



# Directions for Regulatory Financial Reporting

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Statement

Publication date: 30 March 2015

## About this document

This document sets out the adjustments that BT must reflect in its Regulatory Financial Reporting in order for it to be consistent with the regulatory decisions that we made in the 2014 Fixed Access and WBA market reviews.

We explain our decision that BT must prepare and publish an Adjusted Financial Performance Schedule to provide stakeholders with a better understanding of the impact of regulatory decisions at a market review level. A second schedule showing impacts at a market level must be provided to Ofcom in private.

We also set out the directions necessary to implement other decisions made in our 2014 Statement about changes to BT's Regulatory Financial Reporting.

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## Section 1

# Summary

- 1.1 In the 2014 Regulatory Financial Reporting Statement (2014 Statement)<sup>1</sup>, we decided that Regulatory Financial Reporting should, as far as possible be consistent with our regulatory decisions.
- 1.2 In December 2014 we published a consultation (the Directions Consultation)<sup>2</sup> in which we made proposals to give effect to the decisions that we made for the purpose of ensuring that BT's Regulatory Financial Reporting is consistent with regulatory decisions. We also made proposals about reporting by BT of information relating to its financial performance from a regulatory perspective.
- 1.3 In addition, we made proposals to give effect to cost accounting obligations imposed on BT in the Fixed Access Statement about VULA and the electricity charge.<sup>3</sup>
- 1.4 Informed by responses to the Directions Consultation, in this Statement we set out our decisions about how BT's Regulatory Financial Reporting should reflect the adjustments necessary to ensure consistency with our regulatory decisions and the information BT should report about its financial performance from a regulatory perspective. We also confirm the reporting requirements imposed on BT in respect of VULA and the electricity charge.
- 1.5 We also indicated in the Directions Consultation that we would issue the directions necessary to give effect to the new regulatory reporting regime set out in the 2014 Statement, and we do so here.
- 1.6 In the 2014 Statement we decided to introduce new Regulatory Accounting Principles which included the need for BT's Regulatory Financial Reporting to be consistent with our regulatory decisions.
- 1.7 In the Directions Consultation we proposed that the identification of regulatory decisions that should (or should not) be reflected within Regulatory Financial Reporting to achieve consistency is a matter for our judgement and should be considered on a case by case basis. We noted that for this reason Regulatory Accounting Principle 4 - Consistency with regulatory decisions – had been defined by reference to decisions as set out in the Regulatory Accounting Guidelines rather than a more general requirement for consistency. We explained that we would specify the consistency requirements arising out of the Fixed Access and WBA market reviews<sup>4</sup>

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<sup>1</sup> The 2014 Statement followed a call for inputs of November 2011, a consultation in September 2012 (the "2012 Consultation" and a further consultation in December 2013 (the "2013 Consultation"). <http://stakeholders.ofcom.org.uk/binaries/consultations/bt-transparency/statement/financial-reporting-statement-may14.pdf>

<sup>2</sup> Directions for Regulatory Financial Reporting. Consultation. 10 December 2014. <http://stakeholders.ofcom.org.uk/consultations/financial-reporting/>

<sup>3</sup> Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30. Statement on market definition, market power determinations and remedies. 26 June 2014. <http://stakeholders.ofcom.org.uk/telecoms/ga-scheme/specific-conditions-entitlement/market-power/fixed-access-market-reviews-2014/statement/summary/>

<sup>4</sup> Review of the wholesale broadband access markets. Statement on market definition, market power determinations and remedies. 26 June 2014 <http://stakeholders.ofcom.org.uk/consultations/review-wba-markets/statement/>

in a direction to be issued separately. We noted that in future the Regulatory Accounting Guidelines would specify those adjustments which BT must make to ensure consistency.

- 1.8 In Section 3, informed by stakeholders' responses we confirm that it is for Ofcom to make decisions about whether adjustments made in market reviews should be reflected in BT's Regulatory Financial Statements. We confirm that while the starting point for these decisions should be to consider whether and if so, what impact our adjustments have on BT's actual costs these decisions must be made on a case by case basis.

## **The need for additional reporting**

- 1.9 We proposed in the Directions Consultation that BT must prepare two additional schedules ("the Adjusted Financial Performance Schedules") as part of its Regulatory Financial Reporting. These schedules would take the reported financial performance as set out in the Regulatory Financial Statements and show the impact of making further adjustments to the reported results.
- 1.10 We proposed that one schedule ("Schedule 1") would show BT's Adjusted Financial Performance at a market review level. We proposed that this schedule would set out BT's estimate of the impact of those adjustments which in our view should not be reflected in the Regulatory Financial Statements and which affect returns at a market review level.<sup>5</sup> We proposed that BT would be required to publish that schedule.
- 1.11 We proposed that a second schedule ("Schedule 2") would set out the impacts at a market level of those adjustments arising from regulatory decisions that should not be reflected in BT's Regulatory Financial Statements.<sup>6</sup> We considered that this more detailed information would allow us to understand BT's view of the individual impacts of market level adjustments which we made during market reviews when setting charge controls. As such it would help us understand BT's view of the aggregate impact of all of the adjustments on returns at a market review level and the way in which BT has prepared Schedule 1. We proposed that BT would be required to provide this schedule to Ofcom in private.
- 1.12 In Section 3, informed by stakeholders' responses we decide that BT must prepare the Adjusted Financial Performance Schedules. BT must publish Schedule 1 (impact on returns at a market review level) and provide Schedule 2 (impacts at a market level) to Ofcom in private.

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<sup>5</sup> Under the European common regulatory framework for electronic communications, Ofcom is required to carry out periodic reviews of electronic communications markets in the United Kingdom. In carrying out these reviews Ofcom considers the level of competition and, consequently, the regulation that should apply. In order to carry out these reviews we group together communications markets in a set of market reviews.

<sup>6</sup> Each market review considers individual SMP markets. The market review levels and the component SMP markets for which BT has Regulatory Financial Reporting requirements are set out in Section 1 of BT's Regulatory Financial Statements.

<http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/index.htm>

## Consistency with regulatory decisions

- 1.13 In the Directions Consultation we made proposals about the adjustments to BT's Regulatory Financial Reporting necessary in order to achieve consistency in respect of regulatory decisions in the Fixed Access and WBA market reviews.
- 1.14 In Section 4, informed by stakeholders' responses we set out our decisions about the adjustments that BT must make to its Regulatory Financial Reporting in order to achieve consistency in respect of regulatory decisions in the Fixed Access and WBA market reviews:
- We confirm how BT's Regulatory Financial Statements should be adjusted so that they comply with the requirement for consistency with regulatory decisions. In particular, we explain our decisions that a number of adjustments, including the Hypothetical Ongoing Network (HON), WLR Line Cards (Line Cards), ISDN30 and ISDN2 should not be reflected in BT's Regulatory Financial Statements.
  - Where we decide that the decisions should be reflected in the Regulatory Financial Statements, we explain how the adjustments should be made.
  - Where we decide that decisions should not be reflected in BT's Regulatory Financial Statements, we set out our decisions on whether the impacts of those decisions on BT's reported costs should be included in the Adjusted Financial Performance Schedules, and if so, how these adjustments should be made.

## VULA Reporting

- 1.15 In the Directions Consultation we proposed to impose public and private reporting requirements on BT in respect of Virtual Unbundled Loop Access (VULA). These requirements arose from finding in the Fixed Access market review that BT has SMP in the Wholesale Local Access (WLA) market.
- 1.16 In Section 5, informed by stakeholders responses we decide that:
- BT must disclose the revenue, volume, average price and FAC of VULA Migrations and disclose all network components and FAC of VULA Migrations, which is the only VULA service which is currently subject to a charge control.
  - The internal and external revenues and FAC costs of all other VULA services should be reported within the WLA market in the Regulatory Financial Statements. In doing so, BT will be required to include the internal and external revenues and FAC costs in the "Market Summary in the Regulatory Financial Statements in a category called "Other". However, BT will not be required to provide any further published disaggregation of these revenues and costs.
  - BT must provide three schedules in private which in summary will provide:
    - information on the volumes, revenues, costs, MCE and returns of both FTTC and FTTP services;
    - detailed FAC cost component information of both FTTC and FTTP services; and

- information on how BT has treated government grants and the impact of this treatment on VULA costs.

## Electricity Reporting

- 1.17 In the Directions Consultation we proposed to impose public and private reporting requirements on BT in respect of electricity charges. These requirements arose from finding in the Fixed Access market review that BT has SMP in the WLA market.
- 1.18 In Section 6, informed by stakeholders views we have decided that:
- BT must set out and explain its methodology of setting the electricity charges in the Accounting Methodology Documents. The explanation must include a clear description on the individual elements within the charge, how they are calculated and how they are passed through into the per kWh charge end users. The description should also include the date on which the latest annual contractual price was struck and provide an aggregate split of the individual elements in a non-confidential format.
  - BT must provide us with additional information that will allow us to monitor the compliance with the basis of charges obligation for electricity. This information must be reconcilable to the revenues and costs included within the publicly reported totals for the WLA market.

## Directions to implement the 2014 Statement decisions

- 1.19 In the Directions Consultation we said that we would issue the necessary directions giving effect to the policy decisions that we made in the 2014 Statement alongside our decisions about consistency with regulatory reporting, VULA and electricity reporting.
- 1.20 We summarise the decisions in Section 7 and set out in the Annexes the directions which are necessary to implement the decisions that we made in the 2014 Statement. These include the directions specifying:
- new Regulatory Accounting Principles;
  - the methodology to determine the RAV adjustment;
  - requirements in relation to the reconciliation report, accompanying audit opinion and materiality thresholds;
  - transparency requirements for the purposes of preparing and maintaining the accounting records, the Accounting Methodology Documents and the Regulatory Financial Statements;
  - audit, the form of FPIA opinion and the form of PPIA opinion;
  - requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements (incorporating the requirements in relation to EOI reporting, non-confidential compliance statements and form of basket reporting on which we consulted in the 2013 Consultation); and
  - network components.



## Section 2

# Introduction

## Background

- 2.1 The 2014 Regulatory Financial Reporting Statement (2014 Statement)<sup>7</sup> set out the changes we had decided to make to BT's Regulatory Financial Reporting requirements. We introduced these changes to:
- give Ofcom a greater role in the way that BT prepares the Regulatory Financial Statements;
  - improve the presentation of the Published Regulatory Financial Statements and supporting documentation; and
  - ensure that Ofcom and other stakeholders have the information that they need.
- 2.2 Our policy decisions set out in the 2014 Statement were implemented in the Fixed Access Statement<sup>8</sup> and the WBA Statement.<sup>9</sup>
- 2.3 In the Directions Consultation we consulted on the proposed directions necessary to give effect to the decisions that we made in the 2014 Statement and on proposals to give effect to cost accounting and accounting separation obligations imposed on BT in the Fixed Access Statement.
- 2.4 We also confirmed our intention to issue those directions consulted on in the 2013 Consultation that are necessary to give effect to our policy decisions.
- 2.5 In addition, we noted that we had decided in the 2014 Statement that for reasons of clarity Directions 1<sup>10</sup>, 3<sup>11</sup> and 4<sup>12</sup> which had been given under the conditions set out in the statement published in 2004 and which set out the regulatory financial reporting obligations on BT,<sup>13</sup> would be issued afresh (with the amendments proposed in the 2013 Consultation) under the new conditions.

<sup>7</sup> The 2014 Statement followed a call for inputs of November 2011, a consultation in September 2012 (the "2012 Consultation") and a further consultation in December 2013 (the "2013 Consultation").

<sup>8</sup> <http://stakeholders.ofcom.org.uk/telecoms/ga-scheme/specific-conditions-entitlement/market-power/fixed-access-market-reviews-2014/statement/>

<sup>9</sup> <http://stakeholders.ofcom.org.uk/consultations/review-wba-markets/statement/>

<sup>10</sup> Direction 1 published at Annex 4 to the regulatory statement "The regulatory financial reporting obligations on BT and Kingston Communications – Final statement and notification – Accounting separation and cost accounting: final statement and notification" of 22 July 2004 ("the 2004 Statement") (as subsequently modified) specifying network components.

<sup>11</sup> Direction 3 published at Annex 4 to the 2004 Statement (as subsequently modified) specifying requirements for the preparation, audit and delivery of Regulatory Financial Statements in respect of wholesale cost accounting, accounting separation and retail cost accounting.

<sup>12</sup> Direction 4 published at Annex 4 to 2004 Statement (as subsequently modified) specifying requirements for the form and content of Regulatory Financial Statements in respect of wholesale cost accounting, accounting separation and retail cost accounting.

<sup>13</sup> The statement entitled "The regulatory financial reporting obligations on BT and Kingston Communications – Final Statement and notification – Accounting Separation and cost accounting: final statement and notification" of 22 July 2004 and in the statement "Review of the wholesale local

## Responses to consultation

- 2.6 We received six responses to the December 2014 consultation. These responses, received from BT, Sky, TalkTalk, UK Competitive Telecommunications Association (UKCTA), Vodafone and from The Bit Commons, are published on our website: <http://stakeholders.ofcom.org.uk/consultations/financial-reporting/?showResponses=true>
- 2.7 Stakeholders other than BT generally welcomed Ofcom's proposals, whereas BT disagreed with a number of Ofcom's specific proposals.
- 2.8 We summarise and respond to BT's and other stakeholders views in the sections below.
- 2.9 In addition to the matters on which we consulted on in the Directions Consultation Vodafone proposed additional reporting requirements in relation to what it regards as "smaller volume, but critically important, services where the entire industry is reliant upon BT for service"<sup>14</sup> including 112/999 Emergency call handling, Text relay and Payphone Access Charge. UKCTA said that these were also of concern for its members arguing that these "services need to be captured within the regulated framework and the regulatory accounts should be used to provide a badly needed transparency on the cost of providing them."<sup>15</sup> We note UKCTA and Vodafone's desire for more reporting. However, the issues raised by Vodafone and UKCTA were not the subject of the Directions Consultation and we did not therefore make any proposals about reporting requirements relating to these services.
- 2.10 TalkTalk also argued that BT should be required "to present a full set of data that demonstrates compliance with each and every charge control."<sup>16</sup> We explained in the 2014 Statement our decision to require BT to publish separately non-confidential compliance reports for Fixed Access and WBA markets from 2014/15. We said that we expected BT to voluntarily provide those statements for the Business Connectivity and Narrowband markets. We have set out in Section 7 more detail about the direction that we have decided to give in order to implement our decision that BT should publish non-confidential compliance schedules. The reporting requirements concerning the publication of non-confidential compliance statements have been captured in a direction which is issued afresh under the new conditions and which relates to the preparation, delivery, publication, form and content of the Regulatory Financial Statements. This direction is set out in Annex 7.

## Decisions made in this document

### Decisions to give effect to the 2014 Statement

- 2.11 We set out in this document the decisions that we have taken about the reporting requirements which we consider are necessary to enable BT to comply with the consistency with regulatory decisions principle. We explained in the 2014 Consultation that these requirements would be necessary in the interim until we have established the Regulatory Accounting Guidelines. The reasons for our decisions

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access market – Identification and analysis of markets, determination of market power and setting of SMP conditions – Explanatory statement and notification" of 16 December 2004.

<sup>14</sup> Vodafone, Directions Consultation response, page 3, paragraph 6.

<sup>15</sup> UKCTA, Directions Consultation response, page 2, paragraph 6

<sup>16</sup> TalkTalk, Directions Consultation response, page 4, paragraph 6.1

together with our responses to stakeholder comments about our proposals for the reporting requirements are set out in Section 4. The direction required to implement our decisions about the reporting requirements is set out in Annex 2.

- 2.12 We have also set out our decisions to require BT to provide more information to allow the users of the Published Regulatory Financial Statements to gain a reasonable understanding of the impact of regulation on BT and its ability to recover costs. We set out our responses to the comments made in respect of our proposals about the need for additional reporting and our decisions about the proposals for BT to produce two new schedules from 2014/15 onwards in Sections 3.
- 2.13 Our decisions which will allow BT to calculate the impact of adjustments in order to prepare the proposed information, together with our responses to comments received, are set out in Section 4. The direction required to implement our decisions about the additional reporting requirements relating to BT's financial performance from a regulatory perspective is set out in Annex 6.

### **Decisions to give effect to the Fixed Access Statement**

- 2.14 We also set out in Sections 5 and 6 the decisions that we have taken to give effect to cost accounting obligations that we imposed on BT in the Fixed Access Statement, which relate to the following:
- VULA reporting; and
  - Electricity reporting.
- 2.15 The reporting requirements in relation to VULA implementing our decisions in the Fixed Access market review have been captured in a direction which has been issued afresh under the new conditions and which relates to the preparation, delivery, publication, form and content of the Regulatory Financial Statements. This direction is set out in Annex 7. The direction required to implement our decisions in relation to electricity reporting is set out in Annex 9.

## **Implementing decisions set out in other documents**

### **Directions to implement our 2014 Statement decisions**

- 2.16 We explained in the Directions Consultation that we had decided in the 2014 Statement to implement proposals relating to:
- the Regulatory Accounting Principles;
  - transparency requirements;
  - the form of the FPIA opinion;
  - the form of the PPIA opinion;
  - reporting of Equivalence of Input ("EOI") costs;
  - non-confidential compliance reports for Fixed Access, ISDN and WBA markets from 2014/15;

- the form of basket reporting for Fixed Access, ISDN and WBA markets from 2014/15;
  - the preparation of the Regulatory Financial Statements on a RAV basis;
  - the requirement to publish a reconciliation report with an accompanying audit opinion; and
  - the appropriate materiality thresholds in relation to changes and errors for the purpose of their inclusion in a reconciliation report and an accompanying audit opinion.
- 2.17 We also noted in the Directions Consultation our decision made in the 2014 Statement to issue afresh Directions 1, 3 and 4 under the new conditions which were implemented in the Fixed Access and WBA markets.
- 2.18 We said that we would issue the necessary directions giving effect to these policy decisions in early 2015 alongside our decisions on the matters on which we were consulting in December 2014.
- 2.19 With regard to our decisions about the Regulatory Accounting Principles, the transparency requirements, and the form of the FPIA opinion and the form of the PPIA opinion, we set out the proposed directions in the 2013 Consultation. We summarise these decisions in Section 7 and set out the directions implementing our decisions in Annexes 1, 3 and 4 respectively.
- 2.20 In relation to our decisions about the reporting of EOI costs, the non-confidential compliance statements and the form of basket reporting, we said in the 2013 Consultation that we would implement these proposals by amending Directions 3 and 4. We have summarised the decisions in Section 7. As we decided to issue Directions 3 and 4 afresh, we have captured these reporting requirements in a direction which has been issued afresh and which relates to the preparation, delivery, publication, form and content of the Regulatory Financial Statements.<sup>17</sup> This direction is set out in Annex 7.
- 2.21 Our decision concerning the preparation of the Regulatory Financial Statements on a RAV basis has been implemented in the new SMP conditions imposed in the Fixed Access and WBA markets. We set out in Section 7 detailed requirements giving effect to that decision and specifying the RAV methodology which BT will be obliged to follow. These requirements are included in the direction which also sets out the requirements in relation to the consistency with regulatory decisions principle. This direction is set out in Annex 2.
- 2.22 We also set out in Section 7 the requirements concerning the publication of a reconciliation report, an accompanying audit opinion and the appropriate materiality thresholds. The direction specifying these requirements is set out in Annex 5.
- 2.23 In addition, we explain in Section 7 how we captured the requirements contained in Directions 1, 3 and 4 in the directions issued afresh under the new conditions. The relevant directions are set out in Annexes 8 and 7 respectively.

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<sup>17</sup> This direction captures the requirements which are included in both Direction 3 and Direction 4.

## Legal Tests

### Sections 3, 4 and 4A and 49(2)

- 2.24 The decisions we are making in this document either give effect to the SMP conditions which were imposed in the Fixed Access and WBA market reviews or implement the outcomes of these market reviews. We summarise below our duties under sections 3, 4 and 4A and the tests set out in section 49(2) of the Act. We explain how our decisions meet these duties and tests where we discuss our decisions in detail.
- 2.25 Section 3 of the Act sets out Ofcom's duties in carrying out its functions, in particular that it furthers the interests of citizens in relation to communications matters and furthers the interests of consumers in relevant markets, where appropriate by promoting competition.
- 2.26 Section 4 of the Act requires that Ofcom acts in accordance with the six Community requirements concerning: the promotion of competition; the development of the European internal market; the promotion of the interests of all EU citizens; non-discrimination; encouraging the provision of network access and service interoperability for the purpose of securing efficiency and sustainable competition, efficient investment and innovation and the maximum benefit for consumers; and facilitating service interoperability and securing freedom of choice for consumers.
- 2.27 Section 4A of the Act requires Ofcom to take into account all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive. In making the changes described in the sections below, we have taken into account all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive<sup>18</sup>, in particular Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications.<sup>19</sup>
- 2.28 Ofcom can give a direction that gives effect to an SMP obligation under section 49 of the Act but only where it is satisfied that the tests under section 49(2) have been met. The tests are that the direction is:
- objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
  - not unduly discriminatory against particular persons or against a particular description of persons;
  - proportionate to what it is intended to achieve; and
  - transparent in relation to what it is intended to achieve.

<sup>18</sup> Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common framework for electronic communications and services (OJ L 108 24.04.2002, p33), as amended.

<sup>19</sup> "Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications", OJ L 266, 11.10.2005, p 64

## Sections 49A and 49B

- 2.29 Sections 49A and 49B set out the relevant procedures that must be followed for domestic and EU consultations respectively on proposals to give directions. We summarise these procedures below and explain how we have complied with them.
- 2.30 Section 49A applies where the proposals are for the purposes of:
- an SMP apparatus condition; or
  - any other condition set under section 45 where what is proposed would, in Ofcom's opinion, have a significant impact on a market for any of the services, facilities, apparatus or directories in relation to which Ofcom has functions under Chapter 1 of Part 2 of the Act.
- 2.31 Section 49B applies where the proposals are of EU significance. Section 150A(2) sets out the cumulative criteria that must be satisfied in order for a proposal to be of EU significance.<sup>20</sup>

### Our decisions concerning consistency with regulatory decisions, adjusted financial performance, VULA and electricity

- 2.32 We explained in the Directions Consultation that we considered that section 49A(1)(a) did not apply in relation to our proposals concerning consistency with regulatory decisions, adjusted financial performance, VULA and electricity because Ofcom was not proposing to give directions for the purposes of an SMP apparatus condition. With regard to section 49A(1)(b), we said that we did not consider it was necessary to decide whether this was applicable. This was because in any case we thought that it was important to give stakeholders an opportunity to consider and comment on our proposals. Therefore, we formally consulted on our proposals and sent a copy of this consultation and accompanying proposed directions to the Secretary of State in accordance with section 49(C)(1)(a).
- 2.33 We also explained that we considered that section 49B did not apply because our consultation proposals were not of EU significance, as defined under section 150A(2), in particular because in our opinion, given the nature and limited extent of the proposals on which we consulted and on the basis of the analysis and impact assessment set out in this consultation, these proposals would not affect trade between Member States.

### Our decisions to give directions under the new conditions to implement our 2014 Statement decisions

- 2.34 As set out above, we consulted on the following matters and in doing so we complied with the procedures set out in sections 49A of the Act:
- the Regulatory Accounting Principles;
  - transparency requirements;

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<sup>20</sup> The cumulative criteria that must be satisfied in order for a proposal to be of EU significance include the criterion that the proposal would, in Ofcom's opinion, affect trade between Member States (see section 150A(2)(d))

- the form of the FPIA opinion;
  - the form of the PPIA opinion;
  - reporting of EOI costs;
  - non-confidential compliance reports for Fixed Access, ISDN and WBA markets from 2014/15;
  - the form of basket reporting for Fixed Access, ISDN and WBA markets from 2014/15;
  - the requirement to publish a reconciliation report with an accompanying audit opinion; and
  - the appropriate materiality thresholds in relation to changes and errors for the purpose of their inclusion in a reconciliation report and an accompanying audit opinion.
- 2.35 We considered in the 2013 Consultation that section 49B of the Act did not apply to our proposals.
- 2.36 In the Directions Consultation we noted that the requirements specifying the methodology to determine the RAV adjustment had been consistently applied since our statement “The Valuing copper access final statement” across markets (“2005 Copper Statement”)<sup>21</sup> and we were not introducing any changes in this respect. We therefore considered Sections 49A and 49B did not apply and said that we did not consider it necessary to consult on such methodology.<sup>22</sup>
- 2.37 We also considered that Sections 49A and 49B do not apply to our decisions to issue Directions 1, 3 and 4 afresh under the new conditions because we are not introducing any substantive changes to the requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements and the requirements in relation to the network components.

## **Our decisions do not affect KCOM**

- 2.38 We explained in the 2014 Statement that the policy decisions which we made in that statement related to the Regulatory Financial Reporting arrangements for BT. We said that in due course we would consider whether any of the changes might be appropriate to apply to KCOM.
- 2.39 As our decisions concern the implementation of the decisions in the 2014 Statement and are given under the new SMP conditions which have been imposed on BT in the Fixed Access and WBA market reviews, our decisions will not affect KCOM.
- 2.40 In relation to our decisions about reporting of the VULA services and the electricity charge, they will also not affect KCOM.

<sup>21</sup> <http://stakeholders.ofcom.org.uk/binaries/consultations/copper/statement/statement.pdf>

<sup>22</sup> The Directions Consultation, paragraph 2.21

## Impact assessment and EIA framework

### Impact assessment

- 2.41 Section 7 of the Act requires Ofcom to carry out impact assessments where its proposals would be likely to have a significant effect on businesses or the general public, or when there is a major change in Ofcom's activities. Impact assessments form part of best practice policy-making as they provide a valuable way of assessing different options for regulation and showing why the preferred options was chosen. Ofcom is committed to carrying out and publishing impact assessments in relation to the majority of its policy decisions.
- 2.42 We set out our impact assessment in the Directions Consultation. In this document we take into account relevant responses and set out our conclusions on the impact of the changes.

### Equality Impact Assessment

- 2.43 Ofcom is also required to assess the potential impact of all our functions, policies, projects and practices on the equality of individuals to whom those policies will apply. Equality impact assessments assist us in making sure that we are meeting our principal duty of furthering the interests of citizens and consumers regardless of their background or identity.
- 2.44 We have given careful consideration to whether or not our decisions will have a particular impact on race, age, disability, gender, pregnancy and maternity, religion or sex equality. We do not envisage that our decisions in this statement will have a detrimental impact on any particular group of people.

## Terminology

- 2.45 In this document, we use the same terminology used in the 2014 Statement and the Directions Consultation, as follows:
- Regulatory Financial Statements describes the annual regulatory financial statements, prepared according to a defined framework and methodology. We use the term in this document to refer to both the published and unpublished statements. The unpublished financial statements are submitted to us confidentially.
  - Regulatory Financial Reporting refers to the whole of the regulatory reporting methodology, systems and legal framework, as well as the Regulatory Financial Statements.
  - Published Regulatory Financial Statements refers only to the subset of the Regulatory Financial Statements that is published by BT.

## Structure of this document

- 2.46 In **Section 3**, we set out stakeholders' views about the proposals that we made about the need for consistency, and our proposals for additional reporting to give stakeholders a better understanding of BT's financial performance. We set out our responses to the views received and our decisions about the proposals that we made in the Directions Consultation.



- 2.47 In **Section 4**, we set out stakeholders views about the proposals that we made in order to achieve consistency in respect of regulatory decisions in the Fixed Access and WBA market reviews. We set out our responses to the views received and our decisions about how they should be reflected in BT's Regulatory Financial Reporting. In doing so we:
- Confirm the decisions that should be reflected in BT's Regulatory Financial Statements so that they comply with the requirement for consistency with regulatory decisions.
  - Explain how the adjustments to be reflected in BT's Regulatory Financial Statements should be made.
  - Confirm the decisions that should not be reflected in BT's Regulatory Financial Statements.
  - Explain whether and if so, how adjustments to be included in the Adjusted Financial Performance Schedules should be made.
- 2.48 In **Section 5**, we set out stakeholders' views about the proposals that we made about the further reporting that we required in the Fixed Access market review for VULA. We set out our responses to the views received and our decisions.
- 2.49 In **Section 6**, we set out stakeholders' views about the further reporting that we required in the Fixed Access market review for BT's charging for electricity. We set out our responses to the views received and our decisions.
- 2.50 In **Section 7**, we summarise the decisions that we made in the 2014 Statement. We set out in the Annexes the directions that are necessary to implement these decisions.

## Section 3

# The need for consistency and additional reporting

## Introduction

- 3.1 In the 2014 Statement, we decided that Regulatory Financial Reporting should, as far as possible be consistent with our regulatory decisions. However, we also explained why some adjustments made in regulatory decisions should not be included in the Regulatory Financial Statements and why some adjustments should instead be included in a new schedule that would give stakeholders a better understanding of BT's financial performance from a regulatory perspective.
- 3.2 In the Directions Consultation, we consulted on proposals to implement that policy. In Section 4 of this Statement, we consider stakeholders' views on the detailed proposals for specific reporting requirements, including whether regulatory adjustments should be reflected in the Regulatory Financial Statements or in the Adjusted Financial Performance Schedule.
- 3.3 In this section we set out stakeholders' views about our proposals more generally, including the way we proposed the requirement for consistency should be applied in the Regulatory Financial Statements and the Adjusted Financial Performance Schedule intended to give stakeholders a better understanding of BT's financial performance.

## Defining the requirement for consistency

### Our proposal

- 3.4 In the 2014 Statement, we explained that regulatory reporting should, amongst other things, provide us with the information we need to make informed regulatory decisions (including the setting of price controls) and monitor compliance with SMP conditions (including cost orientation obligations).
- 3.5 We also noted the EC Recommendation adopted in 2005 which considered the implementation of cost accounting and accounting separation systems, which stated that the purpose of these obligations is to ensure that fair, objective and transparent criteria are followed by operators in allocating their costs and to provide a higher level of detail of information than is derived from the statutory accounts.
- 3.6 We explained that we therefore need a record of BT's actual costs.
- 3.7 In the 2014 Statement and the Directions Consultation, we explained that Regulatory Financial Reporting should, as far as possible be consistent with our regulatory decisions.
- 3.8 We said that "in general terms, we would expect regulatory decisions to be reflected in the Regulatory Financial Statements unless we consider that there were good reasons not to."

- 3.9 However, we also explained that we do not consider that the requirement for consistency means that all regulatory decisions should be reflected in the Regulatory Financial Statements. For example, we explained in the 2012 Consultation that,
- “It will not be appropriate to require consistency in all circumstances. For example, some charge controls have been set to reflect the costs of a “hypothetical ongoing network” rather than the costs of the network BT actually operates.”
- 3.10 We subsequently explained in the 2013 Consultation that,
- “When we set prices, we may include adjustments to cost calculations that do not strictly reflect BT’s costs (for reasons that we disclose and consult upon)”.
- 3.11 In the 2013 Consultation we identified restating asset values to bring them into line with our view of a “steady state” valuation, as an example of an adjustment that would not be reflected in the Regulatory Financial Statements.
- 3.12 We explained in the 2013 Consultation that attempting to model the impact of adjustments such as steady state valuation adjustments and how they might uplift costs in later years, would require BT to make difficult judgements about how it thinks we deal with these costs on an ongoing basis. We stated that “with the exception of items that should be explicitly excluded from the costs used by us to inform prices and which we consider should instead be allocated to residual activities, we do not propose to require BT to attempt to reflect the effect of price adjustments in the Regulatory Financial Statements.”
- 3.13 We proposed in the Directions Consultation that the identification of regulatory decisions that should or should not be reflected within Regulatory Financial Reporting to achieve consistency is a matter for our judgement and should be considered on a case by case basis. We noted that it was for this reason that Regulatory Accounting Principle 4 - Consistency with regulatory decisions – is defined by reference to decisions as set out in the Regulatory Accounting Guidelines rather than a more general requirement for consistency. We explained that we would make clear in the Regulatory Accounting Guidelines those adjustments which BT must make to ensure consistency.

## Stakeholder responses

- 3.14 BT disagreed with the way we proposed to achieve consistency with regulatory decisions. It argued that, “if changes are to be made to the RFS to reflect the “consistency with regulatory decisions” principle, these changes should align with all material regulatory decisions made in market reviews, and include all material adjustments made by Ofcom in setting charge controls.”<sup>23</sup> BT said that “at present, Ofcom’s proposals do not meet this consistency requirement.”<sup>24</sup>
- 3.15 BT stated that we had justified our decision to exclude certain methodologies from the Regulatory Financial Statements on the basis that the adjustments might not strictly reflect BT’s costs and/or would require BT to make finely balanced judgements about how to treat these costs. BT argued that while it appreciated our

<sup>23</sup> BT, Directions Consultation response, page 2, paragraph 5

<sup>24</sup> BT, Directions Consultation response, page 2, paragraph 5

concerns it struggled “to find a strong thread of consistency or balance in the adjustments Ofcom has proposed to apply and those it has decided should not apply.”<sup>25</sup> BT said that our concerns about its judgement and discretion can be addressed by specifying the required methodology as it has been done in the case of the RAV. This approach would, BT argued, provide transparency and certainty.

- 3.16 BT argued that for the purpose of reflecting adjustments we had made in relation to the treatment of the Regulatory Asset Value (RAV), Line Cards, and ISDN2 and ISDN30, we proposed three different treatments to handle what it saw as “one type of adjustment.”<sup>26</sup> BT also pointed out that the Hypothetical Ongoing Network (HON) adjustment is “not reflected in the proposals for Regulatory Reporting” only in the Adjusted Financial Reporting Schedules.<sup>27</sup>
- 3.17 BT argued that “while it may not always be appropriate to require adjustments of the RFS to reflect regulatory decisions, Ofcom must ensure consistency when deciding which cost adjustments to include and how they should be reported.”<sup>28</sup> BT argued that “Ofcom should have one treatment for all the same adjustments.”<sup>29</sup>
- 3.18 Sky, Vodafone and TalkTalk broadly welcomed Ofcom’s proposals. Sky said that it “agrees with Ofcom that revenues and costs reported in Openreach’s Regulatory Financial Statements (RFS) should reflect regulatory decisions.”<sup>30</sup>
- 3.19 Vodafone said that “we therefore support the view that the default position should be that the accounts reflect regulatory decisions, with case by case exceptions made where appropriate to do so.”<sup>31</sup>
- 3.20 TalkTalk also argued that, “it would be useful for Ofcom to layout general principles for judging whether adjustments made in charge controls should be: included in the regulatory financial statements; included in the ADP; or not included.”<sup>32</sup>
- 3.21 TalkTalk considered that where adjustments are excluded stakeholders should be given an indication how to make the adjustment themselves.

## Our response and decision

- 3.22 As noted above, in the 2014 Statement, we explained that regulatory reporting should, amongst other things, provide us with the information we need to make informed regulatory decisions and monitor compliance with SMP conditions. We explained that we therefore need a record of BT’s incurred costs.
- 3.23 It was against this background that we explained in the Directions Consultation that Regulatory Financial Reporting should, as far as possible, be consistent with our regulatory decisions. This remains the case, even though some adjustments will not be captured in the Regulatory Financial Statements.

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<sup>25</sup> BT, Directions Consultation response, page 4, paragraph 13

<sup>26</sup> BT, Directions Consultation response, page 4, paragraph 14

<sup>27</sup> BT, Directions Consultation response, page 6, paragraph 27

<sup>28</sup> BT, Directions Consultation response, page 4, paragraph 14

<sup>29</sup> BT, Directions Consultation response, page 4, paragraph 14

<sup>30</sup> Sky, Directions Consultation response, page 1, paragraph 1.2

<sup>31</sup> Vodafone, Directions Consultation response, page 3, paragraph 11

<sup>32</sup> TalkTalk, Directions Consultation response, page 2, paragraph 3.2

- 3.24 As explained above, BT has now argued that the HON adjustment should be reflected in the Regulatory Financial Statements. We do not agree.
- 3.25 We addressed a similar point in the May 2014 Statement. TalkTalk had argued that the allocation of costs should primarily be based on economic rather than accounting principles. To that effect TalkTalk suggested that the Regulatory Accounting Principles should include the principles that only forward looking and efficiently incurred costs should be allocated to regulated products in the Regulatory Financial Statements.
- 3.26 In the 2013 Consultation, we explained that we needed a record of BT's actual costs. We explained that the information should be reliable, and be seen to be reliable, and with that in mind should be capable of reconciliation to BT's statutory accounts. We explained in the 2014 Statement that TalkTalk's suggestion appeared to be for something other than a record of BT's actual costs and appeared to be more about the level of costs than how they should be allocated. Specifically, we explained that TalkTalk's proposal appeared to envisage a report based on the costs of a hypothetical efficient network. We explained that, given the complexities involved and the need for significant judgement as to what the hypothetical network would look like and the costs thereof, such an approach would not be practicable for BT or provide a reliable or relevant source of data for Ofcom or stakeholders. We said that for similar reasons, we did not consider it appropriate to require BT to attempt to adjust its actual costs in the Regulatory Financial Statements to reflect either the efficient level of costs on its current network or what those costs might be on a more efficient version of its network.
- 3.27 The same concerns apply to a requirement for reporting on a HON basis. The Regulatory Financial Statements should remain a record of BT's incurred costs.
- 3.28 We do not accept BT's characterisation of what it sees as three different treatments of one type of adjustment (RAV, Line Cards, and ISDN2 and ISDN30). We explain our decisions on the required treatment of these adjustments on an individual basis in Section 4. However, we address BT's statement that these adjustments are similar and should be treated in the same way, below.
- 3.29 The RAV adjustment was introduced in 2005 following consultation. It has been consistently applied in the Fixed Access market review and the Business Connectivity market review. We therefore decided that it was appropriate to align the Regulatory Financial Statements with this well established policy.
- 3.30 The HON adjustment in the WBA charge control and the Line Cards uplift in the Fixed Access market review were made for the purpose of the current charge controls to reflect the circumstances and policy objectives at that time. The values used in the charge control decisions were not based on BT's actual, incurred, costs. In the case of the HON, the value reflected an estimate based on a hypothetical network.
- 3.31 The ISDN2 and ISDN30 charge controls were set to hold charges constant in nominal terms and they were therefore not based directly on BT's actual costs. The prices provide no meaningful information on BT's incurred costs. Regulatory Financial Statements prepared on this basis would reveal nothing about BT's performance against its actual or incurred costs.
- 3.32 Stakeholders other than BT did not challenge our view that it may not always be appropriate to reflect regulatory decisions in the Regulatory Financial Statements.

Vodafone agreed that the decision on whether an adjustment should be treated as an exception should be made on a case by case basis, while TalkTalk said that it would be useful for Ofcom to lay out some general principles about how we would decide whether adjustments made in charge controls should be reflected in the Regulatory Financial Statements.

- 3.33 It is not possible to predict all possible adjustments that might be made in future, and it is therefore difficult to draft a set of enduring “rules” that will be appropriate in all scenarios. Further, given that any decision if and how the adjustments should be reflected in future Regulatory Financial Statements is likely to be subject to consultation. We do not think it is necessary to do so. We therefore remain of the view that these decisions should be made on a case by case basis.
- 3.34 However, for the purposes of reaching the decisions set out in this Statement (and in Section 4 in particular) the starting point for our analysis is that we would expect to see an adjustment arising from a regulatory decision reflected in the Regulatory Financial Statements if it relates to the way BT’s actual or incurred costs should be treated.
- 3.35 We would not expect to see an adjustment arising from a regulatory decision reflected in the Regulatory Financial Statements if:
- the adjustment has the effect of replacing BT’s incurred costs with an alternative estimate of cost. In such case, we would expect to see the adjustment reflected in the Adjusted Financial Performance Schedules.
  - the adjustment has the effect of replacing BT’s incurred costs with a value that is not based on BT’s network (whether actual or estimated). In addition, we would not expect such an adjustment to be reflected in the Adjusted Financial Performance Schedules.

