



BT Regulatory Financial Report 2006

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Introduction

Introduction

This report forms part of the overall body of evidence that demonstrates that BT has complied with key regulatory obligations, in particular the requirements to implement accounting separation, to comply with price controls, to set prices that are cost-oriented and not to unduly discriminate. The report includes the following:

- Costs relating to SMP markets and key individual products, and the relationship of those costs to the prices charged both internally to downstream parts of BT and externally to third parties.
- Key performance indicators relating to regulatory obligations.
- Descriptions of BT's accounting processes and the methodologies used to allocate costs to services and markets.

Current Cost Accounting

The accounting information presented in this report is on a Current Cost Accounting (CCA) basis. This is different from the Historical Cost Accounting basis in that it takes account of changes in the purchasing power of money and the impact that this has on the carrying value of assets. CCA is used for regulatory accounts because regulation takes a forward looking approach to setting prices, which need to give appropriate economic signals to customers, end-users and other network operators. The CCA adjustments relating to each SMP market are identified in the individual statements in this report and isolate the effects of one-off holding gains and losses over the year.

Status of this report

Readers should note that this report is being produced voluntarily by BT, in addition to the main Current Cost Regulatory Financial Statements that BT is required to publish for the year ended 31 March 2006. BT has compiled the information in this report to demonstrate that a more user-friendly form and content of financial and related data gives a high level of assurance of BT's compliance, without the need to publish the very detailed information included in the main Regulatory Financial Statements.

Ofcom consulted on the future of BT's regulatory financial reporting during 2006, and intend to issue a further consultation document in the autumn of 2006. By publishing this report BT aims to contribute to the debate about the most appropriate information to publish regarding BT's compliance with the key obligations referred to above. The content of this report has been influenced by feedback from industry members on a draft pro-forma version that BT put into the public domain earlier in 2006 as part of the consultation process.

Invitation to comment

BT is actively seeking comments on this fully populated report, in order to take the debate forward and to work with key stakeholders on providing relevant and useful information in the future.

Comments and suggestions regarding the form and content of this report should be sent by e-mail to: peter.2.greenwood@bt.com. If you are unable to use electronic mail please send your comments to: The Director of Regulatory Finance at BT Centre, 81 Newgate Street, London, EC1A 7AJ.

Regulatory framework

The Regulatory Regime

BT operates within a regulatory regime based on five EC Communication Directives implemented in April 2002. The Directives, which aim to create harmonised regulation of the electronic communications markets throughout the Community, were transposed into UK law in the Communications Act 2003 (“The Act”). Ofcom use the Act to issue formal Directions on all operators with Significant Market Power (SMP).

Ofcom undertook reviews of communications markets in the UK to determine whether any operators had SMP in specified markets. Following those reviews BT was deemed to have SMP in a number of Wholesale and Retail markets, as described below. Where an operator has SMP, the Act enables Ofcom to impose one or more obligations in relation to each market, including:

- **Accounting separation**, which requires the operator to maintain accounting systems such that the financial results of each SMP market can be separately presented and that costs relating to products and markets are allocated in a transparent and appropriate way. Accounting separation is also used to ensure that there is no undue discrimination.
- **Cost accounting** in relation to both wholesale and retail activities. Wholesale activities include the provision of network access, the use of the network and the availability of various facilities. Retail activities are those that relate to services to end-users. Obligations may include price controls for specified SMP products, cost-orientation of prices for SMP products and the recovery of costs for the purpose of demonstrating transparency.
- **Publication** of financial information in relation to SMP markets. The annual regulatory financial statements satisfy this obligation, and the publication of information relating to SMP markets is intended to provide public assurance that BT has complied with its cost accounting and accounting separation obligations. BT is required to have the published statements audited by an independent auditor.

The form and content of the published regulatory financial statements is reviewed regularly by Ofcom, in the light of changes in the regulatory regime and the needs of stakeholders. Ofcom also requires BT to provide more detailed information to enable Ofcom to regulate effectively and efficiently, this being in addition to the information in the regulatory financial statements, and not published by either BT or Ofcom.

SMP Markets

As referred to above, Ofcom determined that BT has SMP in a number of specified markets. The SMP status of BT in each market is subject to periodic review by Ofcom, and the requirement to publish financial and other relevant information in relation to each SMP may change as a result of these reviews.

The markets in which BT has SMP in the period covered by the current report are as follows:

Wholesale Markets:

- Wholesale residential analogue exchange line services
- Wholesale business analogue exchange line services
- Wholesale business ISDN2 exchange line services
- Call origination on fixed public narrowband networks
- Local-tandem conveyance and transit on fixed public narrowband networks
- Single transit on fixed public narrowband networks
- Technical areas (Interconnect Circuits)
- Fixed call termination
- Traditional interface symmetric broadband origination (up to and including 8Mbit/s)
- Traditional interface symmetric broadband origination (above 8Mbit/s up to and including 155Mbit/s)
- Alternative interface symmetric broadband origination (all bandwidths)
- Wholesale trunk segments
- Technical areas (Point of Handover)
- Wholesale IDD to category B
- Asymmetric broadband origination in the UK
- Broadband conveyance in the UK
- Wholesale residential ISDN2 exchange line services
- Wholesale business ISDN30 exchange line services
- Wholesale local access (i.e. LLU services sold externally).

Retail Markets:

- Residential analogue exchange line services in the UK
- Residential local calls in the UK
- Residential national calls in the UK
- Residential IDD calls category A routes (retail IDD routes which are competitive) in the UK
- Residential IDD calls category B routes (retail IDD routes which are not competitive) in the UK
- Residential calls to mobiles in the UK
- Residential operator assisted calls in the UK.

In this pro-forma report, BT is re-presenting and reporting on the above markets in a revised format that proposes a new basis of financial reporting in the future.

In the wholesale markets above BT has amalgamated the following markets to reflect a ‘hybrid’ view of the revenues, costs, assets and liabilities of the Wholesale Access Markets. This hybrid view does not replicate the Openreach Line of Business (created in 2006 as part of BT’s Undertakings arising from Ofcom’s Telecom Strategic Review), as the market definitions do not exactly map into the products sold by Openreach, and this business did not begin to trade separately until 1 April 2006.

Regulatory framework

The following markets are those identified as Wholesale Access markets:

- Wholesale residential analogue exchange line services
- Wholesale business analogue exchange line services
- Wholesale business ISDN2 exchange line services
- Traditional interface symmetric broadband origination (up to and including 8Mbit/s)
- Traditional interface symmetric broadband origination (above 8Mbit/s up to and including 155Mbit/s)
- Wholesale residential ISDN2 exchange line services
- Wholesale business ISDN30 exchange line services
- Alternative Interface Symmetric Broadband Origination (all bandwidths)
- Wholesale local access in the UK (i.e. LLU services sold externally).

The remaining Wholesale SMP markets are amalgamated and referred to in this pro-forma as Wholesale SMP Markets:

- Call origination on fixed public narrowband networks
- Local-tandem conveyance and transit on fixed public narrowband networks
- Single transit on fixed public narrowband networks
- Technical areas (Interconnect Circuits)
- Fixed call termination
- Wholesale trunk segments
- Technical areas (Point of Handover)
- Wholesale IDD to category B
- Asymmetric Broadband Origination in the UK
- Broadband Conveyance in the UK.

Basis of accounting

Accounting policies and methodologies

The regulatory financial statements are based on the same general ledger information that is used to prepare the statutory accounts for BT Group plc. A reconciliation between the consolidated regulatory financial accounts and the statutory accounts is set out in Annex 5 of the report.

BT prepares its regulatory accounts in accordance with documented accounting policies and methodologies, to ensure consistency year-on-year. These policies and methodologies have been developed over a number of years and are comprehensively described in the following documents, which are available to Ofcom, and to the auditors in support of the independent audit of the published regulatory financial statements:

- Primary Accounting Documents – this consists of subsidiary documents that set out BT's Regulatory Accounting Principles, the Attribution Methods, the Transfer Charge System Methodology, the Accounting Policies and the Long Run Incremental Cost (LRIC) Methodology.
- Secondary Accounting Documents – these provide more detailed information relating to various aspects of the accounting approaches, namely Detailed Attribution Methods, Detailed Valuation Methodologies and Long Run Incremental Costs: Relationships and Parameters.

These documents have been published by BT and are available from the BT Group plc website.

Principles of cost attribution

The Accounting Documents referred to above set out in detail the way in which accounting information is attributed to products and to SMP markets. As far as possible revenues, costs, assets and liabilities are allocated to the specific products and markets to which they directly relate. However, many costs and assets relate to more than one product or market, and attribution approaches need to be developed that allocate amounts on an appropriate cost-causal basis. The basis will vary from case to case, depending on the nature of the cost incurred or the asset used.

The accounting separation process takes these common and shared costs and allocates them in such a way that they are all attributed appropriately to the markets and to the products that sit in each market.

The attribution methodologies apply to the whole of BT's operations; to ensure that costs are fairly allocated to both SMP and non-SMP activities, reflecting the costs caused by activities and the assets used by them during the year.

Prior year comparatives

The financial statements and key indicators presented in this report include prior year comparatives, in order to indicate trends in performance, and as far as possible comparative data is drawn from previously published information. However, in some cases, for example where regulatory

obligations have changed, BT's financial systems may not be able to provide the required data and in these cases comparatives have not been shown.

BT now records its transactions in the accounting records in accordance with UK's legal requirements and for the first time for the year ended 31 March 2006 under International Financial Reporting standards as adopted by the European Union (IFRS). The date and transition for adopting IFRS in the statutory accounts was 1 April 2004 with the exception of IAS 32 'Financial Instruments: Disclosure and Presentation' and IAS 39 'Financial instruments Recognition and Measurement' which has been applied with effect from 1 April 2005. However, in the Regulatory Financial Report the comparative information for the year ended 31 March 2005 was not restated to include the impact of IFRS as the most significant adjustments in respect of pensions and dividends are excluded from the current Regulatory Financial Report and the effect of spreading the impact of other adjustments was minimal across services and markets. The key adjustments to the comparative years between UK GAAP and IFRS, which are not spread across the services and markets, are outlined in Annex 5. A detailed explanation of how the transition from UK GAAP to IFRS has effected the Group financial position and reported performance is set out in the Consolidated Statutory Financial Statements of BT Group plc for the year ended 31 March 2006.

Statements of assurance

Statement of Director's Responsibility

The information presented in this pro-forma document has been prepared in order to demonstrate BT's view of the form and content of its future regulatory reporting obligations.

I hereby confirm that:

- the regulatory financial statements have been prepared on the basis of the Accounting Documents as described above; and
- the information has been accurately extracted or aggregated from the 'Current Cost Financial Statements', dated 7 September 2006.

Neil Taylor

Director, Commercial and Regulatory Finance
7 September 2006

Statement of the Equality of Access Board (EAB) - 2005/06

BT's Undertakings and the Equality of Access Board

In addition to financial reporting regulations, BT is required to report on its compliance with the Undertakings agreed with Ofcom as a result of the 2005 Strategic Review of the UK telecommunications industry. Ofcom accepted the Undertakings on 21 September 2005, and they came into force the following day. Key commitments in the Undertakings include:

- establishing a new BT access services division, Openreach (launched in January 2006);
- delivering 'equivalence of input' for certain key wholesale products and increasing transparency for others;
- ensuring fair access and migration to BT's next generation network (21C network) for other communications providers;
- publishing and making available to all BT people a code of practice explaining what they must do to comply with the Undertakings;
- creating the Equality of Access Board (EAB) to monitor, advise and report on BT's compliance with the Undertakings and the code of practice. The EAB is supported by its own Secretariat and the Equality of Access Office (EAO).

The role of the EAB does not extend to reviewing BT's financial regulatory report. However, the EAB is required to publish an Annual Report of its activities which focus on non-financial performance measures of BT's compliance. The EAB is also obliged to seek external assurance of its Annual Report by an independent auditor, who has a duty of care to Ofcom.

The EAB's first annual report was published on 31 May 2006. An extract from that Report is included at Annex 6 and provides another example of transparent reporting on BT's compliance with its regulatory responsibilities and commitments. The full report can be viewed at www.bt.com/eabreport.

Independent auditors' statement to British Telecommunications plc

We have examined the BT Regulatory Financial Report 2006 of British Telecommunications plc (the "Company").

Respective responsibilities of directors and auditors

The directors are responsible for preparing the BT Regulatory Financial Report 2006. Our responsibility is to report to you our opinion on the consistency of the financial information set out on pages 7 to 35 of the BT Regulatory Financial Report 2006, other than the analysis of mean capital employed between historic cost and current cost accounting elements and the service prices as at 31 March 2006, (the "Financial Information"), with the Current Cost Financial Statements for 2006 prepared by British Telecommunications plc in accordance with the Final Statement and Notification entitled "The regulatory financial reporting obligations on BT and Kingston Communications" issued by Ofcom on 22 July 2004 as amended by the Final Statement and Notification entitled "Changes to BT's regulatory financial reporting framework" issued by Ofcom on 31 August 2005 and the Explanatory Statement and Notification entitled "Changes to BT's regulatory financial reporting and audit requirements" issued by Ofcom on 16 August 2006 (the "Current Cost Financial Statements"). We also read the other information contained in the BT Regulatory Financial Report 2006 and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Current Cost Financial Statements.

