



## **BT's follow up response to Ofcom's consultation document**

Promoting competition and investment in fibre networks: BT Regulatory Financial Reporting Reporting requirements covering wholesale fixed telecoms markets 2021-26

(Published on 6 February 2020)

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# 1. Introduction

- 1.1 In our May 2020 response to Ofcom's reporting consultation "Promoting competition and investment in fibre networks – BT Regulatory Financial Reporting" we said that we would continue to work on proposing amendments to certain proposals.
- 1.2 We also comment on Ofcom's reporting consultation "Further consultation on certain proposed remedies" and on tracking performance of our fibre investment.

## Ofcom proposed their own headings for the RFS

Table 4.2: Proposed attribution of wholesale current costs schedule

Em	Openreach				Rest of BT			BT Group			Total SMP markets
	Physical Infrastructure	SMP markets (additional column for each market)	Non-SMP	Eliminations	SMP markets (additional column for each market)	Non-SMP	Total	Eliminations	Rounding	Total	
Section											
ECC input prices (if applicable)											
Attribution of PFI costs											
Openreach opex (excl depreciation)											
- Service and network delivery											
- Openreach central functions											
- Lower costs											
- SLG payments											
- Other opex											
Rest of BT opex (excl depreciation)											
- Exchanges											
- Other property											
- Cumulo											
- Central functions - Technology											
- Central functions - Group											
- Other opex											
Depreciation											
- Duct											
- Poles											
- Other PIA assets (if applicable)											
- Copper											
- Fibre											
- Electronics											
- Software											
- Land and buildings											
- Other depreciation											
- Less funded assets (BDUK, etc)											
Total opex excl other operating income											
Other operating income											
Total operating costs											
Total CCA adjustments											
- Holding gains											
- Supplementary depreciation											
- Other CCA adjustments											
Rounding											
Total CCA operating costs											

- Requires us to maintain separate reporting hierarchy
- Not easy for stakeholders to compare information to ARA
- May go out of date if BT reorganises, as mixes org structure and cost type

## Ofcom proposed reporting detail of methodologies in confusing way

Table 5.1: Example of attribution rule table – Openreach central functions

	Opex attributed Em	Opex attributed %	Attribution to Openreach SMP markets %
Direct to Openreach products	X	X%	X%
Direct to rest of BT	X	X%	X%
Openreach pay driver	X	X%	X%
Openreach PAC driver	X	X%	X%
Other rules*	X	X%	X%
<b>Total</b>	<b>X</b>	<b>100%</b>	<b>X%</b>

\*Any attribution applied to more than 10% of total category costs would be separately shown.

- Ofcom's proposal did not reflect the multi-stage nature of attributions
  - Unclear quite how BT should comply
  - We believe this format is highly misleading to the reader

## Agreeing with Openreach Response

- Ofcom published a further consultation including private PIA and ECC reporting, which Openreach responded to. Here we confirm that BT Group agree with Openreach.

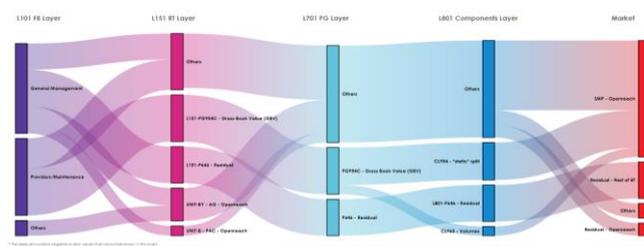
## We are suggesting we use the Annual Report and Accounts lines instead

Attribution of Wholesale Current Costs For the year ended 31 March 20xx

	Openreach			Rest of BT			BT Group			Total SMP markets
	SMP Markets (additional column for each market)	Non-SMP	Eliminations	SMP Markets (additional column for each market)	Non-SMP	Total	Eliminations	Rounding	Total	
<b>Operating costs by nature</b>										
ECC input prices										
Attribution of PFI costs										
Vages and Salaries										
Probit Costs and Sales Commissions										
Payments to telecommunications operators										
Property and Energy costs										
Network operating and IT costs										
TV programme rights charges										
Provision and installation										
Marketing and sales										
Other Operating Costs										
Other Operating Income										
<b>Total Operating costs before depreciation</b>										
<b>Depreciation:</b>										
Duct										
Poles										
Other PIA assets										
Copper										
Fibre										
Electronics										
Software										
Right of use assets										
Other depreciation										
Less funded assets (BDUK, etc)										
<b>Total Depreciation</b>										
<b>Total Operating costs CCA adjustments</b>										
Holding gains										
Supplementary Depreciation										
Other CCA adjustments										
Rounding										
<b>Total CCA operating costs</b>										
<b>Operative costs includes the following:</b>										
Specific items										
Cumulo charges										
Service level guarantees (Openreach)										