## The need for additional reporting

### Our proposal

- 3.36 In the 2013 Consultation, we noted that not reflecting all decisions in the Regulatory Financial Statements could mean that

“...differences may remain between the reported view of BT’s financial performance and the way we might interpret the data in the context of regulatory decisions. We have explained [in Section 3] that we do not regulate the returns that BT can make but we consider that stakeholders should be able to interpret the returns that BT does make, in part to inform their view on what this might mean if and when we need to make further regulatory decisions. As explained [in the 2013 Consultation], there remains a risk that stakeholders may still not understand or potentially misinterpret the reported returns.”<sup>33</sup>

- 3.37 We therefore proposed that BT must prepare the Adjusted Financial Performance Schedules as part of its Regulatory Financial Reporting. These schedules would take the reported financial performance (specifically, returns, MCE and ROCE) as set out

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<sup>33</sup> 2013 Consultation, paragraph 6.10

in the Regulatory Financial Statements and show the impact on the reported results of making further regulatory adjustments.

- 3.38 We proposed that one schedule ("Schedule 1") would show the "Adjusted Financial Performance at a market review level". This schedule would set out BT's estimate of the impact of some adjustments we do not think should be reflected in its Regulatory Financial Statements if they would impact on returns at a *market review* level.<sup>34</sup>
- 3.39 We proposed that a second schedule ("Schedule 2") would set out the impacts at a *market level* of the same adjustments as reflected in Schedule 1.<sup>35</sup> This more detailed information would allow us to understand BT's view of the individual impacts of market level adjustments made during market reviews and in the setting of charge controls. As such it would help us understand BT's view of the aggregate impact of all of the adjustments on returns at a market review level and the way in which BT has prepared Schedule 1.

## Stakeholder responses

- 3.40 BT disagreed "with how Ofcom proposes to report BT's regulatory results requiring both the RFS and a new Adjusted Financial Performance Schedule to be produced."<sup>36</sup>
- 3.41 As explained above, BT argued that the "significant adjustments that Ofcom has proposed to be included within the Adjusted Financial Performance Schedule should be within the RFS."<sup>37</sup> This BT argued "would benefit stakeholders by avoiding confusion as to the right level of profitability shown within the market."<sup>38</sup> BT went on to say that "the current proposal for two published sets of returns would mislead stakeholders. It would also avoid the unnecessary burden for BT to produce two views of market returns."<sup>39</sup>
- 3.42 BT argued that our proposed approach "will increase rather than diminish the risk"<sup>40</sup> that Ofcom set out in the 2013 Consultation that stakeholders do not understand or misinterpret reported returns.<sup>41</sup> BT added that "the treatments that Ofcom proposes to exclude from the RFS and/or the Adjusted Financial Performance Schedules are all adjustments which would tend to reduce BT's reported returns, whereas the treatments that Ofcom proposes to include in the RFS and/or the Adjusted Financial

<sup>34</sup> Under the European common regulatory framework for electronic communications, Ofcom is required to carry out periodic reviews of electronic communications markets in the United Kingdom. In carrying out these reviews Ofcom considers the level of competition and, consequently, the regulation that should apply. In order to carry out these reviews we group together communications markets in a set of market reviews.

<sup>35</sup> Each market review level is composed of individual SMP markets. The market review levels and the component SMP markets for which BT has Regulatory Financial Reporting requirements are set out in Section 1 of BT's Regulatory Financial Statements.

<http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/index.htm>

<sup>36</sup> BT, Directions Consultation response, page 2, paragraph 5

<sup>37</sup> BT, Directions Consultation response, page 2, paragraph 6

<sup>38</sup> BT, Directions Consultation response, page 2, paragraph 6

<sup>39</sup> BT, Directions Consultation response, page 2, paragraph 6

<sup>40</sup> BT, Directions Consultation response, page 4, paragraph 15

<sup>41</sup> 2013 Consultation, page 76, paragraph 6.10

Performance Schedules are mostly adjustments which would tend to increase BT's reported returns."<sup>42</sup>

- 3.43 BT explained that in its view the proposals for the published Adjusted Financial Performance Schedule will "make it more likely that stakeholders will misinterpret reported returns as meaning that, for pricing purposes, BT is making returns in excess of Ofcom's view of BT's returns."<sup>43</sup>
- 3.44 BT said that its preference would be to include the "significant methodology"<sup>44</sup> and valuation adjustments that Ofcom proposed to be included within the Adjusted Financial Performance Schedule" within the Regulatory Financial Statements. This approach BT explained would bring consistency, avoid stakeholder confusion, and avoid unnecessary burden for BT to produce two views of market returns.
- 3.45 BT proposed that if its preference was not acceptable, an alternative was, "to embed in the RFS all the methodology changes, and to reflect in the Adjusted Financial Performance Schedule all the valuation changes. Rather than pick and choose which of these adjustments to include in the RFS or Adjusted Financial Performance Schedules or exclude from the statements entirely, it would be more logical, transparent and less open to misinterpretation for the RFS, to reflect BT's costs absent valuation adjustments,<sup>45</sup> and for the Adjusted Financial Performance Schedules to include such adjustments. In this way it will be clear to all what the incurred costs have been and the impact of Ofcom's adjustments consistent with regulatory decisions."<sup>46</sup>
- 3.46 In order for BT to produce the published Adjusted Financial Performance Schedule, BT said that Ofcom should specify in a similar way to the RAV how the adjustments should be performed by BT.
- 3.47 In relation to Ofcom's proposals for the published Adjusted Financial Performance Schedule, BT made the following comments:
- For the Fixed Access markets most of the proposed adjustments to be included relate to the re-allocation of common costs for which there will be no net impact at the market review level.
  - Where changes would have an impact at the market review level the impacts would be very small in proportion to the Fixed Access markets.
  - "An argument that the schedule will promote competition (by showing returns with two adjustments to NRC for certain relatively minor assets) is very weak. This adjustment could be performed within the RFS."<sup>47</sup>
- 3.48 BT proposed that only those adjustments that affect market level returns should be included in the published Adjusted Financial Performance Schedule. BT argued that

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<sup>42</sup> BT, Directions Consultation response, page 4, paragraph 15

<sup>43</sup> BT, Directions Consultation response, page 4, paragraph 15

<sup>44</sup> BT explained that significant adjustments would exclude those adjustments that attribute costs within a market

<sup>45</sup> BT set out in a footnote that these were RAV, HON, WLR line card, ISDN30 and ISDN2 steady state adjustment.

<sup>46</sup> BT, Directions Consultation response, page 5, paragraph 17

<sup>47</sup> BT, Directions Consultation Response, page 6, paragraph 22



“The adjustments that are within a market (such as LRIC and common cost transfers) are not relevant to assess market level profitability.”<sup>48</sup>

- 3.49 BT agreed that Schedule 2 should not be published.<sup>49</sup> BT also made the following comments:
- Instead of being provided with the Regulatory Financial Statements it should be provided as and when needed for the purposes of regulatory decision making. BT indicated this should be alongside the charge controls set every three years.
  - Ofcom’s choices about which adjustments to include mean “that the Regulatory Financial Reporting would be inconsistent with the WBA charge control with the result that the published returns in these markets may not reflect the economic basis of the charge control decision made by Ofcom, for example due to the impact that the HON would have on reported ROCE.”<sup>50</sup>
  - Other CCA adjustments are “genuine costs within the WBA market”<sup>51</sup> and “should not be excluded from the additional schedules.”<sup>52</sup>
  - The detailed schedule should be provided after the Regulatory Financial Statements so that BT has the required time to “calculate the impact of Ofcom’s detailed and specific adjustments once the RFS has been finalised.”<sup>53</sup>
- 3.50 Vodafone said that they “support the production of the new schedules”<sup>54</sup> and said that these will “support stakeholders in understanding the costs and returns in regulated markets.”<sup>55</sup> Vodafone said that it hoped that the contents of Schedule 2 would be disclosed if “legitimate questions are raised that require answers”<sup>56</sup> and during the course of consulting on charge controls.
- 3.51 TalkTalk said that it “agreed with the proposal to require BT to publish Adjusted Financial Performance Schedules”<sup>57</sup> but went on to say that “ideally all adjustments should be included” and “not be made only by exception.”<sup>58</sup> TalkTalk also argued for:
- Estimated impacts on revenue and CCA operating costs (as well as impact on return and ROCE) should be provided.
  - Impact of each adjustment (on revenue, CCA operating costs, return and ROCE) on each market (as was provided in the impacts of changed cost allocations in the 2012/13 Regulatory Financial Statements).
  - The published schedule may need to evolve over time.

<sup>48</sup> BT, Directions Consultation response, page 6, paragraph 23

<sup>49</sup> BT explained that significant adjustments would exclude those adjustments that attribute costs within a market.

<sup>50</sup> BT, Directions Consultation response, page 7, paragraph 28

<sup>51</sup> BT, Directions Consultation response, page 7, paragraph 29

<sup>52</sup> BT, Directions Consultation response, page 7, paragraph 29

<sup>53</sup> BT, Directions Consultation response, page 7, paragraph 30

<sup>54</sup> Vodafone, Directions Consultation response, page 4, paragraph 12

<sup>55</sup> Vodafone, Directions Consultation response, page 4, paragraph 12

<sup>56</sup> Vodafone, Directions Consultation response, page 4, paragraph 12.

<sup>57</sup> TalkTalk, Directions Consultation response, page 1, paragraph 2.1

<sup>58</sup> TalkTalk, Directions Consultation response, page 1, paragraph 2.2

- There should be a record within BT's reporting of which adjustments have been included in the Regulatory Financial Statements and which are in the Adjusted Financial Performance Schedules. Where an adjustment is not included within the published Additional Financial Performance Schedules (e.g. 2011/12 allocation bases) there should be a clear indication how stakeholders can make the appropriate adjustment themselves.
- Ofcom should explain why actual ROCE might diverge from 'allowed return' (e.g. cost of capital).

## **Ofcom's response and decision**

3.52 We have considered stakeholders' responses to our proposal to require two new schedules under three headings as follows:

- Are the additional schedules necessary?
- Are the additional schedules helpful?
- What should be included in the additional schedules?

### Are the additional schedules necessary?

3.53 BT argued that the schedules are not necessary because the adjustments should be within the Regulatory Financial Statements. We explain why we do not consider all adjustments should be reflected in the Regulatory Financial Statements earlier in this section.

### Are the additional schedules helpful?

3.54 BT argued that our proposed approach would increase the risk that stakeholders do not understand the reported returns.

3.55 We do not agree.

3.56 As a consequence of other changes implemented through this and previous statements - such as the move to reporting on a RAV basis and, for example, BT's move to valuation of assets using indexation rather than an absolute basis - the basis for the view of BT's financial performance reported in the Regulatory Financial Statements is more closely aligned to the approach taken to recent regulatory decisions.

3.57 Nevertheless, we have explained above why we do not consider all adjustments should be reflected in the Regulatory Financial Statements. Part of the reason was that we considered that moving away from BT's actual costs (the LRIC adjustments in relation to LLU and WLR services for example) had the effect of removing any meaningful information about BT's costs and, therefore, its returns.

3.58 Therefore, we have considered whether the provision of the additional schedules will make it easier for stakeholders to understand BT's returns than if the schedules were not published; in this respect, we are satisfied that the additional information in the schedules will make it easier to understand the returns than if no information was published. Other stakeholders, who generally welcomed the proposal to require these new schedules, appear to agree.

### What should be included in the additional schedules?

- 3.59 Stakeholders had different views on what should be included in the additional schedules. In broad terms, most of the comments can be considered to relate to either the *scope* of the Adjusted Financial Performance Schedules, the *level of detail* to be published or the *practicality* of providing the data.
- 3.60 In terms of the *scope* of the Adjusted Financial Performance Schedules; BT has argued that, if we were to decide not to reflect all valuation changes in the Regulatory Financial Statements then none of them should be and they should instead all be reflected in the Adjusted Financial Performance Schedules. TalkTalk said that “ideally all adjustments should be included” and “not be made only by exception”. For the reasons set out above, we do not agree that all adjustments should be included in the Adjusted Financial Performance Schedules, either because some should be included in the Regulatory Financial Statements (notably the RAV adjustment<sup>59</sup>) while some should not be reflected at all (e.g. the ISDN2 adjustment). We consider the case for including each adjustment in Section 4.
- 3.61 Regarding the *level of detail* to be included in the published schedule, we note that the proposed schedules already include the impact on operating costs, as requested by TalkTalk. In the event that a regulatory decision did have an impact on the way revenue should be recorded (and none of the current adjustments does) we would need to consider if and how this should be reflected in the schedule. We have also considered the possible benefits of publishing more detailed information to address, for example, TalkTalk’s wish for more information at a market level and BT’s concern that stakeholders may misinterpret the information provided in Schedule 1. Specifically, we have considered whether, rather than requiring BT to publish Schedule 1 (at a market review level) and provide Schedule 2 (at a market level) to Ofcom, we should instead require BT to publish only Schedule 2.
- 3.62 However, the purpose of the new reporting requirement is to provide a better understanding of BT’s financial performance from a regulatory perspective. We consider that ahead of a more detailed review by Ofcom (for example, in the context of a market review) this can only ever be an approximation. Schedule 1 is intended to provide this high level view (at the market review level). We do not consider that it is necessary to require BT to provide the supporting calculations at a market or service level.
- 3.63 TalkTalk suggested that, where an adjustment is not included within the published Adjusted Financial Performance Schedule (e.g. 2011/12 allocation bases) there should be a clear indication how stakeholders can make the appropriate adjustment themselves. We do not agree with TalkTalk that this would necessarily provide useful information (for similar reasons to those that meant we considered these adjustments should not be included in the Adjusted Financial Performance Schedules in the first place, such as where they do not reflect an estimate of BT’s costs). However, if stakeholders want for example to understand the impact of changing allocation bases, the annual reconciliation reports, that set out the impact of the changes in allocation rules since 2011/12 on costs at a market level, should give stakeholders a reasonable understanding of the approximate impact on the current year’s returns.

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<sup>59</sup> We already decided in the 2014 Statement that the Regulatory Financial Statements should be prepared on a RAV basis.

- 3.64 We agree with Vodafone that there may be occasions when it is appropriate to provide further information about BT's returns. For example in the course of consulting on charge controls, when it may also be appropriate for us to consider the reasons why the reported returns may have differed from our estimate of BT's cost of capital. Setting out views on BT's profitability in the context of a specific issue – such as a market review or price control, when we are able to properly consider the analysis in the appropriate context – would be a more appropriate basis for us to consider returns than trying to provide an ongoing commentary on the possible reasons why actual returns may have diverged from the cost of capital, as TalkTalk suggested.
- 3.65 We have therefore decided to adopt our proposal to require BT to publish Schedule 1 and provide Schedule 2 to Ofcom in private.
- 3.66 Finally, we note that BT has argued that Schedule 2 should be provided after the Regulatory Financial Statements to give it time to calculate the adjustments once the Regulatory Financial Statements have been finalised. We accept that our decision to require BT to prepare two new schedules, one of which is to be published, will impose an additional requirement on BT. Nevertheless we consider that this requirement is proportionate and necessary. In order to prepare and publish Schedule 1 BT will have had to have calculated the adjustments necessary to prepare Schedule 2. There is therefore no reason that BT should not be able to provide Schedule 2 at the same time as it publishes both the Regulatory Financial Statements and Schedule 1.
- 3.67 The form of Schedule 1 is set out in Annex 7.
- 3.68 We explain how our decisions to require BT to produce the Adjusted Financial Performance Schedules meet the tests set out in section 49(2) of the Act and our duties under sections 3, 4 and 4A of the Act at the end of Section 4.

## Section 4

# Consistency with regulatory decisions

## Introduction

- 4.1 In the 2014 Statement we introduced a new requirement for BT to comply with Regulatory Accounting Principles, which would include a requirement that BT's Regulatory Financial Reporting should be consistent with the regulatory decisions as defined in the Regulatory Accounting Guidelines.<sup>60</sup>
- 4.2 In the Directions Consultation we summarised the main adjustments we made to BT's reported financial data in the Fixed Access and WBA market reviews and considered if and how they should be reflected in BT's Regulatory Financial Reporting. Specifically, we:
- identified the decisions that we proposed should be reflected in BT's Regulatory Financial Statements;
  - for those adjustments that we proposed should be included in BT's Regulatory Financial Statements, we proposed how this should be done; and
  - for those adjustments that we proposed should not be reflected in BT's Regulatory Financial Statements, we explained if and how we proposed they should be reflected in the Adjusted Financial Performance Schedules.
- 4.3 In this Section we set out our decisions and in doing so respond to comments made by stakeholders. The decisions that we have made represent the requirements on consistency that BT must follow when preparing its Regulatory Financial Statements. These requirements on consistency will form part of the Regulatory Accounting Guidelines when implemented by direction in 2016.

## Decisions in the Fixed Access market review

- 4.4 We explained in the Directions Consultation that the basis of preparation of the cost information we used to inform our price controls in the Fixed Access markets, differed from the basis of preparation of the 2012/13 Regulatory Financial Statements in the following key respects:
- 4.4.1 Asset values were calculated on the RAV basis, rather than the CCA basis used in the 2012/13 Regulatory Financial Statements. We decided in the 2014 Statement that Regulatory Financial Reporting should be on a RAV basis and said that we would issue a direction setting out requirements in relation to the RAV alongside requirements concerning consistency with regulatory decisions;
- 4.4.2 Costs were based on 2011/12 data, including 2011/12 allocation rules and asset valuation methodologies, rather than 2012/13 data, rules and methodologies; and
- 4.4.3 Specific adjustments were considered in respect of:

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<sup>60</sup> 2014 Statement, annex 3

- a) Internal SMPF volumes;
- b) Telephone Directories;
- c) DSLAM capital /maintenance;
- d) Group overheads;
- e) Deafness provision;
- f) Cumulo rates;
- g) Test Access Matrix Costs;
- h) Evolutionary Test Access Matrix Costs;
- i) Simultaneously provided services;
- j) Combined fault and service level allocations;
- k) Test Access Matrix Mark Up;
- l) Line cards;
- m) LRIC differential;
- n) Caller Display;
- o) Migrations and WLR Transfers;
- p) LRIC adjustments and recovery of common cost;
- q) SMPF;
- r) Absolute valuation of Copper;
- s) ISDN30 pricing; and
- t) ISDN2 pricing.

4.5 We proposed that BT should reflect the adjustments set out in paragraphs 4.4.3(a) – 4.4.3(q) in the order presented above because some of the adjustments, as we explain below, logically must follow others, whilst others have a cumulative effect on either the Regulatory Financial Statements or the Adjusted Financial Performance Schedules. To be consistent with our regulatory decisions, we proposed that BT must be required to apply the adjustments in the order in which they are set out in paragraph 4.4.3 above.

4.6 For the reasons set out below, we did not propose that the adjustments set out in paragraphs 4.4.2 and 4.4.3 (r) – 4.4.3 (t) should be reflected in either the Regulatory Financial Statements or the Adjusted Financial Performance Schedules.

### **Decisions in the WBA market review**

4.7 We explained in the Directions Consultation that the basis of preparation of the cost information we used to inform our price controls in the WBA markets, differed from

the basis of preparation of the 2012/13 Regulatory Financial Statements in the following key respects:

- 4.7.1 Costs were based on 2012/13 cost data, restated using the 2011/12 allocations. In line with our proposals in relation to the adjustments made in the Fixed Access market review, we did not propose that this adjustment should be reflected in either the Regulatory Financial Statements or the Adjusted Financial Performance Schedules.
- 4.7.2 Specific adjustments were made to BT's costs in respect of:
  - a) SG&A Broadband, ATM customer interface 2Mbit/s, ATM customer interface 34Mbit/s, ATM customer interface >155Mbit/s, ATM network interface, ATM network switching and Inter ATM transmissions;
  - b) Allocation of IPstream costs between Market A and Market B;
  - c) Market A market size adjustment;
  - d) 21 CN costs and the future benefits principle;
  - e) Some asset values were based on an estimate of the hypothetical ongoing network, which differed from the CCA value in the Regulatory Financial Statements; and
  - f) a one off, non-recurring other CCA adjustment.
- 4.8 We proposed that BT should reflect the adjustments set out in paragraphs 4.7.2(a) – 4.7.2(f) in the order presented above because some of the adjustments, as we explain below, logically must follow others, whilst others have a cumulative effect on either the Regulatory Financial Statements or the Adjusted Financial Performance Schedules. To be consistent with our regulatory decisions, we therefore proposed that BT must be required to apply the adjustments in the order in which they are set out in paragraph 4.7.2 above.

## Application in other markets

- 4.9 We explained in the Directions Consultation and in the 2014 Statement that the new regulatory reporting SMP conditions would formally apply only to the Fixed Access and WBA markets, but that to preserve the integrity and consistency of BT's Regulatory Financial Reporting, the changes should be implemented across all regulated markets (including markets considered as part of the Business Connectivity and Narrowband market reviews). We said that there are significant advantages to BT and other stakeholders of BT applying one set of accounting rules across all markets.
- 4.10 We also said that we would work with BT to ensure that, as far as possible, our decisions could be applied on a consistent basis to all markets.
- 4.11 In its response, BT argued that in respect of the extension of methodologies outside of the Fixed Access and WBA markets "that any extension to other markets should be assessed on a case-by-case basis to determine whether the application is

appropriate.”<sup>61</sup> BT’s response makes reference to two methodologies where extension may be required outside of the Fixed Access and WBA markets: the future benefits principle; and the RAV.

- 4.12 In relation to the RAV, our decision in the 2014 Statement was that the Regulatory Financial Statements should be prepared on a RAV basis and this requirement was implemented in the SMP conditions. While the new SMP conditions were imposed in the Fixed Access and WBA markets, we explained in the 2014 Statement that to preserve the integrity and consistency of BT’s Regulatory Financial Reporting, the changes should be implemented across all regulated markets (including markets considered as part of the Business Connectivity and Narrowband market reviews). We said that there are significant advantages to BT and other stakeholders of BT applying one set of accounting rules across all markets.
- 4.13 BT also said that it “intended that the RAV adjustment will be applied to Access Duct alone”. BT added that “this is consistent with our understanding of the regulatory decisions within the BCMR”.<sup>62</sup> BT’s understanding is correct. As we explain in more detail in Section 7 below, we will only require BT to report access duct on a RAV basis.
- 4.14 We also note BT’s reference to the future benefits principle and its comment that any extension of methodologies to other markets should be made on a case by case basis. As we explained above, in considering whether and if so, how our regulatory decisions should be reflected in the Regulatory Financial Statements, we will make decisions on a case by case basis. We explain in Section 4 where we consider the stakeholders’ comments in relation to the future benefits in detail that we will also adopt the same approach to that adjustment and will take into account all of the relevant factors and circumstances before making future decisions. However, given that we have concerns about the application of this principle as explained in Section 4, we are unlikely to consider such application as appropriate in future market reviews or should such an allocation be proposed through the change control.

## **Adjustments made in the Fixed Access market review**

### **RAV**

- 4.15 We explained in the 2014 Statement that Regulatory Financial Reporting should be on a RAV basis.<sup>63</sup> We implemented this decision in an SMP condition. We also said that once implemented the Regulatory Accounting Guidelines would provide the guidance necessary for BT to prepare the Regulatory Financial Statements on a RAV basis. We said that in the interim we would set out requirements in relation to the RAV alongside requirements concerning consistency with regulatory decisions. We have set out these requirements in Section 7.

### **Consistency with the 2011/12 cost allocation bases**

- 4.16 In the Directions Consultation we explained that we had decided in the Fixed Access market review to use the 2011/12 Regulatory Financial Statements as the base year for our cost modelling. This was because “the suite of methodological changes made

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<sup>61</sup> BT, Directions Consultation response, page 8, paragraph 32

<sup>62</sup> BT, Directions Consultation response, page 9, paragraph 39

<sup>63</sup> Directions Consultation, page 16, paragraph 4.8.1



by BT in its 2012/13 RFS (and their effects) are potentially interdependent; and that the changes do not represent a balanced approach to the review of allocations.”<sup>64</sup>

- 4.17 Our view in the Fixed Access market review was that “we would not be confident that applying and dis-applying methodological changes on an item-by-item basis would produce a sufficiently accurate or suitable assessment of BT’s relevant costs that could properly be used as the basis for the charge controls. Such an analysis would create the possibility of material delays in the setting of the new charge controls.”<sup>65</sup> We concluded that it would not be appropriate to use the new cost allocations used by BT in its 2012/13 Regulatory Financial Statements for the purpose of the charge controls.<sup>66</sup>

### Our proposal

- 4.18 We proposed not to require BT to revert to the cost allocation bases used in the 2011/12 Regulatory Financial Statements for 2014/15 (and subsequent) Regulatory Financial Statements. We also proposed that it would not be appropriate to require BT to estimate and report the impact of these changes in the Adjusted Financial Performance Schedules. We set out our reasons for making these proposals in the Directions Consultation.
- 4.19 We said that in any case the absolute impacts of BT’s changes in allocation bases from 2011/12 to 2012/13 are set out in the 2013 Reconciliation Report.<sup>67</sup> Going forward, until our review of the bases of BT’s cost allocations is completed and our Regulatory Accounting Guidelines are published in 2016 stakeholders will be able to use the reconciliation reports, published alongside the Regulatory Financial Statements, to gain an understanding of the impact of the changes in allocation bases since 2011/12 for each reported year.

### Stakeholder comments

- 4.20 BT said that it agreed that “the RFS should not be restated upon 2011/12 methods, nor that it is possible to estimate the impact with the Adjusted Financial Performance Schedules.”<sup>68</sup> BT also agreed that Ofcom had explained the practical issues that it would face and that stakeholders who wished to see the impact of methodology changes could do so within the published reconciliation report.
- 4.21 Vodafone said that it agreed that “BT’s 2012/13 RFS changes did not represent a balanced approach to the review of allocations leading Ofcom to use the 2011/12 Regulatory Financial Statements (or 2012/13 data restated using 2011/12 allocations).”<sup>69</sup> Vodafone went on to say that “we recognise the practical challenges that maintaining such an approach would have in future controls.”<sup>70</sup>

<sup>64</sup> Fixed Access Statement, Annexes, paragraphs A22.35.

<http://stakeholders.ofcom.org.uk/binaries/telecoms/ga/fixed-access-market-reviews-2014/statement-june-2014/annexes.pdf>.

<sup>65</sup> Fixed Access Statement, Annexes, paragraph A22.37.

<sup>66</sup> Fixed Access Statement, Annexes, paragraph A22.39.

<sup>67</sup> The 2013/14 Reconciliation Report was published on the 2<sup>nd</sup> October 2014.

<http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2014/ReportrequestedybyOfcomfortheyeaded31March2014.pdf>

<sup>68</sup> BT, Directions Consultation response, page 9, paragraph 40

<sup>69</sup> Vodafone, Directions Consultation response, page 4, paragraph 13

<sup>70</sup> Vodafone, Directions Consultation response, page 4, paragraph 13

- 4.22 TalkTalk suggested that where adjustments such as the 2011/12 allocation bases are excluded from both the Regulatory Financial Statements and Adjusted Financial Performance Schedules, there should be “a clear indication how stakeholders can make the appropriate adjustment themselves.”<sup>71</sup>

### Ofcom’s response and decision

- 4.23 We note stakeholders’ support for our proposal not to require BT to revert to the cost allocation bases used in the 2011/12 Regulatory Financial Statements for 2014/15 (and subsequent) Regulatory Financial Statements.
- 4.24 We note TalkTalk’s use of the 2011/12 adjustment as an example of the need to provide stakeholders with an indication of how to make the adjustments. In this particular case, we said in the Directions Consultation that the absolute impacts of BT’s changes in allocation bases from 2011/12 to 2012/13 are set out in the 2013 Reconciliation Report.
- 4.25 Having considered stakeholders’ responses to the Directions Consultation proposals we have decided:
- not to require BT to revert to the cost allocation bases used in the 2011/12 Regulatory Financial Statements for 2014/15 (and subsequent) Regulatory Financial Statements; and
  - not to require BT to estimate and report the impact of these changes in this way in the Adjusted Financial Performance Schedules.

### **Internal SMPF volumes<sup>72</sup>**

- 4.26 In the Fixed Access market review we set prices for Shared Metallic Path Facility (SMPF) Rentals, SMPF Migrations, SMPF New Provides and Tie Cables using the unit costs which we estimated from the external costs and volumes for SMPF as a proxy for all SMPF (internal and external).<sup>73</sup> As we noted in the Fixed Access market review “WLA services reported in the RFS, exclude internal costs and volumes (including EOI volumes).”<sup>74</sup> These SMPF internal costs and volumes are currently included in the Wholesale Residual market.

### Our proposal

- 4.27 We proposed that the Regulatory Financial Statements should disclose the impact of SMPF internal costs and volumes. We said that the reporting of internal SMPF costs and volumes in the WLA market will increase the transparency and understanding of BT’s Regulatory Financial Reporting and make the Regulatory Financial Statements consistent with our decision. We proposed to require BT to:
- remove the internal costs and volumes for SMPF Rentals, SMPF Migrations, SMPF New Provides and Tie Cables from the Wholesale Residual market and include them within the WLA market in the Regulatory Financial Statements; and

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<sup>71</sup> TalkTalk, Directions Consultation response, page 1, paragraph 2.2

<sup>72</sup> Fixed Access Statement, Annexes, paragraphs A11.20 - A11.32.

<sup>73</sup> Fixed Access Statement, Annex 11, paragraph A11.27.

<sup>74</sup> Fixed Access Statement, Annex 11, paragraph A11.20.

- disclose the internal costs and volumes of SMPF Rentals, SMPF Migrations, SMPF Connections and Tie Cables within the WLA market.

### Stakeholder comments

- 4.28 BT agreed with the proposal but suggested it should be extended to MPF internal services and said “Ofcom’s cost modelling of other WLA services, in particular MPF services, are analogous to SMPF services. To apply this reporting obligation to SMPF services and not to MPF services might therefore be considered inconsistent.”<sup>75</sup> Vodafone said “we are supportive of Ofcom’s decision to require that all internal costs and volumes relating to the consumption of SMPF are disclosed in the WLR market statements. Given the extent of internal supply it is important that these costs are subject to the proper level of external scrutiny.”<sup>76</sup>

### Ofcom’s response and decision

- 4.29 The Fixed Access market review only considered SMPF services, and hence our consultation on consistency with regulatory decisions also only considered SMPF services. However, we agree with BT that it would be consistent with any requirement to disclose internal SMPF services to also disclose internal sales, costs and revenues of other WLA services.
- 4.30 Having considered stakeholders responses we have decided that BT must report all internal as well as external costs, volumes and revenues in the WLA Market Summary. The level of internal disclosure must be the same as the external disclosure. Where the internal products are not explicitly regulated within the WLA market, BT must remove the aggregate revenues and costs in order to ensure the WLA Market Summary reconciles with the totals in the Performance by Market Summary. The format of the “Market Summary” statement is set out in Annex 7.

### **Telephone directories<sup>77</sup>**

- 4.31 BT provides printed telephone directories to almost all residential and business premises in the UK. An element of these costs is recovered from Analogue Core WLR Rentals (“WLR Rentals”). In the Fixed Access market review we decided that costs associated with telephone directories should not be recovered through the WLR wholesale charges. We therefore excluded these costs for WLR Rentals in our market review decision.

### Our proposal

- 4.32 We proposed that BT must allocate the cost of printed telephone directories to the Wholesale Residual market in its Regulatory Financial Statements. The proposed adjustment would exclude the cost of printed telephone directories from WLR Rentals.

### Stakeholder comments

- 4.33 Stakeholders did not make any comments about this proposal apart from Vodafone. Vodafone agreed with the proposal and said “we support the exclusion of these costs

<sup>75</sup> BT, Directions Consultation response, page 10, paragraph 44

<sup>76</sup> Vodafone Directions Consultation Response, page 4, paragraph 13

<sup>77</sup> Fixed Access Statement, Annexes, paragraphs A13.301 - A13.333

from WLR rentals, believing there was never any justification for their original inclusion”<sup>78</sup> Whilst this comment referred to the decision in the Fixed Access market review, this comment also supports our decision to reflect that decision in the Regulatory Financial Statements.

### Ofcom’s response and decision

- 4.34 Having considered stakeholders responses we have decided that BT must allocate the cost of printed telephone directories to the Wholesale Residual market in its Regulatory Financial Statements. The adjustment excludes the cost of printed telephone directories from WLR Rentals.

### **Digital subscriber line access multiplexer (DSLAM) capital/ maintenance**<sup>79</sup>

- 4.35 In the Fixed Access market review we decided that “that 70% of the inappropriately named ‘DSLAM capital/maintenance’ cost actually related to special fault investigations (SFI) and the remaining 30% was related to broadband faults.”<sup>80</sup>
- 4.36 In addition we decided “to allocate the remaining 30% to the main rental services in accordance with the relative fault rates and service level differential”<sup>81</sup> which is reproduced in table 1.

Table 1. Allocation of fault rate and service level allocations

	WLR Rentals	MPF Rentals	SMPF Rentals
<b>Fault rate allocation</b>	0.83	1.00	0.17
<b>Service level allocation</b>	1.00	1.21	1.21
<b>Combined usage factor</b>	0.83	1.21	0.21

- 4.37 We explained in the Directions Consultation that the DSLAM capital maintenance cost within WLR Rentals, MPF Rentals and SMPF Rentals all changed in the Fixed Access market review as a result of this adjustment.

### Our proposal

- 4.38 We proposed that the Regulatory Financial Statements must include this adjustment and that BT must allocate 70% of total DSLAM capital/maintenance costs to SFIs, and the remaining 30% of DSLAM capital/maintenance costs must be allocated to

<sup>78</sup> Vodafone, Directions Consultation response, page 4, paragraph 13

<sup>79</sup> Fixed Access Statement, Annexes, paragraphs A13.263- A13.278.

<sup>80</sup> Fixed Access Statement, Annexes, paragraph A13.266.

<sup>81</sup> Fixed Access Statement, Annexes, paragraph A13.278.

WLR Rentals, MPF Rentals and SMPF Rentals using the combined usage factor set out in table 1 (reproduced from the Fixed Access market review).<sup>82</sup>

### Stakeholder comments

- 4.39 Whilst BT was not opposed to the proposed adjustment in principle, it suggested its accuracy could be improved. BT said that Ofcom proposes that 70% of the DSLAM capital maintenance cost is attributed to SFIs and the remaining 30% is attributed to WLR, MPF and SMPF rentals using the combined usage factor rentals as per FAMR. These percentages were derived in the FAMR statement from analysis of SFI time applied to the MDSL Class of Work.<sup>83</sup>
- 4.40 BT went on to explain that adopting Ofcom's method for estimating the 30%/70% split will result in different percentages each year. In the absence of further analysis or justification, it has been assumed that the percentages estimated in the 2011/12 base year will remain constant. The accuracy of the published accounts will be improved if new estimates, using the same method, are calculated each year as the basis for attributing MDSL costs to SFIs. Accordingly, BT proposes that MDSL COW time is attributed to SFI on the basis of analysis of SFI time in the reporting year, and the residual is allocated to WLR, MPF and SMPF rentals as per the FAMR.<sup>84</sup>
- 4.41 BT additionally noted that there used to be in the years to 2012-13 three DSLAM/Capital Maintenance Components in the DSLAM/Capital Maintenance Super Component.<sup>85</sup> Only one of the components; 'CO188 OR DSLAM/Capital Maintenance' was considered in the Fixed Access market review.<sup>86</sup>
- 4.42 BT recommended that in order to avoid confusion between the costs allocated to component CF188 OR DSLAM Capital/Maintenance referred to in paragraph 4.38 in the Directions Consultation which we adjusted in the Fixed Access market review and the two WBA cost components which did contain costs related to DSLAMs and which did not relate to Openreach activity, we should be more explicit in wording which cost component we required BT to adjust. BT suggested that in the direction "DSLAM/Capital Maintenance" should be reworded to 'Costs incurred in Openreach relating to Class of Work MDSL'.
- 4.43 Vodafone supported Ofcom's proposal: "based on the information available we are supportive of this adjustment being reflected within the accounts."<sup>87</sup>
- 4.44 TalkTalk suggested changes to the Regulatory Financial Statements should be implemented prior to the charge control taking effect. TalkTalk said in relation to DSLAM capital / maintenance that it would be better that this cost category is correctly classified and correctly allocated in the FAC allocations rather than the FAC allocations incorrectly allocating the costs and then the costs being corrected afterwards.<sup>88</sup>

<sup>82</sup> Fixed Access Statement, Annex 13, paragraph A13.278.

<sup>83</sup> BT, Directions Consultation response, page 10, paragraph 45

<sup>84</sup> BT, Directions Consultation response, page 10, paragraph 45

<sup>85</sup> As we explain in section 7 new network components have been added to the list where previous components have been split into multiple categories. DSLAM Capital/Maintenance has been split into DSLAM Support and DSLAM Equipment.

<sup>86</sup> The other two components related only to services within to the WBA market review.

<sup>87</sup> Vodafone, Directions Consultation response, page 4, paragraph 13

<sup>88</sup> TalkTalk, Directions Consultation response, page 2, paragraph 3.1

- 4.45 TalkTalk also said that “it is not appropriate to allocate copper current costs, drop maintenance and DSLAM capital maintenance (which includes SFI costs) based on usage factors that reflect care levels since some of these costs are not incurred in response to a fault repair activity.”<sup>89</sup>

#### Ofcom’s response and decision

- 4.46 We agree with BT’s point that the 30%/70%SFI/Copper split would vary from year to year and therefore BT’s proposal of carrying out a dynamic calculation would provide a more accurate view of the costs. We have modified our approach accordingly to include this dynamic adjustment. We also agree with BT’s suggestion that “DSLAM/Capital Maintenance” should be reworded to “Costs incurred in Openreach relating to Class of Work MDSL” to be clear about the component which needs to be adjusted. The revision suggested by BT is consistent with the adjustment which was applied in the Fixed Access market review.
- 4.47 The Regulatory Financial Statements remain BT’s accounts and it is therefore for BT to decide on appropriate cost classification and allocation methods when preparing the Regulatory Financial Statements. We consider whether accounting treatments adopted by BT are ‘correct’ as part of market reviews. In addition, the changes which we introduced as part of the new regulatory reporting regime which will include the Regulatory Accounting Guidelines, which once implemented will help ensure greater consistency with regulatory decisions.
- 4.48 We note TalkTalk’s argument that “it is not appropriate to allocate copper current costs, drop maintenance and DSLAM capital maintenance (which includes SFI costs) based on usage factors that reflect care levels since some of these costs are not incurred in response to a fault repair activity.”<sup>90</sup> However, our analysis conducted as part of the Fixed Access market review concluded that a combined usage factor for faults and service levels was appropriate for allocating these costs and charges were set on that basis. Where we decide that our regulatory decisions should be reflected in the Regulatory Financial Statements, it is important that these decisions are consistent with the particular decisions which we made in our market reviews. Reporting requirements must seek to follow regulatory decisions.
- 4.49 Having considered stakeholders responses we have decided that BT must include in the Regulatory Financial Statements an adjustment that allocates Costs incurred in Openreach relating to Class of Work MDSL to SFIs based on an analysis of proportion of MDSL COW time attributed to SFI in the reporting year. The remaining Costs incurred in Openreach relating to Class of Work MDSL must be allocated to WLR Rentals, MPF Rentals and SMPF Rentals using the combined usage factor set out in table 1 (reproduced from the Fixed Access market review).<sup>91</sup>

#### **Group Overheads<sup>92</sup>**

- 4.50 Group overheads include costs such as ‘Strategy’, ‘Tax/Treasury’, and ‘Group Finance Control’ that sit within BT’s Group Functions. BT allocates these costs to services using various allocation rules. In the course of the Fixed Access market review we found that the allocation rules did not allocate the ‘Strategy’

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<sup>89</sup> TalkTalk, Directions Consultation response, page 2, paragraph 3.4

<sup>90</sup> TalkTalk, Directions Consultation response, page 2, paragraph 3.4

<sup>91</sup> Fixed Access Statement, Annex 13, paragraph A13.278.