This statement, including the opinion, has been prepared for and only for the Company for management purposes and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this statement is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Basis of opinion

We conducted our work having regard to Bulletin 1999/6, 'The auditors' statement on the summary financial statement' issued by the Auditing Practices Board for use in the United Kingdom.

Opinion

In our opinion the Financial Information set out on pages 7 to 35 within the BT Regulatory Financial Report 2006 is consistent with the Current Cost Financial Statements.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
London
7 September 2006

Wholesale Access Markets – Performance Summary

Wholesale Access Markets Summary Performance for year ended March 2006			
	2006	2005	Better/(worse) % Change
	£m	£m	Year on Year
Profit and Loss Account			
Internal Turnover	4,131	4,294	(4) %
External Turnover	567	259	119 %
Total Turnover	4,698	4,553	3 %
Provision / Maintenance	368	360	(2) %
Network Support	325	300	(8) %
General Support	439	455	4 %
General management	568	582	2 %
Finance and Billing	61	62	2 %
Accommodation	340	292	(16) %
Bad Debts	-	(4)	-
Other Costs	57	86	34 %
HCA Operating Costs	2,158	2,133	(1) %
HCA Return before Depreciation	2,540	2,420	5 %
Depreciation	1,299	1,297	-
CCA Adjustments	(206)	(27)	663 %
Roundings	3	11	73 %
Return	1,444	1,139	27 %
Mean Capital Employed	11,012	11,372	(3) %
RoCE (%)	13%	10%	3 %
* Adjusted RoCE (%)	10%	10%	
(*) Adjusted for year on year CCA movements and estimated full year effect of price cuts of £170m.			

Introduction

Purpose of table

The table summarises the performance of the SMP markets within the Wholesale Access markets sector. These markets will be aligned with the services that are, from 1 April 2006, being reported by Openreach but as this entity was not created in this period and the SMP market definitions do not exactly map to the Openreach products a direct comparison is not presented for 2005/06. This aggregation of SMP markets will however, in future years, be reconciled to a separate statement of the results of Openreach, identifying those activities of Openreach that are not included in the relevant SMP markets described below, and also those markets that do not align with the products sold by Openreach.

These services relate to local access services that link end users to Local Access Nodes, which are typically located in a BT exchange, including Wholesale Line Rental (WLR), Local Loop Unbundling (LLU) and ISDN products, and to services that provide backhaul from Local Access Nodes to core networks (either BT's network or to another operator's network at what is called a Point of Handover).

The markets summarised in the table are:

- Wholesale residential analogue exchange line services (WLR services).
- Wholesale business analogue exchange line services (WLR services).
- Wholesale residential ISDN2 exchange line services.
- Wholesale business ISDN2 exchange line services.
- Wholesale business ISDN30 exchange line services.
- Alternative Interface Symmetric Broadband Origination (all bandwidths).
- Wholesale local access (LLU services only sold externally).
- Traditional Interface Symmetric Broadband Origination (up to and including 8Mbit/s).
- Traditional Interface Symmetric Broadband Origination (above 8Mbit/s up to and including 155Mbit/s).

These markets are explained in more detail on the subsequent pages.

The return on capital employed (RoCE) percentages shown in the table enable readers to compare the returns achieved on these activities in aggregate with the rates used by Ofcom in assessing or setting prices relating to these services. The rate applicable for 2004/05 was 13.5%. During 2005/06 Ofcom determined a new rate of 10.0%, applicable from September 2005. The comparable "regulatory rate" used in the unit cost information in this document, for 2005/06 was therefore prorated to approximately 11.5%.

Wholesale Access Markets – Performance Summary

Key Market Changes

The Wholesale Access Markets has seen a continuing migration of internal revenues from BT's traditional Wholesale calls and lines business into other communication providers and other forms of communication product. This effect has been more than compensated by the growth in revenue for external wholesale line rentals and wholesale local access (i.e. external local loop unbundling) markets. The market by market view can be seen in Annex 2 of this report. The revenues within the Wholesale Access markets has also been affected by the price cuts imposed by Ofcom during 2005/06, particularly the WLR markets. The full year effect of these price cuts will be felt in 2006/07, which will reduce profits by approximately a further £170m.

The total costs have remained relatively stable through the year, with the exception of accommodation which has increased as a result of changes in the treatment of leased properties by the adoption of IFRS accounting standards by BT. As detailed in Annex 1 2004/05 comparatives have not been adjusted for the impact of IFRS, as the main IFRS adjustments related to pensions and dividends are excluded and the other adjustments when allocated across the services were deemed immaterial. The main change in the cost base can be seen in the current cost accounting adjustments (CCA). Here, the effect of a large rise in the market price of copper has led to a material year on year CCA movement within those markets using copper, thereby creating a one-off profit and loss credit of approximately £180m.

The overall return across the Wholesale Access markets will therefore be affected by the full year of price cuts going forward and a stabilisation of the cost of copper prices. If both of these effects were accounted for in 2005/06 the returns would reduce by approximately £350m, leading to a return on capital employed of approximately 10%.

The balance sheet (or Mean Capital Employed) has seen a 3% reduction due to reduced investment in the switch and transmission assets, prior to the effect of the CCA revaluation on the copper and duct assets, and a lower working capital base as a result of the pension prepayment no longer being allocated across the markets under the IFRS rules. It should be noted that these balance sheet values exclude the effects of the Regulatory Asset Valuation (RAV) adjustment which, in August 2005, Ofcom concluded should reduce the CCA value and associated depreciation of the BT copper assets. This copper revaluation was undertaken in order to better reflect Ofcom's position on price setting as annual depreciation levels and the asset value of copper were adjusted. BT maintains that its CCA value of the copper assets are appropriate in this regulatory financial report, however the RAV adjustments would raise the RoCE by less than 1%.

Wholesale Access Markets – Performance Summary by Market

Market: Wholesale residential analogue exchange line services

Summary Market Performance

	Total Turnover £m	Total CCA Operating Costs £m	Return £m	Mean Capital Employed £m	Return on Mean Capital Employed %
2005/06	2,178	1,311	867	6,112	14 % *
2004/05	2,284	1,567	717	6,138	12 %
(*) Adjusted for year on year CCA movements and estimated full year effect of price cuts of £120m					9 %

Definition

The links between a residential end user and the remote concentrator unit by means of analogue technology.

An analogue exchange line provides a single 64Kbit/s channel, designed originally to support voice traffic, but also capable of supporting data modems with bandwidths of up to 56Kbit/s, as well as facsimile traffic. These are the most common types of exchange lines, installed in most residential homes.

Key Regulatory Changes

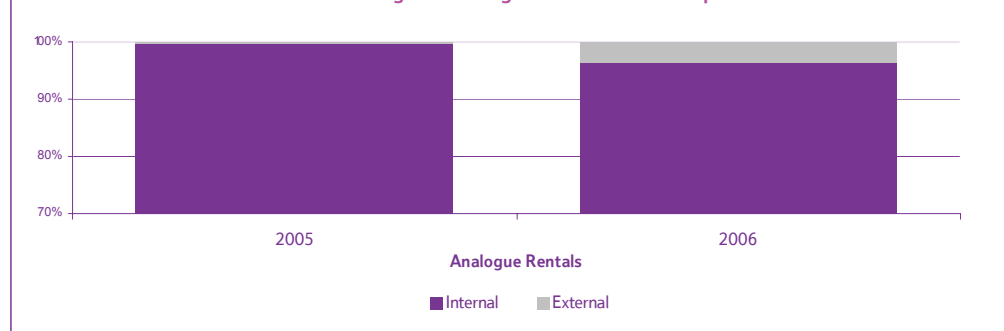
The TSR undertakings and creation of Openreach as a new line of business are the most significant regulatory change to affect this market. Additionally WLR Analogue products achieved Fit For Purpose status in December 2005 following an Ofcom / industry consultation and final determination.

There were two regulatory price changes during the year. The rentals price was reduced by 50p per month on 1st August 2005. Further price changes followed from 1st March 2006, with another 35p per month reduction in the rentals price, an increase from £1.41 to £2.00 in the transfer price and a reduction from £91.99 to £88.00 in the connection price. This was following a consultation on costs with Ofcom which replaced the previously agreed price with a further voluntary price reduction.

Wholesale residential analogue exchange line services - service performance for year ended March 2006

	Total Turnover £m	Volume (lines)	Average Price £p/u	Fully Allocated Cost £p/u	Return on price % p/u
Wholesale residential analogue exchange lines – Connections					
2006 - Internal	108	1,179,432	91.66	63.92	30.26
- External		No service *			
2005 - Internal	114	1,235,188	91.99	70.01	23.89
- External		No service *			
Wholesale residential analogue exchange lines – Rentals					
2006 - Internal	1,996	18,731,800	106.57	99.35	6.78
- External	74	698,884	106.57	105.80	0.73
2005 - Internal	2,166	19,527,093	110.92	118.09	(6.46)
- External	4	38,181	110.92	121.14	(9.21)
2006 total	2,178				
2005 total	2,284				
* BT do not identify and report these external connections separately. The financial data for this service is reported within the wholesale business external connections service. Note: Fully allocated unit costs include a RoCE %, whereas the summary market performance does not.					

Wholesale residential analogue exchange line services - comparative volumetrics



Key Market Changes

The reduction in revenue and costs is as a result of the overall decline in rental volumes due to continued migrations to LLU. The move of customers to other cable and mobile operators who are using the Wholesale Line Rental (WLR) product as a means to deliver services to their customers has resulted in the growth in external rentals as a percentage of internal rentals. Revenue was also

Wholesale Access Markets – Performance Summary by Market

reduced by the price changes implemented in the year. The full year impact of these price changes would reduce turnover and profits by approximately £120m. Combined with a stable cost of copper (which has a year on year credit to the profit and loss account of approximately £180m) this would reduce returns by approximately £300m and the RoCE would fall to 9%.

The reduction in the year on year unit costs for provision of the internal and external rental services is due to the following:

- The impact of the change in the cost of capital from 13.5% in prior year to 11.5% following a determination by Ofcom. This reduction reflects, in part, a lower inherent risk of operating in this market, compared to non-Access markets.
- A dramatic price increase in the cost of copper cable and drop-wire during the year has resulted in a CCA cost adjustment (i.e. a holding gain) that has the effect of reducing the P&L charge in the year.
- The above cost reductions have been offset, in part, by an increase in access network depreciation from £373m to £406m as the capitalised value of drop wires increases and the continued growth in ADSL technology.

Market: Wholesale business analogue exchange line services

Summary Market Performance

	Total Turnover £m	Total CCA Operating Costs £m	Return £m	Mean Capital Employed £m	Return on Mean Capital Employed %
2005/06	799	506	293	1,729	17 % *
2004/05	798	613	185	1,864	10 %
(*) Adjusted for year on year CCA movements and estimated full year effect of price cuts of £50m					11 %

Definition

The links between a business end user and the remote concentrator unit by means of analogue technology.

An analogue exchange line provides a single 64Kbit/s channel, designed originally to support voice traffic, but also capable of supporting data modems with bandwidths of up to 56Kbit/s, as well as facsimile traffic. These are the most common types of exchange lines, installed in many small business premises.

Key Regulatory Changes

The TSR undertakings and creation of Openreach as a new line of business are the most significant regulatory change to affect this market. Additionally WLR Analogue products achieved Fit For Purpose status in December 2005 following an Ofcom / industry consultation and final determination.

From 1st March 2006 the rental price reduced by 78p per month. There was also a marginal increase from £1.41 to £2.00 in the transfer price and a reduction from £91.99 to £88.00 in the connection price. This was following a consultation on costs with Ofcom which replaced the previously agreed price with a further voluntary price reduction.

Wholesale Access Markets – Performance Summary by Market

Wholesale business analogue exchange line services - service performance for year ended March 2006

	Total Turnover £m	Volume (lines)	Average Price £p/u	Fully Allocated Cost £p/u	Return on price % p/u
Wholesale business analogue exchange lines – Connections					
2006 - Internal	90	979,220	91.66	81.60	10.98
- External *	10	107,536	91.66	74.78	18.41
2005 - Internal	87	949,192	91.99	78.04	15.16
- External *	13	141,150	91.99	151.79	(65.00)
Wholesale business analogue exchange lines – Rentals					
2006 - Internal	593	5,002,152	118.62	95.66	19.35
- External	99	830,810	118.62	99.58	16.05
2005 - Internal	641	5,372,059	119.40	119.55	(0.13)
- External	52	436,133	119.40	122.08	(2.24)
Wholesale business analogue exchange lines – Takeovers/Transfers (note)					
2006 - Internal	4	2,815,107	1.46	10.68	n/m
- External *	3	2,188,367	1.46	10.45	n/m
2005 - Internal	4	2,659,386	1.41	14.55	n/m
- External *	1	763,747	1.41	44.24	n/m
2006 total	799				
2005 total	798				

Note: n/m, result not meaningful.

