to add an additional AFI:
- Provision of BT 'Data File'
- 6.50 This refers to the 'data file' as set out under the Section 3 of this document 'A new layer of regulatory financial reporting'. The provision of this capability should allow a reduction in BT's regulatory cost burden, while at the same time increasing the breadth and depth of information available to Ofcom, underpinning many of the proposals in this document.
- 6.51 Ofcom is proposing to withdraw the following AFI schedules which were set out in the 2004 Statement:
- AI 7 - Operator assistance combinatorial test (i.e. costs and revenues for 5 regions of the world) (LRIC basis);
 - AI 11 - Gross call revenues, discounts & option fees by tariff option for each segment containing call revenues;
 - AI 12 - Gross revenues, discounts & option fees by customer option for each segment in respect of non-call revenues where discount scheme(s) apply;
 - AI 17 - Fixed fee revenues (including line rental) by tariff package & associated network costs; and
 - AI 18 - Analysis of profits/(losses) on asset transfers plus analysis of such assets transferred.

- 6.52 Ofcom considers removing the above schedules would not necessarily compromise the range of information available, as it is either available from the audited SMP financial statements or the 'data file' facility; or is information which has not been used by Ofcom in the past.

Amendments to Direction and Annexes

- 6.53 The actual amendments made to Direction 4 in respect of the AFIs are shown in Annex B to Annex 8 of this document (Annex B to Direction 4).

Reporting of revenue discounts

Introduction

- 6.54 The form and content of the Profit and Loss statements under SMP reporting, set out that where applicable, gross revenues and discounts be separately identified.
- 6.55 After testing of 2003/04 data in the new SMP format, BT has requested that Ofcom reviews the requirement separately to disclose discount information. It argues the analysis involved in arriving at a declining level of discount activity, is not proportionate in respect of the value gained, as in many cases it is below materiality thresholds, and that products and services offering discounts are declining.

Proposed changes and rationale

- 6.56 Ofcom has reviewed BT's arguments on the disclosure of discount information, and accepts that levels of discounts in retail markets will vary depending on BT's pricing policy. It also recognises the additional regulatory burden involved in identifying discounts across a large range of products and services, and that for some product groups, discounts would not be above materiality thresholds.
- 6.57 However, Ofcom does consider that disclosure is important for those products and services where discounts are of a significant proportion of gross revenues. Therefore, the proposal is that discount information should be separately identified in each Profit and Loss statement, where discounts account for 10% or more of gross revenues.
- 6.58 This would provide stakeholders with information on the main retail markets where discounts apply, but alleviate unnecessary regulatory burden on BT, in having to report information on all discounted activities.

Amendments to Direction and Annexes

- 6.59 The actual amendments made to Direction 4 in respect of revenue discounts are shown in Annex A to Annex 8 (Annex A to Direction 4).

Question 3: Do stakeholders have any comments in respect of the amendments proposed to Direction 4?

How the legal tests are met

- 6.60 Ofcom has set out in Section 2 the legal tests that have to be met regarding the imposition of regulatory financial reporting conditions on BT.

Section 3 and 4 duties

6.61 As part of the EU market review process, Ofcom imposed wholesale and retail cost accounting and accounting separation obligations (conditions and directions) on BT in specific markets; as appropriate remedies to its SMP in these markets. The individual market reviews have already assessed whether the proposals to impose these obligations meet the tests outlined in Sections 3 and 4 of the Communications Act. Ofcom considers that the amendments contained within this section do not affect either the essence or intentions of the market reviews (i.e. the demonstration of cost orientation and non-discrimination) and as a result, considers that the proposed amendments continue to meet the tests set out in Sections 3 and 4 of the Act.

Section 49 duties

6.62 Ofcom considers that specific proposals set out in this section, that is changes to the audit opinion and changes to publication, meet the tests included in Sections 47 of the Act of being objectively justifiable, proportionate, transparent and not unduly discriminatory.

Justifiable

6.63 Ofcom considers that the amendments proposed in this section are objectively justifiable because the maintenance of accounting systems; preparation, audit, delivery and publication of regulatory financial statement; transparent accounting documentation; and reasonable amendment powers are necessary for Ofcom to effectively monitor and enforce compliance of BT'S obligations for non-discrimination, cost-orientation, cost recovery and price controls.

Proportionate

6.64 Ofcom considers that the proposed changes in this section are proportionate because they are no more than is necessary for securing the following objectives:

- the obligations to have transparent accounting documentation are proportionate because the level of accounting documentation is no more than Ofcom considers necessary for the purpose of ensuring the consistent and comparable preparation of regulatory financial statements and the adequate; and
- the obligations to maintain accounting records and systems are proportionate because they are no more than Ofcom considers necessary for the purpose of being able to provide information to allow the monitoring and enforcing obligations for non-discrimination, cost orientation, cost recovery and price controls.

Transparency

6.65 Ofcom considers the proposals included in this section are transparent as they are being consulted upon, and responses to this consultation will be transparently taken into account.

Not unduly discriminatory

- 6.66 Ofcom considers that the amendments proposed in this section are not unduly discriminatory as the only other dominant provider with SMP in multiple markets, is KCL; who already has a lesser level of regulatory reporting, than BT.

Section 7

Responding to this consultation

How to respond

Ofcom invites written views and comments on the issues raised in this document, to be made by **5pm on 23 June 2005.23 June 2005**

Ofcom strongly prefers to receive responses as e-mail attachments, in Microsoft Word format, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 2), among other things to indicate whether or not there are confidentiality issues. The cover sheet can be downloaded from the 'Consultations' section of our website.

Please can you send your response to william.fell@ofcom.org.uk

Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.

William Fell
Competition and Markets
3rd Floor
Ofcom
Riverside House
2A Southwark Bridge Road
London SE1 9HA

Fax: 020 7783 4103

Note that we do not need a hard copy in addition to an electronic version. Also note that Ofcom will not routinely acknowledge receipt of responses.

It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at Annex 3. It would also help if you can explain why you hold your views, and how Ofcom's proposals would impact on you.

Further information

If you have any want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Bill Fell on on 020 7783 4328.

Confidentiality

Ofcom thinks it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, www.ofcom.org.uk, ideally on receipt (when respondents confirm on their response cover sheer that this is acceptable).

All comments will be treated as non-confidential unless respondents specify that part or all of the response is confidential and should not be disclosed. Please place any confidential parts

of a response in a separate annex, so that non-confidential parts may be published along with the respondent's identity.

Ofcom reserves its power to disclose any information it receives where this is required to carry out its legal requirements. Ofcom will exercise due regard to the confidentiality of information supplied.

Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use, to meet its legal requirements. Ofcom's approach on intellectual property rights is explained further on its website, at www.ofcom.org.uk/about_ofcom/gov_accountability/disclaimer.