<sup>92</sup> Fixed Access Statement, Annex 13, paragraphs A13.64 - A13.72.

'Tax/Treasury', and 'Group Finance Control' subcategories of group overheads to overseas subsidiaries when it would have been reasonable to expect an element of the activity to be driven and consumed by overseas subsidiaries. We therefore estimated the proportion of the total 'Group Functions' cost ('Strategy' 'Tax/Treasury', and 'Group Finance Control') that we considered it was reasonable to assume would be consumed by overseas subsidiaries and allocated those costs using the total average employees within the respective BT subsidiaries.<sup>93</sup>

- 4.51 We explained in the Directions Consultation that this adjustment reduced the cost of regulated services in the Fixed Access markets by £[X] by re-allocating some of the underlying group overheads costs away from the regulated services in the Fixed Access markets to the Wholesale and Retail Residual markets (where overseas subsidiaries are included).

### Our proposal

- 4.52 We proposed that BT must allocate, in its Regulatory Financial Statements, the 'Tax/Treasury', 'Group Finance Control' and 'Strategy' subgroups of 'Group Functions' costs in proportion to the total average employees employed by each respective BT subsidiary.

### Stakeholder comments

- 4.53 BT noted "that the cost of the Ofcom admin fee is within the Strategy subgroup of Group Functions. We do not believe it is Ofcom's intention that the admin fee should be attributed to overseas subsidiaries. We propose that Ofcom excludes this item from the relevant costs to be attributed using total average employees across all BT subsidiaries."<sup>94</sup>
- 4.54 Vodafone agreed with our "proposal to allocate these costs in proportion to the total average employees employed by each respective BT subsidiary."<sup>95</sup>

### Ofcom's response and decision

- 4.55 The Ofcom licence fee is the levy imposed by us on regulated companies (including BT) to recover part of our running costs. The decision to allocate costs to overseas subsidiaries was set out in the analysis in the Fixed Access market review.<sup>96</sup>
- 4.56 The Fixed Access market review decision was taken, in line with the information provided to Ofcom, at the level of sub cost categories. As we have already set out above, it is important that our proposals and decisions for regulatory reporting seek to be consistent with decisions taken as part of market reviews. The decisions taken in the Fixed Access market review about Group Overheads were a result of the analysis performed on the information available at the time.
- 4.57 Having considered stakeholders responses our decision is that in its Regulatory Financial Statements, BT must allocate the 'Tax/Treasury', 'Group Finance Control' and 'Strategy' subgroups of 'Group Functions' costs in proportion to the total average employees employed by each respective BT subsidiary.

<sup>93</sup> Fixed Access Statement, Annex 13, paragraph A13.71.

<sup>94</sup> BT, Directions Consultation response, page 11, paragraph 48

<sup>95</sup> Vodafone, Directions Consultation response, page 4, paragraph 14

<sup>96</sup> Fixed Access Statement, Annex 13, paragraphs A13.64 - A13.72.

## **Deafness Provision<sup>97</sup>**

- 4.58 BT's 2012/13 Regulatory Financial Statements included a "Specific Group Provision" relating to claims for deafness arising from the historical use of copper line testing equipment previously used by BT's engineers. In the Fixed Access market review we decided that as BT could not provide an explicit efficiency justification for this provision and it did not therefore represent an efficiently incurred forward looking cost, this provision should not be allocated to regulated services within the Fixed Access market review for the purpose of the charge control.
- 4.59 We explained in the Directions Consultation that this adjustment reduced costs in the Fixed Access markets by £[X] by re-allocating the non-forward looking deafness provisions to the Wholesale Residual market.

### Our proposal

- 4.60 We proposed that BT must only allocate its provision for deafness to the Wholesale Residual market within the Regulatory Financial Statements.

### Stakeholder comments

- 4.61 BT made no comments about our proposals in relation to deafness provision. Vodafone said that it supports "the exclusion of any backward looking costs from the WLR market statements in the RFS."<sup>98</sup>

### Ofcom's response and decision

- 4.62 Having considered stakeholders responses we have decided that BT must only allocate its provision for deafness to the Wholesale Residual market within the Regulatory Financial Statements.

## **Cumulo rates<sup>99</sup>**

- 4.63 Cumulo rates are the non-domestic (business) rates that BT pays on the rateable assets within its UK network. In the Fixed Access market review we reviewed BT's allocation of its Cumulo assets across regulated markets. We noted that BT allocated any incremental rates associated with NGA assets directly to NGA products and services.<sup>100</sup> For the charge control we concluded that, for non NGA related costs, we would adopt a variant of the Profit Weighted Net Replacement Costs (PWNRC) method with base-year allocations determined according to BT's Regulatory Financial Statements but with allocations determined by Ofcom.<sup>101</sup>

### Our proposal

- 4.64 We proposed that the Regulatory Financial Statements must include the Cumulo rates adjustment. We proposed that all non NGA related Cumulo costs should be assessed and allocated in the same way, i.e. all non NGA related costs should be

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<sup>97</sup> Fixed Access Statement, Annexes, paragraph A13.73 – A13.81.

<sup>98</sup> Vodafone, 2014 Consultation response, page 4, paragraph 14

<sup>99</sup> Fixed Access Statement, Annexes, paragraph A26.4 and A26.5.

<sup>100</sup> Fixed Access Statement, Annexes, paragraph A26.15.

<sup>101</sup> Fixed Access Statement, Annexes, paragraph A26.4 and A26.5.



allocated on the same profit weighted Net Replacement Cost basis.<sup>102</sup> The net replacement costs (NRCs) used should be those for the rateable assets in the relevant financial year. The profit weights should be the relevant weighted average cost of capital for each market. We proposed that BT must reflect this treatment in its Regulatory Financial Statements.

### Stakeholder comments

- 4.65 BT made no comments on this proposal. Vodafone said “it is imperative that all services, including NGA services take an appropriate allocation of BT’s rates costs. We therefore are supportive of adjustments to the RFS that ensure this occurs.”<sup>103</sup> TalkTalk said “it is not clear how Ofcom should determine the NGA related Cumulo costs.”<sup>104</sup>

### Ofcom’s response and decision

- 4.66 Having considered stakeholders responses we have decided that BT must allocate its Cumulo costs as set out in the Directions Consultation. Our requirement is that the net replacement costs should be those for the rateable assets in the relevant financial year. This requirement applies to all rateable assets, including specialised accommodation assets.
- 4.67 With respect to TalkTalk and Vodafone’s comments about NGA liabilities we note that “for NGA, the valuation authorities currently apply an incremental fixed rateable value per connection as an MCC.”<sup>105</sup> The contribution of NGA connections to BT’s Cumulo rateable value has therefore been identifiable. We will be confirming these arrangements as part of the Business Connectivity market review and will ensure that any decisions in these markets reflect any changes in approach to valuation of BT’s Cumulo assessment. In the future we will in any case need to review the allocation in light of any changes that the valuation authorities might make to assessing BT’s Cumulo rateable value for the new rating list that comes into force in England, Wales and Scotland on 1 April 2017.

### **Test Access Matrix (TAMs) Costs<sup>106</sup>**

- 4.68 TAMs equipment is installed on MPF lines to connect them to BT’s line test equipment to enable line testing. The TAM is an integral part of the provision of MPF Rentals, but is not used by WLR Rentals or SMPF Rentals. Therefore, the use of MPF Rentals can be regarded as causing TAM costs. MPF Rentals is also the only service that is likely to benefit from the line capability of TAMs.<sup>107</sup>
- 4.69 In the Fixed Access market review we recalculated TAMs costs and made two adjustments in our decision:

<sup>102</sup> Fixed Access Statement, Annexes, paragraph A2.5.

<sup>103</sup> Vodafone, Directions Consultation response, page 4, paragraph 14

<sup>104</sup> TalkTalk Directions Consultation response, page 2, paragraph 3.4

<sup>105</sup> See description of CUMNOR allocation base, page 54, BT’s 2014 DAM.

<sup>106</sup> Fixed Access Statement, Annexes, paragraphs A13.126 – A13.141 and A13.148.

<sup>107</sup> Fixed Access Statement, Annexes, paragraphs A13.126.

- We extended the time period over which TAMs were depreciated from five years to seven years reflecting the asset life used in the Single Jumper MPF dispute.<sup>108109</sup>
  - We allocated TAMs costs to MPF Rentals only.<sup>110</sup>
- 4.70 When investigating EvoTAM costs we also found that costs relating to the installation of Tie Cables that should have been allocated to EvoTAMs had been incorrectly allocated to TAMs.
- 4.71 We explained in the Directions Consultation that this combined adjustment extends the asset life of TAMs and allocates the cost of TAMs only to the services that use them. The adjustment changed the costs for MPF Rentals, WLR Rentals and SMPF Rentals that we used to determine the prices of these services.

### Our proposal

- 4.72 We proposed that BT must depreciate TAMs over a seven year period and must only allocate TAMs costs to MPF Rentals in its Regulatory Financial Statements. We proposed that Tie Cable installation costs incorrectly allocated to TAMs should be allocated to EvoTAMs.

### Stakeholder comments

- 4.73 BT did not make any specific comments on our proposed regulatory reporting treatment.
- 4.74 TalkTalk agreed that “the TAM depreciation rate should be set to 7 years (not 5).”<sup>111</sup> TalkTalk went on to say that “embedding these changes/corrections in the underlying assumptions should result in more robust allocations, less risk of errors and will avoid any concern of the order in which adjustments are made.”<sup>112</sup> Vodafone agreed with our proposals for TAMs and EVO Tams reporting.

### Ofcom’s response and decision

- 4.75 Having considered stakeholder responses we have decided that BT must depreciate TAMs over a seven year period and must only allocate TAMs costs to MPF Rentals in its Regulatory Financial Statements. We have also decided that Tie Cable installation costs incorrectly allocated to TAMs should be allocated to EvoTAMs.

### **Evolutionary Test Access Matrix (EvoTAMs) Costs<sup>113</sup>**

- 4.76 EvoTAMs are installed on SMPF lines to test SMPF lines that are supplied internally to provide Wholesale Broadband Connect (WBC) services. Externally consumed SMPF lines do not currently use EvoTAMs and are not expected to do so in the future.

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<sup>108</sup> Dispute between TalkTalk and Openreach relating to single jumpered MPF– Annexes, paragraphs A2.142 – A2.144 [http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/open-cases/all-open-cases/cw\\_01019/Provisional\\_Conclusions\\_nonconfidential\\_v2\\_1\\_Oct\\_13.pdf](http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01019/Provisional_Conclusions_nonconfidential_v2_1_Oct_13.pdf)

<sup>109</sup> Fixed Access Statement, Annexes, paragraph A13.128.

<sup>110</sup> Fixed Access Statement, Annexes, paragraph A13.126.

<sup>111</sup> TalkTalk, Directions Consultation response, page 2, paragraph 3.1

<sup>112</sup> TalkTalk, Directions Consultation response, page 2, paragraph 3.1

<sup>113</sup> Fixed Access Statement, Annex 13, paragraphs A13.142 – A13.147 and A13.149.

- 4.77 In the Fixed Access market review we noted that recovering of EvoTAMs from all SMPF lines is a particular concern because the only SMPF lines that are connected to EvoTAMs are internal SMPF lines that is those used by BT Wholesale. This meant that CPs other than BT are paying for EvoTAMs that are used by BT Wholesale. We therefore decided that it was not appropriate to recover EvoTAM cost from SMPF lines that do not use EvoTAMs.<sup>114</sup> When we set the price of SMPF Rental we decided that the charge should not recover any EvoTAM costs.<sup>115</sup>
- 4.78 In the Fixed Access market review we noted that there were some EvoTAM costs relating to the installation of Tie Cables that were incorrectly being allocated to TAMs.<sup>116</sup> We allocated these Tie Cable installation costs to EvoTAMs.
- 4.79 We explained in the Directions Consultation that this adjustment allocated the costs of EvoTAMs away from SMPF Rentals when we set the SMPF Rental prices.

### Our proposal

- 4.80 We proposed that BT must allocate EvoTAM costs away from SMPF Rentals to the Wholesale Residual market in the Regulatory Financial Statements.
- 4.81 We also proposed that the costs relating to the installation of Tie Cables should be allocated to EvoTAMs.

### Stakeholder comments

- 4.82 BT argued that as EvoTAMs are used to provide WBA services and EvoTAM costs are to do with the provision of those services, it would be in line with Ofcom's Fixed Access market review decision to allocate these costs to the WBA market rather than the WLA market. BT proposed that EvoTAM costs should be reported against services in the WBA.<sup>117</sup>

### Ofcom's response and decision

- 4.83 In light of BT's submissions, we have reconsidered our proposal to require BT to allocate EvoTAM costs to the Wholesale Residual market. We no longer believe that we should specify where EvoTAM costs should be allocated. Instead we consider that in line with the decision in the Fixed Access market review we should require BT not to allocate EvoTAM costs to SMPF Rentals.
- 4.84 We note BT's comment that EvoTAM costs should be allocated to the WBA market. As we explained in the Fixed Access market review, "EvoTAMs are installed on SMPF lines that are used to provide WBC services (an ADSL2+ service)."<sup>118</sup> In considering whether it is appropriate to allocate EvoTAM costs to WBA services that utilise EvoTAMs, BT should consider as required under the SMP conditions whether such allocation is in accordance with the Regulatory Accounting Principles.

<sup>114</sup> Fixed Access Statement, Annex 13, paragraph A13.144.

<sup>115</sup> Fixed Access Statement, Annex 13, paragraph A13.149.

<sup>116</sup> Fixed Access Statement, Annex 13, paragraphs A13.131.

<sup>117</sup> BT, Directions Consultation response, page 11, paragraph 47

<sup>118</sup> Fixed Access Statement, Annex 13, paragraph A13.142

- 4.85 Having considered stakeholder responses we have decided that BT must not allocate EvoTAM costs to SMPF Rentals. BT must allocate costs relating to the installation of EvoTAM Tie Cables to EvoTAMs.

### **Simultaneously provided services<sup>119</sup>**

- 4.86 Where two migration/connection services are provided at the same time, the cost of jointly providing the services can be lower than providing them on a separate basis. In the Fixed Access market review we “set the charge controls so as to require a discount on the simultaneous provision of (i) WLR Conversion and SMPF New Provide (the “WLR+SMPF Simultaneous Migration” service), and (ii) WLR Connections and SMPF New Provide (the “WLR+SMPF Simultaneous Connection” service) such that charges for these services reflect the efficiencies associated with their simultaneous provision.”<sup>120</sup>
- 4.87 Our estimate of the result of this allocation of cost savings was to decrease the costs of WLR+SMPF Simultaneous Migrations and Connections by nearly 50% over the charge control period and increase the costs of the remaining services by approximately 15%.<sup>121</sup>

### **Our proposal**

- 4.88 We proposed in the Directions Consultation that BT must disclose the information for these two newly created, charge controlled simultaneously provided services and separately attribute the costs to these services within the Regulatory Financial Statements.

### **Stakeholder comments**

- 4.89 BT did not make any specific comments on our proposed regulatory reporting treatment required for simultaneous provided services.
- 4.90 Vodafone said they “support the requirement for BT to disclose information for simultaneously provided services and separately attribute these costs.”<sup>122</sup>

### **Ofcom’s response and decision**

- 4.91 Having considered stakeholder responses we have decided that BT must allocate and separately identify the costs of simultaneously provided services within its Regulatory Financial Statements and make the required disclosures in the Published Regulatory Financial Statements in line with how these services are regulated.

### **Combined fault and service level allocations<sup>123</sup>**

- 4.92 In the Fixed Access market review we determined a combined fault rate and service level usage factor for allocating the cost of repairing faults on copper lines to services

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<sup>119</sup> Fixed Access Statement, Annex 8.

<sup>120</sup> Fixed Access Statement, Volume 2, para 4.2

<http://stakeholders.ofcom.org.uk/binaries/telecoms/ga/fixed-access-market-reviews-2014/statement-june-2014/volume2.pdf>

<sup>121</sup> Fixed Access Statement, Annexes, paragraph A8.30.

<sup>122</sup> Vodafone, Direction Consultation Response, page 5, paragraph 14

<sup>123</sup> Fixed Access Statement, Annex 13, paragraphs A13.56 – A13.63

based on how often on average that service develops a fault, and on average how quickly that fault is fixed. In the Fixed Access market review our usage factor was applied to the five faults and service related cost components to allocate the costs to the WLR Rentals, MPF Rentals and SMPF Rentals. These components were D-side Copper Current, E-side Copper Current, Local Exchanges, Residential PSTN drop maintenance and DSLAM Capital/Maintenance.

- 4.93 We explained in the Directions Consultation that applying our combined fault rate and service level usage factor to the cost components for WLR Rentals, MPF Rentals and SMPF Rentals in our cost model changed the level of cost allocated to those services.

### Our proposal

- 4.94 We proposed that BT must allocate the five faults and service related cost components to WLR Rentals, MPF Rentals and SMPF Rentals using the combined usage factor. The allocations used in our decision were set out in table A13.2 of the Fixed Access market review<sup>124</sup> which is reproduced in table 1 above.

### Stakeholder comments

- 4.95 Vodafone said they “support the inclusion of these adjustments within BT’s RFS output.”<sup>125</sup> No other stakeholder comments were received.

### Ofcom’s response and decision

- 4.96 Having considered stakeholder responses we have decided that BT must allocate in the Regulatory Financial Statements the five faults and service related cost components to WLR Rentals, MPF Rentals and SMPF Rentals using the combined usage factor. The allocations used in our decision were set out in table A13.2 of the Fixed Access market review<sup>126</sup> which is reproduced in table 1. However as we explain in paragraphs 4.41 – 4.49, the costs described in the Fixed Access market review as DSLAM Capital/Maintenance are called ‘Costs incurred in Openreach relating to Class of Work MDL’.

### **TAMs Mark Up<sup>127</sup>**

- 4.97 When we determined the MPF Rental price in the Fixed Access market review, we did not use the FAC of TAMs from the Regulatory Financial Statements, but instead used a LRIC for TAMs. In our decision we determined that the LRIC of a TAM was £3.75 per MPF line, which was constant over the charge control.
- 4.98 The common costs which exceeded the LRIC were allocated to WLR Rentals and MPF Rentals to maintain the LRIC differential. We describe this LRIC adjustment below.

<sup>124</sup> Fixed Access Statement, Annex 13, Table A13.2.

<sup>125</sup> Vodafone, Direction Consultation Response, page 5, paragraph 14

<sup>126</sup> Fixed Access Statement, Annex 13, Table A13.2.

<sup>127</sup> Fixed Access Statement, Annex 13, paragraph A13.141.

### Our proposal

- 4.99 We did not propose to require BT to include this adjustment in the Regulatory Financial Statements. We explained our reasons for not making such proposal in the Directions Consultation.
- 4.100 However, we said that this adjustment provides us with information on BT's financial performance, in particular how the aggregate LRIC of TAMs, based on our charge control decisions, compares to the aggregate FAC of TAMs.
- 4.101 We proposed that, for the purposes of the Adjusted Financial Performance Schedules, BT must estimate the impact of calculating the LRIC of TAMs for MPF Rentals at a constant £3.75 per MPF line in the Adjusted Financial Performance Schedules. We proposed that the common costs relating to TAMs which exceed the LRIC must be recovered from WLR Rentals and MPF Rentals to maintain the LRIC differential as set out in the 'LRIC Adjustments and Recovery of Common Costs section' below.

### Stakeholder comments

- 4.102 Vodafone agreed in relation to the TAMs Mark Up adjustment that "it is important that the accounts are prepared on a consistent basis and using LRIC and FAC reporting simultaneously would thwart transparency."<sup>128</sup> BT agreed that the methodology proposed for the Adjusted Financial Performance Schedule reflected Ofcom's decision in the Fixed Access market review.

### Ofcom's response and decision

- 4.103 Having considered stakeholders responses to our proposal we have decided not to require BT to include the TAMs Mark Up adjustment in the Regulatory Financial Statements.
- 4.104 We have also decided that BT must estimate the impact of calculating the LRIC of TAMs for MPF Rentals at a constant £3.75 per MPF line in the Adjusted Financial Performance Schedules. The common costs relating to TAMs which exceed the LRIC must be recovered from WLR Rentals and MPF Rentals to maintain the LRIC differential as set out in the 'LRIC Adjustments and Recovery of Common Costs section' below.

### **Line Cards<sup>129</sup>**

- 4.105 Line Cards are the electrical interfaces used to connect the twisted pair copper cable of the local loop to the public switched telephone network (PSTN) via the DSLAM. Combi cards Voice ("combi cards") perform the same tasks on MSANs. Line Cards have been largely depreciated in the Regulatory Financial Statements and have very low net replacement costs (NRC).
- 4.106 In the Fixed Access market review, when we calculated the cost of WLR Rentals we made an adjustment to uplift the NRCs of Line Cards to produce an annual line card FAC of £11<sup>130</sup> per line for 2014/15 within our cost model. We did this within our cost

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<sup>128</sup> Vodafone, Directions Consultation response, page 5, paragraph 14

<sup>129</sup> Fixed Access Statement, Annexes, paragraph A13.101 A13.110.

<sup>130</sup> This was the combined cost of PSTN Line Cards and Combi Cards.

model by increasing the base year NRC for line cards (which was supplied from BT's 2011/12 Regulatory Financial Statements) to £715m and at the same time reducing the NRC of combi cards to zero. In our decision we determined that the LRIC of a Line Card was £7.40 per WLR Rental Line.<sup>131</sup> The common costs which exceeded the LRIC were then allocated to WLR Rentals and MPF Rentals to maintain the LRIC differential.

### Our proposal

- 4.107 We did not propose to require BT to include this adjustment in the Regulatory Financial Statements. We said that including the adjustment would decrease the usefulness of those statements as a source of data for future decisions, while reducing their transparency to stakeholders, as it would replace BT's incurred costs with a subjective economic estimate of the costs and asset values under different assumptions.
- 4.108 However, given that this adjustment could have a significant impact at a market review level we proposed that BT must calculate the combined impact of uplifting the NRC of Line Cards whilst at the same time reducing the NRC for combi cards to zero.
- 4.109 In relation to Line Cards, we proposed that BT must uplift their NRC to £715m in 2011/12 and then adjust this NRC in subsequent years to reflect changes in volumes and efficiency. We proposed, in order to reflect changes in volumes, that BT must use the Local Exchange Asset Volume Elasticity from BT's LRIC model.<sup>132</sup> To reflect changes in efficiency we proposed that BT must reduce the volume adjusted NRC by 5% cumulatively from 2011.<sup>133</sup> We proposed that the common costs relating to Line Cards which exceed the LRIC must be recovered from WLR Rentals and MPF Rentals to maintain the LRIC differential as set out below.

### Stakeholder comments

- 4.110 BT agreed that the Line Card adjustment is "relevant to the Adjusted Financial Performance Schedule."<sup>134</sup> However, BT said that our approach was inconsistent because we proposed different treatments for Line Cards (to be included in the Adjusted Financial Performance Schedule), the RAV (to be included in the Regulatory Financial Statements) and ISDN30 and ISDN2 (not to be included in either the Regulatory Financial Statements or the Adjusted Financial Performance Schedule). In BT's view these adjustments are similar in character. BT said that its preference was that all significant adjustments, by which BT meant all adjustments excluding those which attribute costs within a market, should be included in the Regulatory Financial Statements. We have addressed these arguments in Section 3. BT made no comment about our proposed method of calculating the adjustment.
- 4.111 Vodafone supported our position and considered "Ofcom's approach as reasonable, recognising that in these circumstances the decisions in the charge controls need not to be reflected within the RFS".<sup>135</sup>

<sup>131</sup> Fixed Access Statement, Annexes, paragraph A9.27

<sup>132</sup> We used 0.51 in the Fixed Access Market decision as set out in Table A13.15.

<sup>133</sup> Fixed Access Statement, volume 2, para 1.17

<sup>134</sup> BT, Directions Consultation response, page 11, paragraph 50

<sup>135</sup> Vodafone, Directions Consultation response, page 5, paragraph 11

## Ofcom's response and decision

- 4.112 We explained in Section 3 that we would not expect to see an adjustment (such as the Line Cards adjustment) reflected in the Regulatory Financial Statements if the adjustment had the effect of replacing BT's actual costs with an alternative estimate of cost. We said that in such cases we would expect to see the adjustment reflected in the Adjusted Financial Performance Schedule.
- 4.113 Having considered stakeholders responses we have decided that BT must calculate the impact of uplifting the NRC of Line Cards to £715m in 2011/12 and then adjusting this NRC in subsequent years to reflect changes in volumes and efficiency. In order to reflect changes in volumes, BT must use the Local Exchange Asset Volume Elasticity from BT's LRIC model.<sup>136</sup> To reflect changes in efficiency BT must reduce the volume adjusted NRC by 5% cumulatively from 2011.<sup>137</sup>
- 4.114 The common costs relating to Line Cards which exceed the LRIC must be recovered from WLR Rentals and MPF Rentals to maintain the LRIC differential as set out below. The aggregate impact of these adjustments must be disclosed within the Adjusted Financial Performance Schedule.

## **LRIC differential**

- 4.115 In the Fixed Access market review, we did not consider it was necessary or desirable to set charges to promote MPF-based competition over other forms of competition. We said that this meant that to promote efficiency the relative charges of each of WLR and MPF; and WLR + SMPF and MPF were equal to our estimate of the LRIC differential for providing these services. We said that this implied that MPF and WLR would contribute equally to common cost recovery on a per line basis<sup>138</sup> and that SMPF would be set at LRIC.<sup>139</sup>
- 4.116 For prices regulated at LRIC, the unrecovered common cost was then recovered over the main rental services. This was done in such a way so as to ensure that the price differentials for the main rental services reflected the LRIC differential.<sup>140</sup>

## Our proposal

- 4.117 We did not propose to require BT to include this adjustment in the Regulatory Financial Statements. We said that the adjustment does not change the underlying FAC of WLR Rental, MPF Rental or SMPF Rental and is likely to decrease transparency and stakeholder understanding of the Regulatory Financial Statements.
- 4.118 The adjustment does however provide us with information about BT's financial performance in the WLA and WAEL markets on an ongoing basis. We proposed that BT must calculate the difference between the LRIC of WLR Rentals; and the LRIC of MPF Rentals (the LRIC differential) for the purposes of the Adjusted Financial Performance Schedules. When subsequently spreading the common costs of Caller Display, Migrations and WLR Transfer we proposed that BT must maintain the LRIC differential of £1.79.

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<sup>136</sup> We used 0.51 in the Fixed Access Market decision as set out in Table A13.15.

<sup>137</sup> Fixed Access Statement, volume 2, para 1.17

<sup>138</sup> We describe this adjustment in paragraphs 4.105 to 4.112

<sup>139</sup> We describe this adjustment in paragraphs 4.113 to 4.116

<sup>140</sup> Fixed Access Statement, Annex 11, paragraph A11.46.



## Stakeholder comments

- 4.119 Vodafone said in relation to the LRIC differential adjustment that “it is important that the accounts are prepared on a consistent basis and using LRIC and FAC reporting simultaneously would thwart transparency.”<sup>141</sup> BT agreed that the methodology proposed for the Adjusted Financial Performance Schedule reflected Ofcom’s decision in the Fixed Access market review.

## Ofcom’s response and decision

- 4.120 Having considered stakeholders responses we have decided not to require BT to include the LRIC differential adjustment in the Regulatory Financial Statements.
- 4.121 We have decided that BT must calculate the difference between the LRIC of WLR Rentals; and the LRIC of MPF Rentals (the LRIC differential) in the published Adjusted Financial Performance Schedule. We have decided that when subsequently spreading the common costs of Caller Display, Migrations and WLR Transfer BT must maintain the LRIC differential of £1.79.

## **Caller Display**<sup>142</sup>

- 4.122 Caller Display is an add-on service provided alongside WLR Rentals. In the course of the Fixed Access market review we found that the cost of providing the service was close to zero, whilst BT was charging £6 per line per year.<sup>143</sup> In light of this, we decided to impose a charge control on Caller Display and set the charge at “£0.45, to reflect our estimate for the LRIC of this service”. In order to enable BT to recover costs which are currently allocated to Caller Display, we decided to reallocate £4.8m to all rentals, and £5.0m to WLR charges.”<sup>144</sup>
- 4.123 In our cost model, common costs previously allocated to Caller Display were reallocated across MPF Rental and WLR Rental lines.<sup>145</sup> This was done in such a way so as to ensure the price differentials for the main rental services reflected the LRIC differential.

## Our proposal

- 4.124 We did not propose to require BT to include this adjustment in the Regulatory Financial Statements. We said that this adjustment does not change the underlying FAC of Caller Display service and is likely to decrease transparency and stakeholder understanding of the Regulatory Financial Statements.
- 4.125 We explained that this adjustment would provide us with information about the impact of this LRIC adjustment on BT’s financial performance in the WLA and WAEL markets on an ongoing basis. We proposed that BT must, in the Adjusted Financial Performance Schedules, calculate the impact of setting the costs of the Caller Display service at LRIC and spreading the common costs of Caller Display (i.e. the difference between FAC and LRIC) to WLR Rentals and MPF Rentals so that the LRIC differential is maintained.

<sup>141</sup> Vodafone, Directions Consultation response, page 5, paragraph 14

<sup>142</sup> Fixed Access Statement, Volume 2, paragraphs 4.200 – 4.257

<sup>143</sup> Fixed Access Statement, Volume 2, paragraphs 4.216 – 4.217

<sup>144</sup> Fixed Access Statement, Volume 2, paragraph 4.257

<sup>145</sup> Fixed Access Statement, Annex 8

## Stakeholder comments

- 4.126 Vodafone said that it “considers Ofcom’s approach as reasonable, recognising that in these circumstances the decisions in the charge controls need not be reflected within the RFS.”<sup>146</sup>
- 4.127 BT agreed that the methodology proposed for the Adjusted Financial Performance Schedule reflected Ofcom’s decision in the Fixed Access market review.

## Ofcom’s response and decision

- 4.128 Having considered stakeholders responses we have decided not to require BT to include the Caller Display adjustment in the Regulatory Financial Statements.
- 4.129 We have decided that BT must, in the published Adjusted Financial Performance Schedule, calculate the impact of setting the costs of the Caller Display product at LRIC and spreading the common costs of Caller Display (i.e. the difference between FAC and LRIC) to WLR Rentals and MPF Rentals so that the LRIC differential is maintained.

## **Migrations<sup>147</sup> and WLR Transfer**

- 4.130 Migration charges arise when an end user switches from one CP to another. There are a number of different charges which depend on whether the end user is switching services as well as CP. WLR Transfers are systems updates made when end customers change their WLR provider.
- 4.131 In the Fixed Access market review, we decided to align the charges of all Migrations involving jumpering and set the aligned charge to the volume weighted average of the LRICs.<sup>148</sup> We set the prices of MPF Bulk Migration and SMPF Bulk Migrations in line with a single target charge based on the volume weighted average of their LRICs<sup>149</sup> and set the WLR Transfer Charge to its LRIC.<sup>150</sup>
- 4.132 We decided that the common costs no longer recovered from these services should be recovered through MPF Rental and WLR Rental charges on an equal per line basis.<sup>151</sup>

## Our proposal

- 4.133 We did not propose to require BT to include this adjustment in the Regulatory Financial Statements. We said that this adjustment did not change the underlying FAC of these products and was likely to decrease transparency and stakeholder understanding of the Regulatory Financial Statements. However, we explained that this adjustment would provide us with information about the impact of these LRIC adjustments on BT’s financial performance in the WLA and WAEL markets on an ongoing basis.

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<sup>146</sup> Vodafone, Directions Consultation response, page 5, paragraph 14

<sup>147</sup> Fixed Access Statement, Annex 8

<sup>148</sup> Fixed Access Statement, Volume 2, paragraphs 4.90-4.103

<sup>149</sup> Fixed Access Statement, Volume 2, paragraphs 4.111- 4.119

<sup>150</sup> Fixed Access Statement, Volume 2, paragraphs 4.106- 4.110

<sup>151</sup> Fixed Access Statement, Volume 2, paragraphs 5.60 ii) and iii)

- 4.134 As a result, we proposed that BT must, in the Adjusted Financial Performance Schedules, calculate the impact setting the costs for the Migrations and WLR Transfers at LRIC and spreading the common costs of Migrations and WLR Transfers (i.e. the difference between FAC and LRIC) as set out in the LRIC adjustments and recovery of common costs adjustment explained below.

### Stakeholder comments

- 4.135 Vodafone said that it recognised the reason for excluding Migrations and WLR Transfer from the Regulatory Financial Statements and where appropriate the need for them to be captured within the additional reporting requirements.
- 4.136 BT agreed that the methodology proposed for the Adjusted Financial Performance Schedule reflected Ofcom's decision in the Fixed Access market review.

### Ofcom's response and decision

- 4.137 Having considered stakeholders responses we have decided not to require BT to include the Migrations and WLR Transfer adjustments in the Regulatory Financial Statements.
- 4.138 We have decided that BT must calculate in the published Adjusted Financial Performance Schedule the impact setting the costs for the Migrations and WLR Transfers at LRIC and spreading the common costs of Migrations and WLR Transfers (i.e. the difference between FAC and LRIC) as set out in the LRIC adjustments and recovery of common costs adjustment explained below.

### **LRIC adjustments and recovery of common costs**

- 4.139 In the Fixed Access Market, we set the cost of a number of services to LRIC. These included:

- Caller Display;
- Migrations; and
- WLR Transfers.

- 4.140 We decided that WLR Rental and MPF Rental would contribute equally to common cost recovery for the Caller Display, Migrations and WLR Transfers. For prices regulated at LRIC, the unrecovered common cost was then recovered over the main rental services. This was done in such a way so as to ensure the price differentials for the main rental services reflected the LRIC differential.<sup>152</sup>

### Our proposal

- 4.141 We did not propose to require BT to include this adjustment in the Regulatory Financial Statements. We said that this adjustment does not change the underlying FAC of these services and are likely to decrease transparency and stakeholder understanding of the Regulatory Financial Statements. However, we explained that this adjustment will provide us with information about the impact of these LRIC

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<sup>152</sup> Fixed Access Statement, Annexes, paragraph A11.46.

adjustments on BT's financial performance in the WLA and WAEL markets on an ongoing basis.

- 4.142 As a result we proposed that BT must, in the Adjusted Financial Performance Schedules, allocate the common costs of Caller Display, Migrations and WLR Transfers to WLR Rentals and MPF Rentals so that the LRIC differential is maintained.

### Stakeholder comments

- 4.143 Vodafone said that it recognised the reason for excluding the LRIC adjustments and recovery of common costs adjustments from the Regulatory Financial Statements and where appropriate the need for them to be captured within the additional reporting requirements. BT agreed that the methodology proposed for the Adjusted Financial Performance schedule reflected Ofcom's decision in the Fixed Access market review.

### Ofcom's response and decision

- 4.144 Having considered stakeholders responses we have decided not to require BT to include the LRIC adjustments and recovery of common costs adjustments in the Regulatory Financial Statements.
- 4.145 We have decided that BT must, in the published Adjusted Financial Performance Schedule, allocate the common costs of Caller Display, Migrations and WLR Transfers to WLR Rentals and MPF Rentals so that the LRIC differential is maintained.

### **SMPF**

- 4.146 In the Fixed Access market review, we decided that ultimately common costs should be recovered equally from MPF Rental and WLR Rental lines, with SMPF Rentals making no contribution to common cost recovery. This was to enable both the difference in charges between MPF Rentals and WLR Rentals and the difference between MPF Rentals and WLR Rentals + SMPF Rentals to be equal to the respective differences in LRICs.<sup>153 154</sup> The common cost of SMPF Rentals was allocated to WLR Rentals and MPF Rentals to ensure this differential was maintained.

### Our proposal

- 4.147 We did not propose to require BT to include this adjustment in the Regulatory Financial Statements. We said that this adjustment does not change the underlying FAC of these services and would require WLR Rentals and MPF Rentals to be reported on a different basis (FAC+). However, we explained that this adjustment will provide us with information about the impact of this LRIC adjustment on BT's financial performance in the WLA and WAEL markets on an ongoing basis.
- 4.148 As a result we proposed that BT must for the purposes of the Adjusted Financial Performance Schedules estimate the impact of the SMPF Rental service being

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<sup>153</sup> Fixed Access Statement, Volume 2, paragraphs 3.67 - 3.109

<sup>154</sup> We calculated this to be £1.79 based on SMPF charge being equivalent to its LRIC which we estimated to be £2.61.

priced at LRIC instead of FAC with the SMPF common costs being allocated to WLR Rentals and MPF Rental services so as to maintain the LRIC differential.

### Stakeholder comments

- 4.149 Vodafone said that it recognised the reason for excluding the SMPF adjustment from the Regulatory Financial Statements and where appropriate the need for them to be captured within the additional reporting requirements.
- 4.150 BT agreed that the methodology proposed for the Adjusted Financial Performance schedule reflected Ofcom's decision in the Fixed Access market review.

### Ofcom's response and decision

- 4.151 Having considered stakeholders responses to the 2014 Consultation proposals we have decided not to require BT to include the SMPF adjustment in the Regulatory Financial Statements.
- 4.152 We have decided that BT must estimate in the published Adjusted Financial Performance Schedule the impact of the SMPF Rental service being priced at LRIC instead of FAC with the SMPF common costs being allocated to WLR Rentals and MPF Rental services so as to maintain the LRIC differential.

### **Absolute valuation of copper**

- 4.153 In the Fixed Access Statement we decided to derive the CCA value of the access copper on the basis of BT's 2011/12 absolute valuation. We then adjusted this to calculate the value of copper on a RAV basis.<sup>155</sup>
- 4.154 In 2012/13, BT changed its method of estimating the CCA value of copper, from an absolute valuation to a valuation based on capital expenditure indexed by RPI. However, for the reasons set out in the Fixed Access market review, we continued to use the 2011/12 valuation as the starting point for our assessment of BT's costs.

### Our proposal

- 4.155 We did not propose to require BT to reflect our decision on copper valuation in the Regulatory Financial Statements or in the Adjusted Financial Performance Schedules. We explained our reasons for not making this proposal in the Directions Consultation.

### Stakeholder comments

- 4.156 Vodafone said that in the case of the absolute valuation of copper it recognised the policy rationale for the charge control adjustments and the reasons for its exclusion from the Regulatory Financial Statements.
- 4.157 BT said that it agrees "that reverting to absolute valuation of copper is not appropriate."<sup>156</sup> BT said that Ofcom had described the issues that it faces in producing an absolute valuation of copper and argued that "an indexation valuation is more straightforward, transparent and less volatile than the previous

<sup>155</sup> Fixed Access Statement, Annexes, paragraph A6.73.

<sup>156</sup> BT, Directions Consultation response, page 10, paragraph 41

methodology.”<sup>157</sup> BT said that “Ofcom has correctly decided not to revert to the previous methodology.”<sup>158</sup>

### Ofcom’s response and decision

- 4.158 Having considered stakeholders responses to the Directions Consultation proposals we have decided not to require BT to require the absolute valuation of copper in the Regulatory Financial Statements or the Adjusted Financial Performance Schedule.

### **ISDN30 pricing**

- 4.159 In setting the ISDN30 charge control, we decided that it would be proportionate and appropriate to simply cap charges at their current levels.<sup>159</sup> In the absence of a need for future investment in ISDN30 assets,<sup>160</sup> we considered that it may be unnecessary for future charges to reflect a hypothetical ongoing network in a steady state. Rather, we considered it may be efficient for ISDN30 prices to be below the steady state level. This would align charges more closely to forward looking incremental costs, given that no significant new investment was foreseen.<sup>161</sup>
- 4.160 We considered it likely that BT would have recovered its past investments if charges remained at the level imposed by the 2012 charge control during the market review period.<sup>162</sup> We also considered that it may not be efficient or in consumers’ interests for charges to fall materially. With substantially lower prices, the decline in ISDN30 volumes may reverse, which would then require new ISDN30 investment which the charge control may not be sufficient to cover. Materially lower ISDN30 charges may also undermine recent investment in IP-based services, which could create a perception of regulatory uncertainty (which may again damage investment incentives in the longer term, harming efficiency). The ISDN30 charge control was therefore set so that charges were constant in nominal terms for the relevant basket of services.<sup>163</sup>

### Our proposal

- 4.161 We did not propose to require BT to reflect our decision in relation to ISDN 30 charges in the Regulatory Financial Statements or in the Adjusted Financial Performance Schedules.