Note: Fully allocated unit costs include a RoCE %, whereas the summary market performance does not.

* A proportion of transfers and external connections reported within this market relate to the Wholesale residential exchange line services market but BT do not identify or report these separately.

Key Market Changes

Overall the market shows flat revenue from 2004/05 although the distribution between internal and external revenues has changed significantly with the increase in customers switching from BT Retail to other Communication Providers.

Overall internal rental volumes in the market declined by 7%, which combined with the price reduction noted above has caused a decline in internal revenue. The full year impact of these price changes would reduce future turnover and profits by approximately £50m. The external Wholesale Analogue Business product continued to see strong growth in rentals and takeovers throughout the reporting period.

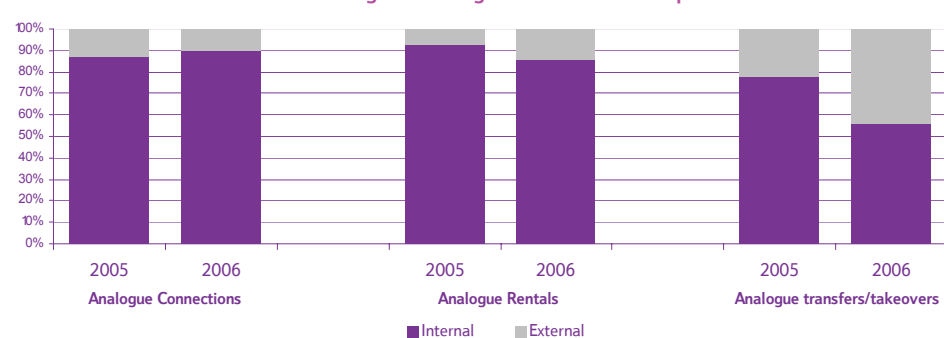
Cost reductions in the market of £107m flow from a combination of HCA total cost movements of approximately £53m (with general support costs reducing by £26m) and a CCA year on year credit to the profit and loss account of approximately £54m, arising from significant price changes in 2005/06 for copper cable and drop wire. This cost reduction is reflected within both the internal and external rental services business.

The combined effect of a full year of price cuts and a stable cost of copper would reduce profits by approximately £104m, which would lower the RoCE to 11%.

For unit costs, the impact of the change in the cost of capital from 13.5% in prior year to 11.5% following a determination by Ofcom also reduces the costs in the market. This reduction reflects, in part the reduced inherent risk of operating in this market and affects the rental service that consume elements of copper costs.

There are also declines in cost to the rental services as certain equipment, mostly Network Terminating Equipment (NTE), is becoming fully depreciated.

Wholesale business analogue exchange line services - comparative volumetrics



Wholesale Access Markets – Performance Summary by Market

Market: Wholesale business ISDN2 exchange line services

Summary Market Performance

	Total Turnover £m	Total CCA Operating Costs £m	Return £m	Mean Capital Employed £m	Return on Mean Capital Employed %
2005/06	204	172	32	344	9 %
2004/05	218	172	46	349	13 %

Definition

Digital ISDN2 exchange lines are basic rate ISDN lines, which provide a means to deploy a wide range of digital services over a standard local loop. A single ISDN2 line supports two 64Kbit/s channels for voice and data calls, plus a 16Kbit/s channel for signalling.

Key Regulatory Changes

The TSR undertakings and creation of Openreach as a new line of business are the most significant regulatory change to affect this product. Prices were reviewed as part of the WLR charge ceiling review and were felt to be reasonable when compared to the cost stack for the product.

Key Market Changes

The overall reduction in Return on Mean Capital employed for ISDN2 services from 13% last year to 9% this year, was driven primarily from a decline in internal revenue. This reduction in revenue reflects a continued migration of customers to broadband and other communication providers. There is a minor increase in the external rental sales reflecting the continuing increase in volumes sold to other communication providers in the market.

Total operating costs for this market remain stable year on year. However, the change in the mix of unit costs between internal and external connection services reflects the treatment of costs which primarily support downstream BT retail operations and therefore are pointed internally rather than to external products.

It should be noted that whilst the unit costs for transfers and takeovers show material changes the total costs of those services is less than £3m which is allocated across relatively small volumes, leading to large unit cost changes.

Wholesale business ISDN2 exchange line services - service performance for year ended March 2006

	Total Turnover £m	Volume (channels)	Average Price £p/u	Fully Allocated Cost £p/u	Return on price % p/u
Wholesale business ISDN2 exchange lines – Connections					
2006 - Internal	31	265,786	116.49	118.80	(1.99)
- External	6	47,470	116.49	40.65	65.10
2005 - Internal	37	321,506	116.49	101.97	12.46
- External	6	54,335	116.49	66.81	42.65
Wholesale business ISDN2 exchange lines – Rentals					
2006 - Internal	148	1,344,190	110.00	116.34	(5.76)
- External	19	171,216	110.00	118.83	(8.03)
2005 - Internal	163	1,485,675	110.00	111.90	(1.73)
- External	11	99,085	110.00	111.76	(1.60)
Wholesale business ISDN2 exchange lines – Takeovers/Transfers					
2006 - Internal	0	44,594	5.65	8.88	(57.15)
- External	0	85,150	5.65	14.54	n/m
2005 - Internal	0	72,114	5.65	40.53	n/m
- External	1	123,440	5.65	20.98	n/m
2006 total	204				
2005 total	218				

Note: n/m, result not meaningful.
Note: Fully allocated unit costs include a RoCE %, whereas the summary market performance does not.

Wholesale business ISDN2 exchange line services - comparative volumetrics



Wholesale Access Markets – Performance Summary by Market

Market: Wholesale residential ISDN2 exchange line services

Summary Market Performance

	Total Turnover £m	Total CCA Operating Costs £m	Return £m	Mean Capital Employed £m	Return on Mean Capital Employed %
2005/06	10	7	3	18	21 %
2004/05	25	17	8	42	19 %

Definition

The links between a residential end user and the remote concentrator unit by means of ISDN2 technology.

Digital ISDN2 exchange lines are basic rate ISDN lines, which provide a means to deploy a wide range of digital services over a standard local loop. A single ISDN2 line supports two 64Kbit/s channels for voice and data calls, plus a 16Kbit/s channel for signalling.

Key Regulatory Changes

The TSR undertakings and creation of Openreach as a new line of business are the most significant regulatory change to affect this product.

Prices were reviewed as part of the WLR charge ceiling review and were felt to be reasonable when compared to the cost stack for the product.

Key Market Changes

The decline in turnover and costs for this market results from the reduction in volumes over the year as customers move from ISDN services to Broadband.

Note that the ISDN2 market is designated by Ofcom as not having cost accounting obligations imposed. As such there is no requirement to include information on the individual services within this market.

Market: Wholesale business ISDN30 exchange line services

Summary Market Performance

	Total Turnover £m	Total CCA Operating Costs £m	Return £m	Mean Capital Employed £m	Return on Mean Capital Employed %
2005/06	325	191	134	398	33 %
2004/05	325	180	145	473	31 %

Definition

The links between an end user and the remote concentrator unit by means of ISDN30 technology.

Digital ISDN30 exchange lines are primary rate ISDN lines, which provide a means to deploy a wide range of digital services over a 2Mbit/s bearer. A single ISDN30 line supports thirty 64Kbit/s channels for voice and data calls, plus a 64Kbit/s channel for signalling. ISDN30 lines are used only by business customers, and always in conjunction with a business PBX (Private Branch Exchange).

Key Regulatory Changes

The TSR undertakings and creation of Openreach as a new line of business are the most significant regulatory change to affect this product.

Key Market Changes

Revenue figures for 2005/06 have been impacted by the current trend in the market which is seeing increasing take-up of additional channels on existing installations as opposed to new bearer installations. Costs have followed at similar overall rate to 2004/05.

Note that the ISDN30 market is designated by Ofcom as not having cost accounting obligations imposed. As such there is no requirement to include information on the individual services within this market.

Wholesale Access Markets – Performance Summary by Market

Market: Traditional interface symmetric broadband origination (up to and including 8Mbit/s)

Summary Market Performance

	Total Turnover £m	Total CCA Operating Costs £m	Return £m	Mean Capital Employed £m	Return on Mean Capital Employed %
2005/06	719	670	49	1,453	3 %
2004/05	659	628	31	1,659	2 %

Definition

Traditional Interface Symmetric Broadband Origination (TISBO) services include:

- Wholesale terminating segments (PPCs)
- Radio base station (RBS) backhaul (but the core conveyance element of an RBS backhaul circuit is included in the trunk segments market)
- LLU backhaul which consists of LLU backhaul trunk and LLU backhaul link. LLU backhaul links are regarded as a symmetric broadband origination service and should therefore be included within the TISBO or AISBO markets, depending on the technology in use – bandwidth considerations being taken into account in the case of the Synchronous Digital Hierarchy (SDH) technology.

Ofcom also concluded that Symmetrical Digital Subscriber Line (SDSL) is a symmetric broadband origination service and that it should be included within the TISBO market.

Ofcom concluded that BT has SMP in the low and high bandwidth TISBO markets and, as such, it is appropriate that regulation be imposed on all circuits and technical areas that fall within these markets, including RBS backhaul circuits. The majority of the regulation for these two markets is identical, and Ofcom therefore considered the regulatory remedies these markets together.

Key Regulatory Changes

PPCs are leased lines that BT sells to other network operators. On 1 October 2004, Ofcom introduced a PPC charge control to replace the annual determinations previously carried out by Oftel. The control arises from regulation established in the Leased Lines Market Review (LLMR) and

deals with PPC terminating segments (the ‘access’ part of the leased line network). The control is a four year RPI-X type control with three separate baskets:

- Low Bandwidth Basket (RPI-4%);
- High Bandwidth Basket (RPI-6.5%); and
- Equipment Basket (RPI-8.9%).

Charges prior to the control were maintained as starting charges and BT is required to make price reductions each year which comply with the controls. However, control formulae are constructed to allow BT some discretion in the timing of the price changes and the ability to meet the control by re-balancing different elements of the PPC charges.

	Total Turnover £m	Volume	Average Price £p/u	Fully Allocated Cost £p/u	Return on price % p/u
Partial and Private Circuits 64kbit/s - connections (circuits)	5	10,035	502.49	1,089.80	n/m
Partial and Private Circuits 64kbit/s - link (links)	52	739,825	70.35	120.15	(70.79)
Partial and Private Circuits 64kbit/s - transmission (km)	68	17,659,331	3.81	3.35	11.92
Partial and Private Circuits 64kbit/s - local end (local ends)	63	242,681	257.69	416.07	(61.46)
Radio Backhaul Service sub 2 mbit/s - connection (circuits)	0	863	502.49	1,078.05	n/m
Radio Backhaul Service sub 2 mbit/s - rental (circuits)	6	x=3	398.60	547.07	(37.25)
Partial and Private Circuits 2mbit/s - connections (circuits)	70	25,410	2,764.96	745.35	73.04
Partial and Private Circuits 2mbit/s - link	78	166,479	472.77	388.90	17.74
Partial and Private Circuits 2mbit/s - distribution (km)	89	1,845,066	47.95	80.52	(67.94)
Partial and Private Circuits 2mbit/s - local end (local ends)	207	323,717	637.97	973.65	(52.62)
Radio Backhaul Service 2 mbit/s - connection (circuits)	9	3,192	2,764.96	741.43	73.18
Radio Backhaul Service 2 mbit/s - rental (circuits)	67	x=3	1,416.54	1,579.98	(11.54)
SDSL (circuits)	5	x=2	1,492.48	220.31	85.24
2006 total	719				

Note: n/m, result not meaningful.
(x) This service comprises a number of individual volumetrics as indicated by the value of x.
Note: No comparable data was published in 2005 for these services with the exception of SDSL.
Note: Fully allocated unit costs include a RoCE %, whereas the summary market performance does not.

Wholesale Access Markets – Performance Summary by Market

Traditional Interface Symmetric Broadband Origination (up to and including 8Mbit/s) - Volumes for year ended March 2006

	Volume unit	External	Internal
Partial and Private Circuits 64Kbit/s - connection	cct	5,502	4,533
Partial and Private Circuits 64Kbit/s - link	lk	134,315	605,510
Partial and Private Circuits 64Kbit/s - transmission	km	3,285,158	14,374,173
Partial and Private Circuits 64Kbit/s - local end	le	26,550	216,131
RBS Backhaul sub 2Mbit/s - connection	cct	863	n/a
RBS Backhaul sub 2Mbit/s - rental	n/a	x=3	n/a
Partial and Private Circuits 2Mbit/s - connection	cct	10,489	14,921
Partial and Private Circuits 2Mbit/s - link	lk	39,086	127,393
Partial and Private Circuits 2Mbit/s - distribution	km	394,406	1,450,660
Partial and Private Circuits 2Mbit/s - local end	le	48,920	274,797
RBS Backhaul 2Mbit/s - connection	cct	3,192	n/a
RBS Backhaul 2Mbit/s - rental	n/a	x=3	n/a

(x) This service comprises a number of individual volumetrics as indicated by the value of x.

volume units: cct = circuits; km = kilometres; lk = links; le = local ends.