Next steps

Following the end of the consultation period, Ofcom intends to publish a statement around the end of July.

Please note that you can register to get automatic notifications of when Ofcom documents are published, at http://www.ofcom.org.uk/static/subscribe/select_list.htm.

Ofcom's consultation processes

Ofcom is keen to make responding to consultations easy, and has published some consultation principles (see Annex 1) which it seeks to follow, including on the length of consultations.

If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at consult@ofcom.org.uk. We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, whose views are less likely to be obtained in a formal consultation.

If you would like to discuss these issues, or Ofcom's consultation processes more generally, you can alternatively contact Tony Stoller, Director, External Relations, who is Ofcom's consultation champion:

Tony Stoller
Ofcom
Riverside House
2A Southwark Bridge Road
London SE1 9HA
Tel: 020 7981 3550
Fax: 020 7981 3333
E-mail: tony.stoller@ofcom.org.uk

Annex 1

Ofcom's consultation principles

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

Before the consultation

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

During the consultation

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

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

We will normally allow ten weeks for responses to consultations on issues of general interest.

There will be a person within Ofcom who will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. This individual (who we call the consultation champion) will also be the main person to contact with views on the way we run our consultations.

If we are not able to follow one of these principles, we will explain why. This may be because a particular issue is urgent. If we need to reduce the amount of time we have set aside for a consultation, we will let those concerned know beforehand that this is a 'red flag consultation' which needs their urgent attention.

After the consultation

We will look at each response carefully and with an open mind. We will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

Annex 2

Consultation response cover sheet

In the interests of transparency, we will publish all consultation responses in full on our website, www.ofcom.org.uk, unless a respondent specifies that all or part of their response is confidential. We will also refer to the contents of a response when explaining our decision, without disclosing the specific information that you wish to remain confidential.

We have produced a cover sheet for responses (see below) and would be very grateful if you could send one with your response. This will speed up our processing of responses, and help to maintain confidentiality by allowing you to state very clearly what you don't want to be published. We will keep your completed cover sheets confidential.

The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their cover sheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.

We strongly prefer to receive responses in the form of a Microsoft Word attachment to an email. Our website therefore includes an electronic copy of this cover sheet, which you can download from the 'Consultations' section of our website.

Please put any confidential parts of your response in a separate annex to your response, so that they are clearly identified. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only so that we don't have to edit your response.

Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

What do you want Ofcom to keep confidential?

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

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

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response. It can be published in full on Ofcom's website, unless otherwise specified on this cover sheet, and I authorise Ofcom to make use of the information in this response to meet its legal requirements. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

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

Name

Signed (if hard copy)

Annex 3

Consultation questions

Question 1: *Has Ofcom characterised the network component identification principles appropriately? Are there any other principles or considerations that are relevant when identifying components which enable BT to effectively demonstrate compliance with its regulatory obligations?*

Question 2: *Do stakeholders have any comments in respect of the amendments proposed to Direction 3?*

Question 3: *Do stakeholders have any comments in respect of the amendments proposed to Direction 4?*

Annex 4

Notification and Proposed Amendments to Direction 1

Proposed modification to Direction 1 for BT: Network Components

Notification of a proposal under section 49 of the Communications Act 2003

Proposal for modifying Directions given under SMP Services Condition OA2 and FA10.2 specifying network components for the purposes of SMP Services Conditions OA1 to OA34, AA1 to AA12, BA1 to BA6, EA1 to EA7, FA1 to FA10, G1 to G9, GG1 to GG9, H1 to H8, HH1 to HH8, KA1 to KA4 and PA1.

1. Ofcom hereby makes, in accordance with section 49 of the Communications Act 2003 ("the Act"), the following proposal to modify:

- i. Direction 1 given under SMP Services Condition OA2 at Annex 4 of *The Regulatory Financial Reporting obligations on BT and Kingston Communications statement, dated 22 July 2004*, specifying network components for the purposes of SMP Services Conditions OA1 to OA34, AA1 to AA12, BA1 to BA6, EA1 to EA7, G1 to G9, GG1 to GG9, H1 to H8, HH1 to HH8, KA1 to KA4 and PA1; and
 - ii. A Direction given under SMP Services Condition FA10.2 at Schedule 2 to the Notification set out in Annex 2 of the *Review of the wholesale local access market*, dated 16 December 2004.
2. The draft modification to the Directions is set out in the Schedule to this notification.
3. The effect of the draft modification to the Directions, and the reasons for making the proposal, are set out in the accompanying explanatory statement.
4. Representation may be made to Ofcom about the proposed draft modification to the Direction by 5 pm on 23 June 2005.
5. In accordance with section 50 of the Act, copies of this notification have been sent to the Secretary of State, the European Commission and to the regulatory authorities of every other Member State.

DAVID K S THOMAS

Director of Regulatory Finance, Ofcom

A person authorised by Ofcom under paragraph 18 of the Schedule to the Office of Communications Act 2002

26 May 2005

Schedule

[Draft] Direction modifying Directions under section 49 of the Communications

Act 2003 and SMP Services Condition OA2 and FA10.2 specifying network components for the purposes of SMP Services Conditions OA1 to OA34, AA1 to AA12, BA1 to BA6, EA1 to EA7, FA1 to FA10, G1 to G9, GG1 to GG9, H1 to H8, HH1 to HH8, KA1 to KA4 and PA1.

WHEREAS:

(A) as a result of a market analysis carried out by the Director General of Telecommunications (the 'Director') and OFCOM in accordance with section 79 of the Act, BT has been designated as having SMP in respect of certain identified markets in accordance with section 79 of the Act;

(B) as a result of such SMP designations, BT has been subjected to various SMP services conditions in accordance with sections 45 and 86 to 92 of the Act, including:

- a) conditions OA1 to OA34 and FA10, imposing obligations on BT in respect of wholesale cost accounting, retail cost accounting and accounting separation in relation to BT's activities in those markets where BT has been designated as having SMP; and
- b) conditions AA1 to AA12; BA1 to BA6; EA1 to EA7, FA1 to FA10, G1 to G9; GG1 to GG9; H1 to H8, HH1 to HH8, KA1 to KA4 and PA1 imposing, amongst other things, obligations on BT in respect of the publication of reference offers and the notification of prices in relation to BT's activities in those markets where BT has been designated as having SMP;

(C) in the SMP services conditions referred to in paragraph B above, 'Network Components' are defined to mean the network components specified in any direction given by the Director or Ofcom (as appropriate) from time to time for the purpose of those conditions;

(D) by virtue of the Transitional Provisions, references to the Director in any of those SMP services conditions should be read as references to OFCOM;

(E) conditions OA2 and FA10 include, in accordance with section 45(10) of the Act, the ability for OFCOM to make such directions as they consider appropriate from time to time in relation to BT's obligations under conditions OA1 to OA34 and FA10, respectively;

(F) this Modified Direction modifies:

- i. Direction 1 given under SMP Services Condition OA2 at Annex 4 of The Regulatory Financial Reporting obligations on BT and Kingston Communications statement, dated 22 July 2004 (the "Original Direction 1"), which relates to BT's obligations under SMP services conditions OA1 to OA34, in that it specifies the network components which apply for the purposes of those conditions; and
- ii. a Direction given under SMP Services Condition FA10.2 at Schedule 2 to the Notification set out in Annex 2 of the Review of the wholesale local access

market, dated 16 December 2004 (the "Original FA10 Direction"), which relates to BT's obligations under SMP services condition FA10, in that it specifies the network components which apply for the purposes of that condition.