### Stakeholder comments

- 4.162 BT disagreed with Ofcom’s “proposed exclusion of the steady state adjustment on the ISDN2 and ISDN30 services.”<sup>164</sup> BT explained that in its view the proposed exclusion is “an inconsistent treatment of asset values compared with Line Cards.”<sup>165</sup> BT argued that significant adjustments should be included with the Regulatory Financial Statements.

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<sup>157</sup> BT, Directions Consultation response, page 10, paragraph 41

<sup>158</sup> BT, Directions Consultation response, page 10, paragraph 41

<sup>159</sup> Fixed Access Statement, Volume 1 paragraph 17.53

<sup>160</sup> Fixed Access Statement, Volume 1 paragraph 17.57

<sup>161</sup> Fixed Access Statement, Volume 1, paragraph 17.57

<sup>162</sup> Fixed Access Statement, Volume 1 paragraph 17.62

<sup>163</sup> Fixed Access Statement, Volume 1, paragraph 17.65

<sup>164</sup> BT, Directions Consultation response, page 2, paragraph 4

<sup>165</sup> BT, Directions Consultation response, page 2, paragraph 4

- 4.163 BT argued that “while Ofcom is correct that the current charges for ISDN30 have not been set upon Openreach’s current cost, these charges have been based on a forecast of the ISDN30 costs from the previous charge control.”<sup>166</sup> BT explained that the forecast was based on a model that included a steady state adjustment and as such “Ofcom should revisit the rationale for the exclusion of the ISDN30 steady state adjustment.”<sup>167</sup>
- 4.164 Vodafone said that in the case of ISDN30 it recognised the policy rationale for the charge control adjustments and the reasons for its exclusion from any output concerning the Regulatory Financial Statements.

### Ofcom’s response and decision

- 4.165 We have addressed BT’s submissions about the inconsistent treatment of the assets adjustments in Section 3. We disagree with BT’s argument that because the current ISDN 30 charges are a nominal continuation of the 2010 charge control, which was based on a hypothetical ongoing network, that the current charge control is therefore cost based.
- 4.166 When setting the current charge control, we did not consider forecasts from the 2010 charge control and charges were not set directly on BT’s actual costs. We were explicit that we did not set charges on a hypothetical ongoing network basis. Our decision was based on the assumption that no future investment in ISDN30 or ISDN2 was expected. We said “in the absence of a need for future investment in ISDN30 or ISDN2, we consider it may be unnecessary for efficiency that future charges reflect a hypothetical ongoing network in a steady state. Rather, it may be efficient for ISDN30 prices to be below the steady state level. This would align charges more closely to forward looking incremental costs, given that no significant new investment is foreseen.”<sup>168</sup>
- 4.167 Having considered stakeholders responses we have decided that the ISDN30 adjustments should not be included in either the Regulatory Financial Statements or the Adjusted Financial Performance Schedules.

### **ISDN2 pricing**

- 4.168 When we determined the ISDN2 charge control, we considered that the assets used to provide ISDN2 rental services were heavily depreciated.<sup>169</sup> We considered that this was a similar issue we had in connection to ISDN30 services. We concluded as with ISDN30 that ISDN2 rentals and connections should be charged in a similar manner with a cap set on average charges based on their current levels.<sup>170</sup> In connection with ISDN2 transfers, we determined that they should be charged at LRIC, which we estimated to be £9 per line (or £4.50 per channel). We did not consider it necessary to allow other ISDN2 charges to rise as a result of reducing the ISDN2 transfer charges.<sup>171</sup>

<sup>166</sup> BT, Directions Consultation response, page 12, paragraph 53

<sup>167</sup> BT, Directions Consultation response, page 12, paragraph 53

<sup>168</sup> Fixed Access Statement, Volume 1, paragraph 17.57

<sup>169</sup> Fixed Access Statement, Volume 1 paragraph 17.121.

<sup>170</sup> Fixed Access Statement, Volume 1 paragraph 17.120.

<sup>171</sup> Fixed Access Statement, Volume 1 paragraph 17.142.

- 4.169 Most of the ISDN2 charge controls were set to hold charges constant in nominal terms, and the ISDN2 transfer charge was set based on a benchmark rather than BT's reported costs for ISDN2 transfers. The charges therefore did not involve calculating any adjustment to the underlying FAC of ISDN2 services. We therefore did not propose to make any adjustment in the Regulatory Financial Statements in relation to ISDN2 services.

#### Our proposal

- 4.170 We did not propose to require BT to reflect our decision in relation to ISDN2 charges in the Regulatory Financial Statements or in the Adjusted Financial Performance Schedules.

#### Stakeholder comments

- 4.171 BT disagreed with Ofcom's "proposed exclusion of the steady state adjustment on the ISDN2 and ISDN30 services."<sup>172</sup> BT explained that in its view the proposed exclusion is "an inconsistent treatment of asset values compared with Line Cards."<sup>173</sup> BT argued that significant adjustments should be included with the Regulatory Financial Statements.

#### Ofcom's response and decision

- 4.172 We have addressed BT's submissions about the inconsistent treatment of the assets adjustments in Section 3 and above.
- 4.173 Having considered stakeholders responses we have decided that the ISDN2 adjustments should not be included in either the Regulatory Financial Statements or the Adjusted Financial Performance Schedules.

### **Adjustments made in the 2014 WBA charge control**

#### **Consistency with the 2011/12 cost allocation bases**

- 4.174 We explained in the Directions Consultation that for the WBA market review we used the 2012/13 data restated using the 2011/12 allocations set out in the reconciliation report.

#### Our proposal

- 4.175 We did not propose to require BT to revert to the cost allocation bases used in the 2011/12 Regulatory Financial Statements in the Regulatory Financial Statements or in the Adjusted Financial Performance Schedules for the same reasons that we have already explained in relation to the Fixed Access market review.
- 4.176 We explained that it would be relatively straightforward for interested parties to assess the impact of recent allocation changes through the information that is already made public in the reconciliation reports.

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<sup>172</sup> BT, Directions Consultation response, page 2, paragraph 4

<sup>173</sup> BT, Directions Consultation response, page 2, paragraph 4



## Stakeholder comments

4.177 We have set out for the Fixed Access market review stakeholders' views about the proposals we made about requiring consistency with the 2011/12 cost allocation bases.

## Ofcom's response and decision

4.178 Having considered stakeholders' responses to the December 2014 consultation proposals we have decided:

- not to require BT to revert to the cost allocation bases used in the 2011/12 Regulatory Financial Statements for 2014/15 (and subsequent) Regulatory Financial Statements; and
- not to require BT to estimate and report the impact of these changes in this way in the Adjusted Financial Performance Schedules.

## **SG&A Broadband, ATM customer interface, ATM network interface, ATM network switching, and Inter ATM transmissions<sup>174</sup>**

4.179 In the WBA market review we said that in setting prices we had made adjustments where BT's allocations were inconsistent with our modelling approach.<sup>175</sup> This included SG&A Broadband, ATM customer interface (2Mbit/s, 34Mbit/s, >155Mbit/s), ATM network interface, ATM network switching and Inter ATM transmissions which are cost components used by WBA services.

4.180 We noted that in the Regulatory Financial Statements BT had allocated 2012/13 restated costs using forecasts of revenues and volumes rather than actual revenues and volumes, which we considered to be the appropriate basis for allocation.<sup>176</sup> We therefore updated data provided by BT for both cost components for "actual revenues and volumes".<sup>177</sup>

4.181 The adjustment we made to use actual revenues and volumes to allocate the SG&A Broadband components reduced Market A operating costs by £1.5m and MCE by £2m. The use of actual data to allocate the ATM cost components reduced Market A operating costs by £1.3m and MCE by £5m.<sup>178</sup>

## Our proposal

4.182 We proposed that BT must allocate the SG&A Broadband, ATM customer interface (2Mbit/s, 34Mbit/s, >155Mbit/s), ATM network interface, ATM network switching and Inter ATM transmissions using actual revenues and volumes instead of forecast revenues and volumes information.

<sup>174</sup>WBA Statement, paragraph 7.186 <http://stakeholders.ofcom.org.uk/binaries/consultations/review-wba-markets/statement/WBA-Statement.pdf>

<sup>175</sup> WBA Statement, paragraph 7.8.

<sup>176</sup> WBA Statement, paragraph 7.182.

<sup>177</sup> WBA Statement, paragraph 7.186.

<sup>178</sup> WBA Statement, paragraph 7.186.

### Stakeholder comments

- 4.183 BT noted that it “considers that the use of actual revenues and volumes for ATM and SG&A cost allocations are appropriate in this instance.”<sup>179</sup> There were no comments on this adjustment in any of the other responses we received on the Directions Consultation.

### Ofcom’s response and decision

- 4.184 Having considered stakeholders’ comments we have decided that BT must, in the Regulatory Financial Statements, allocate SG&A Broadband, ATM customer interface (2Mbit/s, 34Mbit/s, >155Mbit/s), ATM network interface, ATM network switching and Inter ATM transmissions using actual revenues and volumes instead of forecast revenues and volumes information.

### **Allocation of IPstream costs between Market A and Market B<sup>180</sup>**

- 4.185 IPstream is a wholesale service that delivers a managed internet access of up to 8 Megabits per second. It uses the legacy Time Division Multiplexing (TDM) network to provide ADSL in conjunction with DSLAMs that are installed in BT’s exchanges.<sup>181</sup> IPstream is being replaced in Market B by WBC services.
- 4.186 In the WBA market review we decided that the allocation of costs to Market A and Market B should be on a dynamic basis. We decided that BT must apportion the costs of IPstream between Market A and Market B according to measures of IPstream usage such as the number of end users, the bandwidth they consume and/or direct asset volumes used to serve those customers.<sup>182</sup> We said that it was not appropriate to allow BT to recover costs from Market A which were incremental to providing IPstream in Market B. In particular we did not consider it was appropriate for BT to recover from Market A the costs of any DSLAMs which, due to the migration to WBC in Market B, are no longer in use.<sup>183</sup> We did not adopt the revised methodology that BT had applied in its 2013 Regulatory Financial Statements. In applying this decision we allocated DSLAM costs which are used to provide services to end users according to the methodology that BT had applied in its 2011/12 Regulatory Financial Statements.

### Our proposal

- 4.187 We proposed that BT must allocate, in its Regulatory Financial Statements, DSLAM Capital/Maintenance costs which are used to provide services to end users according to the actual volumes of DSLAMs in Markets A and B.

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<sup>179</sup> BT, Directions Consultation response, page 12, paragraph 54

<sup>180</sup> WBA Statement, paragraphs 7.177 -7.181.

<sup>181</sup> Asymmetric Digital Subscriber Line (ADSL) technology which provides standard broadband speed services of up to 8 Mbit/s per second. ADSL2+ technology provides faster broadband speed services of up to 24Mbit/s

<sup>182</sup> WBA Statement, paragraph 7.177.

<sup>183</sup> WBA Statement, paragraph 7.180.

## Stakeholder comments

- 4.188 BT argued that “some DSLAM costs are fixed per DSLAM whilst others vary according to the number of customers, however BT acknowledges that the adjustment proposed to DSLAM cost allocation is consistent with the treatment adopted in the WBA charge control.”<sup>184</sup> BT also suggested that “the approach adopted in paragraph 2.2 of the requirements set out on page 68 of Ofcom’s Consultation document should read “the actual volume of DSLAMs in use in each of Markets A and Market B.” This is because it would be inappropriate to allocate costs to DSLAMs that are not in use and are in the process of being decommissioned.”<sup>185</sup>

## Ofcom’s response and decision

- 4.189 We note BT’s concern about the requirement included in the proposed direction. As we explained in the Directions Consultation, the decisions in the WBA market review and our proposal sought to ensure that BT does not recover costs from Market A that are incremental to providing IPstream in Market B. It would be wrong to allocate any capital costs associated with DSLAMs located in Market B to Market A.
- 4.190 As we explain in section 7, new network components have been added to the list where previous components have been split into multiple categories. The DSLAM Capital/Maintenance component has now been split into two new components, DSLAM Support and DSLAM Equipment. The decision in the WBA market review concerned the allocation of the costs of DSLAM Equipment.
- 4.191 The DSLAM Equipment component predominantly covers the capital costs of the DSLAMs (depreciation and mean capital employed). BT’s proposal that the allocation of the costs of DSLAM Equipment on the basis of DSLAMs that are in use in each market could result in some of the costs of DSLAM Equipment being allocated to Market A where DSLAMs are not used in Market B but are located in that market. This would not be consistent with our decision in the WBA market review where we said that “we do not believe it appropriate for BT to recover from Market A the costs of any DSLAMS which, due to migration to WBC in Market B, are no longer in use”.<sup>186</sup> We have therefore decided to adopt our proposed adjustment in respect of DSLAM Equipment by requiring that DSLAM Equipment must be allocated to each of Market A and Market B according to the actual volume of DSLAMs in each of Market A and Market B.
- 4.192 DSLAM Support in contrast will include other costs associated with running DSLAMs such as maintenance and power costs, as well as some capital costs associated with support assets, for example accommodation plant. As set out above, we did not consider these costs associated with DSLAMs in the WBA market review. It may be more cost causal to allocate this component in a different way to DSLAM Equipment. BT’s comment about the allocation of DSLAM costs according to the actual volume of DSLAMs in use in each market may be appropriate for the DSLAM Support component. In considering the appropriateness of such allocation of the costs of DSLAM Support, BT should consider as required under the SMP conditions whether such allocation is in accordance with the Regulatory Accounting Principles.

<sup>184</sup> BT, Directions Consultation response, page 12, paragraph 54

<sup>185</sup> BT, Directions Consultation response, page 12, paragraph 55

<sup>186</sup> WBA Statement, paragraphs 7.180.

- 4.193 Having considered stakeholders' responses we have decided to require BT to allocate the costs of DSLAM Equipment which are used to provide services to end users according to the actual volume of DSLAMs in each of Market A and Market B.

### **Market A market size adjustment<sup>187</sup>**

- 4.194 In the WBA market review we ensured that input cost data for Market A reflected the current services being provided within it. In the WBA market review we made an adjustment to ensure that the costs of serving WBA fibre customers within Market A who are served by exchanges in Market B, were allocated to the correct market - Market B.

### **Our proposal**

- 4.195 We proposed that BT must allocate, in its Regulatory Financial Statements, the cost of serving WBA customers to markets on the basis of the location of the exchange from which they receive service. This may be different to the exchange area in which they are located. For example the costs for a customer who resides in a Market A exchange area but whose broadband services are provided from a Market B exchange should be allocated to Market B.

### **Stakeholder comments**

- 4.196 There were no stakeholder comments about this proposed adjustment.

### **Ofcom's response and decision**

- 4.197 We have decided that BT must allocate in the Regulatory Financial Statements the costs of serving WBA customers to markets on the basis of the location of the exchange from which they receive service.

### **21CN Costs and the future benefits principle<sup>188</sup>**

- 4.198 21CN costs relate to the capital and operating costs of installing and maintaining BT's 21CN Network. Originally BT planned to replace its legacy TDM voice and data networks with a single IP network. For example BT planned to replace DSLAM equipment with MSAN equipment. WBC services have been available in some parts of the UK since 2008 and BT has deployed MSANs in many exchange areas to provide WBC services.
- 4.199 In the WBA market review we found that BT had allocated some 21CN costs to WBA services, notably IPstream services, which did not use 21CN equipment, on the basis of "future benefits."<sup>189</sup> The future benefits principle assumed that, as IPstream users might migrate to WBC services in the future, they should pick up a share of the costs of establishing the 21CN platform before they migrate.

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<sup>187</sup> WBA Statement, paragraphs 7.197 -7.205.

<sup>188</sup> WBA Statement, paragraphs 7.213 – 7.221.

<sup>189</sup> This allocated costs relating to new 21CN technology to legacy services, such as IPstream Connect, on the basis that 21CN based services might replace these legacy technologies in the future. This is based on the idea that customers who currently use legacy services will benefit from investments in new 21CN technology once they switch to services based on the new technology – see WBA Statement, paragraph 7.219.

- 4.200 Within the charge control model we decided that this was not appropriate and we excluded the costs of 21CN equipment that were not used to supply IPstream services.<sup>190</sup> We also did not include EOI charges that BT had allocated within its Regulatory Financial Statements on a future benefits basis within the compliance formulae.<sup>191</sup>
- 4.201 In the Directions Consultation we explained that we did not consider the ‘future benefits’ principle is appropriate for allocating costs to regulated services. As we set out in the 2014 Statement “we consider that we need a record of BT’s actual costs.”<sup>192</sup> The ‘future benefits’ principle moves away from actual costs to hypothetical costs based on customers potentially migrating to new technology in the future.
- 4.202 We also noted that the “future benefits principle” is used to allocate costs in other markets and that we expected BT to no longer use the “future benefits” principle to allocate costs in other markets. We also provided some guidance on how we would expect BT to allocate the costs of various components to services.

### Our proposal

- 4.203 We proposed that BT must only allocate, in its Regulatory Financial Statements, 21CN costs to services that currently use that technology, such as WBC. We proposed that 21CN costs must not be allocated using the ‘future benefits’ principle to IPstream Connect or to any other services that are not provided using 21CN technology. This principle should apply to all 21CN costs including CCA adjustments such as holding gains and losses, and EOI charges.

### Stakeholder comments

- 4.204 BT disagreed that “Ofcom should “expect BT to no longer use the future benefit’s” principle to allocate costs in other markets.”<sup>193</sup> It argued that “accounting costs can send false economics signals, in particular exaggerating the costs of new services.”<sup>194</sup> BT quoted Ofcom’s 26 September 2013 Fixed Narrowband statement in which we said that “As a result, in periods of low utilisation unit costs are relatively high and in periods of high utilisation unit costs are low.”<sup>195</sup>
- 4.205 BT then went on to argue that “Ofcom’s response to this issue ... has been to use economic depreciation which matches the cost of equipment to its actual and forecast use over the longer term. ... Ofcom has justified this treatment on the basis that this approach provides better economic signals as to underlying costs.”<sup>196</sup>
- 4.206 Finally BT argued that both economic depreciation and the future benefits principle are equally hypothetical approaches. BT said that “the difference is only that future benefits forecasts volumes are based on an objective measure (volumes from migration at legacy service levels), whilst Ofcom appears to forecast volumes based on its view of long run levels. If economic depreciation can be justified in certain circumstances, then there is no good reason why future benefits cannot. To simply

<sup>190</sup> WBA Statement, paragraph 7.221.

<sup>191</sup> WBA statement, Annex 2 Legal Instruments, Annex to Condition 7, Part C.

<sup>192</sup> 2014 Statement, paragraph 3.23.

<sup>193</sup> BT, Directions Consultation response, page 8, paragraph 34

<sup>194</sup> BT, Directions Consultation response, page 8, paragraph 34

<sup>195</sup> Footnote 807, Review of the fixed narrowband services markets, Statement on the proposed markets, market power determinations and remedies, 26 September 2013.

<sup>196</sup> BT, Directions Consultation response page 9, paragraph 36

proscribe 'future benefits' without consideration of the facts as they apply in each case is not warranted, and has not been justified by Ofcom.”<sup>197</sup>

- 4.207 Vodafone viewed “21CN costs as largely historic, belonging to a technology program that largely failed to deliver its overall objectives.” Vodafone therefore considered these as “legacy costs that should be removed from regulatory reporting in as far as is possible.”<sup>198</sup>

### Ofcom's response and decision

- 4.208 Stakeholders did not comment on our proposal not to allow BT to allocate costs using the future benefits principle in the WBA market. We have therefore decided to adopt the proposal that we made in the Directions Consultation.
- 4.209 With respect to BT's more general point about allocations on a future benefits basis we accept that accounting costs can send inappropriate economic signals. Indeed we consider each market on its own merits and have made adjustments to accounting costs when setting prices for charge controls when we consider that doing so will provide better economic signals. The adjustments include, for example, adoption of a hypothetical ongoing network approach or an economic approach to depreciation.
- 4.210 We disagree that allocating costs on a future benefits basis, as BT used to do in WBA markets, is similar to economic depreciation. Under economic depreciation the profile of cost recovery reflects the future demand for that product. If demand is likely to be lower at the start of the asset's life than under an economic depreciation approach less costs will be recovered at the start and relatively more towards the end of the asset's life. But the costs are recovered from the services that use the asset.
- 4.211 In contrast under BT's future benefits principle the profile of cost recovery is not adjusted. Rather the amounts recovered from the services that use the assets are reduced at the start of the asset's life but only by recovering costs from services that do not use the asset.
- 4.212 Further we note that BT's 21CN assets, which are used to provide WBC services, appear to be ✂<sup>199</sup>. Given that the use of these assets is increasing and would have been expected to increase over their lives then an economic depreciation approach could be expected now to result in higher depreciation charges than those under BT's straight line policy.
- 4.213 We note also that BT could have chosen not to use straight line depreciation to recover the costs of these assets. If BT felt that it would have been more appropriate to recover more costs towards the end of these assets lives when volumes were higher then it could have adjusted the depreciation to do so. Such methods are allowed under IAS 16. Doing so would have provided a cost recovery profile closer to an economic approach to depreciation than under BT's future benefits basis.
- 4.214 It is not appropriate to allocate costs for assets and activities away from services that use those assets and services to services that do not. We do not agree that BT's future benefits allocation is “no different in principle to Ofcom's use of forecast costs

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<sup>197</sup> BT, Directions Consultation response page 9, paragraph 37

<sup>198</sup> Vodafone, Directions Consultation response page 5, paragraph 13

<sup>199</sup> Source: BT's Additional Financial Information Schedule, number 11 for 2013/14.

over the longer term”<sup>200</sup>. When Ofcom has applied an economic approach to depreciation costs it has been to set prices that better mimic the outcomes of a competitive market and consequently send economically efficient pricing signals. We do not agree that BT’s approach will necessarily mimic the outcomes of a competitive market nor provide appropriate pricing signals for either the services that use the relevant assets or those services that are not using the assets but are allocated some of the asset’s costs. Consequently we do not consider that BT’s future benefits approach is an appropriate way to allocate costs for 21CN services. We will consider any application of the future benefits principle by BT in future on a case by case basis taking into account all of the relevant factors and circumstances. However, given our above concerns about the application of the future benefits principle, we are unlikely to consider such application as appropriate in future market reviews or should such an allocation be proposed through change control.

### **Hypothetical ongoing network.**<sup>201</sup>

4.215 In the WBA Statement we explained that we had made a hypothetical ongoing network (HON) adjustment, consistent with our anchor pricing approach. This adjustment increases BT’s actual costs by adding capital employed and depreciation into the model.<sup>202</sup>

### Our proposal

4.216 We said that reflecting the HON adjustment in the Regulatory Financial Statements would decrease the usefulness of those statements as a source of data for future decisions, while reducing their transparency to stakeholders, as it would replace BT’s incurred costs with a hypothetical estimate of the costs and asset values under different assumptions. It could therefore leave to BT’s judgement and discretion how to reflect an adjustment that by its nature may need to be re-considered by Ofcom at a later date depending on the market circumstances and policy objectives at the time. We therefore proposed that the HON adjustment should not be included in the Regulatory Financial Statements.

4.217 This adjustment could have a significant impact at a market review level. We therefore consider that it is important for stakeholders to understand its impact.

4.218 For the purposes of the Adjusted Financial Performance Schedules, we proposed that BT must calculate the aggregate impact of the three changes on the returns and MCE in the WBA market review and in WBA Market A and B as follows:

- firstly BT must set the Gross Replacement Cost (GRC) of DSLAMs at their current average costs of DSLAMs;
- secondly BT must uplift and maintain the NRC:GRC ratio (Net Replacement Cost: GRC) at 50% for ATM, SDH and DSLAM assets;
- thirdly BT must use an asset life of 13 years when depreciating these assets.

<sup>200</sup> BT, Directions Consultation response, page 9, paragraph 37.

<sup>201</sup> WBA Statement, paragraphs 7.226 – 7.235.

<sup>202</sup> WBA Statement, paragraph 7.8.

## Stakeholder comments

- 4.219 BT said that “in making the adjustment to the GRC of DSLAMs, BT considers that the current replacement cost of DSLAMs should be used rather than the “current average cost” as the GRC should reflect the cost of replacing the existing stock of DSLAMs on a like for like basis using the most recently available DSLAM cost information. With the number of new DSLAMs likely to be very small, use of a “current average cost” may distort the valuation as newly commissioned DSLAMs may not be typical of the installed based.”<sup>203</sup>
- 4.220 Vodafone said that it was “important for stakeholders to understand this adjustment through additional reporting requirements, but recognise that it would not be appropriate to include it within the RFS output.”<sup>204</sup>

## Ofcom's response and decision

- 4.221 We explained in Section 3 that we would not expect to see an adjustment (such as the HON adjustment) reflected in the Regulatory Financial Statements if the adjustment had the effect of replacing BT's actual costs with an alternative estimate of cost. We said that in such cases we would expect to see the adjustment reflected in the Adjusted Financial Performance Schedules.
- 4.222 The Regulatory Financial Statements should remain a record of BT's incurred costs. We have therefore decided to adopt the proposal we set out in the Directions Consultation and require BT to continue to publish its costs for the WBA market as it currently does, i.e. not on a HON basis.
- 4.223 However, we believe there is some merit in BT's comments concerning the revaluation of DSLAMs for the HON adjustment within the Adjusted Financial Performance Schedules. In the WBA Statement we noted that currently BT does not revalue its DSLAMs. DSLAM valuations reflect historic costs rather than a more forward looking, replacement cost approach.<sup>205</sup> For the WBA Statement we analysed expenditure on DSLAMs over the last three years (which BT said would understate average unit costs) and expenditure since 2006/7.<sup>206</sup> Both measures reduced the average unit cost compared with the average calculated on a historic cost basis, reflecting the reduction in DSLAM prices since they were first introduced.
- 4.224 We accept that, going forward, expenditure on new DSLAMs to provide IPstream services is likely to be small and that our proposal seeks to estimate the current replacement cost of DSLAMs used to provide IPstream services. We would expect estimates of the current average cost of a DSLAM to be similar or below what we calculated from BT's capital expenditure on DSLAMs since 2006/7.
- 4.225 We have therefore decided to accept BT's proposed rewording in the requirement to provide that the GRC should be set at “the current replacement cost of DSLAMs” and not at the average current cost of DSLAM as we proposed.

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<sup>203</sup> BT, Directions Consultation response, page 12, paragraph 56

<sup>204</sup> Vodafone, Directions Consultation response page 5, paragraph 14

<sup>205</sup> See for example paragraph 7.231 of the WBA statement.

<sup>206</sup> See for example paragraph 7.234 of the WBA statement.



## Other CCA adjustments

- 4.226 BT's Regulatory Financial Statements are prepared on a CCA basis. CCA depreciation includes supplementary depreciation and holding gains and losses as a result of the revaluation of assets. However, occasionally there are also some one-off, non-recurring adjustments made by BT. These are referred to as 'Other CCA adjustments' in BT's Regulatory Financial Statements.<sup>207</sup> In the WBA market review we excluded these 'Other CCA adjustments' from the base year data so that we could forecast IPstream Connect CCA operating costs in Market A using the CCA adjustments that would be typically reoccurring each year.<sup>208</sup>

## Our proposal

- 4.227 BT's inclusion of 'Other CCA adjustments' within the Regulatory Financial Statements complies with CCA accounting principles and we therefore considered that it was for BT to decide whether or not they should be included. Therefore, we did not propose that the Regulatory Financial Statements should reflect our decision made in the WBA market review that the 'Other CCA adjustments' should be excluded.
- 4.228 However, we considered that requiring BT to calculate the impact of removing 'Other CCA adjustments' from the WBA markets would provide us and stakeholders with information about how the costs of Market A services are affected by one off CCA adjustments on annual basis.
- 4.229 As a result we proposed that BT must calculate the impact of removing 'Other CCA adjustments' from the WBA markets and that the Adjusted Financial Performance Schedule must reflect this adjustment.
- 4.230 For the purposes of the Adjusted Financial Performance Schedules, we proposed that BT must recalculate the impact of removing 'Other CCA adjustments' in the Regulatory Financial Statements as if these adjustments had not been made.

## Stakeholder comments

- 4.231 BT said "Other CCA adjustments are genuine costs within the WBA market but were only excluded from the base year costs when setting prices. This was because other CCA adjustments are usually one-off or non-recurring costs, such as the cumulative effect of changing a CCA valuation methodology, and so were excluded from the charge control modelling."<sup>209</sup>
- 4.232 BT argued "there is no reason why these costs should not be included when evaluating the Financial Performance of the WBA markets as these form part of the total costs under CCA accounting principles. Therefore, other CCA adjustments should not be excluded from the additional schedules."<sup>210</sup>

<sup>207</sup> Current Cost Financial Statements for 2014 including Openreach Undertakings. Section 5.1 <http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2014/index.htm>

<sup>208</sup> WBA Statement, paragraph 7.194.

<sup>209</sup> BT, Directions Consultation response, page 7, paragraph 29

<sup>210</sup> BT, Directions Consultation response, page 7, paragraph 29

- 4.233 Vodafone said that it was “important for stakeholders to understand this adjustment through additional reporting requirements, but recognise that it would not be appropriate to include it within the RFS output.”<sup>211</sup>

### Ofcom’s response and decision

- 4.234 Stakeholders did not argue that Ofcom should require BT to exclude “Other CCA adjustments” from the Regulatory Financial Statements. As we explained in the Directions Consultation, the inclusion of “Other CCA adjustments” in the Regulatory Financial Statements complies with CCA accounting principles and it is therefore for BT to decide whether or not they should be included. The Regulatory Financial Statements should not reflect our decision made in the WBA market review to exclude ‘Other CCA adjustments’.
- 4.235 While we agree with Vodafone we do not agree with BT about the reporting of these adjustments within the Adjusted Financial Performance Schedule. The published schedule will show the impact on the reported results of making further regulatory adjustments. Reflecting this adjustment is consistent with the approach we adopted when setting the WBA charge control. Such exclusions may increase or reduce costs and hence reduce or increase profitability. In the case of WBA charge control we would not expect these adjustments to be large.
- 4.236 Having considered stakeholders responses we therefore decided that in the Adjusted Financial Performance Schedule BT must set out the impact of removing ‘Other CCA adjustments’ in the Regulatory Financial Statements as if these adjustments had not been made.

## Summary of Ofcom’s decisions and legal tests

- 4.237 Having considered stakeholders’ responses to the proposals set out in the Directions Consultation we have decided that the regulatory decisions made in the Fixed Access Statement should be reflected in BT’s Regulatory Financial Reporting as follows:

**Table 2. Summary of decisions for adjustments in the Fixed Access Statement**

Market Review Adjustment	Required in Regulatory Financial Statements	Required in additional reporting	Not included in Regulatory Financial Statements or additional reporting
2011/12 cost allocation rules			X
Internal SMPF volumes	X		
Telephone Directories	X		
DSLAM capital/maintenance	X		

<sup>211</sup> Vodafone, Directions Consultation response, page 5, paragraph 15

Group overheads	X	
Deafness provision	X	
Cumulo rates	X	
Test Access Matrix Costs	X	
Evolutionary Test Access Matrix Costs	X	
Simultaneously provided services	X	
Combined fault and service level allocations	X	
Test Access Matrix Mark up		X
Line Cards		X
LRIC differential		X
Caller Display		X
Migrations and WLR Transfers		X
LRIC adjustments and recovery of common cost		X
SMPF		X
Absolute valuation of Copper		X
ISDN30 pricing		X
ISDN2 pricing		X

4.238 In summary, we propose that the regulatory decisions made in the WBA Statement should be reflected in BT's regulatory reporting as follows:

**Table 3. Summary of decisions for adjustments in the WBA Statement**

Market Review Adjustment	Required in Regulatory Financial Statements	Required in additional reporting	Not included in Regulatory Financial Statements or additional reporting
2011/12 cost allocation rules			X
SG&A Broadband, ATM	X		

<b>customer interface, ATM network interface, ATM network switching, and Inter ATM network transmissions</b>		
<b>Allocation of IPstream costs between Market A and Market B</b>	X	
<b>Market A market size adjustment</b>	X	
<b>21 CN Costs and the future benefits principle</b>	X	
<b>Hypothetical ongoing network</b>		X
<b>Other CCA adjustments</b>		X

4.239 We have considered our decisions about the Consistency with Regulatory Decisions Direction against the tests set out in section 49(2) of the Act and have concluded that they are:

- Objectively justifiable because we have previously established the need for the Regulatory Financial Statements to be consistent with regulatory decisions and these decisions specify the regulatory decisions with which the Regulatory Financial Statements need to be consistent. The proposed Consistency with Regulatory Decisions Direction will establish further detail and will also provide BT with clarity as to the implementation of Principle 4 of the Regulatory Accounting Principles until the Regulatory Accounting Guidelines have been established.
- Not unduly discriminatory because KCOM is the only other SMP provider which has regulatory accounting obligations, but it is currently not required to ensure its Regulatory Financial Statements are consistent with our regulatory decisions which concern KCOM.
- Proportionate because our decisions which see us specifying the regulatory decisions with which the Regulatory Financial Statements need to be consistent, are no more than is required to ensure consistency with regulatory decisions. While we are specifying the regulatory decisions with which the Regulatory Financial Statements need to be consistent, BT retains an important role in determining the basis of preparation of the Regulatory Financial Statements.
- Transparent because it is clear that the intention of our decisions is to ensure that the Regulatory Financial Statements are consistent with regulatory decisions.

4.240 We have considered our decisions about the Adjusted Financial Performance Schedules against the tests set out in section 49(2) of the Act and have concluded that they are:

- Objectively justifiable because we have previously established that some disclosure of BT's financial performance from a regulatory perspective is appropriate and these proposals specify the detail which will enable BT to produce the additional statement. Our decisions concerning Schedule 2 of the Adjusted Financial Performance Schedules to be provided to us in private seek to enable us to understand the way in which BT has prepared the published Adjusted Financial Performance Schedule.
- Not unduly discriminatory because KCOM is the only other SMP provider which has regulatory accounting obligations, but we have not at present established the need for such regulation.
- Proportionate because our decisions which see us specifying the detailed requirements which will enable BT to produce the Adjusted Financial Performance Schedules, are no more than is required to provide stakeholders with a better understanding of BT's financial performance from a regulatory perspective and to enable us to understand the way in which BT has prepared the published Adjusted Financial Performance Schedule.
- Transparent because it is clear that the intention of our decisions is to ensure that stakeholders can gain a better understanding of BT's financial performance from a regulatory perspective and that we are able to understand the way in which BT has prepared the published Adjusted Financial Performance Schedule.

4.241 We have also considered how our decisions meet the tests in Section 3, 4 and 4A of the Act.

4.242 Our decisions concerning consistency with regulatory decisions are designed to ensure that the Regulatory Financial Statements are aligned with Ofcom's regulatory decisions. They seek to ensure that decisions taken in the Fixed Access and the WBA market reviews are reflected in the accounts where appropriate. The proposals thereby seek to ensure the Regulatory Financial Statements remain relevant, thereby increasing transparency. Ultimately, this promotes competition.

4.243 Our decisions concerning BT's additional reporting are designed to give stakeholders a better understanding of BT's financial performance from a regulatory perspective. The decisions thereby seek to ensure that the Regulatory Financial Statements remain relevant and that we are able to understand the way in which BT has prepared the published Adjusted Financial Performance Schedule. The decisions therefore increase transparency, ultimately promoting competition.

4.244 As noted above, in deciding on these changes we have taken into account all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive, in particular Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications.

4.245 In consequence Ofcom believes the directions meet the tests in Sections 3, 4 and 4A.

## Section 5

# VULA Reporting

## Introduction

- 5.1 In the Directions Consultation we proposed to impose regulatory reporting requirements on BT in connection with Virtual Unbundled Local Access (VULA) services.<sup>212</sup>
- 5.2 We said that in the Fixed Access market review we found BT to have SMP in the WLA market. As a result of BT's SMP in this market, we required BT to provide VULA on fair and reasonable terms, conditions and charges,<sup>213</sup> on a non-discriminatory and EOI basis.<sup>214</sup> We imposed a charge control on Generic Ethernet Access (GEA) migration services (VULA Migrations) and cost accounting and accounting separation conditions in the WLA market which apply to VULA services.<sup>215</sup>
- 5.3 We said that the current WLA market review period is likely to be important for competition in superfast broadband. It is important that BT maintains appropriate and reliable accounts that capture information on an ongoing basis relevant to its provision of VULA. In addition, we said it is important that we are provided with additional information in order to monitor compliance with and the effectiveness of the remedies imposed, particularly our decisions to provide BT with pricing flexibility and to require fair and reasonable VULA charges on a non-discriminatory basis.
- 5.4 We said that that this information will:
- Provide transparency to us regarding how BT has allocated costs across services and mitigates against the risk of double recovery of costs or that costs might be unreasonably allocated to particular services.
  - Be a useful source of information and will serve as an anchor point to reconcile other data with in order to support our decision making in relation to VULA.
- 5.5 We said that additional VULA reporting is required to implement the outcome of the Fixed Access market review and to provide further information to us in private.

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<sup>212</sup> VULA provides access to BT's NGA network in a way that is similar to how LLU provides access on its current Copper Access network. However, rather than providing a physical line, VULA provides a virtual connection that gives CPs a direct link to their customers and provides flexibility over how this link is integrated into their network and over product offerings.

<sup>213</sup> With the exception of the GEA migration charge where we additionally imposed a charge control and contract term restrictions following a GEA migration.

<sup>214</sup> SMP conditions 1.1. and 1.2 – Network access on reasonable request, condition 4 – No undue discrimination and condition 5 – Equivalence of Inputs basis, Fixed Access Statement, Annex 29;

<sup>215</sup> Fixed Access Statement, Volume 1, paragraphs 10.216 – 10.223 set out our decisions on accounting separation obligations and paragraphs 10.363 – 10.373 set out our decisions on cost accounting obligations; SMP condition – Regulatory Financial Reporting imposed these obligations on BT.

## Public information

- 5.6 We proposed that BT must disclose the revenue, volume, average price and FAC of each of VULA and VULA Migrations (market summary in the Regulatory Financial Statements).
- 5.7 In addition, we proposed that BT must disclose all network components and FAC of VULA Migrations (calculation of FAC based on component costs and usage factors for the WLA market in the Regulatory Financial Statements).

## Private information

- 5.8 We proposed that BT should provide to us three new schedules as part of its Regulatory Financial Reporting as follows:
- The first schedule would set out the revenues, volumes and fully allocated costs on a CCA basis of Fibre to the Cabinet (FTTC) and Fibre to the Premises (FTTP) connections, rentals, migrations and other VULA services. The revenues and costs should, in total, be reconciled to the revenues and costs included within the publicly reported totals for the WLA market.
  - The second schedule would set out the calculation of FAC based on component costs and usage factors for all services reported under the first schedule except the other VULA services. The fully allocated service unit costs should reconcile to those given in the first schedule.
  - The third schedule would set out how BT has allocated the government grants, for example from BDUK, for the rollout of superfast broadband services to provide VULA services.
- 5.9 In this Section we set out our decisions and in doing so respond to comments made by stakeholders.