Note: No comparable data was published in 2005 for these services.

Key Market Changes

To improve the transparency of reporting, and at Ofcom's direction, the market for TISBO's has been disaggregated into the different service lines as noted above. There is no comparative information in the same format for the 2004/05 period. Furthermore, the reporting of unit costs and prices for transmission services are on a radial kilometre basis for 2005/06 compared to a route kilometre basis for the prior year. This has been undertaken to aid consistency with published prices. As a result, service costs at a unit level are not comparable year on year.

In the market as a whole, the revenue growth is due to a rise in the 64Kbit/s market due to the increased volume of terminating kilometres and main links, with associated costs rising at a comparable rate.

It is anticipated that Ofcom will be undertaking a full review of the leased lines market in 2006/07 and that the TISBO (up to and including 8Mbit/s) market will form part of that review.

Market: Traditional interface symmetric broadband origination (above 8Mbit/s up to and including 155Mbit/s)

Summary Market Performance

	Total Turnover £m	Total CCA Operating Costs £m	Return £m	Mean Capital Employed £m	Return on Mean Capital Employed %
2005/06	196	197	(1)	450	(0)%
2004/05	138	157	(19)	537	(3)%

Definition

Traditional Interface Symmetric Broadband Origination (TISBO) services include:

- Wholesale terminating segments (PPCs)
- LLU backhaul which consists of LLU backhaul trunk and LLU backhaul link. LLU backhaul links are regarded as a symmetric broadband origination service and should therefore be included within the TISBO or AISBO markets, depending on the technology in use - bandwidth considerations being taken into account in the case of the SDH technology.

Ofcom concluded that BT has SMP in the low and high bandwidth TISBO markets and, as such, it is appropriate that regulation be imposed on all circuits and technical areas that fall within these markets, including RBS backhaul circuits. The majority of the regulation for these two markets is identical, and Ofcom therefore considered the regulatory remedies for these markets together.

Key Regulatory Changes

PPCs are leased lines that BT sells to other network operators. On 1 October 2004, Ofcom introduced a PPC charge control to replace the annual determinations previously carried out by Oftel. The control arises from regulation established in the Leased Lines Market Review (LLMR) and deals with PPC terminating segments (the 'access' part of the leased line network). The control is a four year RPI-X type control with three separate baskets:

- Low Bandwidth Basket (RPI-4%);
- High Bandwidth Basket (RPI-6.5%); and
- Equipment Basket (RPI-8.9%).

Wholesale Access Markets – Performance Summary by Market

Traditional Interface Symmetric Broadband Origination (above 8Mbit/s up to and including 155Mbit/s) - Volumes for year ended March 2006

	Volume unit	External	Internal
Partial and Private Circuits 34/45Mbit/s - link	lk	915	3,533
Partial and Private Circuits 34/45Mbit/s - distribution	km	10,410	44,237
Partial and Private Circuits 34/45Mbit/s - local end	le	1,456	5,056
Partial and Private Circuits 140/155Mbit/s - link	lk	206	4,067
Partial and Private Circuits 140/155Mbit/s - distribution	km	1,154	50,360
Partial and Private Circuits 140/155Mbit/s - local end	le	125	1,910

volume units: km = kilometres; lk = links; le = local ends.

Note: No comparable data was published in 2005 for these services.

Charges prior to the control were maintained as starting charges and BT is required to make price reductions each year which comply with the controls. However, control formulae are constructed to allow BT some discretion in the timing of the price changes and the ability to meet the control by re-balancing different elements of the PPC charges.

Traditional interface symmetric broadband origination (above 8Mbit/s up to and including 155Mbit/s) - service performance for year ended March 2006

	Total Turnover £m	Volume	Average Price £p/u	Fully Allocated Cost £p/u	Return on price % p/u
Partial and Private Circuits 34/45Mbit/s - link (links)	14	4,448	3,231.57	3,768.21	(16.61)
Partial and Private Circuits 34/45Mbit/s - distribution (km)	27	54,647	493.95	1,186.80	n/m
Partial and Private Circuits 34/45Mbit/s - local end (local ends)	19	6,512	2,953.43	6,681.20	n/m
Partial and Private Circuits 140/155Mbit/s - link (links)	46	4,273	10,737.10	6,446.29	39.96
Partial and Private Circuits 140/155Mbit/s - distribution (km)	65	51,514	1,242.61	882.19	29.01
Partial and Private Circuits 140/155Mbit/s - local end (local ends)	25	2,035	12,456.99	26,038.82	n/m
2006 total	196				

Note: n/m, result not meaningful.

Note: No comparable data was published in 2005 for these services

Note: Fully allocated unit costs include a RoCE %, whereas the summary market performance does not.

Key Market Changes

To improve the transparency of reporting, and at Ofcom's direction, the market for TISBOs has been disaggregated into the different service lines as noted above. There is no comparative information in the same format for the 2004/05 period. Furthermore, adjustment to the costs and prices for transmission services on a radial per kilometre basis rather than a route per kilometre basis has occurred in 2005/06. As a result the comparative information at a unit level is difficult to review with any clarity.

Overall, in both the higher bandwidth TISBO services (i.e. 34/45Mbit/s and 140/155Mbit/s) there has been an increase in revenues compared to 2004/05. During this period, externally and internally provided service and volumes have increased as customers switch to the higher bandwidth products.

The growth in revenue this year (42%) has increased at a faster rate than total operating costs (25%) in this market. This combined with a reduction in mean capital employed, due to reduced investment in the traditional switching and transmission assets has resulted in an increase in return on capital employed % to a breakeven point in comparison to a 3% loss last year.

It is anticipated the Ofcom will be undertaking a full review of the leased lines market in 2006/07 and thus TISBO greater than 8Mbit/s market will form part of this review.

Wholesale Access Markets – Performance Summary by Market

Market: Alternative Interface Symmetric Broadband Origination (all bandwidths)

Summary Market Performance

	Total Turnover £m	Total CCA Operating Costs £m	Return £m	Mean Capital Employed £m	Return on Mean Capital Employed %
2005/06	187	116	71	445	16 %
2004/05	92	67	25	285	9 %

Definition

Alternative Interface Symmetric Broadband Origination (AISBO) services include:

- Wholesale Extension Services (WES)
- Backhaul Extension Services (BES)
- Wholesale end to end Extension Services (WEES)

Ofcom concluded that BT has SMP in the wholesale AISBO market (UK excluding Hull) and, as such, it is appropriate that regulation be imposed on all bandwidths that fall within this market. These products are included in the Undertakings and as such will be managed out of Openreach.

These products are point to point dedicated fibre networks that Openreach sell to communication providers and BT downstream businesses.

Local Area Network Extension services (LES/SHDS) are also Alternative Interface services, but are retail products.

Key Regulatory Changes

LES/SHDS currently falls under Retail pricing which is set by BT Global Services (BT GS). From September 2006, Openreach will trade Wholesale end-to-end Extension Services (WEES) as an input product to BT GS LES/SHDS and out to the market via any other Communications Provider.

Alternative interface symmetric broadband origination in the UK - service performance for the year ended March 2006

	Total Turnover £m	Volume (circuits)	Average Price £p/u	Fully Allocated Cost £p/u	Return on price % p/u
Wholesale and LAN Extension Services	181	22,471	8,051.00	7,326.38	9.00
Backhaul Extension Services	6	193	31,804.00	31,544.04	0.82
2006 total	187				

Note: These are new services reported for 2006 - no comparable data was published in 2005.
Note: Fully allocated unit costs include a RoCE %, whereas the summary market performance does not.

Key Market Changes

The establishment of a thriving LLU market has driven the demand for BES circuits from a zero base last year. WES demand has also increased as communication providers begin to install services based on WES rather than the traditional LES circuits. Overall this has had the effect of doubling revenues in the market from last year, which has increased profits with a greater proportion of higher margin connections over lower margin rentals in the period.

In terms of costs, the BES unit costs are relatively high compared to the LES/WES unit costs as a result of the BES total costs of £5m being divided by very small volumes (i.e. less than 200 circuits). Over time we would expect the unit costs to stabilise as the volumes flow through this market.

Wholesale Access Markets – Performance Summary by Market

Market: Wholesale local access (LLU services only sold externally)

Summary Market Performance

	Total Turnover £m	Total CCA Operating Costs £m	Return £m	Mean Capital Employed £m	Return on Mean Capital Employed %
2005/06	80	84	(4)	63	(8)%
2004/05	14	13	1	25	1 %

Definition

Ofcom has determined that BT has significant market power in the market for “wholesale local access in the UK excluding the Hull Area”. Local Access can be defined as those network elements that comprise metallic loop access networks or ‘cable’ access networks, between end user premises and the facility at which those access networks connect to other communications infrastructure. In practice, this is generally a Main Distribution Frame (for a metallic loop access network) or a cable head-end (for a ‘cable’ access network).

Key Regulatory Changes

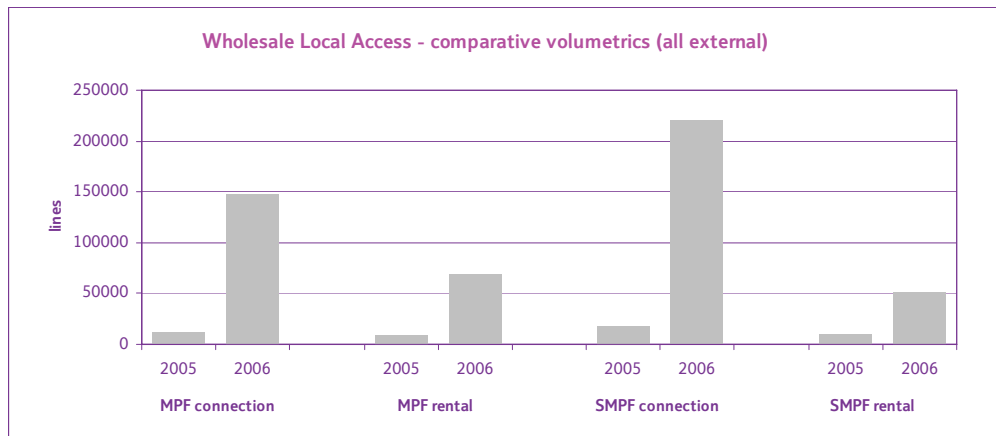
- In July 2004 Ofcom appointed the Independent Telecoms Adjudicator to handle process issues.
- Ofcom completed its review of LLU prices in December 2004 as part of the wholesale local access market review.
- On 16 December 2004, Ofcom announced final charges for most connection and rental prices for LLU services. The charge reductions follow consultations published on 13 May 2004 and 26 August 2004, and the price ceilings came into effect from 1 January 2005.
- In August 2005, Ofcom concluded its cost of capital and cost of copper (regulatory valuation of copper-based local access network) studies and reflected these changes in revised prices for LLU.
- During the 2005 financial year, Ofcom reviewed LLU regulation. Regulation has most recently focused on network investment by competitors. Ofcom’s latest approach to regulating LLU focuses on process and price.

Wholesale local access - service performance for year ended March 2006

	Total Turnover £m	Volume	Average Price £p/u	Fully Allocated Cost £p/u	Return on price % p/u
MPF connections (lines)					
-2006	13	148,244	89.79	99.25	(10.54)
-2005	2	12,075	131.97	183.75	(39.24)
MPF rentals (lines) (note)					
-2006	6	69,103	80.00	221.86	n/m
-2005	1	8,764	160.31	163.63	(2.07)
MPF room build (rooms)					
-2006	34	2,550	13,311.76	2,336.86	82.45
-2005	6	639	9,455.40	1,719.87	81.81
MPF hostel rentals (rooms)					
-2006	3	1,689	1,728.83	8,015.99	n/m
-2005	1	465	2,589.25	14,989.25	n/m
MPF tie cables (cables)					
-2006	15	35,590	427.90	788.99	(84.39)
-2005	2	3,949	621.17	642.19	(3.38)
SMPF connections (lines)					
-2006	8	219,991	34.86	53.55	(53.62)
-2005	1	18,668	42.94	99.16	n/m
SMPF rentals (lines) (note)					
-2006	1	51,602	15.60	49.69	n/m
-2005	0	10,705	25.60	104.97	n/m
2006 total	80				
2005 total (note)	14				

Note: n/m, result not meaningful.
 Note: these are measured rentals at the mid year point of the year i.e. September 2005.
 Note: Fully allocated unit costs include a RoCE %, whereas the summary market performance does not.
 Note: In 2005, the market turnover included £1m for SMPF/MPF system set up.