(G) this modified Direction also serves to specify the network components which apply for the purposes of other SMP services conditions set out at paragraph B(b) above;

(H) for the reasons set out in the explanatory statement accompanying this modified Direction, OFCOM are satisfied that, in accordance with section 49(2) of the Act, this Direction is:

- iii. (i) objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
- iv. (ii) not such as to discriminate unduly against particular persons or against a particular description of persons;
- v. (iii) proportionate to what it is intended to achieve; and
- vi. (iv) in relation to what it is intended to achieve, transparent;

(I) for the reasons set out in the explanatory statement accompanying this modified Direction, Ofcom have considered and acted in accordance with the six Community requirements set out in section 4 of the Act and their duties in section 3 of the Act;

(J) on 26 May 2005, Ofcom published a notification of the proposed modified Direction in accordance with section 49 of the Act (the 'Notification');

(K) a copy of the Notification was sent to the Secretary of State, the European Commission and the regulatory authorities at every other Member State in accordance with section 50 of the Act;

(L) in the Notification and accompanying explanatory statement OFCOM invited representations about any of the proposals therein by 23 June 2005;

(M) by virtue of section 49(9) of the Act, OFCOM may give effect to the proposal set out in the Notification, with or without modification, only if-

- a) they have considered every representation about the proposal that is made to them within the period specified in the Notification; and
- b) 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;

(N) Ofcom has considered every representation about the proposed modified Direction duly made to them and these representations are discussed in Section [...] of the statement accompanying this modified Direction; and the Secretary of State has not notified OFCOM of any international obligation of the United Kingdom for this purpose;

NOW, therefore, pursuant to section 49 of the Act and Conditions OA2 and FA10, OFCOM hereby gives the following modification to the Original Direction 1 and the Original Direction FA10:

1. The network components which apply for the time being for the purposes of SMP services conditions OA1 to OA34, AA1 to AA12, BA1 to BA6, EA1 to EA7, FA1 to FA10, G1 to G9, GG1 to GG9, H1 to H8, HH1 to HH8, KA1 to KA4 and PA1 are those specified at Annex A to this modified Direction.

2. For the purpose of interpreting this modified Direction, the following definitions shall apply:

- a) "Act" means the Communications Act 2003 (c. 21);
- b) "BT" means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 736 of the Companies Act 1985, as amended by the Companies Act 1989;
- c) "Director" means the Director General of Telecommunications as appointed under section 1 of the Telecommunications Act 1984;
- d) 'OFCOM' means the Office of Telecommunications;
- e) "Notification" means the Notifications which set in place the obligations on BT referred to in recital (B) of this modified Direction above; and
- f) 'Transitional Provisions' means sections 408 and 411 of the Act, the Communications Act 2003 (Commencement No.1) Order 2003, and the Office of Communications Act 2002 (Commencement No. 3) and Communications Act 2003 (Commencement No. 2) Order 2003./

3. 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 Notification and otherwise any word or expression shall have the same meaning as it has in the Act.

4. For the purpose of interpreting this modified Direction:

- a) headings and titles shall be disregarded; and
- b) the Interpretation Act 1978 (c. 30) shall apply as if this Direction were an Act of Parliament.

5. This Direction shall take effect on the day it is published.

6. The Schedule to this modified Direction shall form part of this modified Direction.

[Name]

[Title]

A person authorised by Ofcom under paragraph 18 of the Schedule to the Office of Communications Act 2002

[Date]

ANNEX A

Annex A to the Original Direction 1 and the Original Direction FA10 shall be modified to reflect the additions, deletions and re-numbering of the list of network components as highlighted below:

Old #	New #	
1	1	Local exchange concentrator
2	2	Local exchange call set up
3	3	Local exchange call duration
4	4	Main exchange call set up
5	5	Main exchange call duration
6	6	Remote-local transmission link
7	7	Remote-local transmission length
8	8	Local-tandem transmission link
9	9	Local-tandem transmission length
10	10	Inter-tandem transmission link
11	11	Inter-tandem transmission length
12	12	Product management, policy & planning for narrowband call services
13	13	National operator assistance
14	14	International operator assistance
15	15	Outpayments: geographic calls
16	16	Outpayments: non geographic calls
17	17	Outpayments: calls to mobile
18	18	Outpayments: international
19	19	Outpayments: other
20	20	International network
22	21	Fibre access lines
24	22	CWSS network terminating equipment & serving

		exchange equipment
25	23	DWSS network terminating equipment & serving exchange equipment
26	24	PDH multiplexors at third party site
27	25	SDH multiplexors at third party site
28	26	SDH (MSH) multiplexors at third party site
29	27	PDH multiplexors
30	28	SDH mutliplexors
31	29	SDH cross connection/grooming equipment
32	30	Tributary card for SDH network by size
33	31	SDH (MSH) mutliplexors
34	32	SDH (MSH) cross connection/grooming equipment
35	33	Tributary card for SDH (MSH) network by size
36	34	Transmission links over fibre
37	35	Transmission links over radio
38	36	In-building links
42	37	Signalling links
43	38	Network research and development
44	39	Guarantee schemes
45	40	Infrastructure returns
50	41	Carrier Pre Selection System Set-Up
51	42	Carrier Pre Selection Operator Set-Up
52	43	Carrier Pre Selection Customer Set-Up
53	44	Carrier Pre Selection in life management
54	45	IN platform
65	46	Private circuit specific
67	47	Alternative interface symmetric broadband origination specific