## Stakeholder comments

- 5.10 BT agreed that “VULA should be reported within the WLA market” and that “the revenue, volume, average price and FAC of VULA migrations should be disclosed”. BT noted that “such disclosure should only relate to VULA migrations, because this is the only charge controlled VULA service within the WLA market.”<sup>216</sup> BT made a reference to the Fixed Access market review,<sup>217</sup> where we said that: “going forward, it was important that VULA is separately identified in BT’s cost allocation, to ensure that common costs are correctly allocated across the suite of regulated services which are subject to pricing obligations. However, we also said that BT would not be publically required to report these.”<sup>218</sup>
- 5.11 BT proposed that other VULA services (excluding VULA migration services) should be reported within “WLA other.”<sup>219</sup> The Regulatory Financial Statements would report the internal and external revenue, and FAC costs would be included within the WLA market in total.

<sup>216</sup> BT, Directions Consultation response, page 13, paragraphs 60 and 61

<sup>217</sup> Fixed Access Statement, Volume 1, paragraph 12.213.

<sup>218</sup> Directions Consultation, page 28, paragraph 5.3.

<sup>219</sup> BT, Directions Consultation response, pages 13-14, paragraph 63

- 5.12 BT agreed that detailed public reporting of FACs for VULA services and information on BDUK grant income should be limited to Ofcom. BT noted that this was consistent with what we wrote in the Fixed Access market review.<sup>220</sup>
- 5.13 Sky was concerned that we should consider whether the proposed VULA reporting obligations should be amended to capture VULA margin reporting requirements. Sky said “while BT will be subject to separate monitoring obligations in relation to the VULA margin control, it is important for Ofcom to maintain, to the extent that is practicable, the VULA reporting requirements within BT’s financial reporting obligations to ensure effective monitoring.”<sup>221</sup>
- 5.14 UKCTA explained that “VULA is a key concern of UKCTA members, being a product that competes with more heavily regulated services, sharing a large amount of common costs and benefitting from a substantial amount of state aid.”<sup>222</sup> UKCTA argued that a more detailed consultative approach would be welcomed to identify appropriate reporting requirements and make sure that they are in place at the right time.
- 5.15 TalkTalk agreed “that VULA reporting is important.” More specifically that it “is important for Ofcom and stakeholders to be able to identify whether VULA prices are constrained” and that reporting will be important to provide a robust evidence base for setting any future charge control.<sup>223</sup>
- 5.16 TalkTalk did not consider that this information was confidential or how its disclosure could commercially advantage others given BT’s SMP position.<sup>224</sup>
- 5.17 TalkTalk argued that average price and cost data should be provided for GEA (FTTC) connections, rentals and migration services with information for GEA (Fibre to the home) and GEA Fibre to the Distribution Point (FTTdp) if offered reported separately. Subsidies, such as BDUK grants should be shown separately and data provided on the key assumptions underpinning the costs such as depreciation rates and allocations of duct costs.<sup>225</sup>
- 5.18 Vodafone set out its view that “a sound regulatory accounting approach is especially important in newer markets, such as VULA, which are expected to grow substantially in the years ahead.”<sup>226</sup> Further it noted that “given the extent of common infrastructure VULA shares with other services (duct, copper etc.) and the fact that it has been laid down in part with a public subsidy, it is imperative that stakeholders and taxpayers are provided with the right level of transparency over the underlying costs of the service.”<sup>227</sup>
- 5.19 In its more detailed comments about VULA reporting Vodafone said it is “imperative that communications providers have transparency around its cost of provision.”<sup>228</sup> Vodafone welcomed “the publication of revenue, volume, average price and FAC of each VULA service & VULA migration, based on the component information and

<sup>220</sup> BT, Directions Consultation response, page 14, paragraph 64

<sup>221</sup> Sky, Directions Consultation response, page 1, paragraphs 1.6 and 1.7

<sup>222</sup> UKCTA, Directions Consultation response, page 1, paragraph 2

<sup>223</sup> TalkTalk, Directions Consultation response, page 2, paragraphs 4.1 and 4.2

<sup>224</sup> TalkTalk, Directions Consultation response, page 3, paragraph 4.4

<sup>225</sup> TalkTalk, Directions Consultation response, page 3, paragraph 4.4

<sup>226</sup> Vodafone, Directions Consultation response, page 2, paragraph 3

<sup>227</sup> Vodafone, Directions Consultation response, page 2, paragraph 3

<sup>228</sup> Vodafone, Directions Consultation response, page 5, paragraph 16



usage factors for the WLA market.” Vodafone also believed that “the CCA based information should be disclosed as well as details of the government grants from BDUK and other sources to enable roll out. Keeping this information private is not in the public interest as disclosure will not lead to any adverse consequences and will promote transparency around a critical and evolving product.”<sup>229</sup>

5.20 The Bit Commons response focussed on the reporting of government grants. Their response made four recommendations:

- “Ofcom should consider a report for FTTC and other copper dependent variants and a separate report for FTTP.”<sup>230</sup>
- “The private schedule should include the impact of state aid on VULA wholesale prices.”<sup>231</sup>
- “The final Ofcom decision when published should include an illustrative example of the impact of the £1.7bn state aid” and that “Ofcom should use this measure in support of ensuring BT do not game or graze on state aid funds.”<sup>232</sup>
- Ofcom should create a reliable public record of NGA investment. This would include for example a record of annual investment by Openreach, annual BT investment in NGA, annual public funding of NGA together with various volume metrics such as premises capable of receiving superfast broadband.<sup>233</sup>

## Ofcom’s response and decision

### **Public information**

- 5.21 The degree to which we are able to publish information about VULA is central to stakeholders’ concerns. Related to this is the extent of the information we require BT to report privately.
- 5.22 Stakeholders other than BT were seeking more extensive public reporting of the costs and revenues of VULA services. In contrast BT referred in its response to the Fixed Access Statement and noted that we had said that it was important that VULA was separately identified in BT’s cost allocation but that BT would not be publically required to report these. We agree with BT’s submission that in order to implement the outcome of the Fixed Access market review, BT should not be required to separately identify and disclose revenue, volume, average price and FAC of VULA in the Market Summary in the Regulatory Financial Statements.
- 5.23 We agree with BT that VULA services (with the exception of VULA Migrations) should be reported within the WLA market in the Regulatory Financial Statements. These services are currently reported in the Wholesale Residual markets. We consider that the revenues, costs and capital employed of these VULA services should be included in “Other” category in the “Market Summary” statement for the WLA market.

<sup>229</sup> Vodafone, Directions Consultation response, page 6, paragraph 11

<sup>230</sup> The Bit Commons, Directions Consultation response, page 2, paragraph 7

<sup>231</sup> The Bit Commons, Directions Consultation response, page 2, paragraph 10

<sup>232</sup> The Bit Commons, Directions Consultation response, page 2, paragraph 13

<sup>233</sup> The Bit Commons, Directions Consultation response, pages 3 and 4, paragraph 13

- 5.24 In light of the above, we consider that it would be inconsistent with the outcome of the Fixed Access market review to impose any additional disclosure requirements in relation to VULA services.
- 5.25 Having considered stakeholders' responses in relation to VULA Migrations, we have decided to adopt our proposals. BT must therefore:
- publish the revenue, volume, average price and FAC of VULA Migrations ("Market Summary" in the Regulatory Financial Statements); and
  - disclose all network components and FAC of VULA Migrations (calculation of FAC based on component costs and usage factors for the WLA market in the Regulatory Financial Statements).
- 5.26 We also note that stakeholders other than BT consider that it is important to understand the extent to which government grants have contributed to the roll-out of NGA. Nevertheless, a consultation implementing those regulatory reporting requirements arising from the Fixed Access market review is not the appropriate mechanism to consider if, and how greater transparency about government grants can be achieved.
- 5.27 As a consequence we cannot agree to The Bit Commons proposal that we require a reliable public record of NGA investment.

### **Private information**

- 5.28 Stakeholders other than BT submitted that some of the information about VULA services, which we proposed should be provided to us in private, should instead be made public. However, as explained above, we consider that any additional disclosure requirements in relation to VULA services would be inconsistent with the outcome of the Fixed Access market review. BT agreed that detailed public reporting of FACs for VULA services and information on BDUK grant income should be limited to Ofcom.
- 5.29 With regard to the four recommendations made by The Bit Commons, we note the following:
- The proposed first and second private schedules will provide us with information on both FTTC and FTTP services. As a result we will understand how BT allocates costs to these services. This data is as specified within The Bit Commons' first recommendation. We also note that this information is consistent with the type of information which TalkTalk has suggested should be provided. We would expect BT also to provide information on FTTdp services to the extent these are introduced over the next 2-3 years.
  - While we have decided not to adopt The Bit Commons' third and fourth recommendations the proposed third schedule will provide us with greater transparency about how BT has treated government grants. This will enable us to determine the impact on VULA costs (The Bit Commons second recommendation) and addresses some of the key concerns raised by other stakeholders. The information provided in private in this schedule will allow Ofcom to understand how BT accounts for government grants and deter double or inappropriate allocation of costs. It will allow us to construct a history of BT's use of government grants and their impact on VULA costs.

5.30 We have also considered Sky's point about reporting obligations to capture VULA margin reporting requirements. Our final Statement on the "Fixed Access Market Reviews: Approach to the VULA margin"<sup>234</sup> has been published. Reporting and information requirements to support the calculation of the margin between the wholesale VULA price and retail superfast broadband prices have been set out in that statement.

### Ofcom's decision

5.31 Having considered stakeholders' responses we have decided that BT must:

- include the internal and external revenues and FAC costs of VULA services in "Other" category in the "Market Summary" statement in the Regulatory Financial Statements; and
- publish the revenue, volume, average price and FAC of VULA Migrations ("Market Summary" in the Regulatory Financial Statements) and disclose all network components and FAC of VULA Migrations ("Calculation of FAC based on component costs and usage factors" for the WLA market in the Regulatory Financial Statements).

5.32 We have also decided to adopt the proposal that we set out in the Directions Consultation. BT must provide three schedules in private which in summary will provide:

- information on the volumes, revenues, costs, MCE and returns of both FTTC and FTTP services;
- detailed FAC cost component information of both FTTC and FTTP services;
- Information on how BT has treated government grants and the impact of this treatment on VULA costs.

5.33 We will be confirming the exact details of these schedules with BT in due course.

### Legal tests

5.34 We have considered our decisions against the tests set out in section 49(2) of the Act and have concluded that they are:

- Objectively justifiable because by amending reporting requirements we reflect the decisions of the Fixed Access market review and recognise the growing importance of VULA over this market review period. Our decisions concerning the additional information to be provided to us in private seek to ensure that we have the information which we need to carry out our functions.
- Not unduly discriminatory because BT is the only SMP provider who has SMP obligations in relation to VULA services.

<sup>234</sup> [http://stakeholders.ofcom.org.uk/binaries/consultations/VULA-margin/statement/VULA\\_margin\\_final\\_statement.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/VULA-margin/statement/VULA_margin_final_statement.pdf)

- Proportionate because the changes are no more than is required in order to implement the decisions of the Fixed Access market review and to ensure that we have the information which we need to carry out our functions, and do not extend beyond these.
  - Transparent because it is clear that the intention is to make sure that the Regulatory Financial Statements remain fit for purpose and adequately reflect the outcomes of the Fixed Access market review and that we have the information which we need to carry out our functions.
- 5.35 We have also considered how our decisions meet the tests in Section 3, 4 and 4A of the Act. Our decisions relating to reporting of the VULA services seek to ensure that decisions taken in the Fixed Access market review are reflected in the Regulatory Financial Statements, and that Ofcom has the information it needs to carry out its functions. The decisions therefore increase transparency vis-à-vis other stakeholders, ultimately promoting competition.
- 5.36 As noted above, in introducing these changes we have taken into account all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive, in particular Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications.
- 5.37 In consequence Ofcom believes the directions meet the tests in Sections 3, 4 and 4A.

## Section 6

## Electricity Reporting

## Introduction

- 6.1 In the Directions Consultation we proposed to impose regulatory reporting requirements on BT in connection with electricity charges (rate for usage per kWh<sup>235</sup>).
- 6.2 Having found in the Fixed Access market review BT to have SMP in the WLA market<sup>236</sup> we decided to impose a basis of charges obligation. Our decision in the Fixed Access market review was to require BT to set electricity charges that are reasonably derived from its relevant electricity purchase costs plus an appropriate mark-up to reflect BT's own costs related to its wholesale purchase of electricity and the setting of the electricity charge.<sup>237</sup> We said that this obligation will use a FAC based approach.<sup>238</sup> We also imposed cost accounting and accounting separation conditions in the WLA market which apply to the electricity charges.<sup>239</sup>
- 6.3 We said in the Fixed Access Statement that “costs which underpin the electricity charge may be confidential and commercially sensitive as they relate to charges negotiated by BT with its energy suppliers.”<sup>240</sup> We added that where this is the case, we would not expect these to be published. We explained that we would aim to require the publication of such other information as is needed for the purposes of providing transparency.
- 6.4 We also said that whether or not published, BT would need to demonstrate to us that its charges are reasonably derived from the costs of provision and therefore meet the basis of charges obligation. For this purpose, we said that we are likely to require that BT provides Ofcom with its methodology for how charges have been derived and a compliance statement on an annual basis. We noted BT's comments as to what other information could be reported which is not commercially sensitive. We said that we would consider this further before issuing a cost accounting direction setting out the form of reporting for the Regulatory Financial Statements.<sup>241</sup>

<sup>235</sup> Local Loop Unbundling Pricing.

<http://www.openreach.co.uk/orpg/home/products/pricing/loadProductPriceDetails.do?data=MLMNXwvAwKCugz8d0%2FWCcTZyZbQnOqNEcYi%2FuDLUJWklMnGHsqdC0vzO163bJmh34D91D7M0q8u%2FIISqtlFAKw%3D%3D>

<sup>236</sup> Fixed Access Statement, Volume 1 paragraph 7.91.

<sup>237</sup> SMP Condition 6.1 provides: “Unless OFCOM directs otherwise from time to time, [BT] must secure, and must be able to demonstrate to the satisfaction of OFCOM, that the Electricity Charge when averaged over each Relevant Year is reasonably derived from the costs of provision based on the wholesale electricity charges paid by the Dominant Provider plus an appropriate mark-up to reflect the [BT]'s costs related to its wholesale purchase of electricity and the setting of the Electricity Charge.”

<sup>238</sup> Fixed Access Statement, Volume 1 paragraph 13.65.

<sup>239</sup> Fixed Access Statement, Volume 1, paragraphs 10.216 – 10.223 set out our decisions on accounting separation obligations and paragraphs 10.363 – 10.373 set out our decisions on cost accounting obligations; SMP condition – Regulatory Financial Reporting imposed these obligations on BT.

<sup>240</sup> Fixed Access Statement, Volume 1 paragraph 13.82

<sup>241</sup> Fixed Access Statement, Volume 1 paragraph 13.82

6.5 We said that:

- Some limited publication of non-confidential information is needed to provide to stakeholders' transparency as to the methodology which BT uses to set the electricity charges.
- It is important that we are provided with additional information in order to monitor the compliance with and the effectiveness of the remedies imposed, particularly our decisions to impose a basis of charges obligation in relation to the electricity charges.
- The information will provide transparency to us regarding how BT sets the electricity charges including the mark-up to reflect BT's own costs related to its wholesale purchase of electricity and the setting of the electricity charges.

6.6 We said that this information will serve as an anchor point to reconcile other data with in order to support our decision making in relation to the electricity charges.

### **Public information**

6.7 We proposed that BT should set out and explain its methodology of setting the electricity charges in the Detailed Attribution Methods ("the DAM" which is to be replaced by the Accounting Methodology Documents). We did not propose that the explanation contain specific financial information, for example about the precise level of BT's mark up on the purchase electricity costs. We explained that such information could allow third parties to derive the underlying purchase costs which are likely to be confidential and commercially sensitive.

### **Private information**

6.8 We proposed that BT must provide us with additional information in relation to its electricity charges. We proposed that BT must provide a new AFI as part of its Regulatory Financial Reporting.

6.9 We proposed that the additional information will set out the revenues, volumes and FAC on a CCA basis of each electricity charge. We proposed that the revenues and costs must, in total, be reconcilable to the revenues and costs included within the publicly reported totals for the WLA market.

6.10 In the Directions Consultation we asked whether the scope, format and content of the reporting of electricity charges within the Regulatory Financial Statements fairly reflected our decision in the Fixed Access market review.

### **Stakeholder comments**

6.11 BT agreed that our proposals reflected the Fixed Access market review decision. In its response to the Directions Consultation BT described how electricity charges are determined. This description seems a good starting point for the description required for the Accounting Methodology Documents.

6.12 Other stakeholders argued for more detailed information than proposed. TalkTalk argued that BT's electricity costs are not confidential because "prices for electricity are publicly available and, as commodity product, BT will have little ability to

negotiate better than market rates.”<sup>242</sup> TalkTalk went on to explain that “BT’s average electricity cost will be an average of many different supply contracts (e.g. mix of spot purchases, 3 month in advance, 6 months in advance etc). Therefore, it would not be possible to identify from BT’s average electricity costs the amount they paid for particular contract.”<sup>243</sup>

- 6.13 TalkTalk argued that if BT was “unwilling to provide cost information to allow stakeholders to confirm whether it has complied with the basis of charges obligations then another method of confirming compliance is essential.”<sup>244</sup> TalkTalk said “one possibility is that Ofcom makes a statement that BT has complied with its obligation following the publication of BT’s RFS. Without this stakeholders can have no transparency or confidence as to whether BT has complied with its regulatory obligations. A result of this might be a complaint to Ofcom in order to ascertain whether BT has complied.”<sup>245</sup>
- 6.14 TalkTalk also argued that the information provided in the Accounting Methodology Documents needed to be better than what was currently provided in the current DAM. TalkTalk said that “it is essential that the information in relation to electricity is a substantial improvement on the information currently provided in the DAM”<sup>246</sup>
- 6.15 Vodafone’s concern was to ensure that they pay a fair rate for electricity and recoup the benefits of BT buying electricity in bulk. Vodafone said that “we need confidence that we are paying a fair rate for our consumption based on the underlying cost to provide it. It must be recognised that as BT is effectively purchasing electricity on behalf of a number of CPs who are co-located in exchange buildings, with its own business also benefiting from this larger pool of consumption with contract savings possible as a result.”<sup>247</sup> Vodafone argued that increased disclosure either publically or privately was required to reassure them.

### Ofcom’s response

- 6.16 BT’s response<sup>248</sup> provides other stakeholders with greater detail about electricity than is provided currently in the DAM. In particular it explains how BT buys electricity and passes those costs through to CPs. BT’s response has provided answers to some of the points raised by stakeholders in their responses.
- 6.17 In particular, BT has explained that “Openreach buys its raw power for the entire forthcoming financial year in advance to fix the price and remove any volatility in the market thereby providing stability on price. The total power forecast for consumption in the forthcoming financial year is calculated from two quarters of actual consumption from the current financial year.”<sup>249</sup> This answer has in part addressed TalkTalk’s point about the structure of BT’s contracts for purchasing electricity.

<sup>242</sup> TalkTalk, Decision Consultation response, page 3, paragraph 5.1

<sup>243</sup> TalkTalk, Decision Consultation response, page 3, paragraph 5.1

<sup>244</sup> TalkTalk, Decision Consultation response, page 3, paragraph 5.2

<sup>245</sup> TalkTalk, Decision Consultation response, page 3, paragraph 5.2

<sup>246</sup> TalkTalk, Decision Consultation response, page 3, paragraph 5.3

<sup>247</sup> Vodafone, Decision Consultation response, page 6, paragraph 19

<sup>248</sup> <http://stakeholders.ofcom.org.uk/binaries/consultations/financial-reporting/responses/BT.pdf>

<sup>249</sup> BT, Decision Consultation response, page 14, paragraph 67

- 6.18 BT has also explained that “no mark-up is added to the raw energy cost; it is passed through at cost.”<sup>250</sup> This addresses the point made by Vodafone about paying a fair rate based on the underlying cost for providing the power.
- 6.19 We disagree with TalkTalk that Ofcom should make a statement about BT’s compliance with the basis of charges obligation in relation to the electricity charges. As we explained in the 2014 Statement, one of the purposes of the Regulatory Financial Statements is to provide us with information to monitor compliance with SMP conditions (e.g. a cost orientation obligation). However, such information can never be sufficient to establish compliance on its own. This would need to be considered as part of an investigation. Whether or not an investigation into BT’s compliance with the cost orientation obligation would be required is a question which we needs to be assessed on a case by case basis and cannot be established in advance.
- 6.20 We have considered imposing a requirement on BT to publish a non-confidential version of its electricity compliance submission. However, the provided numbers would be confidential and would need to be redacted for publication. A published non-confidential version would therefore serve no purpose. A comprehensive and understandable description in the Accounting Methodology Documents would in our view be more appropriate. Such a description would explain how electricity charges are set, including the strike date of the contract. This will allow stakeholders to check the KWh paid with the wholesale price of electricity on the strike date.

#### Ofcom’s decision

- 6.21 Having considered stakeholders’ responses we have decided that BT must set out and explain its methodology of setting the electricity charges in the Accounting Methodology Documents. The explanation must include a clear description on the individual elements within the charge, how they are calculated and how they are passed through into the per kWh charge end users. The description should also include what date the latest annual contractual price was struck and provide an aggregate split of the individual elements in a non-confidential format.
- 6.22 We have also decided that BT must provide us with additional information that will allow us to monitor compliance with the basis of charges obligation for electricity. This information must be reconcilable to the revenues and costs included within the publicly reported totals for the WLA market.
- 6.23 The direction required to implement our decisions in relation to electricity reporting in Annex 9.

#### Legal tests

- 6.24 We have considered our decisions against the tests set out in section 49(2) of the Act and have concluded that they are:
- Objectively justifiable because our decisions concerning the additional information to be provided in the Accounting Methodology Documents seek to ensure that BT provides to stakeholders transparency as to the methodology which it uses to set the electricity charges. Our decisions concerning the

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<sup>250</sup> BT, Decision Consultation response, page 14, paragraph 67



additional information to be provided to us in private seek to ensure that we have the information which we need to carry out our functions.

- Not unduly discriminatory because BT is the only SMP provider which has SMP obligations in relation to the electricity charges.
- Proportionate because the changes are no more than is required in order to achieve transparency and give us the information we need to carry out our functions, and in particular does not require BT to publish information which may be commercially sensitive.
- Transparent because it is clear that our decisions seek to ensure that the Regulatory Financial Statements remain fit for purpose and adequately reflect the outcomes of the Fixed Access market review, that BT provides to stakeholders transparency as to the methodology which it uses to set the electricity charges, and that we have the information which we need to carry out our functions.

- 6.25 We have also considered how our decisions meet the tests in Section 3, 4 and 4A of the Act. Our decisions relating to reporting of the electricity charges seek to ensure that decisions taken in the Fixed Access market review are reflected in the Regulatory Financial Statements, to achieve transparency and to ensure that Ofcom has the information it needs to carry out its functions. The decisions therefore ultimately promote competition.
- 6.26 As noted above, in introducing these changes we have taken into account all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive, in particular Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications.
- 6.27 In consequence Ofcom believes the directions meet the tests in Sections 3, 4 and 4A.

## Section 7

# Directions to implement the 2014 Statement decisions

## Introduction

- 7.1 In this section we explain the directions that are necessary to implement the decisions that we made in the 2014 Statement. We briefly explain the decisions that we took. The directions implementing our decisions are set out in Annexes 1 to 9.
- 7.2 We intend to consult on and then issue the direction necessary to implement our decision to put in place Regulatory Accounting Guidelines in 2016. The Regulatory Accounting Guidelines will include the high level guidelines and accounting rules together with the detail necessary to enable compliance with the consistency with regulatory decisions principle.

## Regulatory Accounting Principles

- 7.3 We decided in the 2014 Statement to introduce new Regulatory Accounting Principles. These included a requirement for “consistency with regulatory decisions”. We decided that BT’s Regulatory Financial Reporting must comply with the Regulatory Accounting Principles.
- 7.4 The requirement to comply with the new Regulatory Accounting Principles was implemented in the SMP conditions which have been imposed in the Fixed Access and WBA markets. We said that the Regulatory Accounting Principles themselves would be directed separately.
- 7.5 A direction specifying the Regulatory Accounting Principles is set out in Annex 1.

## Legal tests

- 7.6 We have considered our decision to give a direction specifying the Regulatory Accounting Principles against the tests set out in section 49(2) of the Act and have concluded it is:
- Objectively justifiable because by specifying the Regulatory Accounting Principles we will establish the basic attributes for BT’s Regulatory Financial Reporting and provide a necessary reference point in the absence of more specific guidelines.
  - Not unduly discriminatory because KCOM is the only other SMP provider which has regulatory accounting obligations, but we have not at present established the need for such regulation.
  - Proportionate because our decision is no more than is required to ensure an absence of bias and consistency with regulatory decisions. While we are establishing Regulatory Accounting Principles, BT retains an important role in determining the basis of preparation of the Regulatory Financial Statements, and can continue to put through changes where this is in line with the Regulatory Accounting Principles.

- Transparent because it is clear that the intention of our decision is to ensure we take a greater role in the basis of preparation of the Regulatory Financial Statements to ensure an absence of bias and consistency with regulatory decisions.

7.7 We discuss how we meet our duties under sections 3, 4 and 4A of the Act at the end of this section.

## Regulatory Asset Value (RAV)

7.8 In the 2014 Statement we decided that the Regulatory Financial Statements should be prepared on a regulatory asset value (“RAV”) basis from 2014/15. We said that we would issue a direction specifying the requirements in relation to the RAV alongside the requirements relating to consistency with regulatory decisions.<sup>251</sup>

7.9 The RAV was implemented in 2005 to ensure that there is no over recovery of costs of BT’s copper access network assets that existed before 1 August 1997. In the Valuing copper access: Final Statement published on 18 August 2005<sup>252</sup> (the “2005 Copper Statement”) we explained that that if nothing was done the current prices, as set by Ofcom, that BT charged competitors for access to its network would result in BT recovering more than its costs for all the copper access network assets that were already deployed at the time the change in accounting treatment was made, that is 1 August 1997. We also explained that there should be no systematic over- or under-recovery of cost related to network assets purchased after 1997 as these had been consistently treated under current cost accounting.

7.10 We therefore decided to create a RAV to represent the remaining value of the pre-1997 copper access network assets rather than continuing to value those assets at their current cost. We noted that the pre 1997 copper access network consisted of access duct assets and copper assets.<sup>253</sup> We said that the RAV would relate only to the assets which were in place on 1 August 1997<sup>254</sup> and that assets deployed from 1 August 1997 onwards would be treated under a current cost accounting (CCA) basis. The value of RAV was set to equal the closing historical cost accounting value for the pre 1 August 1997 assets for the 2004/5 financial year and its value has increased each year by the Retail Price Index (“RPI”).

7.11 Over time the RAV will gradually disappear as the pre-1997 assets are gradually replaced with new ones. As the accounting life of access copper is much shorter than the accounting life of duct (18 years vis-a-vis 40 years), the RAV adjustment for copper is getting increasingly small and will no longer exist after 2015/16.

7.12 We have implemented the RAV for pre-1997 access duct assets consistently in the recent LLU/WLR charge controls and the Leased Lines charge control.<sup>255</sup> We therefore decided that it is appropriate to align the Regulatory Financial Statements with this well established policy.

<sup>251</sup> 2014 Statement, page 44, paragraphs 3.90 - 3.91

<sup>252</sup> <http://stakeholders.ofcom.org.uk/binaries/consultations/copper/statement/statement.pdf>

<sup>253</sup> The 2005 Copper Statement, paragraph 5.8

<sup>254</sup> The 2005 Copper Statement, paragraph 5.7

<sup>255</sup> BCMR statement <http://stakeholders.ofcom.org.uk/consultations/business-connectivity-mr/final-statement/>

- 7.13 For avoidance of doubt, we expect post-1997 access duct to continue to be valued on a CCA basis. Separately, we note that BT has changed the basis for estimating the CCA valuation of duct assets in the 2012/13 Regulatory Financial Statements from an absolute valuation to one based on capital expenditure indexed using RPI from the date of the expenditure. This is consistent with our decision in recent LLU/WLR charge controls.<sup>256</sup> BT valued post-1997 access duct on the same basis in the 2013/14 RFS and we expect the 2014/15 RFS to reflect this valuation basis.

## Requirements on the application of RAV

- 7.14 We will require BT to follow the requirements set out in the 2005 Copper Statement<sup>257</sup> when preparing the Regulatory Financial Statements on a RAV basis.
- Access duct capitalised prior to 1 August 1997 must be valued on the basis of the closing historical cost at the 2004/2005 financial year-end (i.e. on 31 March 2005) and indexed by the Retail Price Index ("RPI") from that date.
  - Given pre-1997 copper is nearing the end of its accounting life, the adjustment for copper would be immaterial. BT will not therefore be required to report copper on a RAV basis.

## Legal tests

- 7.15 We have considered our decision specifying the RAV methodology against the tests set out in section 49(2) of the Act and have concluded it is:
- Objectively justifiable because in specifying the RAV methodology we are seeking to ensure that the Regulatory Financial Reporting is consistent with regulatory decisions. The requirements specifying the RAV methodology will establish further detail and will also provide BT with clarity as to the requirements which BT will need to follow to ensure that the Regulatory Financial Statements are prepared on the RAV basis.
  - Not unduly discriminatory because KCOM is the only other SMP provider which has regulatory accounting obligations, but we have not decided that KCOM should prepare its Regulatory Financial Statements on a RAV basis.
  - Proportionate because our decisions are no more than is required to ensure that the Regulatory Financial Reporting is consistent with regulatory decisions and that BT is provided with clarity as to the requirements which it will need to follow to ensure that the Regulatory Financial Statements are prepared on the RAV basis.
  - Transparent because it is clear that our decisions seek to ensure that the Regulatory Financial Reporting is consistent with regulatory decisions and to provide BT with clarity as to the requirements which it will need to follow to ensure that the Regulatory Financial Statements are prepared on the RAV basis.
- 7.16 We discuss how we meet our duties under sections 3, 4 and 4A of the Act at the end of this section.

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<sup>256</sup> LLU WLR CC statement <http://stakeholders.ofcom.org.uk/consultations/llu-wlr-further-consultation/statement>

<sup>257</sup> 2014 Statement, page 45, paragraph 3.92

## Reconciliation report and audit

7.17 We decided in the 2014 Statement that BT must prepare and publish a reconciliation report. We decided that the reconciliation report must set out changes to the regulatory accounting methodology and the impact of such changes on the Regulatory Financial Statements. We said that we expected that the reconciliation report would cover all changes and individually disclose the impact of all material changes and that changes below the materiality threshold would be aggregated.

7.18 We also decided that the reconciliation report must set out all material errors that BT decided to correct and the impact of such errors on the Regulatory Financial Statements. We said that the reconciliation report would set out the impact of changes and errors, expressed as an absolute amount and as a percentage change.

7.19 We decided that BT must secure an audit opinion on the reconciliation report. We said that the audit opinion would confirm that:

- BT's notification of changes to its regulatory accounting methodology contained all material changes put through by BT (with the exception of any changes specifically requested by the auditors); and
- BT included and correctly calculated the impact of all material changes and all material errors in the reconciliation report.

7.20 We also explained that we expected that material change would be defined as follows<sup>258</sup>:

**“Change control materiality** - A change in any element of the Regulatory Financial Reporting is material if the resultant percentage change (be it positive or negative) in any figure in the Regulatory Financial Statements exceeds the higher of 5% or £1 million. The resultant percentage change in a figure shall be calculated by taking the value of the affected figure before the change in the Regulatory Financial Reporting is applied, and subtracting from it, the value of the same figure after the change in the Regulatory Financial Reporting is applied, and then dividing this result by the former value.”

7.21 We indicated that material errors were expected to be defined in the following way<sup>259</sup>:

**“Error notification materiality** – An error is material if the required percentage correction (be it positive or negative) in any figure in the Regulatory Financial Statements exceeds the higher of 5% or £1 million. The required percentage correction in a figure shall be calculated by taking the value of the affected figure in the Regulatory Financial Reporting before the error is corrected, and subtracting from it, the value of the same figure after the error is corrected, and then dividing this result by the former value.”

7.22 The requirements to prepare and publish the reconciliation report and to secure an audit were implemented in the new SMP conditions imposed in the Fixed Access and WBA markets. We said that the detailed requirements concerning the content of the reconciliation report, the content of the audit opinion on the reconciliation report, the

<sup>258</sup> 2014 Statement, page 61, paragraph 3.194

<sup>259</sup> 2014 Statement, page 58, paragraph 3.177

change control materiality threshold and the error materiality threshold will be specified in a direction.

- 7.23 Following the publication of the 2014 Statement BT expressed concerns about the expected level of error materiality which is far lower than that required for statutory reporting purposes. BT explained that it cannot currently provide reasonable assurance that all errors will be detected to the level of materiality set out in the 2014 Statement.
- 7.24 BT pointed out that auditors in their opinion on BT's 2013/14 consolidated statutory financial statements set the audit materiality at £110m. BT also explained that the level of error materiality for preparing and auditing the statutory financial statements had been implemented to ensure compliance with relevant legislation including the UK's Companies Act of 2006 and the USA's Sarbanes-Oxley Act of 2002.
- 7.25 In light of this, BT said that its current systems and processes cannot with certainty detect all errors over £1m which might have the potential to affect any figure in the Regulatory Financial Statements. BT explained that to comply with the error materiality threshold expected by Ofcom, new processes and systems with the lower materiality threshold would need to be implemented to encompass BT's general ledger, and its numerous associated systems. BT considered that the implementation of such new error notification systems and processes would be complex, costly and disproportionate.
- 7.26 BT also noted the following extract from the 2013/14 audit report where the auditors said: "We agreed with the Audit & Risk Committee that we would report to them misstatements identified during our audit above £5m as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons."<sup>260</sup>
- 7.27 BT suggested that the error materiality threshold should be set to apply only to the attribution systems, rather than all of the input data. BT said that such modification would ensure that BT is able to comply with the error materiality threshold without the need to introduce new systems and processes.
- 7.28 Having considered concerns raised by BT about the expected level of error materiality that we set out in the 2014 Statement we have decided to require BT to report only those errors that arise in the regulatory attribution system and associated models.
- 7.29 We have decided to require that an error must be included in the reconciliation report if it has been reported by the auditors to the BT's Audit and Risk Committee.
- 7.30 As noted above, we also said in the 2014 Statement that the audit opinion would confirm among others that BT included and correctly calculated the impact of all material errors in the reconciliation report. In light of further discussion with BT's auditors, we now consider that the requirement regarding the inclusion of all material errors could be disproportionate to the benefit it would deliver. This is because it would require the auditors to apply a level of materiality that differs from that which the auditors deemed appropriate for the audit overall. We have therefore decided not to impose that requirement. However, we will require that the auditors provide an

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<sup>260</sup> BT, Annual Reports 2014, Page 118

<http://www.btplc.com/Sharesandperformance/Annualreportandreview/index.cfm>

opinion confirming the correctness of BT's calculation. In particular, the auditors will be required to confirm that the previous year figures adjusted for the material errors have been properly prepared in accordance with the Accounting Methodology Documents as adjusted for such material errors.

- 7.31 The remaining requirements concerning the content of the reconciliation report and an accompanying audit, and the definition of material change which we have decided to specify are consistent with what we expected these requirements would be in the 2014 Statement.
- 7.32 These requirements are summarised above. A direction setting the requirements in relation to the reconciliation report, accompanying audit opinion and materiality thresholds is set out in Annex 5.
- 7.33 We also note that we decided in the 2014 Statement to require BT to prepare and publish a systems reconciliation report where BT replaces the whole or part of its regulatory accounting system. We said that we would issue separately a direction setting out how materiality of differences should be measured.<sup>261</sup> We note that on the transition from ASPIRE to the new system, REFINE, BT published the systems reconciliation report applying the materiality threshold which we had set out in the 2014 Statement.<sup>262</sup> We have not included the requirements regarding the materiality threshold applicable to the systems reconciliation report in the direction set out in Annex 5. When BT proposes to replace the whole or part of the regulatory accounting system in future, we will give a direction specifying the applicable materiality threshold. In doing so, we will consider whether the materiality threshold which we indicated in the 2014 Statement remains appropriate.

## Legal tests

- 7.34 We have considered our decisions specifying the requirements in relation to the reconciliation report and the accompanying audit opinion against the tests set out in section 49(2) of the Act and have concluded that they are:
- Objectively justifiable because it is necessary for there to be visibility in relation to changes and errors made in the Regulatory Financial Statements both for us and for other stakeholders and it is therefore necessary for us to specify the requirements in relation to the content of the reconciliation report and the accompanying audit opinion.
  - Not unduly discriminatory because KCOM is the only other SMP provider which has regulatory accounting obligations, but KCOM is not subject to a requirement to publish a reconciliation report.
  - Proportionate because our decisions are no more than is required to provide visibility in relation to changes and errors both for us and for other stakeholders.
  - Transparent because it is clear that our decisions seeks to provide visibility in relation to changes and errors both for us and for other stakeholders and to provide BT with clarity about the requirements specifying the content of the reconciliation report and the accompanying audit opinion.

<sup>261</sup> The 2014 Statement, paragraph 6.52

<sup>262</sup> <http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2014/SystemReconciliationReport22December2014.pdf>



- 7.35 We discuss how we meet our duties under sections 3, 4 and 4A of the Act at the end of this section.

## Transparency

- 7.36 In the 2014 Statement we decided to amend the Transparency Direction requiring that accounting documents provide a “clear” rather than “detailed” understanding. We also decided to remove the requirement for the documentation to provide enough detail for a user to “make their own judgement as to the reasonableness of these methodologies and driver data and any changes to them.”
- 7.37 We said that the amendments would take effect for the 2014/15 Regulatory Financial Statements and the Accounting Methodology Document to be published in July 2015. We said that the changes to the transparency requirements would be implemented by way of a direction to be published separately.
- 7.38 A direction specifying the transparency requirements for the purposes of preparing and maintaining the accounting records, the Accounting Methodology Documents and the Regulatory Financial Statements is set out in Annex 3.

## Legal tests

- 7.39 We explained how our decision about the changes to the transparency requirements met the tests set out in section 49(2) of the Act in paragraph 4.75 of the 2014 Statement. We explained how we met our duties under sections 3, 4 and 4(a) of the Act in paragraphs 2.121 to 2.124 of the 2014 Statement.

## Audit

- 7.40 In the 2014 Statement we decided to update Direction 5 relating to the form of FPIA opinion and Direction 6 relating to the form of PPIA opinion.
- 7.41 We said that these amendments would take effect for the 2014/15 Regulatory Financial Statements and the Accounting Methodology Document to be published in July 2015. The requirements concerning the form of FPIA opinion and the form of PPIA opinion are set out in a direction which is contained in Annex 4.
- 7.42 We note that certain requirements relating to audit are also contained in Direction 3, in particular the requirements that BT shall secure audit opinions in relation to the Regulatory Financial Statements as a whole on an FPIA basis, and in relation to each Regulatory Financial Statement or group of Regulatory Financial statements on either an FPIA or PPIA basis as specified by Ofcom from time to time.
- 7.43 As we explained in Section 3 above, we decided in the 2014 Statement that for reasons of clarity Direction 3 would be issued afresh under the new conditions imposed in the Fixed Access and WBA markets. In doing so, we have considered the requirement that BT should secure an appropriate audit opinion on an FPIA basis in respect of the Published Regulatory Financial Statements as a whole.
- 7.44 We note that BT previously explained that its auditors had advised that more prescriptive Regulatory Accounting Guidelines may not be consistent with FPIA assurance. BT said that there was therefore a risk that auditors may disagree with



Ofcom's requirement in the Regulatory Accounting Guidelines and qualify the audit opinion.<sup>263</sup>

- 7.45 BT's auditors have repeated this concern in response to the Directions Consultation, in which we proposed to impose requirements obliging BT to reflect specific regulatory decisions in the Regulatory Financial Statements. We recognise that this may be an issue in certain circumstances and that we would need to consider this further. In light of these submissions, we have decided to revise the requirement to enable us to specify whether BT will be required to obtain either an FPIA or a PPIA opinion on the Regulatory Financial Statements as a whole. This requirement is captured in the direction which is set out in Annex 4.