- Easier to maintain and produce (better aligns with internal reporting)
- Easier to compare to ARA
- Largely already mandated by Ofcom

## We are suggesting diagrams instead



- Makes methodologies easier to understand
- Shows which methodologies are most important
- Cross-refers to existing AMD

## Reporting of FTTP Investment

- We propose that we share records of spend on the FTTP investment privately
- This would help build investor confidence by signalling a 'no surprises' approach

## 2. Transparency

### Market Performance Schedules

- 2.1 We have developed our proposal from the following principles, all of which are similar to a traditional set of accounts such as BT's Annual Report and Accounts (ARA):
- Headings are as far as possible those used internally in management and statutory reporting
  - Costs are analysed by type and by organisation separately. We propose a separate "Operating Costs by Organisation" table. This is similar to "Segment Information" in the ARA
  - Areas of particular focus for Ofcom and other stakeholders are separated from the main categories of expense by nature. This is similar to "notes to the accounts" in the ARA
  - Formats (particularly for organisation) will evolve over time, as the business changes
- 2.2 The format originally proposed by Ofcom mixes reporting by organisation and cost. This is hard to report because we will need to create a new reporting structure, separate from other reporting, for RFS reporting.
- 2.3 Structuring our reporting around the existing lines we use for external reporting in the annual report means we have existing assurance procedures and controls to ensure reporting is robust and reliable and makes it easier to compare the RFS to the ARA.
- 2.4 Below we have proposed changes to the three schedules Ofcom has proposed – "Proposed Summary by market performance schedule" (Reporting Consultation 4.11), "Proposed Attribution of wholesale current costs schedule" (Reporting Consultation 4.22), "Proposed attribution of wholesale MCE schedule" (Reporting Consultation 4.38). We have also proposed a fourth table: "Operating Costs by Organisation".



- 2.6 Our proposed format for “Attribution of Wholesale Current Costs” uses headings from our management and/or statutory accounts. Depreciation is unchanged from Ofcom’s proposal, with the exception of inclusion of Right of Use assets. We would expect property costs to be recognised here in line with our May response para 4.31.
- 2.7 Right of use asset depreciation is reported as much of our property estate is recognised under IFRS16.
- 2.8 Where there are differences between the RFS and ARA these will be explained by notes to the table or references to the relevant line in the reconciliations in section 5 of the RFS.
- 2.9 Areas for particular focus relating to Openreach are below the table under the heading “*Operating costs includes the following*”. The main table can more closely align to other external reporting and draws a distinction between a high-level summary and more granular reporting on areas of Ofcom focus.
- 2.10 This section would include specific items (but see our May response para 4.33 for timing). Leaver costs would also naturally fit here, though we have outlined in our May response why it should be omitted entirely (para 4.30).

	Openreach				Rest of BT			BT Group				
	Physical Infrastructure	SMP Markets (additional column for each market)	Non-SMP	Eliminations	Total	SMP Markets (additional column for each market)	Non-SMP	Total	Eliminations	Rounding	Total	Total SMP markets
<b>Operating costs by organisation</b>												
<b>Openreach</b>												
Service and Network Delivery												
Openreach Support Functions												
<b>Openreach Total</b>												
<b>Rest of BT</b>												
Group Centre (excluding Property and Facilities)												
Property and Facilities												
Technology												
Consumer, Global and Enterprise												
<b>Rest of BT Total</b>												
<b>Total operating costs before depreciation</b>												

- 2.11 We propose to report Operating costs before depreciation by organisation as shown above. Where a business unit does not allocate significant costs to SMP markets we would report these collectively as a single line.
- 2.12 Our proposed format for Attribution of Wholesale Current Cost Mean Capital Employed (below) is unchanged from our May proposal, with the exception of inclusion of Right of Use asset reflecting recognition of our property estate post adoption of IFRS16. We also include exchange costs in property costs, as explained in our May response para 4.31.