70 48 Wholesale bad debts

New components on list

49 E-side copper (capital)

50 E-side copper (current)

51 D-side copper (capital)

52 D-side copper (current)

53 Local exchange general frames (capital)

54 Local exchange general frames (current)

55 Dropwire (capital) including PSTN NTE

56 Business PSTN drop maintenance

57 Residential PSTN drop maintenance

58 Pair gain

59 PSTN line test equipment

60 Test access management system (TAMS)

61 PSTN line cards

62 ISDN2 line cards

63 ISDN2 NTE / other

64 ISDN2 drop (maintenance)

65 ISDN 30 (line cards / maintenance)

66 DSLAM (capital / maintenance)

67 Other SG & A

68 External WLR SG & A

69 Internal WLR SG & A

70 Local loop unbundling system set up

71 Local loop unbundling connection activities

72 Local loop unbundling room build activities

73	<u>Local loop unbundling hostel activities</u>
74	<u>Local loop unbundling tie cables</u>
75	<u>Shared local loop unbundling (SMPF) connection activities</u>
76	<u>FRIACO Ports</u>
77	<u>ATM customer interface 2mb</u>
78	<u>ATM customer interface 34mb</u>
79	<u>ATM customer interface > 155mb</u>
80	<u>ATM network interface</u>
81	<u>ATM network switching</u>
82	<u>Internal PPC SG & A</u>
83	<u>External PPC SG & A</u>
84	<u>Internal PSTN business connection activities</u>
85	<u>Internal PSTN residential connection activities</u>
86	<u>Internal ISDN30 connection activities</u>
87	<u>Internal ISDN2 business connection activities</u>
88	<u>Internal ISDN2 residential connection activities</u>
89	<u>ADSL connection activities</u>
90	<u>SDSL connection activities</u>
91	<u>External ISDN2 conversion activities</u>
92	<u>External PSTN connection activities</u>
93	<u>External PSTN transfer activities</u>
94	<u>Internal PSTN takeovers activities</u>
95	<u>Internal ISDN2 takeover activities</u>
96	<u>Service provider gateway (capital / maintenance)</u>
97	<u>External ISDN2 connection activities</u>
98	<u>External ISDN2 transfer activities</u>
99	<u>Internal ISDN30 takeover activities</u>

100	<u>External ISDN30 connection activities</u>
101	<u>External ISDN30 transfer activities</u>

Deletions from previous list

21	Copper access lines
23	Network terminating equipment (not elsewhere identified) for copper lines
39	ATM switches
40	Third party facing ATM tributary cards by size
41	Network facing ATM tributary cards by size
46	PSTN (analogue) specific
47	Passive optical network
48	ISDN 2 specific
49	ISDN 30 specific
55	Copper loop line information & testing
56	Copper cabling within exchange buildings
57	Copper cabling from within exchange buildings to outside
58	Operational buildings – electricity
59	Operational buildings – space
60	Operational buildings – other
61	Operational buildings – modifications (including for co-location)
62	Bespoke network build – copper
63	Bespoke network rearrangement – copper
64	Product management, policy & planning for narrowband access services
66	Product management, policy & planning for partial private circuits
68	xDSL specific

69

~~Product management, policy & planning for xDSL
interconnect services~~

Annex 5

Cross references to descriptions for all additions to the network component list

Revised ref #	Component title	Component description reference (where not in DAM) as per Annex 6	BT DAM reference	BT component/plant group title as per DAM (where different from proposed title)
49	E-side copper (capital)		PG117C	E Side Copper Capital
50	E-side copper (current)		PG117M	E Side Copper Current
51	D-side copper (capital)		PG118C	D Side Copper Capital
52	D-side copper (current)		PG118M	D Side Copper Current
53	Local exchange general frames (capital)		PG217C	Local Exchanges General Frames Capital
54	Local exchange general frames (current)		PG217M	Local Exchanges General Frames Current
55	Dropwire (capital) including PSTN NTE	CL178		
56	Business PSTN drop maintenance	CL179		
57	Residential PSTN drop maintenance	CL180		
58	Pair gain	CL185		
59	PSTN line test equipment	CL177		
60	Test access management system (TAMS)	CL187		
61	PSTN line cards		PG127A	
62	ISDN2 line cards	CL184		
63	ISDN2 NTE / other	CL186		

64	ISDN2 drop (maintenance)	CL181		
65	ISDN 30 (line cards / maintenance)		PG124C/M	ISDN30 Capital / Maintenance
66	DSLAM (capital / maintenance)	CL188		Digital Subscriber Lines (DSL) Rentals
67	Other SG & A	CL509		SG & A General Access
68	External WLR SG & A		CL507	SG & A Wholesale Access
69	Internal WLR SG & A		CL508	SG & A Retail Access
70	Local loop unbundling system set up		CL126	Local Loop Unbundling System Setup
71	Local loop unbundling connection activities		CL129	Local Loop Unbundling Connections
72	Local loop unbundling room build activities		CL131	Local Loop Unbundling Room Build
73	Local loop unbundling hostel activities		CL132	Local Loop Unbundling Hostel Rentals
74	Local loop unbundling tie cables		CL133	Local Loop Unbundling Tie Cables
75	Shared local loop unbundling (SMPF) connection activities		CL134	Shared Local Loop Unbundling (SMPF) Connections
76	FRIACO Ports	CO223		
77	ATM customer interface 2mb		CO310	
78	ATM customer interface 34mb		CO311	
79	ATM customer interface > 155mb		CO312	
80	ATM network interface		CO313	
81	ATM network switching		CO314	
82	Internal PPC SG & A		CO505	SG & A Private Circuits
83	External PPC SG & A		CO506	SG & A Partial Private Circuits

84	Internal PSTN business connection activities		CL111	PSTN Business Connections
85	Internal PSTN residential connection activities		CL112	PSTN Residential Connections
86	Internal ISDN30 connection activities		CL114	ISDN30 Connections
87	Internal ISDN2 business connection activities	CL115		ISDN2 Business Connections
88	Internal ISDN2 residential connection activities	CL116		ISDN2 Residential Connections
89	ADSL connection activities		CL118	ADSL Connections
90	SDSL connection activities		CL136	SDSL Connections
91	External ISDN2 conversion activities	CL138		Wholesale ISDN2 Conversions
92	External PSTN connection activities	CL140		Wholesale PSTN Connections
93	External PSTN transfer activities		CL141	Wholesale PSTN Transfers
94	Internal PSTN takeovers activities	CL142		PSTN Takeovers
95	Internal ISDN2 takeover activities	CL143		ISDN2 Takeovers
96	Service provider gateway (capital / maintenance)		CL144	Wholesale Access specific (SPG)
97	External ISDN2 connection activities	CL145		Wholesale ISDN2 Connections
98	External ISDN2 transfer activities	CL146		Wholesale ISDN2 Transfers
99	Internal ISDN30 takeover activities	CL147		ISDN30 Takeovers
100	External ISDN30 connection activities	CL148		Wholesale ISDN30 Connections
101	External ISDN30 transfer activities	CL149		Wholesale ISDN30 Transfers

Annex 6

Descriptions for component additions where not available from most recently published Detailed Attribution Methods (DAM)