## Legal tests

- 7.46 We explained how our decision about the changes to the audit requirements met the tests set out in section 49(2) of the Act in paragraph 4.75 of the 2014 Statement. We explained how we met our duties under sections 3, 4 and 4(a) of the Act in paragraphs 2.121 to 2.124 of the 2014 Statement.

## EOI Reporting

- 7.47 In the 2014 Statement we decided that BT must report EOI cost components on the same basis as non-EOI components, at the level that they are regulated. We said that the form that this reporting will take in the 2014/15 Regulatory Financial Statements would be set out in a direction to be published separately.
- 7.48 The requirements relating to EOI reporting have been captured in a direction which we have issued afresh and which specifies the requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements. This direction is set out in Annex 7.

## Legal tests

- 7.49 We explained how our decision about the requirements in relation to the reporting of EOI cost components met the tests set out in section 49(2) of the Act in paragraph 4.24 of the 2014 Statement. We explained how we met our duties under sections 3, 4 and 4(a) of the Act in paragraphs 2.121 to 2.124 of the 2014 Statement.

## Non-confidential compliance statements

- 7.50 In the 2014 Statement we decided that BT must produce non-confidential compliance schedules for each regulated market. We decided that these non-confidential compliance statements must be published on BT's website in the same location as the Published Regulatory Financial Statements at the same time the confidential compliance statements are provided to Ofcom.
- 7.51 We said that the form that this reporting would take in the 2014/15 Regulatory Financial Statements would be set out in a direction published separately.
- 7.52 The requirements relating to non-confidential compliance statements have been captured in a direction which we have issued afresh and which specifies the requirements in relation to preparation, delivery, publication, form and content of the

<sup>263</sup> The 2014 Statement, paragraph 3.66.

Regulatory Financial Statements. The form and content of the non-confidential compliance statement contains all the information which will be required to be presented as a minimum, however it should be tailored to reflect the test of the control with reference to the relevant charge control condition. This direction is set out in Annex 7.

## Legal tests

- 7.53 We explained how our decision about the publication of non-confidential compliance statements met the tests set out in section 49(2) of the Act in paragraph 4.52 of the 2014 Statement. We explained how we met our duties under sections 3, 4 and 4(a) of the Act in paragraphs 2.121 to 2.124 of the 2014 Statement.

## Form of reporting

- 7.54 We decided in the 2014 Statement that the Published Regulatory Financial Statements should provide the appropriate level of detail and make clear in which basket regulated products are reported. We said that we would set out in a direction published separately the form of reporting for Fixed Access, ISDN and WBA markets from 2014/15. We also decided to remove the requirement for BT to publish the Network Services Reconciliation from the 2014/15 Regulatory Financial Statements onwards and to require BT to provide it to Ofcom on a confidential basis.
- 7.55 The requirements relating to the form of reporting and the provision of the Network Services Reconciliation on a confidential basis have been captured in a direction which we have issued afresh and which specifies the requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements. This direction is set out in Annex 7.

## Legal tests

- 7.56 We explained how our decision about the changes to the met the tests set out in section 49(2) of the Act in paragraph 4.86 of the 2014 Statement. We explained how we met our duties under sections 3, 4 and 4(a) of the Act in paragraphs 2.121 to 2.124 of the 2014 Statement.

## Requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements

- 7.57 In the 2013 Consultation we proposed that Direction 3 and Direction 4 would continue to have force in the Fixed Access and WBA markets as if they were given under the new conditions.
- 7.58 In the 2014 Statement we decided that for reasons of clarity we would issue afresh Directions 3 and 4 under the new conditions which were imposed in the Fixed Access and WBA markets.<sup>264</sup>
- 7.59 We have captured the existing requirements in Directions 3 and 4 in one direction which sets out the requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements. In doing so we have sought to express these requirements in a generic way to reduce the need for future

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<sup>264</sup> 2014 Statement, page 110, paragraph 7.14.

modifications of the direction on a yearly basis to reflect regulatory decisions over the previous 12 months.

- 7.60 The reporting requirements contained in the new direction will apply to all regulated markets obliging BT to report information at the level specified in each relevant market review. Where necessary the relevant statements will set out in notes specific requirements for particular markets. This is the case in particular for the “Market/Technical Area Summary” and the “Market/Technical Area Calculation of FAC based on component costs and usage factors” statements.
- 7.61 The new direction setting out the requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements is set out in Annex 7.

## Legal tests

- 7.62 We have considered our decisions against the tests set out in section 49(2) of the Act and have concluded that they are:
- Objectively justifiable because it is necessary for us to give a direction specifying the requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements and to reflect the decisions of the 2014 Fixed Access and WBA market reviews.
  - Not unduly discriminatory because KCOM is the only other SMP provider which has regulatory accounting obligations, but we have not established at present that it is necessary to specify new requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements for KCOM.
  - Proportionate because our decision to give the direction is no more than is required to specify the requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements and to reflect the decisions of the 2014 Fixed Access and WBA market reviews.
  - Transparent because it is clear that our decisions is to specify the requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements and to reflect the decisions of the 2014 Fixed Access and WBA market reviews.
- 7.63 We discuss how we meet our duties under sections 3, 4 and 4A of the Act at the end of this section.

## Network Components

- 7.64 In the 2013 Consultation we proposed that Direction 1 specifying network components would continue to have force in the Fixed Access and WBA markets as if it were given under the proposed conditions.
- 7.65 In the 2014 Statement we decided that for reasons of clarity we would issue Direction 1 afresh under the new conditions imposed in the Fixed Access and WBA markets.<sup>265</sup>

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<sup>265</sup> 2014 Statement, paragraph 7.14.

- 7.66 Network component is defined in the conditions as an element of the network that is used to provide Wholesale Services, and, to the extent the network components are used in the Market or Technical Area (as applicable), as specified in a direction given by Ofcom from time to time for the purposes of the SMP conditions.
- 7.67 We have reviewed the list of network components with BT. The new list set out in the direction and in Annex 10 includes the following changes:
- 7.67.1 Components have been renamed and new components have been added to the list where the previous components have been split into multiple categories. For example, the 'Ethernet Electronics' component has been split into 'Ethernet Electronics' and 'Other Ethernet new provides –CCTV'. The 'DSLAM Capital/Maintenance component' has been split into 'DSLAM Equipment' and 'DSLAM Support'. This addition of new components seeks to aid clarity and transparency.
- 7.67.2 Components that are only utilised by services in markets where no cost accounting obligation exists have been removed from the component list. An example of such a component is 'ISDN 2 Drop Maintenance'.
- 7.67.3 Three new components have been introduced in order to implement the reporting decisions relating to the Fixed Access markets which requires that costs should now be recorded against 'Co-mingling electricity' and 'Caller Display'. The new 'Metro BRAS and MSE' component includes the costs that were previously recorded within the component 'Core/Metro (Broadband)' in order to provide clarity to the readers.
- 7.67.4 Two components have been withdrawn, 'Pair gain' and 'MSAN TDM card', because these components are not expected to contain costs in 2014/15 or future years.
- 7.68 The new direction specifying network components is set out in Annex 8.

## **Legal tests**

- 7.69 We have considered our decisions against the tests set out in section 49(2) of the Act and have concluded that they are:
- Objectively justifiable because it is necessary for us to give a direction specifying network components and to reflect the decisions of the 2014 Fixed Access and WBA market reviews.
  - Not unduly discriminatory because KCOM is the only other SMP provider which has regulatory accounting obligations and KCOM has a list of components which enables it to prepare its Regulatory Financial Statements.
  - Proportionate because our decision is no more than is required to specify network components and reflect the decisions in relation to the network components taken in the Fixed Access and WBA market reviews.
  - Transparent because it is clear that our decision seeks to specify network components and to reflect the decisions in relation to the network components taken in the Fixed Access and WBA market reviews.

- 7.70 We discuss how we meet our duties under sections 3, 4 and 4A of the Act at the end of this section.

### **Legal tests under sections 3, 4 and 4A of the Act**

- 7.71 Our decisions set out in this section 7 are designed to give Ofcom a greater role in determining how BT should prepare its Regulatory Financial Statements, thereby ensuring the Regulatory Financial Statements are aligned with Ofcom's regulatory decision and giving confidence to stakeholders about the absence of bias in the preparation of the Regulatory Financial Statements. They also ensure that the presentation and usability of the Regulatory Financial Statements is improved, and that the obligations that are imposed on BT are proportionate. The proposals thereby seek to ensure the RFS remain relevant, thereby increasing transparency. Ultimately, this promotes competition.
- 7.72 In making the changes described in this section above, Ofcom has also taken into account all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive, in particular Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications.
- 7.73 In consequence Ofcom believes the decisions meet the tests in Sections 3, 4 and 4A.

## Annex 1

# Direction under section 49 of the Communications Act 2003 and SMP Services Conditions 13A.4 and 8A.4 specifying the Regulatory Accounting Principles

## Background

1. On 20 December 2013, Ofcom published a consultation entitled “Regulatory Financial Reporting – a review” (the “2013 Consultation”), which set out proposals for SMP services conditions relating to regulatory financial reporting to be imposed in the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area; and
  - Wholesale broadband access provided in Market A.
2. The 2013 Consultation also set out proposals to set the Regulatory Accounting Principles with which BT would be required to comply in preparing and maintaining the Regulatory Financial Statements, the Accounting Methodology Documents, the accounting records and the Regulatory Accounting System.
3. On 20 May 2014, Ofcom published a policy statement entitled “Regulatory Financial Reporting – Final Statement”, which set out Ofcom’s conclusions on the requirements for regulatory financial reporting that Ofcom considered should be applied to BT in markets in which BT has significant market power. Ofcom noted, among others, that the Regulatory Accounting Principles would be implemented in a statement to be issued separately.
4. On 26 June 2014, Ofcom published a statement entitled “Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30” (the “FAMR Statement”). At Annex 29 of the FAMR Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 13A) in relation to the following markets:

- The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area; and
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area.
5. On 26 June 2014, Ofcom published a statement entitled “Review of the wholesale broadband access markets: Statement on market definition, market power determinations and remedies” (the “WBA Statement”). At Annex 2 of the WBA Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 8A) in relation to the following market:
- Wholesale broadband access provided in Market A.
6. Under condition 13A.8 set out at Annex 29 to the FAMR Statements and condition 8A.8 set out at Annex 2 of the WBA Statement, BT is required to comply with, among others, the Regulatory Accounting Principles.
7. Under condition 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement, Ofcom may from time to time make such directions as they consider appropriate in relation to BT’s obligations under conditions 13A.8 and 8A.8 respectively.
8. The Direction set out in the Schedule to this Notification is given under condition 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement and specifies the Regulatory Accounting Principles.
9. For the reasons set out in the explanatory statement accompanying this Notification, Ofcom is satisfied that, in accordance with section 49(2) of the Act, the Direction set out in the Schedule to this Notification is:
- a. Objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
  - b. Not such as to discriminate unduly against particular persons or against a particular description of persons;
  - c. Proportionate to what it is intended to achieve; and
  - d. In relation to what it is intended to achieve, transparent.
10. For the reasons set out in the explanatory statement accompanying this Notification, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements set out in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.

11. A copy of this Notification, together with the Direction set out in the Schedule to this Notification, has been sent to the Secretary of State in accordance with section 49C(1)(b) of the Act, and the European Commission in accordance with section 49C(2)(a) of the Act.

**Direction**

1. Ofcom has decided to give the Direction which is set out in the Schedule to this Notification.

**Interpretation**

2. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 29 of the FAMR Statement and Annex 2 of the WBA Statement each as appropriate and otherwise any word or expression shall have the same meaning as it has in the Act.

Signed



David Brown

Director of Competition Finance, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

30 March 2015



## **Schedule**

### **Direction specifying the Regulatory Accounting Principles**

#### **Part 1: Definitions and Interpretation**

In this Direction:

'Regulatory Financial Reporting' means the whole of the Regulatory Financial Statements, the Accounting Methodology Documents, the accounting records and the Regulatory Accounting System.

#### **Part 2: Direction**

The Regulatory Accounting Principles which apply for the purposes of preparing and maintaining the Regulatory Financial Statements, the Accounting Methodology Documents, the accounting records and the Regulatory Accounting System are the following:

##### **1. Completeness**

Regulatory Financial Reporting must encompass all revenues, costs, assets and liabilities of the Markets and Technical Areas, together with residual activities (including wholesale and retail).

##### **2. Accuracy**

Regulatory Financial Reporting must maintain an adequate degree of accuracy, such that the information included in the Regulatory Financial Statements is free from material errors and double-counting. Materiality must be determined in accordance with the definition set out below.

##### **3. Objectivity**

Each element of Regulatory Financial Reporting, so far as is possible, must take account of all the available financial and operational data that is relevant to that element. Where an element of Regulatory Financial Reporting is based on assumptions, those assumptions must be justified and supported by all available relevant empirical data. The assumptions must not be formulated in a manner which unfairly benefits BT or any other operator or entity, or creates undue bias towards any part of BT's or any other operator's business or product.

##### **4. Consistency with regulatory decisions**

Regulatory Financial Reporting must be consistent with Ofcom's regulatory decisions as set out in the Regulatory Accounting Guidelines.

##### **5. Causality**

Regulatory Financial Reporting must ensure that:

- a) revenues (including revenues resulting from transfer charges);
- b) costs (including costs resulting from transfer charges);
- c) assets; and
- d) liabilities

are attributed in accordance with the activities which cause the revenues to be earned, or costs to be incurred, or assets to be acquired, or liabilities to be incurred respectively.

## **6. Compliance with the statutory accounting standards**

Regulatory Financial Reporting must comply with the accounting standards applied in BT's statutory accounts; with the exception of any departures as Ofcom may direct from time to time (including in the Regulatory Accounting Guidelines).

## **7. Consistency of the Regulatory Financial Statements as a whole and from one period to another**

Regulatory Financial Reporting must be applied consistently in all the Regulatory Financial Statements relating to the same period.

Regulatory Financial Reporting must be applied consistently from one period to another.

All the changes in Regulatory Financial Reporting from one period to another must be justified by reference to the Regulatory Accounting Guidelines and the Regulatory Accounting Principles.

If there are material changes in Regulatory Financial Reporting from one period to another, BT must restate the previous period's Regulatory Financial Statements, applying the changes to the Regulatory Financial Statements for that period.

The Regulatory Accounting Principles must be applied to all material items of revenue, costs, assets and liabilities in the Regulatory Financial Statements, or material changes in those items. A material item of revenue, costs, assets or liabilities, or a material change in those items, is one which is reasonably expected by virtue of its magnitude or nature, to affect the views of any user of the Regulatory Financial Statements.

Where it appears to BT that any of the Regulatory Accounting Principles set out above conflict with each other in a particular case, BT must resolve such conflict by giving priority to them in the order in which they are set out above, with a previous principle taking precedence over a later principle.

## Annex 2

# Direction under section 49 of the Communications Act 2003 and SMP Services Conditions 13A.4 and 8A.4 specifying the requirements in relation to consistency with regulatory decisions and regulatory asset value

## Background

1. On 20 May 2014, Ofcom published a policy statement entitled “Regulatory Financial Reporting – Final Statement” (the “May 2014 Statement”), which set out Ofcom’s conclusions on the requirements for regulatory financial reporting that Ofcom considered should be applied to BT in markets in which BT has SMP. Ofcom decided among others to introduce:
  - new Regulatory Accounting Principles which principles will include a requirement for “Consistency with regulatory decisions” (“Principle 4”);
  - a requirement to prepare all Regulatory Financial Statements, explanations and other required information on a regulatory asset value current cost basis (the “RAV basis”).
2. On 26 June 2014, Ofcom published a statement entitled “Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30” (the “FAMR Statement”). At Annex 29 of the FAMR Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 13A) in relation to the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area.
3. On 26 June 2014, Ofcom published a statement entitled “Review of the wholesale broadband access markets: Statement on market definition, market power determinations and remedies” (the “WBA Statement”). At Annex 2 of the WBA Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 8A) in relation to the following market:

- Wholesale broadband access provided in Market A.
4. On 10 December 2014, Ofcom published a consultation entitled “Directions for Regulatory Financial Reporting”, which set out a proposal for a direction specifying the requirements in relation to Principle 4 of the Regulatory Accounting Principles.
  5. Under condition 13A.8 set out at Annex 29 of the FAMR Statement and condition 8A.8 set out at Annex 2 of the WBA Statement, BT is required to comply with, among others, the Regulatory Accounting Principles.
  6. Under condition 13A.10 set out at Annex 29 of the FAMR Statement and condition 8A.10 set out at Annex 2 of the WBA Statement, BT shall prepare all Regulatory Financial Statements, explanations or other information required by virtue of the conditions 13A and 8A respectively on the RAV basis.
  7. Under condition 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement, Ofcom may from time to time make such directions as they consider appropriate in relation to BT's obligations under the respective conditions.
  8. The Direction set out in the Schedule to this Notification is given under condition 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement and specifies the requirements in relation to Principle 4 of the Regulatory Accounting Principles and the preparation of the Regulatory Financial Statements, explanations or other required information on the RAV basis.
  9. For the reasons set out in the explanatory statement accompanying this Notification, Ofcom is satisfied that, in accordance with section 49(2) of the Act, the Direction set out in the Schedule to this Notification is:
    - a. Objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
    - b. Not such as to discriminate unduly against particular persons or against a particular description of persons;
    - c. Proportionate to what it is intended to achieve; and
    - d. In relation to what it is intended to achieve, transparent.
  10. For the reasons set out in the explanatory statement accompanying this Notification, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements set out in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.
  11. A copy of this Notification, together with the Direction set out in the Schedule to this Notification, has been sent to the Secretary of State in accordance with section 49C(1)(b) of the Act, and the European Commission in accordance with section 49C(2)(a) of the Act.

**Direction**

12. Ofcom has decided to give the Direction which is set out in the Schedule to this Notification.

**Interpretation**

13. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 29 of the FAMR Statement and Annex 2 of the WBA Statement each as appropriate and otherwise any word or expression shall have the same meaning as it has in the Act.

Signed

A handwritten signature in black ink, appearing to read 'David Brown', with a stylized, cursive script.

David Brown

Director of Competition Finance, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

30 March 2015

## **Schedule**

### **Direction specifying the requirements in relation to consistency with regulatory decisions and regulatory asset value**

#### **Part 1: Definitions and Interpretation**

In this Direction:

‘21CN’ means BT’s next generation network upgrade;

‘Access Ducts’ mean the underground pipes which hold copper and fibre lines and which are used in the part of BT’s network which connects directly to customers from the local telephone exchange;

‘Cumulo costs’ means the non-domestic (business) rates that BT pays on its Cumulo Rateable Assets within the United Kingdom;

‘Cumulo Rateable Assets’ means the assets that make up BT’s Cumulo non domestic rating assessments in the United Kingdom as defined for England in The Central Rating List (England) Regulations 2005 (SI 2005/551), as amended by The Central Rating List (Amendment) (England) Regulations 2006 (SI 2006/495) and The Central Rating List (Amendment) (England) Regulations 2008 (SI 2008/429), and the analogous legislation that define these assets in Wales, Scotland and Northern Ireland;

‘Digital Subscriber Line or DSL’ means the family of technologies generically referred to as DSL, or xDSL, which are capable of transforming ordinary local loops into high-speed digital lines and of supporting advanced services;

‘Digital Subscriber Loop Access Multiplexer or DSLAM’ means the apparatus used to terminate DSL enabled local loops, which comprises a bank of DSL modems and a multiplexer which combines many local loops into one data path;

‘Evolutionary Test Access Matrices’ or ‘evoTAMs’ means the equipment used by some SMPF Rental lines which is installed to conduct broadband line testing;

‘FAMR Statement’ means the statement entitled “Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30” which was published by Ofcom on 26 June 2014;

‘Future Benefits Principle’ means the principle in accordance with which costs relating to new 21CN technology are allocated to legacy services on the basis that 21CN based services might replace these legacy technologies in the future;

‘Generic Ethernet Access or GEA’ means the BT Wholesale non-physical service providing communications providers with access to higher speed broadband products;

‘Gross Replacement Cost or GRC’ means the cost of replacing an existing tangible fixed asset with an identical or substantially similar new asset having a similar production or service capacity;

‘IPstream Connect’ means the wholesale broadband access product supplied by BT to communications providers (including itself) based on IP connectivity that allows those communications providers to connect at a number of handover points to BT’s network in

order to provide a service to end users with an access connection capable of supporting downstream speeds of up to 8Mb/s, such product being currently known as IPstream Connect Max and IPstream Connect Max Premium;

‘Main Distribution Frame or MDF’ means the equipment where local loops terminate and cross connection to competing providers’ equipment can be made by flexible jumpers;

‘Maintenance of Digital Subscriber Line Class of Work or MDSL Class of Work’ means the class of work used in BT’s Regulatory Accounting System against which BT records engineering time and other associated costs each of which relates to maintaining and repairing Digital Subscriber Lines;

‘Net Replacement Cost’ means the Gross Replacement Cost less accumulated depreciation based on Gross Replacement Cost;

‘Next Generation Access or NGA’ means the wired access networks which consist wholly or in part of optical elements and which are capable of delivering broadband access services with enhanced characteristics as compared to those provided over already existing copper networks;

‘NGA related Cumulo costs’ means the element of BT’s Cumulo costs within the United Kingdom that is directly attributable to NGA Network Components;

‘NGA Network Components’ means the Network Components which are used solely to supply VULA services;

‘Non-NGA Network Components’ means the Network Components other than the NGA Network Components;

‘Non-NGA related Cumulo costs’ means the Cumulo costs excluding the NGA related Cumulo costs;

‘Retail Price Index’ means the measure of inflation which is published monthly by the Office for National Statistics;

‘Shared Metallic Path Facility or SMPF’ means the provision of access to the copper wires from the customer’s premises to a BT MDF that allows a competing provider to provide the customer with broadband services, while BT continues to provide the customer with conventional narrowband communications;

‘Test Access Matrices or TAMs’ means the equipment used by every MPF Rental line which is installed to conduct broadband line testing;

‘WBA Statement’ means the statement entitled “Review of the wholesale broadband access markets: Statement on market definition, market power determinations and remedies” which was published by Ofcom on 26 June 2014;

‘Wholesale Local Access Market’ means the supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;

‘Wholesale Residual Market’ means the primarily unregulated products, services and components currently referred to as ‘Wholesale Residual Market’ in the Regulatory Financial Statements;

‘WLR + SMPF Simultaneous Connections’ means, in the case of:

WLR Start of Stopped MPF Line; or

WLR Standard Connection,

when that service or product is ordered simultaneously with SMPF New Provide but excluding instances in which the relevant service or product is not provided simultaneously as a consequence of a request made by the requesting third party;

‘WLR + SMPF Simultaneous Migrations’ means, in the case of WLR Conversion, when that service or product is ordered simultaneously with SMPF New Provide but excluding instances in which the relevant service or product is not provided simultaneously as a consequence of a request made by the requesting third party;

## Part 2: Direction

### **Requirements to ensure the Regulatory Financial Statements are consistent with specified regulatory decisions made by Ofcom in the FAMR Statement**

1. BT shall prepare the Regulatory Financial Statements in accordance with the requirements set out in paragraphs 1.1 – 1.10 below. BT shall give priority to the requirements set out in paragraphs 1.1 – 1.10 in the order in which they are set out below.
  - 1.1. BT shall:
    - 1.1.1. separately identify in the Regulatory Financial Statements each of the internal and external Network Services used in the Wholesale Local Access Market;
    - 1.1.2. separately attribute the costs, revenues and volumes of each of the internal and external Network Services used in the Wholesale Local Access Market.
  - 1.2. BT shall attribute the costs of Directories to the Wholesale Residual Market.
  - 1.3. In the case of the costs incurred by Openreach in relation to MDSL Class of Work, BT shall:
    - 1.3.1. identify the proportion of the costs incurred by Openreach in relation to MDSL Class of Work which relate to Special Fault Investigation Services;
    - 1.3.2. attribute the costs identified in paragraph 1.3.1 to Special Fault Investigation Services; and
    - 1.3.3. attribute the remainder of the costs incurred by Openreach in relation to MDSL Class of Work to each of Analogue Core WLR Rentals, MPF Rentals and SMPF Rentals using the combined usage factor set out in Table 1 below.



Table 1

	<b>Analogue Core WLR Rentals</b>	<b>MPF Rentals</b>	<b>SMPF Rentals</b>
<b>Combined usage factor</b>	0.83	1.21	0.21

1.4. BT shall attribute the costs of each of the following sub-groups of BT's group functions:

1.4.1. Tax/Treasury;

1.4.2. Group Finance Control; and

1.4.3. Strategy

to each of BT's UK subsidiaries and BT's overseas subsidiaries according to the total average number of employees employed by each subsidiary.

1.5. BT shall attribute the costs of the provision for deafness claims arising from the past use of copper line testing equipment to the Wholesale Residual Market.

1.6. In the case of Cumulo costs, BT shall follow the requirements set out in paragraphs 1.6.1 – 1.6.2 in the order in which these requirements are set out below:

1.6.1. BT shall attribute the NGA related Cumulo costs to the NGA Network Components;

1.6.2. BT shall attribute the Non-NGA related Cumulo costs to the Non-NGA Network Components on the basis of profit weighted Net Replacement Costs in accordance with the following formula:

$$Cumall_{i=NGA} \times \left( \frac{\sum_{j=1}^m nrc_{ij} land\%_j wacc_i}{\sum_{i=1}^n \sum_{j=1}^m nrc_{ij} land\%_j wacc_i} \right)$$

Where

$Cumall_i$  = the allocation of the Non-NGA related Cumulo costs to component  $i$

$NNGACC$  = Non-NGA related Cumulo costs

$nrc_{ij}$  = the Net Replacement Costs of the Cumulo Rateable Asset  $j$  that has been attributed to component  $i$

$land\%_j$  = the percentage of the Cumulo Rateable Asset  $j$  that is regarded as being a landlord asset within the most recent rating model used by the Valuation Office Agency in England and Wales to value BT's Cumulo assessment

$wacc_i$  = the weighted average cost of capital that is applicable for component  $i$

m = the number of the Cumulo Rateable Asset categories

n = the number of the Non-NGA Network Components

1.7. In the case of TAMs, BT shall:

- 1.7.1. depreciate the costs of TAMs over a seven year period;
- 1.7.2. attribute the costs of TAMs to MPF Rentals; and
- 1.7.3. attribute the costs of installation of Tie Cables to EvoTAMs.

1.8. In the case of EvoTAMs, BT shall not attribute the costs of EvoTAMs to SMPF Rentals.

1.9. BT shall:

- 1.9.1. separately identify each of WLR + SMPF Simultaneous Connections and WLR + SMPF Simultaneous Migrations; and
- 1.9.2. separately attribute the costs of each of WLR + SMPF Simultaneous Connections and WLR + SMPF Simultaneous Migrations.

1.10. In the case of Analogue Core WLR Rentals, MPF Rentals and SMPF Rentals, BT shall attribute the costs of each of the following Network Components:

- 1.10.1. D-side Copper Current;
- 1.10.2. E-side Copper Current;
- 1.10.3. Local Exchanges General Frames Maintenance; and
- 1.10.4. Analogue Line Drop Maintenance

using the combined usage factor set out in Table 1 above.

## **Requirements to ensure the Regulatory Financial Statements are consistent with specified regulatory decisions made by Ofcom in the WBA Statement**

2. BT shall prepare the Regulatory Financial Statements in accordance with the requirements set out in paragraphs 2.1 – 2.4 below. BT is required to give priority to the requirements set out in paragraphs 2.1 – 2.4 in the order in which they are set out below.

2.1. BT shall attribute the costs of each of the following Network Components:

- 2.1.1. ATM customer interface 2Mbit/s;
- 2.1.2. ATM customer interface 34Mbit/s;
- 2.1.3. ATM customer interface >155Mbit/s;
- 2.1.4. ATM network interface;
- 2.1.5. ATM network switching;

- 2.1.6. Inter ATM transmissions; and
- 2.1.7. Customer Support - Broadband

according to the actual revenues and volumes.

- 2.2. BT shall attribute the costs of DSLAM equipment which are used to provide the Network Services to the End Users to each of Market A and Market B according to the actual volumes of DSLAM in each of Market A and Market B.
- 2.3. BT shall attribute the costs of the Network Services provided to the End Users in Market A and Market B to each of Market A and Market B according to the location of the exchange from which the End User receives the Network Services.
- 2.4. BT shall not attribute the costs of 21CN in accordance with the Future Benefits Principle to the Network Services considered in the WBA Statement which do not use 21CN.

### **Requirements in relation to the preparation of the Regulatory Financial Statements on a regulatory asset value adjusted current costs basis**

- 3. In preparing the Regulatory Financial Statements, explanations and other required information on a regulatory asset value adjusted current costs basis, BT shall value the Access Ducts capitalised prior to 1 August 1997 on the basis of the closing historical cost on 31 March 2005 which is indexed by the Retail Price Index from 31 March 2005.

## Annex 3

# Direction under section 49 of the Communications Act 2003 and SMP Services Conditions 13A.4 and 8A.4 specifying the transparency requirements for the purposes of preparing and maintaining the accounting records, the Accounting Methodology Documents and the Regulatory Financial Statements

## Background

1. On 20 December 2013, Ofcom published a consultation entitled “Regulatory Financial Reporting – a review” (the “2013 Consultation”), which set out proposals for SMP services conditions relating to regulatory financial reporting to be imposed in the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area; and
  - Wholesale broadband access provided in Market A.
2. The 2013 Consultation also set out proposals to specify the level of transparency required to be met by BT in preparing and maintaining the Accounting Methodology Documents under the proposed SMP services conditions.
3. On 20 May 2014, Ofcom published a policy statement entitled “Regulatory Financial Reporting – Final Statement”, which set out Ofcom’s conclusions on the requirements for regulatory financial reporting that Ofcom considered should be applied to BT in markets in which BT has significant market power. Ofcom noted among others that the level of transparency required to be met by BT in preparing and maintaining the accounting records, the Accounting Methodology Documents

and the Regulatory Financial Statements would be specified in a statement to be published separately.

4. On 26 June 2014, Ofcom published a statement entitled “Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30” (the “FAMR Statement”). At Annex 29 of the FAMR Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 13A) in relation to the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area; and
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area.
5. On 26 June 2014, Ofcom published a statement entitled “Review of the wholesale broadband access markets: Statement on market definition, market power determinations and remedies” (the “WBA Statement”). At Annex 2 of the WBA Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 8A) in relation to the following market:
  - Wholesale broadband access provided in Market A.
6. Under condition 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement, Ofcom may from time to time make such directions as they consider appropriate in relation to BT’s obligations under conditions 13A and 8A respectively.
7. The Direction set out in the Schedule to this Notification is given under condition 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement and specifies the level of transparency required to be met by BT in preparing and maintaining the accounting records, the Accounting Methodology Documents and Regulatory Financial Statements as required under conditions 13A and 8A respectively.
8. For the reasons set out in the explanatory statement accompanying this Notification, Ofcom is satisfied that, in accordance with section 49(2) of the Act, the Direction set out in the Schedule to this Notification is:
  - a. Objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
  - b. Not such as to discriminate unduly against particular persons or against a particular description of persons;
  - c. Proportionate to what it is intended to achieve; and

- d. In relation to what it is intended to achieve, transparent.
- 9. For the reasons set out in the explanatory statement accompanying this Notification, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements set out in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.
- 10. A copy of this Notification, together with the Direction set out in the Schedule to this Notification, has been sent to the Secretary of State in accordance with section 49C(1)(b) of the Act, and the European Commission in accordance with section 49C(2)(a) of the Act.

**Direction**

- 11. Ofcom has decided to give the Direction which is set out in the Schedule to this Notification.

**Interpretation**

- 12. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 29 of the FAMR Statement and Annex 2 of the WBA Statement each as appropriate and otherwise any word or expression shall have the same meaning as it has in the Act.

Signed



David Brown

Director of Competition Finance, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

30 March 2015

## **Schedule**

### **Direction specifying the transparency requirements for the purposes of preparing and maintaining the accounting records, the Accounting Methodology Documents and the Regulatory Financial Statements**

In preparing and maintaining the accounting records, the Accounting Methodology Documents and the Regulatory Financial Statements, BT shall ensure that any data, information, description, material or explanatory document prepared in respect of accounting and other methods used in the preparation of the accounting records and Regulatory Financial Statements shall be sufficiently transparent and prepared such that a suitably informed reader can gain a clear understanding of such data, information, description, material or explanatory document, and, if necessary, the overall structure of BT's financial and information systems from which regulatory accounting data is derived and in particular the sequence of the processing and 'cascade' effect of the intermediate cost centres; and gain a clear understanding of all the material, methodologies and drivers (e.g. systems, Processes and procedures) applied in the preparation of regulatory accounting data.

## Annex 4

# Direction under section 49 of the Communications Act 2003 and SMP Services Conditions 13A.4 and 8A.4 setting the requirements in relation to audit, form of the FPIA opinion and form of PPIA opinion for Regulatory Financial Statements

## Background

1. On 20 December 2013, Ofcom published a consultation entitled “Regulatory Financial Reporting – a review” (the “2013 Consultation”), which set out proposals for SMP services conditions relating to regulatory financial reporting to be imposed in the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area; and
  - Wholesale broadband access provided in Market A.
2. The 2013 Consultation also set out proposals to specify the level of audit which must, where so required by Ofcom, be secured by BT in obtaining:
  - an audit to “fairly presents in accordance with” (“FPIA”) standards;
  - an audit to “properly prepared in accordance with” (“PPIA”) standards.
3. Ofcom also proposed that certain directions given under a statement entitled “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” would, in relation to the markets referred to in paragraph 1, continue to have force as if they were given under the proposed SMP services conditions. These proposals concerned, among others, a direction relating to the Preparation, audit, delivery and publication of the Regulatory Financial Statements (“Direction 3”).



4. On 20 May 2014, Ofcom published a policy statement entitled “Regulatory Financial Reporting – Final Statement”, which set out Ofcom’s conclusions on the requirements for regulatory financial reporting that Ofcom considered should be applied to BT in markets in which BT has significant market power. Ofcom noted that the proposals in relation to the level of audit referred to in paragraph 3 above would be implemented in a statement to be issued separately. Ofcom also noted that Direction 3 incorporating the amendments proposed in the 2013 Consultation would be issued afresh under the new SMP services conditions once these conditions were adopted in the markets identified in paragraph 1 subject to comments from the European Commission.
  
5. On 26 June 2014, Ofcom published a statement entitled “Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30” (the “FAMR Statement”). At Annex 29 of the FAMR Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 13A) in relation to the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area; and
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area.
  
6. On 26 June 2014, Ofcom published a statement entitled “Review of the wholesale broadband access markets: Statement on market definition, market power determinations and remedies” (the “WBA Statement”). At Annex 2 of the WBA Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 8A) in relation to the following market:
  - Wholesale broadband access provided in Market A.
  
7. Under conditions 13A.1 to 13A.37 set out at Annex 29 of the FAMR Statement and conditions 8A.1 to 8A.37 set out at Annex 2 of the WBA Statement, and in particular conditions 13A.8(iii) and 8A.8(iii), BT is required to secure the expression of an audit opinion upon the Regulatory Financial Statements as notified by Ofcom from time to time.
  
8. Under condition 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement, Ofcom may from time to time make such directions as they consider appropriate in relation to BT’s obligations under conditions 13A.8 and 8A.8 respectively.

9. The Direction set out in the Schedule to this Notification is given under condition 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement and sets the requirements in relation to audit, form of the FPIA opinion and form of PPIA opinion for the Regulatory Financial Statements.
10. For the reasons set out in the explanatory statement accompanying this Notification, Ofcom is satisfied that, in accordance with section 49(2) of the Act, the Direction set out in the Schedule to this Notification is:
  - a. Objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
  - b. Not such as to discriminate unduly against particular persons or against a particular description of persons;
  - c. Proportionate to what it is intended to achieve; and
  - d. In relation to what it is intended to achieve, transparent.
11. For the reasons set out in the explanatory statement accompanying this Notification, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements set out in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.
12. A copy of this Notification, together with the Direction set out in the Schedule to this Notification, has been sent to the Secretary of State in accordance with section 49C(1)(b) of the Act, and the European Commission in accordance with section 49C(2)(a) of the Act.

### **Direction**

13. Ofcom has decided to give the Direction which is set out in the Schedule to this Notification.

### **Interpretation**

14. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 29 of the FAMR Statement and Annex 2 of the WBA Statement each as appropriate and otherwise any word or expression shall have the same meaning as it has in the Act.

Signed



David Brown

Director of Competition Finance, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

30 March 2015

## Schedule

### **Direction setting the requirements in relation to audit, form of the FPIA opinion and form of PPIA opinion for Regulatory Financial Statements**

1. BT shall secure, to the satisfaction of Ofcom, an appropriate audit opinion in respect of the published Regulatory Financial Statements as a whole, in respect of each Regulatory Financial Statement and in respect of groups of Regulatory Financial Statement, to either “fairly presents in accordance with” (“FPIA”) standards or “properly prepared in accordance with” (“PPIA”) standards, as specified by Ofcom and as shall be notified in writing to BT from time to time by Ofcom.
2. Where BT is required to secure the expression of an audit opinion to FPIA standards upon any Regulatory Financial Statement, BT shall ensure that the Regulatory Auditor shall state whether in his opinion:
  - a. each Regulatory Financial Statement has been prepared in accordance with the applicable SMP services conditions, the Regulatory Accounting Guidelines, the Regulatory Accounting Principles and the Accounting Methodology Documents;
  - b. each Regulatory Financial Statement and corresponding audit opinion that BT delivers to Ofcom and/or publishes is fit for such purpose (or purposes), if any, as notified by Ofcom to BT in writing;
  - c. each Regulatory Financial Statement fairly presents in accordance with the Regulatory Accounting Principles, the Regulatory Accounting Guidelines and the Accounting Methodology Documents:
    - i. in the case of the Performance Summary by Market or Technical Area and the BT Reconciliation Statement – Consolidated Profit and Loss Account, the results in the relevant Market, Technical Area, Basket, Single Charge Category and Network Service (as appropriate) for the relevant Financial Year and Prior Year Comparatives;
    - ii. in the case of the Attribution of Wholesale Current Cost Mean Capital Employed and the BT Reconciliation Statement – Consolidated Mean Capital Employed, the mean capital employed in the relevant Market, Technical Area, Basket, Single Charge Category and Network Service (as appropriate) for the relevant Financial Year and Prior Year Comparatives; and
    - iii. in the case of the other statements of revenues, costs, assets, liabilities and other quantities, the revenues, costs, assets, liabilities and other quantities incurred or employed in the relevant Market, Technical Area, Basket, Single Charge Category and Network Service (as appropriate) for the relevant Financial Year and Prior Year Comparatives.

3. Where BT is required to secure the expression of an audit opinion to PPIA standards upon any Regulatory Financial Statement, BT shall ensure that the Regulatory Auditor shall state whether in his opinion:
  - a. each Regulatory Financial Statement has been properly prepared in accordance with the applicable SMP services conditions, the Regulatory Accounting Guidelines, the Regulatory Accounting Principles, and the Accounting Methodology Documents, including the Prior Year Comparatives;
  - b. each Regulatory Financial Statement and corresponding audit opinion that BT delivers to Ofcom and/or publishes is fit for such purpose (or purposes), if any, as notified by Ofcom to BT in writing; and
  - c. anything has come to his attention that would lead him to conclude that the applicable SMP services conditions, the Regulatory Accounting Guidelines, the Regulatory Accounting Principles and the Accounting Methodology Documents have not been properly applied in the preparation of the relevant Regulatory Financial Statement, disclosing where practicable any adjustments he considers to be required in respect of any such matter.