**Attribution of Wholesale Current Cost Mean Capital Employed**

For the year ended 31 March 20xx

Section	Openreach				Rest of BT			BT Group			Total SMP markets	
	Physical Infrastructure	SMP Markets (additional column for each market)	Non-SMP	Eliminations	Total	SMP Markets (additional column for each market)	Non-SMP	Total	Eliminations	Rounding		Total
<b>Non-current assets</b>												
Duct												
Poles												
Other PIA assets												
Copper												
Fibre												
Electronics												
Software												
Right of use assets												
Other assets												
Less funded assets (BDUK, etc)												
<b>Current Assets</b>												
<b>Current Liabilities</b>												
<b>Provisions</b>												
Rounding												
<b>Total MCE</b>												

**Attribution Schedules for costs and MCE**

- 2.13 Ofcom has proposed detailed attribution schedules as part of the Reporting Consultation (5.28). Due to the multi-layer nature of our methodologies, these may not be the clearest way to present our methodologies. Any given cost passes through many methodologies, hence the table would not be easily reconcilable to other information in the RFS.
- 2.14 We propose instead that attribution of costs and MCE could be better represented with a series of Sankey diagrams. The individual flows shown in these diagrams would represent the cost (or MCE) and the apportionment of these costs (or MCE) through the layers of our cost allocation system. The size of each flow represents the relative proportion of costs and MCE attributed in this way.
- 2.15 These diagrams will a) enable the reader to understand the main drivers operating on a category of cost; and b) help the reader to understand which of the methodologies detailed in the AMD are the largest and most significant methodologies.
- 2.16 We propose showing diagrams for the largest reported balances covering the majority of costs and MCE in the “Attribution of Wholesale Operating Costs and MCE” tables which attribute to the SMP markets. We believe Sankey diagrams will provide a simplified overview of methodologies, to supplement more detailed specific methodologies in the AMD.
- 2.17 In some cases objects at one layer may allocate to many objects at the next layer. To ensure these diagrams are clear and easy to understand, minor allocations would be amalgamated into an “other” category.
- 2.18 This type of flow diagram does not easily accommodate a mixture of positive and negative balances therefore certain negative balances will need to be excluded. In

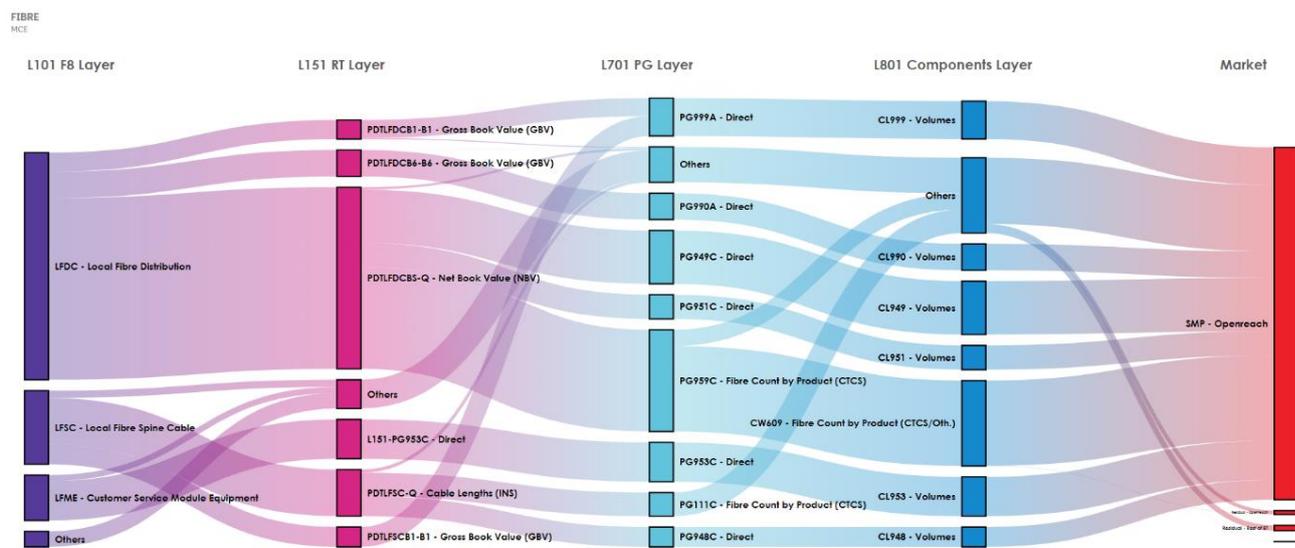
our testing, these were negligible and did not detract from the usefulness of the diagrams. Should excluded balances become material in the future, we would need to discuss alternative ways of presenting the information with Ofcom.