#	Component title	BT code	Component description
55	Dropwire (capital) including PSTN NTE	CL178	Provision and installation exchange lines pay for business & residential (NWR & NWB), non-capital provision and installation exchange lines activities (NWKR, NWKB), general management pay, rates on installation, Telereal rent, fuel, BTextact charges
56	Business PSTN drop maintenance	CL179	Customer network wiring & NTE maintenance (SUNB), reactive repair wiring dropwire (OB), line faults (MG), general management pay
57	Residential PSTN drop maintenance	CL180	Customer network wiring & NTE maintenance (SUNR), reactive repair wiring dropwire (OR), line faults (MG), testing & records for lines (RHD), general management pay, Telereal rent, BTextact charges
58	Pair gain	CL185	Includes depreciation and maintenance of electronic equipment which provides additional virtual capacity in the access network
59	PSTN line test equipment	CL177	Local exchange measure & test equipment (LXTM, LTS), Operations & Surveillance (OSD), management pay, rent
60	Test access management system (TAMS)	CL187	Depreciation & maintenance of Test Access Management equipment used to provide testing access to the main distribution frame

62	ISDN2 line cards	CL184	Construction & maintenance of System X & Y, rent, electricity
63	ISDN2 NTE / other	CL186	NTE equipment, low band digital access pay (DAB), general management
64	ISDN2 drop (maintenance)	CL181	Maintain Low band digital Access business & residential (MDAB, MDAR). SUNB/R OB/OR drop maintenance
66	DSLAM (capital/maintenance)	CL188	Construction & maintenance of DSL, network building depreciation, electricity, BText charges
67	Other SG & A	CL509	OLO support costs, software depreciation, BTWM general ICT accrual, BTR IPLCs to OLOs
76	FRIACO Ports	CO223	This component captures the cost relevant to the Flat Rate Internet Access Call Origination (FRIACO) port (allowing un-metered access to the internet over Public Switched Telephone Network (PSTN)) connecting with the internet supplier at the Local Exchange
87	Internal ISDN2 business connection activities	CL115	Costs incurred for the provision of ISDN2 to BT Retail business customers including MDF jumpering, service activation, network routing & order handling
88	Internal ISDN2 residential connection activities	CL116	Costs incurred for the provision of ISDN2 to BT Retail residential customers including MDF jumpering, service activation, network routing & order handling
91	External ISDN2 conversion activities	CL138	Costs incurred for the conversion of an existing wholesale/service provider PSTN line to ISDN2 working including MDF jumpering changes, service activation & order handling
92	External PSTN connection activities	CL140	Costs incurred for the provision of PSTN line to wholesale/service provider end customers including MDF jumpering, service activation, network routing & order handling
94	Internal PSTN takeovers	CL142	Costs incurred for the takeover of an existing line for BT Retail residential &

	activities		business customers including records and order handling
95	Internal ISDN2 takeover activities	CL143	Costs incurred for the takeover of an existing ISDN2 line for BT Retail residential & business customers including records and order handling
97	External ISDN2 connection activities	CL145	Costs incurred for the provision of ISDN2 services to wholesale customers. The costs include MDF jumpering, service activation, network routeing & order handling
98	External ISDN2 transfer activities	CL146	Costs of ISDN2 transfers for wholesale customers which include primarily provisioning and installations and general management
99	Internal ISDN30 takeover activities	CL147	Costs incurred for the takeover of an existing ISDN30 line for BT Retail business customers including records and order handling
100	External ISDN30 connection activities	CL148	Costs incurred for the provision of ISDN30 to wholesale/service provider end customers including circuit connection, service activation, network routeing & order handling
101	External ISDN30 transfer activities	CL149	Costs incurred for the transfer of ISDN30 from a wholesale/service provider end customer to another wholesale/service provider customer including circuit connection, service activation, network routeing & order handling

Annex 7

Notification and Proposed Amendments to Direction 3

Notification of a proposal under section 49 of the Communications Act 2003

Proposal for modifying Directions given under SMP Services Condition OA2 and FA10.2 specifying requirements for the preparation, audit and delivery of Regulatory Financial Statements in respect of wholesale cost accounting, accounting separation and retail cost accounting

1. Ofcom hereby makes, in accordance with section 49 of the Communications Act 2003 ("the Act"), the following proposal to modify:

- i. Direction 3 given under SMP Services Condition OA2 at Annex 4 of The Regulatory Financial Reporting obligations on BT and Kingston Communications statement, dated 22 July 2004, specifying requirements for the preparation, audit and delivery of Regulatory Financial Statements in respect of wholesale cost accounting, accounting separation and retail cost accounting; and
 - ii. A Direction given under SMP Services Condition FA10.2 at Schedule 4 to the Notification set out in Annex 2 of the Review of the wholesale local access market, dated 16 December 2004, specifying requirements for the preparation, audit and delivery of Regulatory Financial Statements in respect of wholesale cost accounting, accounting separation and retail cost accounting.
2. The draft modification to the Directions is set out in the Schedule to this notification.
3. The effect of the draft modification to the Directions, and the reasons for making the proposal, are set out in the accompanying explanatory statement.
4. Representation may be made to Ofcom about the proposed draft modification to the Direction by 5 pm on 23 June 2005.
5. In accordance with section 50 of the Act, copies of this notification have been sent to the Secretary of State, the European Commission and to the regulatory authorities of every other Member State.

DAVID K S THOMAS

Director of Regulatory Finance, Ofcom

A person authorised by Ofcom under paragraph 18 of the Schedule to the Office of Communications Act 2002

26 May 2005

Schedule

[Draft] Direction modifying Directions under section 49 of the Communications Act 2003 and SMP Services Conditions OA2 FA10.2 specifying requirements for the preparation, audit and delivery of Regulatory Financial Statements in respect of wholesale cost accounting, accounting separation and retail cost accounting

WHEREAS:

(A) as a result of a market analysis carried out by the Director General of Telecommunications (the 'Director') and OFCOM in accordance with section 79 of the Act, BT has been designated as having SMP in respect of certain identified markets in accordance with section 79 of the Act;

(B) as a result of such SMP designations, BT has been subjected to various SMP services conditions in accordance with sections 45 and 86 to 92 of the Act, including conditions OA1 to OA34 and FA10 imposing obligations on BT in respect of wholesale cost accounting, accounting separation and retail cost accounting in relation to BT's activities in those markets where BT has been designated as having SMP;

(C) in complying with the SMP services conditions referred to in paragraph B above, and in particular conditions OA5 and FA10.5, BT is required to, amongst other things:

- a) prepare;
- b) secure an audit opinion in respect of;
- c) deliver to OFCOM (with the corresponding audit opinion); and
- d) publish (with the corresponding audit opinion)

the Regulatory Financial Statements as directed by OFCOM from time to time.