Wholesale Access Markets – Performance Summary by Market



Key Market Changes

The Wholesale Local Access Market describes only the externally sold LLU products. The internally sold LLU to downstream BT lines of business (the IPstream and Datastream products) can be seen in the Broadband Origination and Conveyance markets.

There has been increased investment in the LLU market by other communications providers in 2005/06 as they locate their equipment into BT's telephone exchanges, as can be seen from the volume growth in the services for MPF room build (which excludes up front capital costs) and hostel rentals in the service performance table above. The total revenue and total costs have increased at a similar rate during the year. Increased investment in the access network infrastructure has resulted in a lower return on capital employed year on year.

During the year, BT introduced a special offer price for communication provider bulk migrations from IPstream or Datastream to Shared MPF to stimulate the market. BT also implemented a simplified pricing structure for its MPF product.

The unit costs across the LLU markets are still largely above the average prices for the services for the year, even with the general reduction in average costs as a result of the increased volumes. The main cost increases are in accommodation, reflecting the build out costs required and general management costs which increased due to the increased activity in this market.

Wholesale Access Markets – LRIC Floor and Ceiling exception analysis

Wholesale Access Markets (note b)	(£ per unit)	Floor	CCA Fully Allocated Cost	Ceiling	Average charge for the year	Price at 31st March 2006	Notes
Wholesale residential analogue internal service connections		60.76	63.92	80.62	91.66	88.00	
Wholesale business analogue internal service takeovers		10.36	10.68	14.75	1.46	2.00	
Wholesale business analogue external service transfers		8.69	10.45	12.37	1.46	2.00	
Wholesale business analogue internal service rentals		50.72	95.66	114.10	118.62	110.00	
Wholesale business analogue external service rentals		53.64	99.58	118.26	118.62	110.00	
Wholesale business ISDN2 internal service takeovers		8.56	8.88	11.57	5.65	5.65	
Wholesale business ISDN2 external service connections		36.51	40.65	48.68	116.49	116.49	
Wholesale business ISDN2 external service transfers		11.97	14.54	17.23	5.65	5.65	
MPF connections		90.82	99.25	122.66	89.79	66.35	(a)
MPF rentals		157.99	221.86	270.67	80.00	80.00	
MPF room build		1,712.91	2,336.86	2,615.14	13,311.76	13,311.76	(a)
MPF hostel rentals		5,763.87	8,015.99	10,179.72	1,728.83	1,728.83	(a)
SMPF connections		49.24	53.55	66.85	34.86	34.86	
SMPF rentals		39.80	49.69	61.28	15.60	15.60	
Partial and Private Circuits 64kbit/s - connections		870.92	1,089.80	1,982.50	502.49	499.94	(a)
Partial and Private Circuits 64kbit/s - link		105.45	120.15	191.77	70.35	69.99	(a)
Partial and Private Circuits 64kbit/s - local end		309.07	416.07	589.34	257.69	256.76	(a)
Radio Backhaul Service sub 2 mbit/s - connection		857.44	1,078.05	1,955.53	502.49	499.94	(a)
Radio Backhaul Service sub 2 mbit/s - rental		421.43	547.07	798.93	398.60	396.59	(a)
SDSL		148.75	220.31	261.98	1,492.48	1,492.48	(a)
Partial and Private Circuits 2mbit/s - connections		693.43	745.35	1,202.24	2,764.96	2,756.14	(a)
Partial and Private Circuits 2mbit/s - distribution		65.84	80.52	146.78	47.95	47.70	(a)
Radio Backhaul Service 2 mbit/s - connection		687.13	741.43	1,189.61	2,764.96	2,756.14	(a)
Partial and Private Circuits 34/45mbit/s - link		3,334.01	3,768.21	5,190.29	3,231.57	3,173.58	(a)
Partial and Private Circuits 34/45mbit/s - distribution		1,004.22	1,186.80	1,957.05	493.95	485.17	(a)
Partial and Private Circuits 34/45mbit/s - local end		4,204.50	6,681.20	8,614.87	2,953.43	2,904.85	(a)
Partial and Private Circuits 140/155mbit/s - link		5,747.47	6,446.29	9,285.52	10,737.10	10,544.44	(a)
Partial and Private Circuits 140/155mbit/s - local end		17,358.59	26,038.82	33,543.03	12,456.99	12,243.97	(a)

Note (a): composite of different charging activities.
Note (b): Total number of services in the Wholesale Access Markets is 51.

Reason for Floor and Ceiling variations

The Long Run Incremental Cost (LRIC) floors and ceilings are derived from the fully allocated cost (FAC). The floor represents the incremental cost of providing that service, which excludes common costs. The ceiling represents the stand alone cost of providing that service, which includes a recovery of common costs.

The purpose of the floors and ceilings is to provide a first order test to ensure an operator is charging for a service within an appropriate range around their FAC. If prices are below the floor this indicates the possibility of inappropriately low pricing, however prices may be deliberately set outside these boundaries. Should prices be above the ceiling this might indicate the possibility of an operator charging excessive prices, however costs may be reduced through efficiency gains.

Indicative results

The results show, by exception, those services which have prices outside of the floor and ceiling. There are a number of reasons why this may happen, as detailed below:

- Prices are set by the regulator that follow a market review or a price investigation. It can be the case that the regulated prices set in a previous period are not comparable with costs reported in the current period. For example the WLR business internal rental price shown of £118.62 is an average for the period. Once the year end price of £110.00 is substituted the price falls within the cost ceiling.
- Prices set by the regulator are forward looking and assume levels of efficiencies over the pricing period. It can therefore be the case that the costs have yet to catch up with the assumed future efficiencies and are therefore out of line with the floors and ceilings. For example these markets have been drawn up, as agreed with Ofcom, with no reference to the reduced Regulatory Asset Value that emerged from Ofcom's cost of copper review in August 2005. As such price setting will be undertaken using this lower asset value, but the cost floors and ceilings as reported in 2005/06 will not take this into account.
- A regulated price maybe set in order to stimulate an overall market. As a result the prices set are not related to FAC. One example is the WLR business transfers where the price shown of £1.46 is set by Ofcom without reference to the underlying FAC of £10.45.
- Within the market itself there may be occasions where services need to be reviewed together rather than individually. For example in the TISBO market (i.e. Partial Private circuits and Radio Backhaul services) noted above there are several cases where prices are either above the ceiling or below the floor and as such the services need to be reviewed as a whole package rather than individually. Furthermore where price caps are set over a basket of services there may be scope for the individual services to flex their price setting within that basket and therefore the individual floors and ceilings may be breached as the prices vary.

Wholesale Access Markets – Mean Capital Employed

Movement in MCE for year ended 2006			
	2006	2005	Variance
	£m	£m	£m
Fixed Assets			
Land and Buildings	268	314	(46)
Access Copper	3,590	3,186	404
Access Fibre	627	633	(6)
Duct	3,950	3,859	91
Switch	585	700	(115)
Transmission	1,218	1,395	(177)
Other	655	692	(37)
Total Fixed Assets	10,893	10,779	114
Other MCE	119	593	(474)
Mean Capital Employed	11,012	11,372	(360)
<i>Analysed as:</i>			
Historical Cost	9,406	9,903	(497)
Current Cost Adjustments	1,606	1,469	137
Mean Capital Employed	11,012	11,372	(360)

Overview of movement in Access MCE

The main movements within the Mean Capital Employed fall into four broad areas.

Access Copper

The actual cost of copper that is traded as a commodity has risen dramatically over the past year, leading to a material year on year credit to the profit and loss account of approximately £200m. The balance of the copper increase is due to normal investment in the access network.

Duct

There have also been increases in the current cost value for duct owing to contract rates increasing by approximately 3% in 2005/06.

Transmission and switching

The CCA value of the combined transmission switching assets have declined by approximately £300m. The reasons behind this are firstly the reduced investment in the traditional network as BT prepares for a material investment in the 21C network planned for roll-out in the years ahead. As an overlaying factor, there is a holding loss as a result of this legacy technology becoming cheaper, in particular the prices of Synchronous Digital Hierarchy (SDH) transmission equipment.

Other MCE

The reduction in Other MCE as a result of the new treatment in pension costs under the new IFRS accounting rules – IAS 19 “Employee Benefits”. In prior years the value of the prepayment relating to the BT Group pension scheme was included from the regulatory mean capital employed. In 2005/06 the accounting for the pension scheme is excluded in the regulatory accounts.

Wholesale SMP Markets – Performance Summary

Wholesale SMP Markets Summary Performance for year ended March 2006			
	2006	2005	Better/(worse) % Change
	£m	£m	Year on Year
Profit and Loss Account			
Internal Turnover	1,708	1,512	13 %
External Turnover	472	557	(15) %
Total Turnover	2,180	2,069	5 %
Provision / Maintenance	190	176	(8) %
Network Support	73	79	8 %
General Support	103	125	18 %
General management	231	220	(5) %
Finance and Billing	29	30	3 %
Accommodation	208	167	(25) %
Bad Debts	-	(21)	100 %
Other Costs	7	32	78 %
HCA Operating Costs	841	808	(4) %
HCA Return before Depreciation	1,339	1,261	6 %
Depreciation	593	619	4 %
CCA Adjustments	18	29	38 %
Roundings	22	20	(10) %
Return	706	593	19 %
Mean Capital Employed	2,936	3,172	(7) %
RoCE (%)	24 %	19 %	5 %

Introduction

Purpose of table

The table summarises the performance of the SMP markets that align themselves with the non-Access parts of the network. As such they cover a wide range of services from traditional call origination on narrowband to new wave broadband conveyance.

List of Markets

- Call origination on Fixed Public Narrowband (FPN) networks
- Local-tandem conveyance and transit on FPN networks
- Single transit on FPN networks
- Fixed call termination
- Wholesale trunk segments
- Technical areas (Interconnect Circuits)
- Technical areas (Point of Handover)
- Wholesale International Direct Dial (IDD) to category B
- Asymmetric Broadband Origination (ASBO)
- Broadband conveyance

Commentary

The performance of these markets reflects the overall trend within BT of contraction in traditional products of calls and lines combined with rapid growth in new wave products such as Broadband.

Many of these markets are subject to a price cap, where the 'X' factor in the 'RPI-X' is a function of the competition in those markets. BT's performance against those price caps is discussed in page 24 of this document. The current Network Charge Control (NCC), that governs certain Wholesale PSTN convergence services, was completed on the 1 October 2005 and will last until September 2009.

The detailed performance of each of the markets is shown in Annex 3. This shows the key performance indicators in each Wholesale SMP market, including the overall returns made in those markets.

Revenue for the whole of non-Access Wholesale SMP markets has increased for 2005/06 but this is a mix of steep declines in traditional markets being more than matched by increasing volumes in the new wave, broadband markets. Costs overall have broadly followed the pattern of revenue, with increased provision and maintenance costs as 21C network costs start to roll-out into the network. Accommodation costs are rising mostly due to the revised treatment in reporting lease costs due to new IFRS rules. The comparative figures for accommodation costs in the prior year do not reflect changes as a result of IFRS.

Wholesale SMP Markets – Performance Summary

The traditional markets in call origination, call termination, single transit and local tandem conveyance have seen volumes decline as customers either migrate to other communication providers or alternative forms of communication. When combined with the RPI-X price controls this has a material decline in revenues. Cost reductions programmes have been unable to keep pace with this decline, causing falling profit margins. Furthermore the profit levels generated reflect the lack of depreciation in the legacy transmission and switching assets. In future periods it is expected this will change as increased depreciation will flow through these markets as a result of the 21C network investment.

The new wave markets have compensated for declines in traditional markets. Broadband origination and conveyance have seen volumes in both connections and rentals increase rapidly over the 2005/06 period, causing revenues to rise by over 40% in these markets. The cost base in these markets has not increased at the pace of the volumes and combined profits in the broadband markets which has risen to over £200m from a zero base last year.

In the market for trunk segments (effectively the link between the local end TISBO markets for other communication providers who do not have an available network), volumes have increased, as customers request higher bandwidth circuits. Costs however have remained steady as the trunk market has limited costs related to incremental volume. It is anticipated that Ofcom will be undertaking a full review of the leased lines market in 2006/07 and the trunk segments and two Access TISBO markets will form part of that review.

The remaining markets, namely the two Technical Areas (for interconnect and handover services) and the small Wholesale IDD market to category B routes (i.e. those which Ofcom did not deem to be competitive during 2005/06) have seen minor increases in returns, mostly as a result of increases in volumes and minor price adjustments combined with continuing cost reduction programmes.