2.19 These diagrams are also much clearer to understand when Rest of BT Residual transfer charges methodologies are excluded. We propose noting any such omissions below the diagrams, or in separate transfer charge diagrams or analysis if significant.

2.20 As the success of this diagram at its aims is somewhat subjective, and as there may be a period of bedding in while we hone the format, any directions Ofcom makes regarding this disclosure should be general and allow flexibility. For the same reason it feels premature to include the diagrams in the scope of the Regulatory Audit.

**Example**

2.21 The below diagram is an example of the diagram for the Fibre MCE attribution, showing an overview of how costs are allocated by the layers in our allocation system.



2.22 The diagram shows that Fibre is grouped by asset type in L101 F8 Layer. Methodologies applied depend on the asset type, the largest of which is local fibre distribution. Here we predominantly use methodologies based on the book value of the assets (GBV and NBV) to allocate the costs to plant groups and components representing parts of the network. Components are then allocated to services (and hence to Openreach or Rest of BT) based on service volumes.

2.23 The reader who wants to know more about any particular stage can refer to the detailed AMD for that part of the calculation.

### 3. Regulatory reporting requirements in further consultation

- 3.1 In Ofcom's "Further consultation on certain proposed remedies"<sup>1</sup> Ofcom proposes that we should provide operating and capital costs associated with PIA ancillaries and ECC Contractor costs. We agree with the Openreach response to this consultation; we believe that this should not be an AFI reporting requirement but an Openreach compliance statement provided privately to Ofcom. Further detail is included in section 7 of the Openreach response to the WFTMR further consultation

### 4. Tracking the performance of our fibre investment over its lifetime

- 4.1 In Ofcom's "Pricing wholesale local access services in Geographic Area 3 with a BT Commitment to deploy a fibre network" consultation<sup>2</sup> it indicates that it may in future impose price controls on full fibre services at speeds above 40Mbps and that the level of any such controls will need to consider a fair level of returns over the whole investment period.
- 4.2 In her speech to the FTTH Council Europe, Ofcom CEO Melanie Dawes recognised that investors needed clarity on Ofcom's approach to potential future regulation, and in this context that "the full-fibre investment was a long term investment, taking more than a decade – if not two – to pay back". She added that, if companies play by the rules, competition is healthy and prices remain affordable, Ofcom would not expect to intervene during the investment cycle in a way that hampers that investment, and that Ofcom would then "aim to allow all companies to achieve a fair return over their whole investment period, allowing for a margin above their cost of capital to reflect the risks."<sup>3</sup>
- 4.3 In light of this, we consider that the data needed for such an exercise, should it be needed, is recorded as the investment period proceeds. This would help build investor confidence by signalling a 'no surprises' approach, especially when coupled with greater clarity about the triggers that Ofcom will use when deciding whether, and when further regulation of fibre prices may be required.
- 4.4 We therefore propose to work with Ofcom to create an agreed reporting template, to be shared with Ofcom privately, which captures year on year, actual FTTP costs (capital expenditure and operating expenditure), total number of FTTP connections and revenues to track how our investment is progressing. Our objective is that, in this way, there should then be minimal disagreement on the actual FTTP costs, revenues and volumes up to the point of possible future price regulation (volumes

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<sup>1</sup> Wholesale Fixed Telecoms Market Review 2021-26 Further consultation on certain proposed remedies 6/11/2020 paragraph 7.14

<sup>2</sup> Promoting competition and investment in fibre networks: Wholesale Fixed Telecoms Market Review 2021-26 Pricing wholesale local access services in Geographic Area 3 with a BT Commitment to deploy a fibre network, 29/07/2020, paragraph 3.47

<sup>3</sup> Speech by Dame Melanie Dawes, Ofcom Chief Executive, to FTTH Council Europe, 3 December 2020

are already recorded as part of our existing regulatory reporting requirements). Such a record would also provide a common understanding on what we have spent and what remains to be recovered.