(D) by virtue of the Transitional Provisions, references to the Director in any of those SMP services conditions should be read as references to OFCOM;

(E) condition OA2 and FA10 include, in accordance with section 45(10) of the Act, the ability for OFCOM to make such directions as they consider appropriate from time to time in relation to BT's obligations under conditions OA1 to OA34 and FA10;

(F) this Modified Direction modifies:

- i. Direction 3 given under SMP Services Condition OA2 at Annex 4 of The Regulatory Financial Reporting obligations on BT and Kingston Communications statement, dated 22 July 2004 (the "Original Direction 3"), which relates to BT's obligations under SMP services conditions OA1 to OA34, in that it sets out an amendment to the Regulatory Financial Statements which are required to be prepared, audited (including the level of audit), delivered to OFCOM and/or published by BT under condition OA5; and
- ii. a Direction given under SMP Services Condition FA10.2 at Schedule 4 to the Notification set out in Annex 2 of the Review of the wholesale local access market, dated 16 December 2004, (the "Original FA10 Direction" which relates to BT's obligations under SMP services condition FA10, in that it sets out an

amendment to the Regulatory Financial Statements which are required to be prepared, audited (including the level of audit), delivered to OFCOM and/or published by BT under condition FA10.5;

(G) for the reasons set out in the explanatory statement accompanying this modified Direction, OFCOM are satisfied that, in accordance with section 49(2) of the Act, this Direction is:

- i. (i) objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
- ii. not such as to discriminate unduly against particular persons or against a particular description of persons;
- iii. proportionate to what it is intended to achieve; and
- iv. in relation to what it is intended to achieve, transparent;

(H) for the reasons set out in the explanatory statement accompanying this modified Direction, Ofcom have considered and acted in accordance with the six Community requirements set out in section 4 of the Act and their duties in section 3 of the Act;

(I) on 26 May 2005, Ofcom published a notification of the proposed modified Direction in accordance with section 49 of the Act (the 'Notification');

(J) a copy of the Notification was sent to the Secretary of State, the European Commission and the regulatory authorities at every other Member State in accordance with section 50 of the Act;

(K) in the Notification and accompanying explanatory statement OFCOM invited representations about any of the proposals therein by 23 June 2005;

(L) by virtue of section 49(9) of the Act, OFCOM may give effect to the proposal set out in the Notification, with or without modification, only if-

- a) they have considered every representation about the proposal that is made to them within the period specified in the Notification; and
- b) 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;

(M) Ofcom has considered every representation about the proposed modified Direction duly made to them and these representations are discussed in Section [...] of the statement accompanying this modified Direction; and the Secretary of State has not notified OFCOM of any international obligation of the United Kingdom for this purpose;

NOW, therefore, pursuant to section 49 of the Act and Condition OA2, OFCOM hereby gives the following modification to the Original Direction 3 and the Original FA10 Direction:

1. BT shall, for the purposes of condition OA5 and FA10.5 and as appropriate, prepare, secure an appropriate audit opinion in respect of, deliver to OFCOM and publish the Regulatory Financial Statements in accordance with Annexes A, B and C of the Original Direction 3 and the Original FA10 Direction modified by Annex A to this Direction;

2. For the purpose of interpreting this modified Direction, the following definitions shall apply:

- a) "Act" means the Communications Act 2003 (c. 21);
- b) "BT" means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 736 of the Companies Act 1985, as amended by the Companies Act 1989;
- c) "Director" means the Director General of Telecommunications as appointed under section 1 of the Telecommunications Act 1984;
- d) 'OFCOM' means the Office of Telecommunications
- e) "Notification" means the Notifications which set in place the obligations on BT referred to in recital (B) of this modified Direction above; and
- f) 'Transitional Provisions' means sections 408 and 411 of the Act, the Communications Act 2003 (Commencement No.1) Order 2003, and the Office of Communications Act 2002 (Commencement No. 3) and Communications Act 2003 (Commencement No. 2) Order 2003./

3. 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 Notification and otherwise any word or expression shall have the same meaning as it has in the Act.

4. For the purpose of interpreting this modified Direction:

- a) headings and titles shall be disregarded; and
- b) the Interpretation Act 1978 (c. 30) shall apply as if this Direction were an Act of Parliament.

5. This Direction shall take effect on the day it is published.

6. The Schedule to this modified Direction shall form part of this modified Direction.

[Name]

[Title]

A person authorised by Ofcom under paragraph 18 of the Schedule to the Office of Communications Act 2002

[Date]

ANNEX A

Annexes A, B and C of the Original Direction 3 and Annexes A and B of the Original FA10 Direction shall be modified to reflect the following changes to the basis of reporting of the financial statements as highlighted below:

Financial Statement	Market or Service		Audit Opinion		Published	
	Market	Service	FPIA	PPIA	Yes	No
Market network services reconciliation statement (NCR FA) - Annex 40		X	X	<u>X</u>	X	<u>X</u>
Statements of costs and charges for internal and external wholesale services (SoCC Ext) – Annex 34		X		X	<u>X</u>	X
Statements of costs and charges for internal only wholesale services (SoCC Int) – Annex 35		X		X	<u>X</u>	X
Residential IDD calls to category B routes (retail IDD routes which are not competitive at WS) in the UK excluding the Hull area – Consolidated statement for all category B routes	X		X		X	
- note: individual service statements by route for above market, will not be produced						
BT Network Consolidated Profitability and Mean Capital Employed Statement by Wholesale Service – Annex 36		X		X	X	<u>X</u>
Following Statements removed from reporting matrix						
Wholesale summary narrowband P&L statement (RTW) Annex 7	X		X		X	
Wholesale summary narrowband MCE statement (RTW) Annex 8	X		X		X	
Retail summary narrowband statement P&L statement (RTR) Annex 17	X		X		X	
Retail summary narrowband statement MCE statement (RTR) Annex 18	X		X		X	

Annex 8

Notification and Proposed Amendments to Direction 4

Proposed modification to Direction 4 for BT: Form and content of Regulatory Financial Statements

Notification of a proposal under section 49 of the Communications Act 2003

Proposal for modifying a Direction given under SMP Services Condition OA2 and FA10.2 specifying requirements for the form and content of Regulatory Financial Statements in respect of wholesale cost accounting, accounting separation and retail cost accounting

1. Ofcom hereby makes, in accordance with section 49 of the Communications Act 2003 ("the Act"), the following proposal to modify:

- i. Direction 4 given under SMP Services Condition OA2 at Annex 4 of *The Regulatory Financial Reporting obligations on BT and Kingston Communications statement, dated 22 July 2004*, specifying requirements for the form and content of Regulatory Financial Statements in respect of wholesale cost accounting, accounting separation and retail cost accounting; and
 - ii. a Direction given under SMP Services Condition FA10.2 at Schedule 5 to the Notification set out in Annex 2 of the *Review of the wholesale local access market, dated 16 December 2004*, specifying requirements for the form and content of Regulatory Financial Statements in respect of wholesale cost accounting, accounting separation and retail cost accounting;
2. The draft modification to the Direction is set out in the Schedule to this notification.
3. The effect of the draft modification to the Direction, and the reasons for making the proposal, are set out in the accompanying explanatory statement.
4. Representation may be made to Ofcom about the proposed draft modification to the Direction by 5 pm on 23 June 2005.
5. In accordance with section 50 of the Act, copies of this notification have been sent to the Secretary of State, the European Commission and to the regulatory authorities of every other Member State.