Wholesale SMP Markets – Price Controls by Markets

Price controls in Wholesale SMP Markets for year ended March 2006				
	NCC Control X factor	Average charges 2005/06	Average charges 2004/05	% Change
Basket	Effective from 1 Oct 2005			
Call Termination	RPI - 5%	ppm	ppm	
- Internal		0.167	0.177	(6.0)
- External		0.173	0.191	(9.1)
Call Origination	RPI - 3.75%	ppm	ppm	
- Internal		0.178	0.190	(5.8)
- External		0.185	0.204	(8.9)
Single Transit	RPI - 11.5%	ppm	ppm	
- Internal		0.061	0.054	12.8
- External		0.057	0.057	0.0
Local Tandem Conveyance	RPI - 0%	ppm	ppm	
- Internal		0.053	0.063	(15.9)
- External		0.075	0.087	(13.5)
Product Management, Policy & Planning	RPI + 0.75%	ppm	ppm	
- Internal		0.008	0.020	(59.1)
- External		0.008	0.021	(60.9)
DLE FRIACO	RPI - 8%	2mb cct	2mb cct	
- Internal		7,020.21	7,427.52	(5.5)
- External		7,020.21	7,427.52	(5.5)
Interconnection Circuits	RPI - 5.25%			
Wholesale standard CSI connections		cct	cct	
- Internal		1,334.71	1,241.00	7.6
- External		1,334.71	1,241.00	7.6
Wholesale standard CSI rentals - fixed		cct	cct	
- Internal		1,693.67	1,829.80	(7.4)
- External		1,693.67	1,829.80	(7.4)
Wholesale standard CSI rentals - per km		radial km	route km	
- Internal		24.73	8.21	201.2 (1)
- External		24.73	8.21	201.2 (1)

Price controls in Wholesale SMP Markets for year ended March 2006 (continued)				
	NCC Control X factor	Average charges 2005/06	Average charges 2004/05	% Change
Wholesale ISI rentals		100m	100m	
- Internal		-	-	
- External		68.75	68.75	0.0
Wholesale IEC connections		cct	cct	
- Internal		-	-	
- External		179.61	167.00	7.6
Wholesale IEC rentals - fixed		cct	cct	
- Internal		-	-	
- External		376.43	350.00	7.6
Wholesale IEC rentals - per km		radial km	route km	
- Internal		-	-	
- External		24.73	9.47	161.1 (1)
Wholesale IBC connections		cct	cct	
- Internal		758.23	705.00	7.6
- External		758.23	705.00	7.6
Wholesale IBC rentals		cct	cct	
- Internal		63.97	59.48	7.5
- External		63.97	59.48	7.5
Wholesale rearrangements		cct	cct	
- Internal		-	-	
- External		499.04	464.00	7.6

(1) Prices in 2004/05 were set on a route km basis, 2005/06 prices are set on a radial km basis.
Actual increase in 2005/06 was 7.5%.

Price Controls by Market

Reasons for price controls in SMP Markets

As part of the regulatory regime imposed on BT there is a requirement to set prices for services in accordance with the price control rules as agreed with Ofcom. The purpose of this price control schedule is to show those markets where BT is deemed to have Significant Market Power (SMP) and where markets are not deemed to be sufficiently competitive. The regulatory remedy in these markets include the setting of a price cap which reflects the forecast changes in costs.

Wholesale SMP Markets – Price Controls by Markets

Network Charge Control

BT's charges for a range of interconnect services are controlled by the Network Charge Control (NCC) regime, as determined by Ofcom. The current NCC began on 1 October 2005 and will last until 30 September 2009.

The controls are designed to ensure that BT's charges are reasonably derived from costs, including an appropriate return on capital employed. Depending on the degree of competition for these services, charges are cap-controlled each year by RPI minus X for services Ofcom considers unlikely to become competitive in the near future. They also safeguard cap-controls (i.e. no increases above RPI during any relevant year of the overall control period) on uncompetitive services likely to become competitive. Product management, policy and planning is a component of the services covered by the NCC regime, and has a separate cap of RPI + 0.75%. It is designed to cover BT's administrative costs of providing narrowband interconnection services.

In addition to some re-structuring of the baskets and to changes in the percentage values for X, Ofcom determined that BT no longer has Significant Market Power (SMP) in the market for inter-tandem conveyance and transit, and as such, this market has been de-regulated, and is no longer subject to price controls.

A market review was also carried out for the local-tandem conveyance and local-tandem transit markets, and BT was deemed still to have SMP. However, the price control has been relaxed for these markets and the safeguard cap of 0% has been applied for the duration of the current control. BT must publish a notification to Ofcom and other operators if it intends to amend existing charges or to offer new services.

Notice periods range from 28 to 90 days for regulated services, depending on the degree to which they are judged to be competitive. Any such price changes are reflected in the Current Cost Financial Statements for year ended 31 March 2006.

Number portability

The number portability charge control runs from 1 August 2002 until 31 July 2006. The charges are controlled by a RPI minus X formula, with X set at 5%. This control is not contained in an SMP condition, but in a nonbinding undertaking given by BT to Ofcom. Under the new regime, General Condition 18 requires all providers to offer number portability, among other things, on reasonable terms and for charges to be cost oriented.

Wholesale access charge control

In discussion with Ofcom, BT agreed that the wholesale access residential price would be reduced in two stages. The first was a reduction of 50 pence a month (£1.50 per quarter) implemented on 1 August 2005. The second reduction followed the publication of Ofcom's statement on setting and

reviewing charge ceilings for Wholesale Line Rental (WLR) on 24th January 2006. From March 2006 the rates have been as follows:

- Residential analogue lines: new line installation @ £88, transfer @ £2 a line, and annual line rental - £100.68
- Business analogue lines: new line installation @ £88, transfer @ £2 a line, and annual line rental - £110

Partial Private Circuit (PPC) Charge Control

PPCs are leased lines that BT sells to other network operators. On 1 October 2004, Ofcom introduced a PPC charge control to replace the annual determinations previously carried out by Oftel. The control arises from regulation established in the Leased Lines Market Review (LLMR) and deals with PPC terminating segments (the 'access' part of the leased line network).

The control is a four year RPI-X type control with three separate baskets:

- Low Bandwidth Basket (RPI-4%);
- High Bandwidth Basket (RPI-6.5%); and
- Equipment Basket (RPI-8.9%).

Charges prior to the control were maintained as starting charges and BT is required to make price reductions each year which comply with the controls. However, control formulae are constructed to allow BT some discretion in the timing of the price changes and the ability to meet the control by re-balancing different elements of the PPC charges. PPCs are also subject to obligations to notify operators and Ofcom if we intend to revise charges or other contractual conditions. The notification periods range from same day to 90 calendar days depending on the nature of the change.

Additionally, within BT's Undertakings under the Enterprise Act, BT has agreed to make available via the new Openreach organisation, and subject to demand from other Communications Providers, a new form of wholesale private circuit services – termed Traditional Interface Leased Lines Access Product (TILLAP) and Traditional Interface Leased Lines Backhaul Product (TILLBP). However, as at 31 March 2006 these products are not yet available.

Wholesale SMP Markets – Mean Capital Employed

Movement in MCE for year ended 2006			
	2006	2005	Variance
	£m	£m	£m
Fixed Assets			
Land and Buildings	222	237	(15)
Access Copper	281	216	65
Access Fibre	8	7	1
Duct	601	639	(38)
Switch	559	694	(135)
Transmission	740	807	(67)
Other	474	361	113
Total Fixed Assets	2,885	2,961	(76)
Other MCE	51	211	(160)
Mean Capital Employed	2,936	3,172	(236)
<i>Analysed as:</i>			
Historical Cost	2,910	3,104	(194)
Current Cost Adjustments	26	68	(42)
Mean Capital Employed	2,936	3,172	(236)

Overview of movements in Wholesale MCE

The main movements within the Mean Capital Employed fall into four broad areas.

Access Copper

The actual cost of copper that is traded as a commodity has risen dramatically over the past year, leading to an increase in the current cost valuation. The balance on the copper increase is due to normal investment in the access network.

Transmission and switching

The CCA value of the combined transmission switching assets have declined in the year. The rationale for this reflects reduced investment in the traditional network as BT prepares for the material investment in the 21C network planned for roll-out in the years ahead. In addition, certain legacy technology has become cheaper, in particular the prices of Synchronous Digital Hierarchy (SDH) transmission equipment.

Other Fixed Assets

The increase in 'Other' fixed assets is a result of increased spend as part of the roll-out programme of 21C network and new wholesale system development following BT Undertakings as outlined in the 'Telecom Strategic Review'.

Other MCE

The reduction in Other MCE is a result of the new treatment in pension costs under the new IFRS accounting rules – IAS 19 "Employee Benefits". In prior years the value of the prepayment relating to the BT Group pension scheme was included in the regulatory mean capital employed. In 2005/06 the accounting for the pension scheme was excluded in the regulatory accounts.

Retail SMP Markets – Performance Summary

Retail SMP Markets Summary Performance for year ended March 2006			
	2006	2005	Better/(worse) % Change
	£m	£m	Year on Year
Profit and Loss Account			
Internal Turnover	7	7	-
External Turnover	3,552	3,830	(7.0) %
Total Turnover(including discounts <5%)	3,559	3,837	(7.0) %
Charges from Wholesale	2,728	3,035	10.0 %
Retail Operating costs	513	465	(10.0) %
Return	318	337	(6.0) %
Return on Turnover	8.9%	8.8%	0.1 %
Mean Capital Employed	(422)	(369)	14.4 %

Introduction

Purpose of table

The table summarises the performance of the Retail SMP markets. As such they cover only the residential product set as these markets are where Ofcom has deemed BT has SMP reporting obligations.

List of Markets

- Residential analogue exchange line services in the UK
- Residential local calls in the UK
- Residential national calls in the UK
- Residential IDD calls category A routes
- Residential IDD calls category B routes
- Residential calls to mobiles in the UK
- Residential operator assisted calls in the UK.

Commentary

The overall position reflects BT Retail's strategic shift towards new wave products and the defence of the traditional products. The markets where BT Retail has SMP reporting obligations are all within the residential traditional calls and lines area.

Overall the total revenues across the residential calls and lines declined by over 7%. The reduction includes the effect of high migration to broadband which is reflected in a decline of 46% in dial up minutes over the year. The total charges from Wholesale have declined at a similar rate to the declining traditional revenues, however, the direct costs show a greater share of the allocation of call centre costs in 2005/06.

In July 2006 Ofcom announced that the BT Retail price caps will end, which reflects the growing competition in the Retail market across the UK telecommunication industry.

Annex 1 – Notes

Statutory accounts

The Regulatory Financial Report 2006, which is not statutory accounts within the meaning of the Companies Act 1985, has been prepared in accordance with the Primary Accounting Documents, Detailed Attribution Methods (DAM), Detailed Valuation Methods (DVM) and Long Run Incremental Cost Model: Relationships and Parameters (R&P), all dated 7 September 2006. The information has been extracted and aggregated from the Current Cost Financial Statements for 2006, and is a voluntary presentation of the information relating to BT's regulatory obligations.

The Regulatory Financial Report includes comparative information for the year ended 31 March 2005. The prior year comparative information is prepared in accordance with the Accounting Documents, DAM, DVM & R&P dated 2 September 2005. No restatement of the prior year amounts has been undertaken.

The Annual Report prepared for the Group headed by BT Group plc for the year ended 31 March 2006, on which the auditors made an unqualified report, which did not contain a statement under Section 237(2) or (3) of the Companies Act 1985, has been delivered to the Registrar of Companies.

BT now records its transactions in the accounting records in accordance with the UK legal requirements and International Financial Reporting Standards (IFRS). The date of transition for adopting IFRS in the statutory accounts was 1 April 2004 with the exception of IAS 32 'Financial Instruments: Disclosure and Presentation' and IAS 39 'Financial Instruments: Recognition and Measurement' which have been applied with effect from 1 April 2005. However, in this Regulatory Financial Report comparative information for year ended 31 March 2005 has not been restated to include the impact of IFRS as the main IFRS changes related to pensions and dividends are excluded for regulatory purposes, and the effect of spreading the other adjustments was minimal across services and markets. The key differences between UK GAAP and IFRS, which are not spread across the services and markets are outlined in Annex 5 to this report.

A detailed explanation of how the transition from UK GAAP to IFRS has effected the Group's financial position and reported performance is set out in the Group Consolidated Statutory Financial Statements of BT Group plc for the year ended 31 March 2006.

Effect of certain Regulatory Decisions

The notes below refer to changes to the treatment of specific costs included in the Current Cost Financial Statements for year ended 31 March 2006, and therefore reflected in this report which reflect regulatory decisions made during the year which have not been restated within the prior year results.

Cost of Capital

On 18 August 2005 Ofcom published a final statement entitled "Ofcom's approach to risk in the assessment of the cost of capital" in which BT's weighted average cost of capital (WACC) was reviewed and disaggregated into two parts. The WACC for copper access network business was re-assessed at 10% and the rest of BT at 11.4%.

For the Current Cost Financial Statements for 2004/05 a single WACC of 13.5% was used. For the 2005/06 statements WACC's of 10% and 11.4% have been pro-rated during the year and can be seen in the table below:

Note that for Partial Private Circuits (excluding trunk) the WACC for April 2005 is 13% as per the PPC charge control.