## Annex 5

# Direction under section 49 of the Communications Act 2003 and SMP Services Conditions 13A.4 and 8A.4 setting the requirements in relation to reconciliation report and accompanying audit opinion

## Background

1. On 20 December 2013, Ofcom published a consultation entitled “Regulatory Financial Reporting – a review” (the “2013 Consultation”), which set out proposals for SMP services conditions relating to regulatory financial reporting to be imposed in the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area; and
  - Wholesale broadband access provided in Market A.
2. The 2013 Consultation also set out proposals in relation to the content of the reconciliation report and of the accompanying audit opinion.
3. On 20 May 2014, Ofcom published a policy statement entitled “Regulatory Financial Reporting – Final Statement”, which set out Ofcom’s conclusions on the requirements for regulatory financial reporting that Ofcom considered should be applied to BT in markets in which BT has significant market power. Ofcom noted that the proposals referred to in paragraph 2 above would, with certain amendments, be implemented under the new SMP services conditions once these conditions were adopted in the markets identified in paragraph 1 subject to comments from the European Commission.
4. On 26 June 2014, Ofcom published a statement entitled “Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30” (the “FAMR Statement”). At Annex 29 of the FAMR Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 13A) in relation to the following markets:

- The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area; and
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area.
5. On 26 June 2014, Ofcom published a statement entitled “Review of the wholesale broadband access markets: Statement on market definition, market power determinations and remedies” (the “WBA Statement”). At Annex 2 of the WBA Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 8A) in relation to the following market:
- Wholesale broadband access provided in Market A.
6. Under conditions 13A.8(vi) and 13A.23 set out at Annex 29 to the FAMR Statement and conditions 8A.8(vi) and 8A.23 set out at Annex 2 of the WBA Statement, BT is required to prepare and publish a reconciliation report as directed by Ofcom from time to time. The reconciliation report must set out changes to the Regulatory Accounting Methodology and the impact of such changes on the Regulatory Financial Statements, and Material Errors corrected in the Regulatory Financial Statements and the impact of such Material Errors on the Regulatory Financial Statements.
7. Under conditions 13A.8(vi) and 13A.24 set out at Annex 29 to the FAMR Statement and conditions 8A.8(vi) and 8A.24 set out at Annex 2 of the WBA Statement, BT is required to obtain an audit opinion on the reconciliation report as directed by Ofcom from time to time.
8. Under conditions 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement, Ofcom may from time to time make such directions as they consider appropriate in relation to BT’s obligations under conditions 13A and 8A respectively.
9. The Direction set out in the Schedule to this Notification is given under conditions 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement and specifies the requirements in relation to the content of the reconciliation report and the content of the accompanying audit opinion.
10. For the reasons set out in the explanatory statement accompanying this Notification, Ofcom is satisfied that, in accordance with section 49(2) of the Act, the Direction set out in the Schedule to this Notification is:

- a. Objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
  - b. Not such as to discriminate unduly against particular persons or against a particular description of persons;
  - c. Proportionate to what it is intended to achieve; and
  - d. In relation to what it is intended to achieve, transparent.
11. For the reasons set out in the explanatory statement accompanying this Notification, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements set out in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.
12. A copy of this Notification, together with the Direction set out in the Schedule to this Notification, has been sent to the Secretary of State in accordance with section 49C(1)(b) of the Act, and the European Commission in accordance with section 49C(2)(a) of the Act.

### **Direction**

13. Ofcom has decided to give the Direction which is set out in the Schedule to this Notification.

### **Interpretation**

14. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 29 of the FAMR Statement and Annex 2 of the WBA Statement each as appropriate, and otherwise any word or expression shall have the same meaning as it has in the Act.

Signed



David Brown

Director of Competition Finance, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

30 March 2015

## Schedule

### Direction setting the requirements in relation to reconciliation report and accompanying audit opinion

#### Part 1: Definitions and Interpretation

In this Direction:

‘Audit and Risk Committee’ means the committee of the board of directors of BT whose principal duties include financial reporting, internal controls, risk management and audit and includes any committee or unit established from time to time by the board of directors of BT to perform such duties;

‘Change Control Notification’ means a list of each and every change to the Regulatory Accounting Methodology which BT is required to publish and deliver to Ofcom by 31 March of the Financial Year in which the change to the Regulatory Accounting Methodology is to be made;

‘Markets and Technical Areas Level’ means the level at which total costs, total revenue and total assets are reported for each separate Market and Technical Area to which this Direction applies;

‘Material Change’ means a change in any element of the Regulatory Accounting Methodology which results in a change (be it positive or negative) in any figure in the Regulatory Financial Statements which exceeds the higher of 5% or £1 million. The percentage change in a figure shall be calculated by taking the value of the affected figure before the change in the Regulatory Accounting Methodology is applied, and subtracting from it, the value of the same figure after the change in the Regulatory Accounting Methodology is applied, and then dividing this result by the former value;

‘Material Error’ means an Error which:

- i. results in a correction (be it positive or negative) in any figure in the Regulatory Financial Statements which exceeds the higher of 5% or £1 million. The percentage correction in a figure shall be calculated by taking the value of the affected figure in the Regulatory Financial Reporting before the error is corrected, and subtracting from it, the value of the same figure after the error is corrected, and then dividing this result by the former value; and
- ii. fulfils at least one of the following conditions set out in paragraphs (ii)(a) and (ii)(b) below:
  - a) the error has arisen within the Regulatory Attribution System;
  - b) the error has been brought to the attention of the Audit and Risk Committee by the Regulatory Auditor;

‘Regulatory Attribution System’ means the set of computerised and manual accounting methods, procedures, Processes and controls established to attribute the costs, revenues, assets and liabilities and summarise, interpret, and present the resultant financial data in an accurate and timely manner for the purposes of the whole of the Regulatory Financial Statements, the Accounting Methodology Documents, the accounting records and the Regulatory Accounting System.



## Part 2: Direction

1. BT must prepare a reconciliation report which sets out:
  - i. In relation to changes to the Regulatory Accounting Methodology:
    - a) each and every change;
    - b) the impact of all changes on all figures presented in the Regulatory Financial Statements, by setting out, on an aggregated basis, the difference between the Current Year Figures and the Current Year Figures had such changes not been made, expressed as an absolute amount and as a percentage change;
    - c) the impact of each Material Change at the Markets and Technical Areas Level, by setting out, for each Material Change separately, the difference between the Current Year Figures and the Current Year Figures had such Material Change not been made, expressed as an absolute amount and as a percentage change;
    - d) the impact of changes which are not Material Changes at the Markets and Technical Areas Level, by setting out, on an aggregated basis, the difference between the Current Year Figures and the Current Year Figures had such changes not been made, expressed as an absolute amount and as a percentage change; and
  - ii. in relation to Material Errors identified since the publication of the previous Financial Year's Regulatory Financial Statements:
    - a) for each Material Error, a description of the Material Error, the circumstances of discovery of the Material Error, the reason for the Material Error, and whether such Material Error has been corrected in the restated Prior Year Comparatives;
    - b) the impact of all Material Errors on all figures presented in the Regulatory Financial Statements for the previous Financial Year, by setting out, on an aggregated basis:
      - i. the Current Year Figures set out in the Regulatory Financial Statements for the previous Financial Year had such Material Errors been corrected in the previous Financial Year ("the Corrected Previous Year Figures"); and
      - ii. the difference as an absolute amount and as a percentage change between the Current Year Figures set out in the Regulatory Financial Statements for the previous Financial Year and the Corrected Previous Year Figures.
    - c) the impact of each Material Error at the Markets and Technical Areas Level, by setting out, for each Material Error, the difference as an absolute amount and as a percentage change between:

- i. the Current Year Figures set out in the Regulatory Financial Statements for the previous Financial Year; and
  - ii. the Current Year Figures set out in the Regulatory Financial Statements for the previous Financial Year had such Material Error been corrected in the previous Financial Year.
- 2. BT must obtain an audit opinion on the reconciliation report which must set out:
  - i. whether all Material Changes were included in the Change Control Notification. Where this is not the case, the audit opinion must report whether Material Changes other than those included in the Change Control Notification were made as a result of an audit requirement made following delivery of the Change Control Notification or otherwise;
  - ii. whether the description of each of the Material Changes provided by BT in the Change Control Notification is accurate;
  - iii. whether BT included each and every Material Change in the reconciliation report and correctly calculated the impact of all changes on all figures presented in the Regulatory Financial Statements in accordance with paragraph 1(i)(b) above;
  - iv. whether the description of each of the Material Errors provided by BT in the reconciliation report is accurate; and
  - v. whether the Corrected Previous Year Figures set out in the reconciliation report in accordance with paragraph 1(ii)(b)(i) above are properly prepared in accordance with the Accounting Methodology Documents for the previous Financial Year had these Accounting Methodology Documents not included these Material Errors.

## Annex 6

# Direction under sections 49 and 49A of the Communications Act 2003 and SMP Services Condition OA2, 13A.4 and 8A.4 specifying the requirements in relation to additional reporting of information relating to BT's adjusted financial performance

## Background

1. On 22 July 2004, Ofcom published a statement entitled "The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification" (the "July 2004 Statement"). At Annex 2 of this statement, Ofcom imposed SMP services conditions with respect to regulatory accounting on BT in markets in which BT had been found to have significant market power in previously concluded market reviews.
2. On 26 June 2014, Ofcom published a statement entitled "Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30" (the "FAMR Statement"). At Annex 29 of the FAMR Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 13A) in relation to the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area.
3. On 26 June 2014, Ofcom published a statement entitled "Review of the wholesale broadband access markets: Statement on market definition, market power determinations and remedies" (the "WBA Statement"). At Annex 2 of the WBA Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 8A) in relation to the following market:

- Wholesale broadband access provided in Market A.
4. On 10 December 2014, Ofcom published a consultation entitled “Directions for Regulatory Financial Reporting”, which set out a proposal for a direction specifying the requirements in relation to additional reporting of information relating to BT’s adjusted financial performance.
  5. Under condition OA2 set out at Annex 2 of the July 2004 Statement, condition 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement, Ofcom may from time to time make such directions as they consider appropriate in relation to BT’s obligations under conditions OA5, 13A.8(i) and 8A.8(i) respectively.
  6. The Direction set out in the Schedule to this Notification is given under condition OA2 set out at Annex 2 of the July 2004 Statement, condition 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement and specifies the requirements in relation to the Regulatory Financial Statements which BT is required to prepare, and in particular BT’s reporting of information relating to its adjusted financial performance.
  7. For the reasons set out in the explanatory statement accompanying this Notification, Ofcom is satisfied that, in accordance with section 49(2) of the Act, the Direction set out in the Schedule to this Notification is:
    - a. Objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
    - b. Not such as to discriminate unduly against particular persons or against a particular description of persons;
    - c. Proportionate to what it is intended to achieve; and
    - d. In relation to what it is intended to achieve, transparent.
  8. For the reasons set out in the explanatory statement accompanying this Notification, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements set out in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.
  9. A copy of this Notification, together with the Direction set out in the Schedule to this Notification, has been sent to the Secretary of State in accordance with section 49C(1)(b) of the Act, and the European Commission in accordance with section 49C(2)(a) of the Act.

## Direction

10. Ofcom has decided to give the Direction which is set out in the Schedule to this Notification.

## Interpretation

11. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 2 of the July 2004 Statement, Annex 29 of the FAMR Statement and Annex 2 of the WBA Statement and otherwise any word or expression shall have the same meaning as it has in the Act.

Signed

A handwritten signature in black ink, appearing to read 'David Brown', with a stylized, cursive script.

David Brown

Director of Competition Finance, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

30 March 2015

## **Schedule**

### **Direction specifying the requirements in relation to additional reporting of information relating to BT's adjusted financial performance**

#### **Part 1: Definitions and Interpretation**

In this Direction:

'Asynchronous Transfer Mode or ATM' means the network technology that uses asynchronous time division multiplexing techniques and which supports data transmissions at up to 622Mbit/s;

'Asset Volume Elasticity or AVE' means the percentage increase in capital costs required for a 1% increase in volume;

'Digital Subscriber Loop Access Multiplexer or DSLAM' means the apparatus used to terminate DSL enabled local loops, which comprises a bank of DSL modems and a multiplexer which combines many local loops into one data path;

'Fully Allocated Cost or FAC' means an accounting approach under which all the costs of the company are distributed between its various products and services. The fully allocated cost of a product or service may therefore include some common costs that are not directly attributable to the service;

'Gross Replacement Cost or GRC' means the cost of replacing an existing tangible fixed asset with an identical or substantially similar new asset having a similar production or service capacity;

'Long Run Incremental Cost or LRIC' means the cost caused by the provision of a defined increment of output given the costs can, if necessary, be varied and that some level of output is already produced;

'Net Replacement Cost or NRC' means the Gross Replacement Cost less accumulated depreciation based on the Gross Replacement Cost;

'Other CCA Adjustments' means the one-off, non-recurring adjustments made by BT when preparing the Regulatory Financial Statements and which are referred to by BT as 'Other CCA adjustments' in BT's Regulatory Financial Statements;

'Synchronous Digital Hierarchy or SDH' means the digital transmission standard that is widely used in communications networks;

'Test Access Matrices or TAMs' means the equipment used by every MPF line which is installed to conduct broadband line testing;

'WBA Statement' means the statement entitled "Review of the wholesale broadband access markets: Statement on market definition, market power determinations and remedies" which was published by Ofcom on 26 June 2014.

## Part 2: Direction

BT shall prepare the “Adjusted Financial Performance at a market review level” statement and the “Adjusted Financial Performance at a market level” statement in order to show the impact on the Regulatory Financial Statements of the adjustments set out below in aggregate.

1. BT shall give priority to the requirements set out in paragraphs 1.1 – 1.7 in the order in which they are set out below.

- 1.1. BT shall calculate the difference between:

- 1.1.1.1. the LRIC of Analogue Core WLR Rentals; and
- 1.1.1.2. the LRIC of MPF Rentals,

(the "WLR Minus MPF LRIC Differential").

- 1.2. In the case of TAMs, BT shall:

- 1.2.1. set the LRIC of TAMs per line used by MPF Rentals at £3.75; and
- 1.2.2. attribute the common costs of TAMs which exceed LRIC to each of Analogue Core WLR Rentals and MPF Rentals so that the WLR Minus MPF LRIC Differential remains as calculated in paragraph 1.1.

- 1.3. In the case of PSTN Line Cards, BT shall:

- 1.3.1. increase the NRC of the assets of PSTN Line Cards to £715 million in the Financial Year ending on 31 March 2011;
- 1.3.2. adjust the NRC identified in point 1.3.1 in each subsequent Financial Year by complying with the following requirements in the order in which they are set out below:
  - i. applying the Asset Volume Elasticity for the local exchange asset sector derived from BT's Long Run Incremental Cost Methodology; and
  - ii. reducing the resultant NRC identified in point 1.3.2(i) by a cumulative 5 per cent per year starting with the Financial Year 2012;
- 1.3.3. set the NRC of PSTN Line Cards at LRIC and attribute the common costs of PSTN Line Cards which exceed LRIC to each of Analogue Core WLR Rentals and MPF Rentals so that the WLR Minus MPF LRIC Differential remains as calculated in paragraph 1.1.

- 1.4. In the case of Combi Card Voice, BT shall reduce the NRC of the assets of Combi Card Voice to £0.

- 1.5. BT shall set the costs of the following Network Services at LRIC:

- 1.5.1. Caller Display;
- 1.5.2. MPF Single Migration;

- 1.5.3. MPF Bulk Migration;
- 1.5.4. SMPF Single Migration;
- 1.5.5. SMPF Bulk Migration; and
- 1.5.6. WLR Transfer.

1.6. BT shall:

- 1.6.1. identify the common costs of the Network Services set out in paragraphs 1.5.1 – 1.5.6 which exceed their respective LRICs; and
- 1.6.2. attribute the common costs identified in paragraph 1.6.1 to Analogue Core WLR Rentals and MPF Rentals so that the WLR Minus MPF LRIC Differential remains as calculated in paragraph 1.1.

1.7. In the case of SMPF Rentals, BT shall:

- 1.7.1. set the costs of SMPF Rentals at LRIC;
- 1.7.2. identify the common costs of SMPF Rentals which exceed LRIC; and
- 1.7.3. attribute the common costs identified in paragraph 1.7.2 to Analogue Core WLR Rentals and MPF Rentals so that the WLR Minus MPF LRIC Differential remains as calculated in paragraph 1.1.

- 2. BT shall give priority to the requirements set out in paragraphs 2.1 – 2.2 in the order in which they are set out below.

2.1. BT shall:

- 2.1.1. set the GRC of DSLAM at the current replacement cost of DSLAM;
- 2.1.2. set and maintain the NRC:GRC ratio at 50% in relation to the following assets:
  - 2.1.2.1. ATM;
  - 2.1.2.2. SDH; and
  - 2.1.2.3. DSLAM;
- 2.1.3. depreciate the assets set out in paragraphs 2.1.2.1 – 2.1.2.3 over a thirteen year period.

- 2.2. BT shall remove the Other CCA Adjustments considered in the WBA Statement by presenting the figures in the Regulatory Financial Statements as if these Other CCA adjustments had not been made.



## Annex 7

# Direction under section 49 of the Communications Act 2003 and SMP Services Conditions 13A.4 and 8A.4 setting the requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements

## Background

1. On 20 December 2013, Ofcom published a consultation entitled “Regulatory Financial Reporting – a review” (the “2013 Consultation”), which set out proposals for SMP services conditions relating to regulatory financial reporting to be imposed in the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area; and
  - Wholesale broadband access provided in Market A.
2. The 2013 Consultation also set out proposals for requirements to be imposed by direction in relation to the preparation, audit, delivery, publication, form and content of the Regulatory Financial Statements. Ofcom proposed that certain directions given under a statement entitled “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” would (with certain amendments), in relation to the markets referred to in paragraph 1, continue to have force as if they were given under the proposed SMP services conditions. These proposals concerned, among others, the following directions as modified:
  - a direction relating to the preparation, audit, delivery and publication of the Regulatory Financial Statements (“Direction 3”); and
  - a direction relating to the form and content of the Regulatory Financial Statements (“Direction 4”).

3. On 20 May 2014, Ofcom published a policy statement entitled “Regulatory Financial Reporting – Final Statement”, which set out Ofcom’s conclusions on the requirements for regulatory financial reporting that Ofcom considered should be applied to BT in markets in which BT has significant market power. Ofcom noted that Direction 3 and Direction 4 incorporating the amendments proposed in the 2013 Consultation would be issued afresh under the new SMP services conditions once these conditions were adopted in the markets identified in paragraph 1 subject to comments from the European Commission.
4. On 26 June 2014, Ofcom published a statement entitled “Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30” (the “FAMR Statement”). At Annex 29 of the FAMR Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 13A) in relation to the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area; and
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area.
5. On 26 June 2014, Ofcom published a statement entitled “Review of the wholesale broadband access markets: Statement on market definition, market power determinations and remedies” (the “WBA Statement”). At Annex 2 of the WBA Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 8A) in relation to the following market:
  - Wholesale broadband access provided in Market A.
6. On 10 December 2014, Ofcom published a consultation entitled “Directions for Regulatory Financial Reporting” which included, among others, proposals to impose requirements under condition 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement in relation to:
  - the preparation, delivery and publication of the information relating to Virtual Unbundled Local Access, Virtual Unbundled Local Access Migration and the Electricity Charge in the Regulatory Financial Statements; and
  - the form and content of the information relating to Virtual Unbundled Local Access and Virtual Unbundled Local Access Migration in the Regulatory Financial Statements.
7. Under conditions 13A.1 to 13A.37 set out at Annex 29 of the FAMR Statement and conditions 8A.1 to 8A.37 set out at Annex 2 of the WBA Statement, and in particular conditions 13A.8 and 8A.8, BT is required to prepare, deliver to Ofcom and publish the Regulatory Financial Statements as directed by Ofcom from time to time.

8. Under condition 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement, Ofcom may from time to time make such directions as they consider appropriate in relation to BT's obligations under conditions 13A.8 and 8A.8 respectively.
9. The Direction set out in the Schedule to this Notification is given under condition 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement and sets the requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements.
10. For the reasons set out in the explanatory statement accompanying this Notification, Ofcom is satisfied that, in accordance with section 49(2) of the Act, the Direction set out in the Schedule to this Notification is:
  - a. Objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
  - b. Not such as to discriminate unduly against particular persons or against a particular description of persons;
  - c. Proportionate to what it is intended to achieve; and
  - d. In relation to what it is intended to achieve, transparent.
11. For the reasons set out in the explanatory statement accompanying this Notification, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements set out in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.
12. A copy of this Notification, together with the Direction set out in the Schedule to this Notification, has been sent to the Secretary of State in accordance with section 49C(1)(b) of the Act, and the European Commission in accordance with section 49C(2)(a) of the Act.

**Direction**

13. Ofcom has decided to give the Direction which is set out in the Schedule to this Notification.

**Interpretation**

14. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 29 of the FAMR Statement and Annex 2 of the WBA Statement each as appropriate and otherwise any word or expression shall have the same meaning as it has in the Act.

Signed

A handwritten signature in black ink, appearing to read 'David Brown', with a stylized, cursive script.

David Brown

Director of Competition Finance, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

30 March 2015

## Schedule

### Direction setting the requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements

#### Part 1: Definitions and Interpretation

In this Direction:

'Fixed Access Markets' mean the following markets identified in a statement entitled "Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30" published on 26 June 2014:

- The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
- Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
- Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area; and
- Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area;

'Market A' means the following market identified in a statement entitled "Review of the wholesale broadband access markets: Statement on market definition, market power determinations and remedies" published on 26 June 2014:

- Wholesale broadband access provided in Market A.

#### Part 2: Direction

1. BT shall prepare, deliver to Ofcom and publish the following statements:
  - a. the following statements in respect of all Markets considered together, or each individual Market, as appropriate:
    - i. Statement by Ofcom;
    - ii. Statement of Responsibility;
    - iii. Regulatory Financial Review;
    - iv. Notes to the Regulatory Financial Statements;
    - v. Report of the Regulatory Auditor;
    - vi. Performance Summary by Market or Technical Area;
    - vii. Attribution of Wholesale Current Costs;
    - viii. Attribution of Wholesale Current Cost Mean Capital Employed;
    - ix. Market/Technical Area Summary;
    - x. Market/Technical Area Calculation of FAC based on component costs and usage factors;
    - xi. BT Reconciliation Statement – Consolidated Profit and Loss Account;
    - xii. BT Reconciliation Statement – Consolidated Mean Capital Employed;
    - xiii. Consolidated Network Activity Statement;
    - xiv. Adjusted financial performance at a market review level;
    - xv. Price controls in wholesale markets (Non Confidential Statements).

- b. the following statements in respect of the Fixed Access Markets:
    - i. Time Related Charges Costs Relating to the Fixed Access Markets (Non Confidential Statements);
    - ii. Special Fault Investigation Costs Relating to the Fixed Access Markets (Non Confidential Statements);
  - c. the following statement in respect of Market A:
    - i. Calculation of EOI Input Prices.
- 2. BT shall publish the statements set out in paragraph 1 of this Direction within four months after the end of the Financial Year to which they relate with the exception of:
  - a. Price controls in wholesale markets (Non Confidential Statements) which must be published at the same time as the Price controls in wholesale markets (Confidential Statements), as referred to in paragraph 5(a)(xv) of this Direction, are delivered to Ofcom;
  - b. Time Related Charges Costs Relating to the Fixed Access Markets (Non Confidential Statements) which must be published at the same time as the Time Related Charges Costs Relating to the Fixed Access Markets (Confidential Statements), as referred to in paragraph 5(b)(i) of this Direction, are delivered to Ofcom;
  - c. Special Fault Investigation Costs Relating to the Fixed Access Markets (Non Confidential Statements) which must be published at the same time as the Special Fault Investigation Costs Relating to the Fixed Access Markets (Confidential Statements), as referred to in paragraph 5(b)(ii) of this Direction, are delivered to Ofcom.
- 3. Except where BT is entitled to amend the form and content of the Regulatory Financial Statements, BT shall prepare the Regulatory Financial Statements as to form and content in manner set out in Annex A to this Direction;
- 4. BT shall publish the Regulatory Financial Statements in Excel spreadsheet format as well as in portable document format ("PDF").
- 5. BT shall prepare and deliver to Ofcom:
  - a. the following additional financial information as described in Annex B in respect of each Market:
    - i. Cost category (as used within regulatory LRIC model) analysis for network components, increments and relevant layers of common cost;
    - ii. Summarised activity analysis of components for network activities, increments and the relevant layers of common cost (LRIC basis);
    - iii. Cost category (as used within regulatory LRIC model) analysis for network components and increments;
    - iv. Summarised activity analysis for network components and increments;
    - v. Analysis, by asset category and network activities, of the depreciation charge for the year and impact of CCA valuation adjustments on costs for the year;
    - vi. CCA fixed asset movement statement;

- vii. Total mean capital employed and detailed activity analysis for all network components;
  - viii. Detailed network activity analysis of mean capital employed for all network components;
  - ix. Graphs over time of the various raw indices, index weightings and composite indices used by BT to revalue assets onto a current cost basis;
  - x. Estimated economic useful lives, valuation and depreciation basis, survey used for valuation or index used to revalue, historical cost accounting (HCA) and current cost accounting (CCA) depreciation, gross book values (GBV) by year of acquisition, gross replacement costs (GRC) and net replacement costs (NRC) across asset categories;
  - xi. Total operating costs and mean capital employed costs (and associated volumes) for each plant group and their individual exhaustion, including the disclosure of relevant usage factors, onto each network activity and/or (sub) component;
  - xii. Provision of BT 'Data File';
  - xiii. CCA information to allow Ofcom to re-calculate the regulatory asset value (RAV) for copper assets used in BT's access network;
  - xiv. BT Network Services Reconciliation;
  - xv. Price controls in wholesale markets (Confidential Statements);
  - xvi. Adjusted financial performance at a market level;
- b. the following additional financial information as described in Annex B in respect of the Fixed Access Markets:
- i. Time Related Charges Costs Relating to the Fixed Access Markets (Confidential Statements);
  - ii. Special Fault Investigation Costs Relating to the Fixed Access Markets (Confidential Statements);
  - iii. Provision of FAC, DLRIC and DSAC data per service;
  - iv. Market summary of individual VULA services;
  - v. Calculation of FAC based components costs and usage factors of individual VULA services;
  - vi. VULA allocation of government grants;
  - vii. Additional financial information for Electricity Charges;
- c. the following additional financial information as described in Annex B in respect of Market A:
- i. Comprehensive analysis of the transfer charges where this information is summarised in the published statements;
  - ii. Wholesale broadband access geographical analysis of costs and assets on a cost accounting and EOI basis; and
  - iii. Provision of DLRIC and DSAC data per service.

## **Annex A**

### **Statement by Ofcom**

The statement provided by Ofcom commenting on the figures in, the notes to, or the presentation of any or all of the Regulatory Financial Statements, in relation to each of the markets to which cost accounting and/or accounting separation obligations apply.



### **Statement of Responsibility**

The statement provided by the board of directors of BT shall set out the basis of preparation of the Regulatory Financial Statements and confirm the approval of the Regulatory Financial Statements by BT's board of directors.

## **Regulatory Financial Review**

BT shall be required to summarise the financial performance:

1. across all of the SMP markets to which cost accounting and/or accounting separation obligations apply;
2. at the market review level encompassing individual SMP markets to which cost accounting and/or accounting separation obligations apply considered as part of such market review; and
3. at the level of each individual SMP market to which cost accounting and/or accounting separation obligations apply.

The Regulatory Financial Review (RFR) shall be included in the Regulatory Financial Statements either as a separate statement or as notes to relevant other statements.

The RFR should assist the user's assessment of the Regulatory Financial Statements and provide commentary on compliance with these regulatory conditions.

The RFR should focus on those matters which are relevant to the users of the information, be clearly written and readily understandable.

The information and analysis contained within the RFR should be complete and free from bias.

Disclosure should make clear any issues of comparability that would assist the reader's understanding of the RFR. It should highlight accounting policies that are key to the understanding of performance, focusing on those which have required the particular exercise of judgement in their application and those accounting policies which have changed in the year.

When using financial and non financial measures in the RFR it is important these are defined and explained, assumptions set out and Prior Year Comparatives are disclosed on the same basis as Current Year Figures.

The RFR should explain the main factors that underlie all of the regulated activities, all of the individual SMP markets forming part of each market review and each individual SMP market. In particular, the RFR should explain those factors which have either varied in the past or are expected to change in the future. It should also set out an analysis of the effect of changes in each individual SMP market or the environment in which it operates and of developments within each individual SMP market. For example it should include changes in the market conditions, introduction or announcement of new products and services, new and discontinued activities, other acquisitions and disposals.

The RFR should also analyse the main factors and influences that may have an effect on future performance, whether or not they were significant in the period under review. There should be a discussion of the principal risks facing all of the regulated activities, all of the individual SMP markets forming part of each market review, and each individual SMP market, with a commentary on the approach taken to manage them.

## **Notes to the Regulatory Financial Statements**

The Regulatory Financial Statements shall contain, as a separate statement or as notes to relevant other statements, notes, modelled on statutory accounting conventions, to assist the user in the interpretation of the individual Regulatory Financial Statements.

The notes will address issues necessary to ensure the fair presentation of the Regulatory Financial Statements (where BT is required to obtain an audit to “fairly presents in accordance with” standards) and the proper preparation of the Regulatory Financial Statements (where BT is required to obtain an audit to “properly prepared in accordance with” standards). They should set out to the extent necessary the basis of accounting, accounting policies, changes for restatement, non compliance with the ICAEW Guidance and any other information that will enable users to properly understand the individual Regulatory Financial Statement.

Amongst others the necessary notes would be expected to include:

- a description of the basis on which revenue from sales to other operators arise and other related matters necessary to understand how financial performance has been measured;
- a commentary setting out how the principle of non discrimination and the calculation of usage factors have been applied in the preparation and presentation of Regulatory Financial Statements in respect of Wholesale Services.

## **Report of the Regulatory Auditor**

The statement by the Regulatory Auditor shall set out the duties and responsibilities of BT and of the Regulatory Auditor, the basis of audit opinion in accordance with current auditing standards, to whom a duty of care is owed and their opinion in respect of each Regulatory Financial Statement.

## Performance Summary by Market or Technical Area 20XX

For the year ended 31 March 20XX

Market Review 1	Section	Internal Revenue £m	External Revenue £m	Total Revenue £m	Operating Costs £m	Depreciation £m	Holding (gain)/loss £m	Supp. Dep. £m	Other CCA Adjs £m	Roundings £m	Total CCA Operating Costs £m	Return £m	Mean Capital Employed £m	Return on MCE %
Market/Technical Area 1	X.X	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xx%
Market/Technical Area 2 etc	X.X	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xx%
<b>Total</b>		xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xx%
<b>Market Review 2 etc</b>														
Market/Technical Area 1	X.X	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xx%
Market/Technical Area 2 etc	X.X	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xx%
<b>Total</b>		xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xx%
Total SMP Markets		xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xx%
Wholesale Residual		xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xx%
Retail Residual		xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xx%
<b>Total Markets</b>		xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xx%

## Attribution of Wholesale Current Costs 20XX

**For the year ended 31 March 20XX**

[illegible]

# Attribution of Wholesale Current Cost Mean Capital Employed 20XX

For the year ended 31 March 20XX

	Market Review 1		Market Review 2 etc		Wholesale Residual	Roundings	Total Wholesale Markets
	Market/Technical Area 1	Market/Technical Area 2 etc	Market/Technical Area 1	Market/Technical Area 2 etc			
	£m	£m	£m	£m	£m	£m	£m
<b>Non-current Assets</b>							
Land & Buildings	xxx	xxx	xxx	xxx	xxx	xxx	xxx
Access - Copper	xxx	xxx	xxx	xxx	xxx	xxx	xxx
Access - Fibre	xxx	xxx	xxx	xxx	xxx	xxx	xxx
Access - Duct	xxx	xxx	xxx	xxx	xxx	xxx	xxx
Switch	xxx	xxx	xxx	xxx	xxx	xxx	xxx
Transmission	xxx	xxx	xxx	xxx	xxx	xxx	xxx
Other	xxx	xxx	xxx	xxx	xxx	xxx	xxx
Investments	xxx	xxx	xxx	xxx	xxx	xxx	xxx
<b>Total Non-current Assets</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>
<b>Current Assets</b>							
Inventories	xxx	xxx	xxx	xxx	xxx	xxx	xxx
Receivables							
- Internal	xxx	xxx	xxx	xxx	xxx	xxx	xxx
- External	xxx	xxx	xxx	xxx	xxx	xxx	xxx
<b>Total Current Assets</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>
<b>Current Liabilities</b>							
- Internal	xxx	xxx	xxx	xxx	xxx	xxx	xxx
- External	xxx	xxx	xxx	xxx	xxx	xxx	xxx
<b>Total liabilities falling due within one year</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>
<b>Net Current Assets/(Liabilities)</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>
<b>Total Assets less Current Liabilities</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>
Provisions for Liabilities & Charges	xxx	xxx	xxx	xxx	xxx	xxx	xxx
Roundings	xxx	xxx	xxx	xxx	xxx	xxx	xxx
<b>Mean Capital Employed</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>



## Market/Technical Area Summary 20XX

### Summary for Market 1/Technical Area 1 etc

For the year ended 31 March 20XX

	Internal Revenue £m	External Revenue £m	Total Revenue £m	Internal Volume	External Volume	Unit(s)	Average Internal price £	Average External Price £	Internal FAC* £m	External FAC £m
Basket 1	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x
Basket 2 etc	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x
Single Charge 1 (if applicable)	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x
Single Charge 2 etc (if applicable)	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x
Specific services required to be shown separately by Ofcom (if applicable)	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x
Other (if applicable)	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x
<b>Total Market 1 etc</b>	<b>x.x</b>	<b>x.x</b>	<b>x.x</b>						<b>x.x</b>	<b>x.x</b>
Adjustment for EOI and Internal (if appropriate)	x.x		x.x						x.x	x.x
<b>Total Market 1 etc (excluding EOI and Internal)</b>	<b>x.x</b>	<b>x.x</b>	<b>x.x</b>						<b>x.x</b>	<b>x.x</b>

Internal and External FAC as required by Ofcom

Average Prices may require more detailed analysis as required by Ofcom

\* Only where Internal unit FAC is different from External unit FAC

**Notes to the statement entitled “Market/Technical Area Summary”**

BT shall disclose financial information shown in the “Market/Technical Area Summary” as follows:

1. In relation to the market “The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area”:
  - a. the information is required to be provided for each Basket, Single Charge Category and VULA Migration;
  - b. the information for “Other” should include Virtual Unbundled Local Access;
2. In relation to the market “Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area” the information is required to be provided for each Basket and Single Charge Category;
3. In relation to the market “Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area” the information is required to be provided for each Basket and Single Charge Category; FAC information does not need to be provided.
4. In relation to the market “Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area” the information is required to be provided for each Basket and Single Charge Category; FAC information does not need to be provided.
5. In relation to the market “Wholesale broadband access provided in Market A” the information is required to be provided for:
  - a. each Basket;
  - b. each Single Charge Category; and
  - c. the following Network Services:
    - i. Wholesale Broadband Connect end user access rentals;
    - ii. Wholesale Broadband Connect connections;
    - iii. Wholesale Broadband Connect bandwidth; and
    - iv. Wholesale Broadband Connect ancillary charges and other.

## Market/Technical Area calculation of FAC based on component costs and usage factors 20XX

Calculation of FAC based on component costs and usage factors for Market 1/Technical Area 1 etc

For the year ended 31 March 20XX

			Market/Technical Area 1 etc							
Fully Allocated Cost (£m)		Average cost per unit (from annex XX)	Basket 1 - internal *	Basket 1 - external	Basket 2 etc - internal *	Basket 2 etc - external	Single Charge Category 1 - Internal*	Single Charge Category 1 - External	Single Charge Category 2 etc - Internal*	Single Charge Category 2 etc - External
Components	Unit		£m	£m	£m	£m	£m	£m	£m	£m
Component 1	X	X	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x
Component 2 etc	X	X	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x
EOI Inputs Prices (Basket level Part 3)			x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x
Fully Allocated Costs (£m)			x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x

Volumes (unit) (where applicable)

xxx      xxx      xxx      xxx      xxx      xxx

Unit Cost (£)

x.xx      x.xx      x.xx      x.xx      x.xx      x.xx

Specific services required to be shown separately by Ofcom (if applicable)

\* Only where Internal unit FAC is different from External unit FAC

**Notes to the statement entitled “Market/Technical Area Calculation of FAC based on component costs and usage factors”**

BT shall disclose financial information shown in the “Market/Technical Area Calculation of FAC based on component costs and usage factors” as follows:

1. In relation to the market “The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area” the information is required to be provided for each Basket, Single Charge Category and VULA Migration;
2. In relation to the market “Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area” the information is required to be provided for each Basket and Single Charge Category;
3. In relation to the market “Wholesale broadband access provided in Market A” the information is required to be provided for:
  - a. each Basket;
  - b. each Single Charge Category; and
  - c. the following Network Services:
    - i. Wholesale Broadband Connect end user access rentals;
    - ii. Wholesale Broadband Connect connections;
    - iii. Wholesale Broadband Connect bandwidth; and
    - iv. Wholesale Broadband Connect ancillary charges and other.
4. BT is not required to provide information in relation to the following markets:
  - a. Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area;
  - b. Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area.