DAVID K S THOMAS

Director of Regulatory Finance, Ofcom

A person authorised by Ofcom under paragraph 18 of the Schedule to the Office of Communications Act 2002

26 May 2005

Schedule

[Draft] Direction modifying a Direction under section 49 of the Communications

Act 2003 and SMP Services Condition OA2 and FA10.2 specifying requirements for the form and content of Regulatory Financial Statements in respect of wholesale cost accounting, accounting separation and retail cost accounting

WHEREAS:

(A) as a result of a market analysis carried out by the Director General of Telecommunications (the 'Director') and OFCOM in accordance with section 79 of the Act, BT has been designated as having SMP in respect of certain identified markets in accordance with section 79 of the Act;

(B) as a result of such SMP designations, BT has been subjected to various SMP services conditions in accordance with sections 45 and 86 to 92 of the Act, including conditions OA1 to OA34 and FA10 imposing obligations on BT in respect of wholesale cost accounting, accounting separation and retail cost accounting in relation to BT's activities in those markets where BT has been designated as having SMP;

(C) in complying with the SMP services conditions referred to in paragraph B above, and in particular condition OA5 and FA10.5, BT is required to prepare such Regulatory Financial Statements as directed by OFCOM from time to time;

(D) by virtue of the Transitional Provisions, references to the Director in any of those SMP services conditions should be read as references to OFCOM;

(E) conditions OA2 and FA10.2 includes, in accordance with section 45(10) of the Act, the ability for OFCOM to make such directions as they consider appropriate from time to time in relation to BT's obligations under conditions OA1 to OA34 and FA10;

(F) this Modified Direction modifies:

- i. Direction 4 given under SMP Services Condition OA2 at Annex 4 of The Regulatory Financial Reporting obligations on BT and Kingston Communications statement, dated 22 July 2004 (the "Original Direction 4"), which relates to BT's obligations under SMP services conditions OA1 to OA34, in that it sets out the form and content to be applied by BT in preparing certain Regulatory Financial Statements required by virtue of condition OA5 and the Original Direction 4; and
- ii. A Direction given under SMP Services Condition FA10.2 at Schedule 5 to the Notification set out in Annex 2 of the Review of the wholesale local access market, dated 16 December 2004 (the "Original FA10 Direction"), which relates to BT's obligations under SMP services condition FA10, in that it sets out the form and content to be applied by BT in preparing certain Regulatory Financial Statements required by virtue of condition FA10.5 and the Original FA10 Direction;

(G) BT is entitled to depart from the form and content set out in this Direction in certain circumstances in accordance with conditions OA7 and OA21 and FA10.7 and FA10.21;

(H) for the reasons set out in the explanatory statement accompanying this modified Direction, OFCOM are satisfied that, in accordance with section 49(2) of the Act, this Direction is:

- i. objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
- ii. not such as to discriminate unduly against particular persons or against a particular description of persons;
- iii. proportionate to what it is intended to achieve; and
- iv. in relation to what it is intended to achieve, transparent;
- v. for the reasons set out in the explanatory statement accompanying this modified Direction, Ofcom have considered and acted in accordance with the six Community requirements set out in section 4 of the Act and their duties in section 3 of the Act;

(J) on 26 May 2005, Ofcom published a notification of the proposed modified Direction in accordance with section 49 of the Act (the 'Notification');

(K) a copy of the Notification was sent to the Secretary of State, the European Commission and the regulatory authorities at every other Member State in accordance with section 50 of the Act;

(L) in the Notification and accompanying explanatory statement OFCOM invited representations about any of the proposals therein by 23 June 2005;

(M) by virtue of section 49(9) of the Act, OFCOM may give effect to the proposal set out in the Notification, with or without modification, only if-

- a) they have considered every representation about the proposal that is made to them within the period specified in the Notification; and
- b) 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;

(N) Ofcom has considered every representation about the proposed modified Direction duly made to them and these representations are discussed in Section [...] of the statement accompanying this modified Direction; and the Secretary of State has not notified OFCOM of any international obligation of the United Kingdom for this purpose;

NOW, therefore, pursuant to section 49 of the Act and Condition OA2, OFCOM hereby gives the following modification to the Original Direction 4 and the Original FA10 Direction:

1. Except where BT is entitled to amend the form and content of the Regulatory Financial Statements in accordance with conditions OA7 and OA21 and FA10.7 and FA10.21, BT shall ensure that the Regulatory Financial Statements required by conditions OA5 and FA10.5 and Original Direction 3 and Original FA10 Direction (both as amended) shall be prepared, as appropriate, as to form and content in the manner set out in the Original Direction 4 and the Original FA10 Direction as modified by the Annexes to this Direction;

2. The Original Direction 4 and the Original FA10 Direction shall be modified so that the Regulatory Financial Statements shall be prepared to include the following form and content:

- a) the Dominant Provider shall use reporting denominations in million pound units (£ m) rather than thousand pound units (£ k);
- b) the Regulatory Financial Statements shall include the following standard list of expenditure categories specific to all wholesale markets:
 - provision and installation/maintenance
 - network support
 - general support
 - general management
 - finance and billing
 - accommodation
 - bad debts
 - other costs
 - depreciation
 - o access
 - o switch and transmission
 - o other
- c) the Regulatory Financial Statements shall include the following standard list of expenditure categories specific to all retail markets:
 - inputs @ tariff
 - inputs @ cost
 - outpayments
 - marketing and sales
 - customer services
 - finance and billing
 - bad debts
 - general management
 - computing
 - BT messaging service payments
 - other costs
- d) The Dominant Provider shall not be required to prepare comparative statements for the year 2003/04 for the following Annex of the Original Direction 4 and the Original FA10 Direction:

- Annex 24 – Wholesale sales by market statement, external sales;
- e) The Dominant Provider shall be required to prepare partial or de-facto comparative statements for the year 2003/04 for the following Annexes of the Original Direction4 and the Original FA10 Direction:
- Annex 36 – Consolidated profitability and MCE statements by wholesale service;
 - Annex 37 – Consolidated statement of costs on a current cost basis, network activity statement;
 - Annex 38 – Market statement of costs on a current cost basis, network activity statement;
 - Annex 39 – Consolidated network services reconciliation statement;
 - Annex 40 – Market network services reconciliation statement; and
 - Annex 41 – Network component statement on incremental cost basis (reconciliation).
- f) discount information should be separately identified in each Profit and Loss Statement, where discounts account for 10% or more of gross revenues;

Illustrative examples of the changes in (a) to (c) and (f) are set out in Annex A to this Direction

3. The Additional Financial Information set out in Annex 42 to the Original Direction 4 and the Original FA10 Direction shall be amended as set out in Annex B to this Direction.