%	Core	Access	Other PPC	Trunk PPC
April - Aug 2005	13.5	13.5	13.0	13.5
Sept 2005 - March 2006	11.4	10.0	11.4	11.4
WACC for 2006 (pro-rated)	12.3	11.5	12.1	12.3

Openreach

As part of the creation of Openreach, arising from the Undertakings, a provision of £70m to cover the set-up costs of the Openreach business was recognised in the 2006 financial year. This has been shown as a reconciling item in both the Current Cost Financial Statements and the Regulatory Financial Report in Annex 5 and has not been allocated to any SMP Markets.

Changes to costing methodologies

The notes below refer to key changes to the treatment of costs included in the Regulatory Financial Report for year ended 31 March 2006, which have not been restated within the prior year results.

Partial Private Circuits (PPCs)

To improve the transparency of reporting for PPCs there have been a number of changes made to the Regulatory Financial Statements for year ended 31 March 2006. These include:

- a disaggregation of the reported services in the three relevant markets:

Annex 1 – Notes

- (i) traditional interface symmetric broadband origination (up to and including 8Mbit/s)
 - (ii) traditional interface symmetric broadband origination (above 8Mbit/s up to and including 155Mbit/s)
 - (iii) Wholesale trunk segments
- a change in reporting to show costs and prices for trunk and transmission services on a radial kilometre basis to be consistent with published prices. In prior years these prices were converted to a route kilometre basis to align with the costing of the underlying circuits.

CCA adjustments

The Current Cost Financial Statements for the Group and therefore the Regulatory Financial Report are prepared under the Financial Capital Maintenance convention in accordance with the principles set out in the handbook “Accounting for the effects of changing prices”, published in 1986 by the Accounting Standards Committee.

Set out below is a summary of the treatment of the CCA adjustments:

- Changes in fixed asset values are referred to as holding gains or losses arising during the year and are attributed between all Markets, Technical Areas, Components and Wholesale Services on the same basis as the associated assets.
- A supplementary depreciation adjustment on fixed assets arising from differences between historic cost account (HCA) and current cost account (CCA) valuations is also attributed between the various Markets, Technical Areas, Components and Wholesale Services.
- Realised holding gains or losses previously recognised as unrealised arise only on disposal of fixed assets and are attributed to Wholesale residual.
- Other adjustments largely reflecting costs reported within the historic cost accounts (HCA) which are not included in the current cost valuations (e.g. non capacity spend on Duct that does not increase capacity or functionality) are also attributed between all Markets, Technical Areas, Components and Wholesale Services on the same basis as the associated assets.
- Adjustments arising from foreign exchange translation of overseas investments are attributed to Wholesale residual.

The inflation adjustment to ordinary shareholders’ funds is not relevant to the Markets, Technical Areas and Wholesale Services for which Current Cost Financial Statements are prepared.

Inter-market balances

The mean capital employed statements for the Markets, Technical Areas and Wholesale Services include balances relating to the charges from the Wholesale markets to the Retail markets. The Retail markets are deemed to settle these charges in the same 59-day period as other operators.

Charges from Wholesale markets to Retail markets

The Statements of costs on a current cost basis show component unit costs on a 24-hour basis. However, charges to Retail markets and other communications providers for call conveyance services vary by the time period, e.g. day or evening, during which the service was purchased. The charges for other Wholesale services to Retail markets and other communication providers do not require adjustment for the time of day at which they are purchased.

Annex 2 – Wholesale Access Markets Market Performance

Wholesale Access Markets SMP Financial Summary by Market 2005/06

	Total Turnover £m	Total HCA Operating Costs £m	Depreciation £m	CCA Adjustments £m	Roundings £m	Total CCA Operating Costs £m	Return £m	Mean Capital Employed £m	Return on Mean Capital Employed %
Wholesale residential analogue exchange line services	2,178	1,000	594	(284)	1	1,311	867	6,112	14.2 %
Wholesale business analogue exchange line services	799	415	173	(81)	(1)	506	293	1,729	16.9 %
Wholesale business ISDN2 exchange line services	204	121	63	(13)	1	172	32	344	9.1 %
Wholesale residential ISDN2 exchange line services	10	4	3	(1)	1	7	3	18	20.6 %
Wholesale business ISDN30 exchange line services	325	116	66	11	(2)	191	134	398	33.4 %
TISBO (up to and including 8Mbits)	719	329	250	88	3	670	49	1,453	3.4 %
TISBO (above 8Mbits up to and including 155Mbits)	196	58	75	64	-	197	(1)	450	(0.2) %
AISBO (all bandwidths)	187	58	46	9	3	116	71	445	15.9 %
Wholesale local access	80	57	29	1	(3)	84	(4)	63	(8.4) %
Total	4,698	2,158	1,299	(206)	3	3,254	1,444	11,012	13.1 %

Wholesale Access Markets SMP Financial Summary by Market 2004/05

	Total Turnover £m	Total HCA Operating Costs £m	Depreciation £m	CCA Adjustments £m	Roundings £m	Total CCA Operating Costs £m	Return £m	Mean Capital Employed £m	Return on Mean Capital Employed %
Wholesale residential analogue exchange line services	2,284	1,076	592	(100)	(1)	1,567	717	6,138	11.7 %
Wholesale business analogue exchange line services	798	458	181	(27)	1	613	185	1,864	10.0 %
Wholesale business ISDN2 exchange line services	218	111	68	(6)	(1)	172	46	349	13.5 %
Wholesale residential ISDN2 exchange line services	25	9	8	(1)	1	17	8	42	19.4 %
Wholesale business ISDN30 exchange line services	325	90	74	14	2	180	145	473	30.9 %
TISBO (up to and including 8Mbits)	659	302	268	56	2	628	31	1,659	1.9 %
TISBO (above 8Mbits up to and including 155Mbits)	138	53	77	26	1	157	(19)	537	(3.3) %
AISBO (all bandwidths)	92	28	28	10	1	67	25	285	8.8 %
Wholesale local access	14	6	1	1	5	13	1	25	1.0 %
Total	4,553	2,133	1,297	(27)	11	3,414	1,139	11,372	10.0 %

Annex 3 – Wholesale SMP Markets Performance

Wholesale SMP Financial Summary by Market 2005/06

	Total Turnover £m	Total HCA Operating Costs £m	Depreciation £m	CCA Adjustments £m	Roundings £m	Total CCA Operating Costs £m	Return £m	Mean Capital Employed £m	Return on Mean Capital Employed %
Call origination on FPN networks	350	144	107	(16)	7	242	108	615	17.3 %
Local-tandem conveyance and transit on FPN network	99	42	41	1	4	88	11	212	5.7 %
Single transit on FPN networks	18	3	4	-	-	7	11	10	105.0 %
Technical areas (Interconnect Circuits)	126	32	29	12	8	81	45	159	28.3 %
Fixed call termination	212	78	76	(12)	1	143	69	430	16.0 %
Wholesale trunk segments	345	29	37	27	-	93	252	322	78.4 %
Technical areas (Point of Handover)	6	-	2	2	1	5	1	9	15.5 %
Wholesale IDD to category B	1	-	-	-	1	1	-	2	0.0 %
Asymmetric Broadband Origination	895	465	217	(5)	-	677	218	840	25.9 %
Broadband conveyance in the UK	128	48	80	9	-	137	(9)	337	(2.7) %
Total	2,180	841	593	18	22	1,474	706	2,936	24.0 %

Wholesale SMP Financial Summary by Market 2004/05

	Total Turnover £m	Total HCA Operating Costs £m	Depreciation £m	CCA Adjustments £m	Roundings £m	Total CCA Operating Costs £m	Return £m	Mean Capital Employed £m	Return on Mean Capital Employed %
Call origination on FPN networks	478	156	150	(7)	1	300	178	789	22.3 %
Local-tandem conveyance and transit on FPN network	147	48	53	4	8	113	34	278	12.4 %
Single transit on FPN networks	18	3	4	-	1	8	10	13	81.4 %
Technical areas (Interconnect Circuits)	139	53	38	5	6	102	37	223	16.5 %
Fixed call termination	242	72	83	(5)	3	153	89	448	19.8 %
Wholesale trunk segments	322	28	38	12	(1)	77	245	373	65.8 %
Technical areas (Point of Handover)	5	-	1	-	-	1	4	5	73.4 %
Wholesale IDD to category B	2	-	-	-	1	1	1	2	64.5 %
Asymmetric Broadband Origination	621	421	183	22	2	628	(7)	769	(1.0) %
Broadband conveyance in the UK	95	27	69	(2)	(1)	93	2	272	0.9 %
Total	2,069	808	619	29	20	1,476	593	3,172	18.7 %

Annex 4 – Retail SMP Markets Performance

Retail SMP Financial Summary by Market 2005/06

	Total Turnover £m	Wholesale charges £m	Total HCA Operating Costs £m	CCA Adjustments £m	Return £m	Return on Turnover %	Mean Capital Employed £m
Residential analogue exchange line services in the UK	2,103	2,108	259	(1)	(263)	(12.5) %	(473)
Residential local calls in the UK	591	132	105	-	354	59.9 %	37
Residential national calls in the UK	174	84	41	-	49	28.3 %	3
Residential IDD calls category A routes	181	83	29	-	69	38.3 %	9
Residential IDD calls category B routes	10	2	2	-	6	60.2 %	1
Residential calls to mobiles in the UK	492	318	78	-	96	19.5 %	(3)
Residential operator assisted calls in the UK	8	1	-	-	7	82.2 %	4
	-				-		
Total	3,559	2,728	514	(1)	318	8.9 %	(422)

Retail SMP Financial Summary by Market 2004/05

	Total Turnover £m	Wholesale charges £m	Total HCA Operating Costs £m	CCA Adjustments £m	Return £m	Return on Turnover %	Mean Capital Employed £m
Residential analogue exchange line services in the UK	2,136	2,285	213	1	(363)	(17.0) %	(481)
Residential local calls in the UK	659	154	98	1	406	61.7 %	52
Residential national calls in the UK	223	96	46	-	81	36.0 %	21
Residential IDD calls category A routes	209	102	31	-	76	36.4 %	27
Residential IDD calls category B routes	21	2	3	-	16	76.4 %	3
Residential calls to mobiles in the UK	583	394	71	1	117	20.1 %	6
Residential operator assisted calls in the UK	6	2	-	-	4	68.5 %	3
Total	3,837	3,035	462	3	337	8.8 %	(369)

Annex 5 – Reconciliation to Statutory Accounts

Annex 5a - Reconciliation to Statutory Consolidated Profit and Loss Account

For the year ended 31 March 2006

	Turnover £m	Operating Costs £m	HCA Return or Profit before taxation £m	Holding gain/(loss) and other adjustments £m	Supplementary depreciation £m	CCA Return or Profit Before Taxation £m
Markets						
Access markets	4,698	3,460	1,238	379	(173)	1,444
Wholesale markets	2,180	1,456	724	(94)	76	706
Retail markets	3,559	3,242	317	1	-	318
Sub total markets	10,437	8,158	2,279	286	(97)	2,468
Residual activities						
- Wholesale residual activities	3,488	3,469	19	(18)	8	9
- Retail residual activities	13,358	12,646	712	108	-	820
Sub total residual activities	16,846	16,115	731	90	8	829
Adjustments						
- Wholesale	3	3	-			
- Retail	3	2	1			
Sub total adjustments	6	5	1			
Total BT Markets	27,289	24,278	3,011			
Adjustments						
Elimination of inter-market turnover and costs	(7,775)	(7,775)	-			
Other Operating Income	-	225	-			
Goodwill	-	-	-			
Profit on disposal of joint venture	-	1	-			
Share of post tax profit of associates and joint ventures	-	16	-			
Profits on disposal of property, plant and equipment	-	2	-			
Net short term interest	-	429	-			
Long term interest payable	-	-	(901)			
Creation of Openreach	-	70	(70)			
As in the Annual Report	19,514	17,246	2,040			