# Calculation of EOI Input Prices 20XX

calculation of EOI Input prices within Market A

For the year ended 31 March 20XX

			Market/Tehchnical Area 1 etc							
EOI Input Prices (£m)		Average EOI input price per unit (from annex XX)	Basket 1 - internal *	Basket 1 - external	Basket 2 etc - internal *	Basket 2 etc - external	Single Charge Category 1 - Internal*	Single Charge Category 1 - External	Single Charge Category 2 etc - Internal*	Single Charge Category 2 etc - External
			£m	£m	£m	£m	£m	£m	£m	£m
EOI Input Prices		Unit								
EOI Input Price 1	x	x	x.X	x.X	x.X	x.X	x.X	x.X	x.X	x.X
EOI Input Price 2	x	x	x.X	x.X	x.X	x.X	x.X	x.X	x.X	x.X
EOI Input Prices (£m)			x.X	x.X	x.X	x.X	x.X	x.X	x.X	x.X

Volumes (unit) (where applicable)

xxx

xxx

xxx

xxx

xxx

Unit Cost (£)

x.XX

x.XX

x.XX

x.XX

x.XX

Specific services required to be shown seperately by Ofcom (if applicable)

\* Only where Internal unit FAC is different from External unit FAC

## BT Reconciliation Statement - Consolidated Profit and Loss Account 20XX

For the year ended 31 March 20XX

	External Revenue £m	Operating Costs £m	Return or Profit before taxation £m
<b>As in the Annual Report</b>	X	X	X
<b>Adjustments</b>			
Elimination of inter-market revenue and costs	X	X	X
Share of Post tax loss of associates and joint ventures	X	X	X
Loss on disposal of interest in associates and joint ventures	X	X	X
Net short term interest	X	X	X
Specific pension interest	X	X	X
Long term interest payable	X	X	X
Other adjustment(s) as required	X	X	X
<b>Total Markets (HCA)</b>	X	X	X
Holding (gain)/loss	X	X	X
Supplementary Depreciation	X	X	X
Other CCA adjustments	X	X	X
Roundings	X	X	X
<b>Total Markets (CCA)</b>	X	X	X

# BT Reconciliation Statement - Consolidated Mean Capital Employed 20XX

For the year ended 31 March 20XX

	20XX £m	20XX-1 £m	Mean capital employed of BT Markets	20XX £m	20XX-1 £m
<b>Shareholders' funds as in the 20XX Annual Report</b>	X	X			
CCA adjustments	X	X	Market Review 1	X	X
	X	X	Market Review 2 etc	X	X
<b>Adjustments</b>			Sub total SMP Markets	X	X
	X	X			
Derivative financial instruments - assets	X	X	<b>Residual activities</b>		
Deferred tax liabilities	X	X	Wholesale residual activity	X	X
Deferred tax assets	X	X	Retail residual activity	X	X
Current tax assets	X	X			
Current tax liabilities	X	X	Sub total residual activities	X	X
Long term loans and other borrowings:					
Due in less than one year	X	X	<b>Roundings and other adjustments</b>		
Due in more than one year	X	X	Wholesale markets	X	X
Derivative financial instruments - liabilities	X	X	Retail markets & activities	X	X
Other liabilities	X	X			
Retirement benefit obligations	X	X	Sub total roundings and other adjustments	X	X
Other adjustment(s) as required	X	X			
			Total CCA mean capital employed	X	X
<b>Closing CCA capital employed at 31 March</b>	X	X			
<b>Opening CCA capital employed at 1 April</b>	X	X			
<b>Total CCA mean capital employed</b>	X	X			

## Directions for Regulatory Financial Reporting

### Consolidated Network Activity Statement 20XX

For the year ended 31 March 20XX

Network Activity Statement - Consolidated (this is a consolidation of all markets where there are cost accounting obligations)

Fully Allocated Cost (£m)	Footnotes	HCA operating cost	Supplementary depreciation	Holding gain/(loss) and other CCA adjustments	Total CCA operating costs	CCA mean capital employed	Applicable rate of return on capital %	Capital costs	Total of operating costs and capital costs relating to current year	Volume (units)	Average costs per min/unit on a current cost basis relating to current year
<b>Network Components</b>											
Component 1		X	X	X	X	X	X	X	X	X	X
Component 2 etc		X	X	X	X	X	X	X	X	X	X
Residual components		X	X	X	X	X	X	X	X	X	X
Roundings		X	X	X	X	X	X	X	X	X	X
<b>Total</b>		X	X	X	X	X	X	X	X	X	X



# Adjusted financial performance at a market review level 20XX

For the year ended 31 March 20XX

	As reported							Estimated impacts				Impact on return		
	Revenue	HCA Costs	CCA Adjustments	CCA Operating Costs	Return	MCE	Return on MCE	Revenue	CCA Operating Costs	Return	MCE	Revised return	Revised MCE	Return on MCE
	£m	£'m	£m	£m	£m	£m	%	£m	£m	£m	£m	£m	£m	Δ %
Market Review 1	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Market Review 2 etc	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total	-	-	-	-	-	-	-	-	-	-	-	-	-	-
	Estimated impacts													
	Revenue	CCA Operating Costs	Return	MCE										
	£'m	£m	£'m	£'m										
Adjustment a	-	-	-	-										
Adjustment b etc	-	-	-	-										
	-	-	-	-										

**Price controls in wholesale markets (Non confidential Statements)**

Basket 1 Total	Condition x.xx	Year	20XX/20XX+1	Notes
		RPI/CPI (as appropriate)	X.X%	
		X	X.X%	
		RPI/CPI (as appropriate) - X	X.X%	
		Changes made in prior year	X.X%	
		Control percentage	X.X%	
		Prior year Revenue	X	
		Changes made	X	
		% price change	X.X%	
		Carry-over %	X.X%	
		Complies	YES/NO	
		Sub Cap service 1	X.XX%	
		Complies	YES/NO	
	condition x.xx	Sub Cap service 1a	X.XX%	
	condition x.xx	Complies	YES/NO	
		Sub Basket 1 CP	X.X%	
	condition x.xx	Complies	YES/NO	
		% sub basket change	X.X%	
		Complies	YES/NO	
Basket 2 etc Total	Condition x.xx	Year	20XX/20XX+1	Notes
		RPI/CPI (as appropriate)	X.X%	
		X	X.X%	
		RPI/CPI (as appropriate) - X	X.X%	
		Changes made in prior year	X.X%	
		Control percentage	X.X%	
		Prior year Revenue	X	
		Changes made	X	
		% price change	X.X%	
		Carry-over %	X.X%	
		Complies	YES/NO	
		Sub Cap service 1	X.XX%	
		Complies	YES/NO	
	condition x.xx	Sub Cap service 1a	X.XX%	
	condition x.xx	Complies	YES/NO	
		Sub Basket 1 CP	X.X%	
	condition x.xx	Complies	YES/NO	
		% sub basket change	X.X%	
		Complies	YES/NO	
Single Charge Category 1 Total	Condition x.xx	Year	20XX/20XX+1	Notes
		RPI/CPI (as appropriate)	X.X%	
		X	X.X%	
		RPI/CPI (as appropriate) - X	X.X%	
		Changes made in prior year	X.X%	
		Control percentage	X.X%	
		Prior year Revenue	X	
		Changes made	X	
		% price change	X.X%	
		Carry-over %	X.X%	
		Complies	YES/NO	
Single Charge Category 2 Total	condition x.xx	Year	20XX/20XX+1	Notes
		RPI/CPI (as appropriate)	X.X%	
		X	X.X%	
		RPI/CPI (as appropriate) - X	X.X%	
		Changes made in prior year	X.X%	
		Control percentage	X.X%	
		Prior year Revenue	X	
		Changes made	X	
		% price change	X.X%	
		Carry-over %	X.X%	
		Complies	YES/NO	

## Price controls in wholesale markets (Non confidential Statements) (continued)

## Basket Model

Redacted

	RPI/CPI (as appropriate)	X_XX%
	X*	20XX/20XX+1
Basket 1	XX0%	XX%
Sub-basket	XX0%	XX%
Basket 2 etc	XX0%	XX%
Single Charge Category 1	XX0%	XX%
Single Charge Category 2 etc	XX0%	XX%

Feature	Price list reference	Sub basket (if applicable)	Sub cap/inertia clause (if applicable)	Sub Cap/inertia Clause % (if applicable)	Volume metric Time of day prices	Prior Year revenue	Prices			Price Change dates			Basket Days			Sub cap compliance	Average Price		% price Change	Basket Revenue Impacts
						20XX-1/XX £	Start Price xx/xx/20XX+1 £	Change 1 xx/xx/20XX+1 £	Change 2 etc xx/xx/20XX+1 £	20XX/XX+1 Start Change 1 Change 2 etc (if applicable)			20XX/XX+1 Start Change 1 Change 2 etc (if applicable)			20XX/XX+1 (if applicable)	20XX/XX £	20XX/XX+1 £	20XX/XX+1	20XX/XX+1 £
<b>Basket 2</b>																				
Basket 1 - Service 1		Yes	Yes	XX%			X	X	X	xx/xx/xx	xx/xx/xx	xx/xx/xx	X	X	X	YES/NO	X	X	XX%	X
Basket 1 - Service 1a		Yes	No				X	X	X	xx/xx/xx	xx/xx/xx	xx/xx/xx	X	X	X		X	X	XX%	X
Basket 1 - Sub basket 1 sub total							X												XX%	X
Basket 1 - Service 2 etc		No	No					X	X	xx/xx/xx	xx/xx/xx	xx/xx/xx	X	X	X		X	X	XX%	X
Basket 1 Total							X												XX%	X
<b>Basket 2</b>																				
Basket 2 etc - Service 1		No	Yes	XX%			X	X	X	xx/xx/xx	xx/xx/xx	xx/xx/xx	X	X	X	YES/NO	X	X	XX%	X
Basket 2 etc - Service 2		No	No				X	X	X	xx/xx/xx	xx/xx/xx	xx/xx/xx	X	X	X		X	X	XX%	X
Basket 2 etc Total							X												XX%	X
Single Charge Category 1			No				X	X	X	xx/xx/xx	xx/xx/xx	xx/xx/xx	X	X	X		X	X	XX%	X
Single Charge Category 2 etc			No				X	X	X	xx/xx/xx	xx/xx/xx	xx/xx/xx	X	X	X		X	X	XX%	X

Note 1	
Note 2	

Total Revenues/Volumes	X	X	X
Revenues/Volumes per RFS	X	X	X
Difference	X	X	X
Reconciliation of difference:			
Difference 1	X	X	X
Difference 2	X	X	X
Total Difference	x	X	X
CHECK	YES/NO	YES/NO	YES/NO
BT to provide explanations for all differences listed above			

## Price controls in wholesale markets (Non confidential Statements) (continued)

Redacted

BTW Prices	
Feature	31/03/20XX+1 £
Basket 1 - Service 1	X
Basket 1 - Service 2 etc	X
Basket 1 Total	
Basket 2 - Service 1 etc	X
Basket 2 - Service 2 etc	X
Basket 2 Total etc	
Single Charge Category 1	X
Single Charge Category 2 etc	X

Openreach Input Prices			
Feature	31/03/20XX+1 Prices £	31/03/20XX+1 Volumes	31/03/20XX+1 Contribution £
Basket 1 - Service 1	X		X
Basket 1 - Service 2 etc	X		X
Basket 1 Total			
Basket 2 - Service 1 etc	X		X
Basket 2 - Service 2 etc	X		X
Basket 2 Total etc			
Single Charge Category 1	X		X
Single Charge Category 2 etc	X		X

Note 1: The above table is required to calculate the average input price for a service within the WBA basket, as shown on the 'basket model' tab. The formula to undertake this calculation is given below and is defined in Condition 7.4 set out in Annex 2 of the WBA Statement.

$$\bar{q}_{i,t} = \sum_{j=1}^m u r_j \frac{\sum_{k=1}^n q_{j,k} v_{k,t-1}}{z_{t-1}}$$

Note 2: The revenue weights ( $R_i - S_i$ ) as defined in Annex 2 of the WBA Statement, to be used in the WBA Charge Control are the difference between  $R_i$ , the revenue during the Prior Financial Year in respect of service  $i$  and  $S_i$ , the payments made by BT to itself for input services during the Prior Financial Year used to provide service  $i$ . The complete formulae for the basket is given below and is defined in condition 7.5 as set out in Annex 2 of the WBA Statement.

$$C_t = \frac{\sum_{i=1}^n \left[ (R_i - S_i) \frac{(\{\bar{p}_{i,t} - \bar{q}_{i,t}\} - \{\bar{p}_{i,t-1} - \bar{q}_{i,t-1}\})}{\{\bar{p}_{i,t-1} - \bar{q}_{i,t-1}\}} \right]}{\sum_{i=1}^n (R_i - S_i)}$$

## Time Related Charges Costs Relating to the Fixed Access Markets 20XX

For the year ended 31 March 20XX

### Volumes (hours) - Billed (exc volume deals)

Normal Hours		x
Other Hours		x
Sunday/Bank Holiday hours		x
Total TRC hours		<hr/> X

<b>Total Direct Costs £ per hour</b>		x.xx
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## Special Fault Investigation Costs Relating to the Fixed Access Markets 20XX

For the year ended 31 March 20XX

### Volume information

Module	Cost per module £'m
Base	X.X
Network	X.X
Frame	X.X
Internal Wiring	X.X
Internal Equipment	X.X
Coop	X.X
Frame Direct	X.X

## Annex B

Reference	Additional Financial Information	Description
<u>Additional Financial Information to be provided in respect of each Market</u>		
5(a)(i)	<p>Cost category (as used within regulatory LRIC model) analysis for network components, increments and relevant layers of common cost</p> <p>(LRIC basis)</p>	<ol style="list-style-type: none"> <li>1. ensure the LRIC model reconciles to BT group's total cost and asset and liability base;</li> <li>2. review the outputs of BT's LRIC model for the whole BT group by cost category and components, increments and layers of common costs;</li> <li>3. identify all relevant layers of common costs separately within BT group;</li> <li>4. enable trend analysis of this breakdown to be undertaken;</li> <li>5. enable assessment of cost-volume relationships;</li> <li>6. provide input into network price control reviews.</li> </ol>

5(a)(ii)	Summarised activity analysis of components for network activities, increments and the relevant layers of common cost (LRIC basis)	<ol style="list-style-type: none"> <li>1. review the outputs of BT's LRIC model by activity analysis for network components, increments and the layers of common costs;</li> <li>2. identify all relevant layers of common costs separately for network activities;</li> <li>3. enable trend analysis of this breakdown to be undertaken;</li> <li>4. provide input into network price control reviews;</li> <li>5. ensure LRIC model reconciles to the total cost and asset and liability base for BT's network activities.</li> </ol>
5(a)(iii)	Cost category (as used within regulatory LRIC model) analysis for network components and increments	Similar to "Cost category (as used within regulatory LRIC model) analysis for network components, increments and relevant layers of common cost" but on a fully allocated cost basis.
5(a)(iv)	Summarised activity analysis for network components and increments	Similar to "Summarised activity analysis of components for network activities, increments and the relevant layers of common cost" but on a fully allocated cost basis.



5(a)(v)	<p>Analysis, by asset category and network activities, of the depreciation charge for the year and impact of CCA valuation adjustments on costs for the year for example:</p> <ul style="list-style-type: none"> <li>- HCA depreciation</li> <li>- CCA supplementary depreciation</li> <li>- Holding gain</li> <li>- Other CCA adjustments</li> </ul>	<ol style="list-style-type: none"> <li>1. provide impact on profit and loss cost base of the application of CCA methodologies;</li> <li>2. enable trend analysis of this breakdown to be undertaken;</li> <li>3. provide sub-analysis (for the cost/gain line items left) of the asset movement statement in relation to network components;</li> <li>4. provide input into network price control reviews.</li> </ol>
5(a)(vi)	<p>CCA fixed asset movement statement</p> <p>a) gross replacement costs brought forward, additions/disposals/transfers, holdings gains/(loss), gross replacement costs carried forward; and</p> <p>b) gross depreciation brought forward, HCA depreciation charge, supplementary CCA depreciation, disposals/transfers/other movements, holding gains/(loss), gross depreciation carried forward)</p> <p>by asset category for BT Group</p> <p>plus reconciliation to HCA fixed assets movement statement in the group statutory accounts</p>	<ol style="list-style-type: none"> <li>1. review the breakdown of asset costs between principal asset categories and how such CCA asset values have moved in the year;</li> <li>2. enable trend analysis of CCA asset values to be undertaken;</li> <li>3. provide input into network price control reviews.</li> </ol>

5(a)(vii)	Total mean capital employed and detailed activity analysis for all network components	<ol style="list-style-type: none"> <li>1. review network component costs;</li> <li>2. enable trend analysis of these breakdowns to be undertaken;</li> <li>3. provide input into price control reviews;</li> <li>4. assist in dealing with investigations;</li> <li>5. ensure summarised activity analysis presented elsewhere reconciles to BT's network activities cost base.</li> </ol>
5(a)(viii)	Detailed network activity analysis of mean capital employed for all network components	<ol style="list-style-type: none"> <li>1. enable trend analysis of these breakdowns to be undertaken;</li> <li>2. ensure summarised activity analysis reconciles to BT's network activity mean capital employed.</li> </ol>
5(a)(ix)	Graphs over time of the various raw indices, index weightings and composite indices used by BT to revalue assets onto a current cost basis	<ol style="list-style-type: none"> <li>1. evaluate the price trends for composite elements of BT's asset revaluation indices;</li> <li>2. evaluate the weightings within individual asset revaluation indices;</li> <li>3. evaluate the trend of individual asset revaluation indices;</li> <li>4. provide input into price control reviews and determinations.</li> </ol>

5(a)(x)	Estimated economic useful lives, valuation and depreciation basis, survey used for valuation or index used to revalue, historical cost accounting (HCA) and current cost accounting (CCA) depreciation, gross book values (GBV) by year of acquisition, gross replacement costs (GRC) and net replacement costs (NRC) across asset categories	<ol style="list-style-type: none"> <li>1. review the nature and relative distribution of BT's asset base;</li> <li>2. evaluate BT's chosen asset lives for individual asset categories;</li> <li>3. review the relationship between gross HCA and CCA valuations;</li> <li>4. evaluate the appropriateness of the CCA valuation basis for each asset category;</li> <li>5. evaluate the appropriateness of the CCA depreciation methodology for each asset category;</li> <li>6. review the impact of CCA accounting on the cost base;</li> <li>7. enable trend analysis of CCA costs to be undertaken;</li> <li>8. provide input into network price control reviews.</li> </ol>
5(a)(xi)	Total operating costs and mean capital employed costs (and associated volumes) for each plant group and their individual exhaustion, including the disclosure of relevant usage factors, onto each network activity and/or (sub) component	<ol style="list-style-type: none"> <li>1. review the breakdown of costs to all the different components and sub-components within BT's network activities;</li> <li>2. enable trend analysis of this breakdown to be undertaken;</li> <li>3. provide input into network price control reviews;</li> <li>4. ensure total plant group costs reconcile to the cost base for BT's network activities.</li> </ol>

5(a)(xii)	Provision of BT 'Data File'	<p>Delivery of "data file" in prescribed format containing all records from cost attribution system. Format of file to allow for identification of sources of data, data flows (from the input sources at F8 code level through to products and services) and attribution bases.</p> <p>The data would as a minimum, be able to replicate the outputs of the financial statements, and therefore would include transfer charges and CCA adjustments, and be able to identify the attribution bases to those described in the Accounting Methodology Documents. The basis of preparation must be consistent with BT's SMP conditions, the Regulatory Accounting Guidelines, the Regulatory Accounting Principles and the Accounting Methodology Documents.</p> <p>The information to be provided annually within 10 days of the publication of the regulatory accounts. The outputs of the annual file would be consistent with published audited information.</p> <p>BT to maintain file in format consistent with Ofcom/third party import routine, accompanied by provision of control totals, and any technical advice which allows seamless data transfers and it should be updated where appropriate. In consultation with Ofcom, BT shall procure an appropriate audit opinion in relation to the data file.</p>
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5(a)(xiii)	CCA information to allow Ofcom to re-calculate the regulatory asset value (RAV) for copper assets used in BT's access network.	<ol style="list-style-type: none"> <li>1. Provide breakdown of the following information: <ol style="list-style-type: none"> <li>a) Full CCA on an actual price index basis;</li> <li>b) Pre 1997 assets on an RPI basis;</li> <li>c) Post 1997 assets on an actual price index basis;</li> </ol> </li> <li>2. Enable Ofcom to re-calculate and monitor the effect of this going forward.</li> </ol>
5(a)(xiv)	BT Network Services Reconciliation	Provide a breakdown of FAC into BT services and components and reconcile both categories to the total FAC for the year.
5(a)(xv)	Price controls in wholesale markets (Confidential Statements)	Demonstrate compliance with charge controls, including provision of revenue, price change, any relevant calculations and any other required information.
5(a)(xvi)	Adjusted financial performance at a market level	Provide revenue, cost, return and MCE at a market level adjusted for consistent application of Ofcom's price controls, including reconciliation to the numbers published in the Regulatory Financial Statements.
<u>Additional Financial Information to be provided in respect of the Fixed Access Markets</u>		
5(b)(i)	Time Related Charges Costs Relating to the Fixed Access Markets (Confidential Statements)	Provide Time Related Charges costs and billed volumes information.
5(b)(ii)	Special Fault Investigation Costs Relating to the Fixed Access Markets (Confidential Statements)	Provide Special Fault Investigation costs by module.
5(b)(iii)	Provision of FAC, DLRIC and DSAC data per service	Provide FAC, DLRIC and DSAC information for each regulated service.

5(b)(iv)	Market summary of individual VULA services	Provide volume, revenue, cost, return and MCE information for VULA services.
5(b)(v)	Calculation of FAC based components costs and usage factors of individual VULA services	Provide FAC breakdown into component costs for VULA services.
5(b)(vi)	VULA allocation of government grants	Provide a breakdown of government grant funding for VULA services.
5(b)(vii)	Additional financial information for Electricity Charges	Provide information setting out the calculation of Electricity Charges which is reconciled to the published Regulatory Financial Statements.
<u>Additional Financial Information to be provided in respect of Market A</u>		
5(c)(i)	Comprehensive analysis of the transfer charges where this information is summarised in the published statements because there are a significant number of variants with different charging bases.	<ol style="list-style-type: none"> <li>1. Allow Ofcom to check that material items have been separately disclosed in the published Regulatory Accounts.</li> <li>2. Allow BT to demonstrate compliance with its non-discrimination obligations.</li> </ol>
5(c)(ii)	Wholesale broadband access geographical analysis of costs and assets on a cost accounting and EOI basis	There will be a Profit and Loss and MCE statement on a cost accounting basis and an equivalence of input basis for the two geographical markets for wholesale broadband access. These will be in a format similar to the Attribution of Wholesale Current Costs for the Profit and Loss and the Attribution of Wholesale Current Cost Mean Capital Employed for the MCE statement. Revenues, costs and assets for Market A and Market B will be shown on a geographical basis where possible. Where they cannot be split geographically the entire wholesale broadband access market results will be reported.
5(c)(iii)	Provision of DLRIC and DSAC data per service	Provide DLRIC and DSAC information for each service.

## Direction under section 49 of the Communications Act 2003 and SMP Services Conditions 13A.4 and 8A.4 specifying network components

### Background

1. On 20 December 2013, Ofcom published a consultation entitled “Regulatory Financial Reporting – a review” (the “2013 Consultation”), which set out proposals for SMP services conditions relating to regulatory financial reporting to be imposed in the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area; and
  - Wholesale broadband access provided in Market A.
2. The 2013 Consultation also set out proposals to specify the network components under the proposed SMP services conditions. Ofcom proposed that certain directions given under a statement entitled “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” would, in relation to the markets referred to in paragraph 1, continue to have force as if they were given under the proposed SMP services conditions. These proposals concerned, among others, a direction under SMP services Conditions OA2 specifying network components (“Direction 1”).
3. On 20 May 2014, Ofcom published a policy statement entitled “Regulatory Financial Reporting – Final Statement”, which set out Ofcom’s conclusions on the requirements for regulatory financial reporting that Ofcom considered should be applied to BT in markets in which BT has significant market power. Ofcom noted that Direction 1 would be issued afresh under the new SMP services conditions once these conditions were adopted in the markets identified in paragraph 1 subject to comments from the European Commission.
4. On 26 June 2014, Ofcom published a statement entitled “Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2

and ISDN30” (the “FAMR Statement”). At Annex 29 of the FAMR Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 13A) in relation to the following markets:

- The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area; and
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area.
5. On 26 June 2014, Ofcom published a statement entitled “Review of the wholesale broadband access markets: Statement on market definition, market power determinations and remedies” (the “WBA Statement”). At Annex 2 of the WBA Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 8A) in relation to the following market:
- Wholesale broadband access provided in Market A.
6. In the conditions 13A.1 to 13A.37 set out at Annex 29 of the FAMR Statement and conditions 8A.1 to 8A.37 set out at Annex 2 of the WBA Statement, network components are defined as the network components specified in a direction given by Ofcom from time to time for the purposes of these conditions.
7. Under conditions 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement, Ofcom may from time to time make such directions as they consider appropriate in relation to BT’s obligations under conditions 13A and 8A respectively.
8. The Direction set out in the Schedule to this Notification is given under conditions 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement and specifies network components for the purposes of conditions 13A.1 to 13A.37 set out at Annex 29 of the FAMR Statement and conditions 8A.1 to 8A.37 of the WBA Statement.
9. For the reasons set out in the explanatory statement accompanying this Notification, Ofcom is satisfied that, in accordance with section 49(2) of the Act, the Direction set out in the Schedule to this Notification is:
- a. Objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
  - b. Not such as to discriminate unduly against particular persons or against a particular description of persons;
  - c. Proportionate to what it is intended to achieve; and
  - d. In relation to what it is intended to achieve, transparent.



10. For the reasons set out in the explanatory statement accompanying this Notification, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements set out in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.
11. A copy of this Notification, together with the Direction set out in the Schedule to this Notification, has been sent to the Secretary of State in accordance with section 49C(1)(b) of the Act, and the European Commission in accordance with section 49C(2)(a) of the Act.

**Direction**

12. Ofcom has decided to give the Direction which is set out in the Schedule to this Notification.

**Interpretation**

13. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 29 of the FAMR Statement and Annex 2 of the WBA Statement each as appropriate, and otherwise any word or expression shall have the same meaning as it has in the Act.

Signed



David Brown

Director of Competition Finance, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

30 March 2015

## Schedule

### Direction specifying network components

The network components shall be as shown below:

1. Low TISBO 3rd Party Equipment Depn
2. Medium TISBO 3rd Party Equipment Depn
3. High TISBO 3rd Party Equipment Depn
4. TISBO Excess Construction
5. AISBO Excess Construction
6. PC rentals 2Mbit/s regional trunk
7. PC rentals 34Mbit/s regional trunk
8. PC rentals 140Mbit/s regional trunk
9. Co-mingling set up
10. Co-mingling rentals
11. WLA Tie cables
12. Local Loop Unbundling systems development
13. Wholesale Access specific
14. Routeing & records
15. MDF Hardware jumpering
16. E side copper capital
17. E side copper current
18. D side copper capital
19. D side copper current
20. Local exchanges general frames equipment
21. Local exchanges general frames maintenance
22. Analogue line test equipment
23. Dropwire capital & analogue NTE
24. Analogue line drop maintenance
25. Analogue line cards
26. OR Service Centre - Provision AISBO
27. OR Service Centre - Provision Analogue/ISDN2
28. OR Service Centre - Provision WLA
29. Service Level Guarantees
30. OR Service Centre - Assurance Ethernet
31. OR Service Centre - Assurance Analogue/ISDN2
32. OR Service Centre - Assurance WLA
33. Ethernet Switch Access HE/MEAS
34. Ethernet Switches HE/MEAS
35. Combi Card and MSAN Access - Voice
36. Combi Card - Broadband
37. EES and MSAN Access - Broadband
38. Core Directors - Broadband
39. Edge Ethernet ports broadband
40. Ethernet Backhaul Direct
41. Ethernet Backhaul Direct extended reach
42. Ethernet Backhaul Direct resilience

43. Ethernet Switch BB
44. Core/Metro (broadband)
45. Metro-core broadband transmission
46. ADSL connections
47. EVOTAM testing systems
48. MPF line testing systems
49. Broadband line testing systems
50. DSLAM support
51. DSLAM equipment
52. ATM customer interface 2Mbit/s
53. ATM customer interface 34Mbit/s
54. ATM customer interface > 155Mbit/s
55. ATM network interface
56. ATM network switching
57. Inter ATM transmissions
58. PC rental 2Mbit/s link per km distribution
59. PC rental 34Mbit/s link per km distribution
60. PC rental 140Mbit/s link per km distribution
61. Point of Handover electronics
62. PC rental 64kbit/s link
63. PC rental 2Mbit/s link
64. PC rental 34Mbit/s link
65. PC rental 140Mbit/s link
66. PC rental 64kbit/s link per km transmission
67. 2Mbit/s and above PC link connection cct provision
68. 64kbit/s PC link connection cct provision
69. PC rental 64kbit/s link local end
70. PC rental 34Mbit/s link local end
71. PC rental 140Mbit/s link local end
72. PC rental 2Mbit/s local end copper
73. PC rental 2Mbit/s local end fibre
74. Backhaul Extension Services Fibre
75. Wholesale Extension Services Fibre
76. OR systems & development - Ethernet
77. Ethernet Access Direct Fibre
78. Other Ethernet rentals - CCTV
79. Interconnect local end rental 2Mbit/s
80. Interconnect 2Mbit/s connection
81. Interconnect extension circuits (IEC) 2Mbit/s link
82. Customer Sited Interconnect cct (CSI) 2Mbit/s link
83. Nominated In Span I/Connect cct (ISI) transmission
84. Interconnect Extension Circuits (IEC) 2Mbit/s per km
85. Customer Sited Interconnect (CSI) 2Mbit/s per km
86. In Span Interconnect circuits (ISI) transmission
87. Intra Building Circuit (IBC) connection
88. Intra Building Circuit (IBC) rental

- 89. PPC support services
- 90. Ethernet main links
- 91. Ethernet Electronics
- 92. Other Ethernet new provides - CCTV
- 93. Customer support - partial private circuits
- 94. Customer support - calls
- 95. Customer support - interconnect
- 96. Customer support - broadband
- 97. Broadband backhaul circuits (excl Virtual Paths)
- 98. Openreach sales product management
- 99. Co-mingling power & vent
- 100.100 Revenue Receivables
- 101.Co-mingling electricity
- 102.Caller display
- 103.Metro BRAS and MSE

## Direction under sections 49 and 49A of the Communications Act 2003 and SMP Services Condition 13A.4 specifying the requirements in relation to reporting of information relating to BT's Attribution Methods in relation to the Electricity Charge

### Background

1. On 26 June 2014, Ofcom published a statement entitled "Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30" (the "FAMR Statement"). At part 1 of annex 29 of the FAMR Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 13A) in relation to the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area.
2. On 10 December 2014, Ofcom published a consultation entitled "Directions for Regulatory Financial Reporting", which set out a proposal for a direction in relation to the Accounting Methodology Documents which BT is required to prepare, maintain, keep up-to-date, deliver to Ofcom and publish, and in particular BT's Attribution Methods in relation to the Electricity Charge.
3. Under condition 13A.18 set out at annex 29 of the FAMR Statement BT must prepare, maintain and keep up-to-date the Accounting Methodology Documents in accordance with those conditions, with the Regulatory Accounting Guidelines and with the Regulatory Accounting Principles.

4. Under condition 13A.20 BT must deliver an up-to-date version of the Accounting Methodology Documents to Ofcom when it delivers the Regulatory Financial Statements to Ofcom and publish such up-to-date version on or before the day of publication of the Regulatory Financial Statements which have been prepared in accordance with such version.
5. Under condition 13A.4 Ofcom may from time to time make such directions as they consider appropriate in relation to BT's obligations under condition 13A.
6. The Direction set out in the Schedule to this Notification is given under condition 13A.4 set out at Annex 29 of the FAMR Statement and specifies the requirements in relation to the Accounting Methodology Documents which BT is required to prepare, maintain, keep up-to-date, deliver to Ofcom and publish, and in particular BT's Attribution Methods in relation to the Electricity Charge.
7. For the reasons set out in the explanatory statement accompanying this Notification, Ofcom is satisfied that, in accordance with section 49(2) of the Act, the Direction set out in the Schedule to this Notification is:
  - a. Objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
  - b. Not such as to discriminate unduly against particular persons or against a particular description of persons;
  - c. Proportionate to what it is intended to achieve; and
  - d. In relation to what it is intended to achieve, transparent.
8. For the reasons set out in the explanatory statement accompanying this Notification, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements set out in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.
9. A copy of this Notification, together with the Direction set out in the Schedule to this Notification, has been sent to the Secretary of State in accordance with section 49C(1)(b) of the Act, and the European Commission in accordance with section 49C(2)(a) of the Act.

## **Direction**

10. Ofcom has decided to give the Direction which is set out in the Schedule to this Notification.

## **Interpretation**

11. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in annex 29 of the FAMR Statement and otherwise any word or expression shall have the same meaning as it has in the Act.

Signed

A handwritten signature in black ink, appearing to read 'David Brown', with a stylized, cursive script.

David Brown

Director of Competition Finance, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

30 March 2015

## **Schedule**

### **Direction specifying the requirements in relation to reporting of information relating to BT's Attribution Methods in relation to the Electricity Charge**

1. BT shall include in the Accounting Methodology Documents documentation setting out a description of the Attribution Methods in relation to the Electricity Charge.



## Annex 10

# Changes to the network component list

Code	Super Component 2013-14	Super-component 2014-15	To Publish?
CD100	Low Tisbo Equipment Depn	Low TISBO 3rd Party Equipment Depn	Y
CD101	High Tisbo Equipment Depn	Medium TISBO 3rd Party Equipment Depn	Y
CD102	Very High Tisbo Equipment Depn	High TISBO 3rd Party Equipment Depn	Y
CE103	Low Tisbo Excess Construction	TISBO Excess Construction	Y
CE104	AISBO Excess Construction	AISBO Excess Construction	Y
CG101	PC rental 2Mbit link per km regional trunk	PC rentals 2Mbit/s regional trunk	Y
CG102	PC rental 34Mbit link per km regional trunk	PC rentals 34Mbit/s regional trunk	Y
CG103	PC rental 140Mbit link per km regional trunk	PC rentals 140Mbit/s regional trunk	Y
CL131	Local Loop Unbundling room build	Co-mingling set up	Y
CL132	Local Loop Unbundling hostel rentals	Co-mingling rentals	Y
CL133	Local Loop Unbundling tie cables	WLA Tie cables	Y
CL139	Local Loop Unbundling systems development	Local Loop Unbundling systems development	Y
CL144	Wholesale Access specific	Wholesale Access specific	Y
CL160	Routeing & records	Routeing & records	Y
CL161	MDF Hardware jumpering	MDF Hardware jumpering	Y
CL171	E side copper capital	E side copper capital	Y
CL172	E side copper current	E side copper current	Y
CL173	D side copper capital	D side copper capital	Y
CL174	D side copper current	D side copper current	Y
CL175	Local exchanges general frames capital	Local exchanges general frames equipment	Y
CL176	Local exchanges general frames current	Local exchanges general frames maintenance	Y
CL177	PSTN line test equipment	Analogue line test equipment	Y
CL178	Dropwire capital & PSTN NTE	Dropwire capital & analogue NTE	Y
CL180	Residential PSTN drop maintenance	Analogue line drop maintenance	Y
CL183	PSTN line cards	Analogue line cards	Y
CL501	Service Centres - Provision	OR Service Centre - Provision AISBO	Y
CL501	Service Centres - Provision	OR Service Centre - Provision Analogue/ISDN2	Y
CL501	Service Centres - Provision	OR Service Centre - Provision WLA	Y
CL501	Service Centres - Provision	Service Level Guarantees	Y
CL503	Service Centres - Assurance	OR Service Centre - Assurance Ethernet	Y
CL503	Service Centres - Assurance	OR Service Centre - Assurance Analogue/ISDN2	Y
CL503	Service Centres - Assurance	OR Service Centre - Assurance WLA	Y
CN001	Access Cards (other services)	Ethernet Switch Access HE/MEAS	Y
CN001	Access Cards (other services)	Ethernet Switches HE/MEAS	Y
CN002	Combi Card voice	Combi Card and MSAN Access - Voice	Y
CN003	Combi Card Broadband Access	Combi Card - Broadband	Y
CN003	Combi Card Broadband Access	EES and MSAN Access - Broadband	Y
CN007	Core/Metro connectivity	Core Directors - Broadband	Y
CN008	Edge Ethernet ports	Edge Ethernet ports broadband	Y
CN013	21CN Backhaul Link & Length	Ethernet Backhaul Direct	Y
CN013	21CN Backhaul Link & Length	Ethernet Backhaul Direct extended reach	Y
CN013	21CN Backhaul Link & Length	Ethernet Backhaul Direct resilience	Y
CN013	21CN Backhaul Link & Length	Ethernet Switch BB	Y
CN015	Core/Metro (broadband)	Core/Metro (broadband)	Y
CN015	Core/Metro (broadband)	Metro-core broadband transmission	Y
CO118	ADSL connections	ADSL connections	Y

# Directions for Regulatory Financial Reporting

CO187	Broadband line testing systems	EVOTAM testing systems	Y
CO187	Broadband line testing systems	MPF line testing systems	Y
CO187	Broadband line testing systems	Broadband line testing systems	Y
CO188	DSLAM capital/maintenance	DSLAM support	Y
CO188	DSLAM capital/maintenance	DSLAM equipment	Y
CO310	ATM customer interface 2Mbit/s	ATM customer interface 2Mbit/s	Y
CO311	ATM customer interface 34Mbit/s	ATM customer interface 34Mbit/s	Y
CO312	ATM customer interface > 155Mbit/s	ATM customer interface > 155Mbit/s	Y
CO313	ATM network interface	ATM network interface	Y
CO314	ATM network switching	ATM network switching	Y
CO316	Inter ATM transmissions	Inter ATM transmissions	Y
CO371	PC rental 2Mbit/s link per km distribution	PC rental 2Mbit/s link per km distribution	Y
CO373	PC rental 34Mbit/s link per km distribution	PC rental 34Mbit/s link per km distribution	Y
CO375	PC rental 140Mbit/s link per km distribution	PC rental 140Mbit/s link per km distribution	Y
CO379	Point of Handover electronics	Point of Handover electronics	Y
CO381	PC rental 64kbit/s link	PC rental 64kbit/s link	Y
CO383	PC rental 2Mbit/s link	PC rental 2Mbit/s link	Y
CO385	PC rental 34Mbit/s link	PC rental 34Mbit/s link	Y
CO388	PC rental 140Mbit/s link	PC rental 140Mbit/s link	Y
CO391	PC rental 64kbit/s link per km transmission	PC rental 64kbit/s link per km transmission	Y
CO413	2Mbit/s and above PC link connection cct provision	2Mbit/s and above PC link connection cct provision	Y
CO417	64kbit/s PC link connection cct provision	64kbit/s PC link connection cct provision	Y
CO432	PC rental 64kbit/s link local end	PC rental 64kbit/s link local end	Y
CO434	PC rental 34Mbit/s link local end	PC rental 34Mbit/s link local end	Y
CO436	PC rental 140Mbit/s link local end	PC rental 140Mbit/s link local end	Y
CO438	PC rental 2Mbit/s local end copper	PC rental 2Mbit/s local end copper	Y
CO439	PC rental 2Mbit/s local end fibre	PC rental 2Mbit/s local end fibre	Y
CO447	Backhaul extension services fibre etc	Backhaul Extension Services Fibre	Y
CO450	Wholesale & LAN extension services fibre etc	Wholesale Extension Services Fibre	Y
CO450	Wholesale & LAN extension services fibre etc	OR systems & development - Ethernet	Y
CO450	Wholesale & LAN extension services fibre etc	Ethernet Access Direct Fibre	Y
CO450	Wholesale & LAN extension services fibre etc	Other Ethernet rentals - CCTV	Y
CO452	Interconnect local end rental 2Mbit/s	Interconnect local end rental 2Mbit/s	Y
CO453	Interconnect 2Mbit/s connection	Interconnect 2Mbit/s connection	Y
CO458	Interconnect extension circuits (IEC) 2Mbit/s link	Interconnect extension circuits (IEC) 2Mbit/s link	Y
CO459	Customer Sited Interconnect cct (CSI) 2Mbit/s link	Customer Sited Interconnect cct (CSI) 2Mbit/s link	Y
CO460	Nominated In Span I/Connect cct (ISI) transmission	Nominated In Span I/Connect cct (ISI) transmission	Y
CO466	Interconnect extension circuits (IEC) 2Mbit per km	Interconnect Extension Circuits (IEC) 2Mbit/s per km	Y
CO467	Customer Sited Interconnect cct (CSI) 2Mbit per km	Customer Sited Interconnect (CSI) 2Mbit/s per km	Y
CO468	In Span Interconnect circuits (ISI) transmission	In Span Interconnect circuits (ISI) transmission	Y
CO469	Intra Building Circuit (IBC) connection	Intra Building Circuit (IBC) connection	Y
CO470	Intra Building Circuit (IBC) rental	Intra Building Circuit (IBC) rental	Y
CO474	PPC support services	PPC support services	Y
CO484	Ethernet main links	Ethernet main links	Y
CO485	Ethernet Electronics	Ethernet Electronics	Y
CO486	Ethernet Electronics	Other Ethernet new provides - CCTV	Y
CO506	SG & A partial private circuits	Customer support - partial private circuits	Y
CO512	Product management policy & planning	Customer support - calls	Y
CO586	SG&A Interconnect	Customer support - interconnect	Y
CO609	SG&A Broadband	Customer support - broadband	Y
CO681	Broadband backhaul circuits (excl Virtual Paths)	Broadband backhaul circuits (excl Virtual Paths)	Y
CP502	Sales product management	Openreach sales product management	Y
CT134	Local Loop Unbundling hostel rentals power & vent	Co-mingling power & vent	Y
	Revenue Debtors	Revenue Receivables	Y
		Co-mingling electricity	Y
		Caller display	Y
		Metro BRAS and MSE	Y
Key:			
	Renamed component		
	Split component		
	Not published/withdrawn		
	New component		