4. For the purpose of interpreting this modified Direction, the following definitions shall apply:

- a) "**Act**" means the Communications Act 2003 (c. 21);
- b) "**BT**" means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 736 of the Companies Act 1985, as amended by the Companies Act 1989;
- c) "**Director**" means the Director General of Telecommunications as appointed under section 1 of the Telecommunications Act 1984;
- d) '**Direction 3**' means this Modified Direction given under SMP Services Condition OA2 at Annex 4 of The Regulatory Financial Reporting obligations on BT and Kingston Communications statement, dated 22 July 2004, which relates to BT's obligations under SMP services conditions OA1 to OA34, in that it sets out the Regulatory Financial Statements which are required to be prepared, audited (including the level of audit), delivered to OFCOM and/or published by BT under condition OA5 as modified;
- e) '**OFCOM**' means the Office of Telecommunications
- f) "**Notification**" means the Notifications which set in place the obligations on BT referred to in recital (B) of this modified Direction above; and

- g) **'Transitional Provisions'** means sections 408 and 411 of the Act, the Communications Act 2003 (Commencement No.1) Order 2003, and the Office of Communications Act 2002 (Commencement No. 3) and Communications Act 2003 (Commencement No. 2) Order 2003./

4. 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 Notification and otherwise any word or expression shall have the same meaning as it has in the Act.

5. For the purpose of interpreting this modified Direction:

- a) headings and titles shall be disregarded; and
- b) the Interpretation Act 1978 (c. 30) shall apply as if this Direction were an Act of Parliament.

6. This Direction shall take effect on the day it is published.

7. The Schedule to this modified Direction shall form part of this modified Direction.

[Name]

[Title]

A person authorised by Ofcom under paragraph 18 of the Schedule to the Office of Communications Act 2002

[Date]

ANNEX A

The Original Direction 4 and the Original FA10 Direction shall be modified as highlighted below in underlining and italics

BT Wholesale Market Statement

CURRENT COST PROFIT AND LOSS ACCOUNT for the year ended 31 March 2005		Restated (cross refer to notes)				
	Notes	£m -£k 2005	% per line item/total	£m -£k 2004	% per line item/total	% Change Year on Year
Turnover (<i>identifying Gross, Discounts and Net turnover</i>)						
Internal Sales (<i>Gross/Net</i>)						
- services which are also available externally						
- services provided internally only						
External Sales (<i>Gross/Net</i>)						
<i>Discounts (No disclosure required if less than 10% of Gross Revenue)</i>						
Total Turnover			100%		100%	
Operating costs						
Charges from Other BT Wholesale Markets						
Operating costs of Wholesale Market (<i>to show all cost categories that exceed 10% of operating cost</i>)						
<i>- Provision & Installation / Maintenance</i>						
<i>- Network support</i>						
<i>- General support</i>						
<i>- General management</i>						
- Finance and billing						
<i>- Accommodation</i>						
- Bad debts						
- Other Costs (<i>total of items below 10% of operating cost</i>)						
<i>- Depreciation</i>						
<i>Access</i>						
<i>Switch and transmission</i>						
<i>Other</i>						
- Outpayments						
	Sub total operating expenditure		100%		100%	
CCA adjustments:						
Holding (gain)/loss						
Supplementary depreciation						
Other adjustments						
Total operating costs						
Return						
RETURN ON MEAN CAPITAL EMPLOYED AND TURNOVER						
for the year ended 31 March 2005		2005		2004		
		%		%		%
Return on mean capital employed						
Return on turnover						

BT Wholesale Market Statement

STATEMENT OF CURRENT COST MEAN CAPITAL EMPLOYED		Restated (cross refer to notes)		
for the year ended 31 March 2005				
	Notes	£m - £k 2005	£m - £k 2004	% Change
Fixed assets				
Tangible fixed assets (identifying asset categories where the value exceeds 10% of total fixed asset base)				
- Land & Buildings				
- Duct				
- Transmission Equipment				
- Exchange Equipment				
- Other				
Investments				
Total fixed assets				
Current assets				
Stocks				
Debtors				
- internal				
- external				
Total current assets				
Creditors: amounts falling due within one year				
Other creditors				
- internal				
- external				
Total creditors: amounts falling due within one year				
Net current assets				
Total assets less current liabilities				
Provisions for liabilities and charges				
Mean capital employed				

BT Retail Market Statement

CURRENT COST PROFIT AND LOSS ACCOUNT for the year ended 31 March 2005				Restated (cross refer to notes)		
	Notes	£m -£k 2005	% per line item/total	£m -£k 2004	% per line item/total	% Change Year on Year
Turnover (identifying Gross, Discounts and Net turnover)						
<i>Discounts (No disclosure required if less than 10% of Gross Revenue)</i>						
Total Turnover			100%		100%	
Operating costs						
Charges from BT Wholesale Markets						
- wholesale market A						
<u>inputs @ tariff</u>						
<u>inputs @ cost</u>						
- wholesale market B						
<u>inputs @ tariff</u>						
<u>inputs @ cost</u>						
<i>Outpayments</i>						
<u>Sub total</u>						
Operating costs of Retail Market						
- Marketing & sales						
- Customer services						
- Finance & Billing						
- Bad debts						
- <u>General management</u>						
- <u>Computing</u>						
- <u>BT Messaging service payments</u>						
- Other Costs (total of items below 10% of operating cost)						
Sub total operating expenditure						
			100%		100%	
CCA adjustments:						
Holding (gain)/loss						
Supplementary depreciation						
Other adjustments						
Total operating costs						
Return						
RETURN ON MEAN CAPITAL EMPLOYED AND TURNOVER						
for the year ended 31 March 2005		2005		2004		%
		%		%		%
Return on mean capital employed						
Return on turnover						

BT Retail Market Statement

STATEMENT OF CURRENT COST MEAN CAPITAL EMPLOYED		Restated (cross refer to notes)		
for the year ended 31 March 2005				
	Notes	£m - £k 2005	£m - £k 2004	% Change
Fixed assets				
Tangible fixed assets (identifying asset categories where the value exceeds 10% of total fixed asset base)				
- Land & Buildings				
- Duct				
- Transmission Equipment				
- Exchange Equipment				
- Other				
Investments				
Total fixed assets				
Current assets				
Stocks				
Debtors				
- internal				
- external				
Total current assets				
Creditors: amounts falling due within one year				
Other creditors				
- internal				
- external				
Total creditors: amounts falling due within one year				
Net current assets				
Total assets less current liabilities				
Provisions for liabilities and charges				
Mean capital employed				