Annex 5 – Reconciliation to Statutory Accounts

Annex 5b - Reconciliation to Statutory Consolidated Profit and Loss Account

For the year ended 31 March 2005

	Turnover £m	Operating Costs £m	HCA Return or Profit before taxation £m	Holding gain/(loss) and other adjustments £m	Supplementary depreciation £m	CCA Return or Profit Before Taxation £m
Markets						
Access markets	4,553	3,441	1,112	119	(92)	1,139
Wholesale markets	2,069	1,447	622	(115)	86	593
Retail markets	3,837	3,497	340	(4)	1	337
Sub total markets	10,459	8,385	2,074	-	(5)	2,069
Residual activities						
- Wholesale residual activities	3,822	3,825	(3)	(8)	12	1
- Retail residual activities	12,401	11,455	946	(89)	34	891
Sub total residual activities	16,223	15,280	943	(97)	46	892
Adjustments						
- Wholesale	-	(1)	1			
- Retail	-	(1)	1			
Sub total adjustments	-	(2)	2			
Total BT Markets	26,682	23,663	3,019			
Adjustments						
Elimination of inter-market turnover and costs	(8,059)	(8,059)	-			
IFRS adjustments						
Net off of service provider revenues/costs	(194)	(194)	-			
Employee Benefits (Pensions)	-	75	123			
Share based payments	-	28	(28)			
Goodwill	-	(16)	16			
Leases	-	94	(104)			
Other	-	(4)	4			
Other Operating Income	-	171	-			
Goodwill	-	16	(16)			
Impairment of assets in joint ventures	-	-	(25)			
Profit on sale of non current asset investments	-	-	358			
Profit on disposal of property, plant and equipment	-	22	-			
Net short term interest	-	230	-			
Long term interest payable	-	-	(1,031)			
Release of deferred debtor (LLU set up costs)	-	(37)	37			
Amortisation of deferred debtor (LLU set up costs)	-	(1)	1			
As in the Annual Report	18,429	15,988	2,354			

Annex 5 – Reconciliation to Statutory Accounts

Annex 5c -Reconciliation to Statutory Consolidated Balance Sheet		
Consolidated mean capital employed For the year ended 31 March 2006	2006	2005
	£m	Re-presented (see note 1) £m
Shareholders' funds as in the Annual Report 2006	1,555	45
Reversal of IFRS adjustments		
Employee Benefits (Pensions)	n/a	4,092
Dividends	n/a	(551)
Share based payments	n/a	(7)
Leases	n/a	288
Other operating income	n/a	(16)
Total IFRS adjustments	n/a	3,806
Shareholders' funds as in the Annual Report 2005	n/a	3,851
CCA adjustments	1,764	1,543
Adjustments		
Dividends	n/a	551
Goodwill	(560)	(504)
Deferred tax liabilities	1,505	2,174
Deferred tax assets	(764)	n/a
Corporation taxes payable	598	645
Long term loans and other borrowings		
Due in less than one year	1,287	4,496
Due in more than one year	7,995	8,091
Derivative financial instrument	1,152	n/a
Retirement benefit obligations	2,547	n/a
Other payables	485	n/a
Minority interests	52	50
Closing CCA capital employed at 31 March	17,616	20,897
Opening CCA capital employed at 1 April	20,897	21,351
Adjustment to opening capital employed (see Annex 1)	n/a	(28)
Adjustment to opening capital employed (a)	-	(44)
Adjustment to opening capital employed (see Annex 1)	(718)	-
Revised opening CCA capital employed at 1 April	20,179	21,279
Average CCA capital employed	18,898	21,088
Daily averaging adjustment	1,172	102
Openreach Set-Up Costs	18	-
Total CCA mean capital employed	20,088	21,190

Reconciliation to Statutory Consolidated Balance Sheet (Continued)		
Consolidated mean capital employed For the year ended 31 March 2006	2006	2005
	£m	Re-presented (see note 1) £m
Mean capital employed of BT Markets		
- Access markets	11,012	11,372
- Wholesale markets	2,936	3,172
- Retail markets	(422)	(369)
Sub total BT Markets	13,526	14,175
Residual activities		
- Wholesale residual activity	1,046	1,439
- Retail residual activity	5,516	5,581
Sub total residual activities	6,562	7,020
Roundings and other adjustments		
- Wholesale markets (u)	-	(5)
- Retail markets (u)	-	-
Sub total roundings and other adjustments	-	(5)
Total CCA mean capital employed	20,088	21,190

(a) Wholesale redundancy included in prior year.

(u) Roundings and other adjustments in 2005 are mainly due to the restatement of Statutory Accounts as result of IFRS adoption.

Annex 6 –The Equality of Access Board

The Equality of Access Board

BT includes below an extract from the 2005/06 Annual Report of the EAB published on 11 May 2006. This is presented to enable BT to demonstrate an increased level of confidence in reporting under the requirements of BT's Undertakings of 2005. This extract from the EAB Annual Report makes reference to an independent Assurance report from PricewaterhouseCoopers LLP (PwC). The assurance report issued by PwC was addressed to BT and Ofcom to meet the requirements of BT's Undertakings and accordingly shall not be relied upon by any other person for any other purpose. The full report including the assurance report can be viewed at <http://www.bt.com/EABreport/>.

Executive Summary

This report fulfils a requirement in BT's Undertakings for the Equality of Access Board (EAB) to publish an Annual Report on its activities. It explains who sits on the EAB, what its role is and how this is being delivered with the support of the Equality of Access Office (EAO). The EAB's opinions on BT's delivery of the Undertakings and related governance arrangements are set out with supporting evidence. Arrangements for handling complaints and breaches, for dialogue with stakeholders and verifying the EAB's work are explained. An independent report from PricewaterhouseCoopers LLP (PwC), including its opinion concludes the report.

Compliance with the Undertakings to date

In the EAB's opinion, BT's compliance with the Undertakings has been satisfactory, although it has had concerns including a missing management control for the IPStream product and the delayed set up of the account management function in Openreach. Both of these concerns have now been addressed. Neither constituted a breach of the Undertakings, but they were key vulnerabilities and areas for management improvement.

The EAB was impressed by the commitment BT has shown to the delivery of the Undertakings so far. The EAB has reviewed all of the Undertakings for which the due date fell in this reporting period. For all of the completed reviews, those Undertakings have been confirmed as delivered. Some have been delivered ahead of their due date, such as the Code of Practice. In addition, no complaints from communications providers (CPs) or breaches of the Undertakings have been reported to the EAB by BT or the EAO.

BT also needs to demonstrate compliance on an ongoing basis. The only Equivalence of Input (Eol) product provided in the reporting period was IPStream. BT Wholesale is still reviewing the detailed IPStream fulfilment (provision) key performance indicators (KPIs) to demonstrate to the satisfaction of the EAB that similar performance levels are being delivered to all customers.

The EAB recognises that the Undertakings represent a challenge to BT and CPs. All parties need to recognise the role they play in successful implementation. The development of strong relationships by BT will be the key component in this process.

Measures to influence behaviours

In the EAB's opinion, BT has made a good start in delivering changed behaviours in line with the spirit of the Undertakings. BT has made significant progress in rolling out the Code of Practice and associated training across the entire company. The EAB also agreed with the inclusion of questions relating to equivalence in BT's external customer satisfaction and internal employee surveys. However, the real test is in industry perceptions of BT's behaviour. There is limited evidence of change in these perceptions as yet, although the EAB accepts it is still early days.

BT's governance

The EAB has reviewed the governance structures, processes and policies within BT to support the Undertakings. The EAB considers these arrangements to be satisfactory with some exceptions. These include the handling of complaints from CPs and the co-ordination of major BT-wide deliverables. BT is addressing the EAB's concerns.

The EAB's Governance

The EAB views its governance arrangements as satisfactory, though it recognises areas for improvement that some of these arrangements have not yet been tested e.g. judging complaint or the materiality of a breach.

Work carried out by BT's Internal Audit and Regulatory Compliance department (IARC) and discussions with PwC regarding their assurance procedures in the context of this report have identified some areas for improvement.

Future focus

Looking to the coming year, the EAB has some concerns. BT has to deliver many challenging Undertakings and several of these are under time pressure. BT needs to enable timely and compliant delivery whilst not sacrificing the service levels delivered to customers.

The focus of the EAB will therefore be on the key deliverable dates, on ongoing compliance and behavioural issues and on longer term, strategic matters, most notably Next Generation Networks. The areas of focus will include the following:

Annex 6 –The Equality of Access Board

- **Local Loop Unbundling (LLU) Eol Ready for Service (RFS) 30 June 2006**

This Undertaking requires significant systems and process work. It is of key importance to industry and also has implications for other Undertakings such as other Eol products, which rely on LLU as input. Work to date been challenging and the programme delivery status remains at risk.

- **Wholesale Line Rental (WLR) Eol RFS (good faith gesture date) 31 December 2006**

This Undertaking is the largest in terms of the scale of the customer base. The timescales for this task are proving to be extremely challenging and its delivery is at risk.

- **Ongoing Product KPIs**

By the end of 2006/07, IPStream, LLU and WLR (for new customers) should all be operating on Eol principles; IPStream for some 15 months. The EAB will be examining whether the products KPIs demonstrate consistent levels of performance between all customers.

- **Ongoing behaviours**

As the Openreach and BT Wholesale product organisations mature and the early Undertakings deliverables move into business as usual, the EAB will be giving particular attention to whether BT has adopted appropriate behaviours. In addition to looking at existing measures such as the Code of Practice training completions, it will examine how much the reality of doing day to day business with BT has changed since the inception of the Undertakings.

- **Next Generation Networks**

Whilst the Undertakings obligations for the Eol product deliverables are clear in most areas, obligations around BT's 21st Century Network (21CN) are less straightforward. The EAB will monitor how BT delivers its obligations in this area.

Conclusion

This report concludes that satisfactory progress has been made to date and that the EAB is positioned to oversee BT's future performance.

Glossary

Accounting Documents	The Primary Accounting Documents, DAM, DVM and R&P.	Mean capital employed	Mean capital employed is defined as total assets less current liabilities, excluding corporate taxes and dividends payable, and provisions other than those for deferred taxation. The mean is computed from the start and end values for the period, except in the case of short-term investments and borrowings, where daily averages are used in their place.
Accounting separation	Accounting separation requirements arise where there is an obligation to not unduly discriminate: and/or there is a reasonable concern that a Dominant Provider may make cross-subsidies, e.g. the means by which a margin squeeze may be funded.	n/a	Not applicable.
Annual Report	BT's consolidated Group Financial Statements for the year ended 31 March. These are available on the BT website at http://www.bt.com .	n/m	Not meaningful.
Baskets	Baskets are collections of services not considered to be competitive and for which prices are subject to specific charge controls.	Network Charge Control regime (NCC)	The basis on which interconnect charges have been set with effect from 1 October 1997.
Components	Within these statements, the term components includes both network components and network parts.	Oftel	Office of Telecommunications.
Cost accounting	Cost accounting obligations are to meet the requirements where there is an obligation in relation to: <ul style="list-style-type: none">• Price controls• Cost-orientation• Cost recovery	Other communications providers	Other telecommunication companies operating in the UK, which purchase telecommunication services from BT.
CPS	Carrier Pre-Selection.	PPP	Product management, policy and planning.
Current Cost Accounting (CCA) adjustments	The change to historical costs arising from the revaluation of assets on a current cost basis. In the statements for individual Businesses and activities the adjustments comprise the holding gains or losses arising from changes in asset values, together with the effect on asset values and depreciation of the appropriate allocation of current cost asset values between Markets, Technical Areas and Wholesale Services.	Primary Accounting Documents	Set out the framework within which the Current Cost Financial Statements are prepared.
DAM	The Detailed Attribution Methods. This sets out the detailed processes by which revenues and costs are attributed to the Markets, Technical Areas and Wholesale Services.	Relationships and Parameters (R&P)	The BT publication "Long Run Incremental Cost Model: Relationships and Parameters" describes in detail how BT has applied the principles contained within the LRIC Methodology section of the Accounting Documents to construct cost volume relationships and to calculate LRIC. The R&P also contains appendices which detail the relationships and parameters used within the model.
DLRIC	LRIC plus a share of common costs.	Retail cost accounting	Cost accounting in retail markets deals with products and services sold to end users.
DVM	The Detailed Valuation Methodology. This sets out the methodology by which current cost valuations are obtained.	Safeguard Caps	Safeguard Caps are a collection of services considered prospectively competitive and for which the rates are subject to specific charge controls.
DSAC	Stand alone cost (SAC) excluding a share of core common costs.	SDSL	Synchronous Digital Subscriber Line.
FRIACO	Flat Rate Internet Access Call Origination.	Stand alone cost (SAC)	The stand alone cost of an activity or subset of activities is the cost incurred in providing that activity or activities of services by itself. Stand alone cost will include all direct variable, activity specific fixed costs, common fixed costs and joint costs associated with the activity or subset of activities in question.
LLU	Local Loop Unbundling.	Usage Factors	Usage Factors refer to the usage of any network component, including conveyance components.
Long Run Incremental Cost (LRIC)	Defined as the cost caused by the provision of a defined increment of output given that costs can, if necessary, be varied and that some level of output is already produced.	Wholesale cost accounting	Cost accounting in wholesale markets deals with products and services sold to Communications Providers.

Documentation

Hard copy versions of the published Current Cost Financial Statements, Primary Accounting Documents, Detailed Attribution Methods, Detailed Valuation Methodology and Long Run Incremental Cost Model: Relationships and Parameters can be obtained from:

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Electronic copies of the above documents are also available from the following website:

<http://www.btplc.com/thegroup/regulatoryinformation/financialstatements/index.htm>



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Registered office: 81 Newgate Street, London EC1A 7AJ
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Produced by BT Group in conjunction with Xansa plc
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