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## **BT Regulatory Financial Reporting**

Regulatory reporting directions covering the wholesale local access, narrowband and wholesale broadband access markets for 2018/19 and following years

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**STATEMENT:**

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# Contents

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## Section

1. Overview	1
2. Introduction	7
3. Regulatory financial reporting in relation to all regulated markets	16
4. Legal tests	43

## Annex

A1. Directions	49
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# 1. Overview

**Each year BT prepares a set of Regulatory Financial Statements (RFS) which include published statements. It also provides information that is submitted to Ofcom privately. Ofcom has completed a review of BT's obligations for its RFS covering the wholesale local access, narrowband and wholesale broadband access markets for 2018/19 and following years.**

In this document, we set out our conclusions on BT's regulatory financial reporting. Specifically, this document will only cover the areas which were consulted on in Section 3 'Regulatory financial reporting in relation to all regulated markets' and Section 5 'Regulatory financial reporting in relation to the wholesale broadband access markets' of the December 2018 BT Regulatory Financial Reporting Consultation.<sup>1</sup>

This document imposes on BT a new set of directions implementing our detailed regulatory financial reporting requirements for the wholesale local access, narrowband and wholesale broadband access markets. We are publishing these decisions now, so they can be reflected in BTs 2018/19 RFS. We have consulted on extending these requirements to the physical infrastructure and business connectivity markets (subject to market-specific modifications). The decisions will be set out later this year when our statements for these market reviews are published.

Our decisions are in line with our long-term strategy set out in our Strategic Review of Digital Communications<sup>2</sup> and our July 2018 Strategic Policy Position.<sup>3</sup> We have increased our focus on Openreach while reducing the overall extent of the reporting making BT's RFS more relevant.

We have recently started a wider review of BT's regulatory financial reporting which could lead to a more holistic approach to reporting across all regulated markets from 2021.<sup>4</sup> The regulatory reporting requirements we impose as a result of this wider review may in due course supersede the requirements we are imposing as part of the current review.

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<sup>1</sup> Ofcom, *BT Regulatory Financial Reporting: Proposed regulatory reporting directions covering all regulated fixed telecoms markets*, 4 December 2018, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0018/129060/Consultation-BT-regulatory-financial-reporting.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0018/129060/Consultation-BT-regulatory-financial-reporting.pdf), (2018 BT RFR Consultation).

<sup>2</sup> Ofcom, *Making communications work for everyone: Initial conclusions from the Strategic Review of Digital Communications*, 25 February 2016, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0016/50416/dcr-statement.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0016/50416/dcr-statement.pdf) (Strategic Review of Digital Communications).

<sup>3</sup> Ofcom, *Regulatory certainty to support investment in full-fibre broadband: Ofcom's approach to future regulation*, 24 July 2018, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0025/116539/investment-full-fibre-broadband.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0025/116539/investment-full-fibre-broadband.pdf) (July 2018 Strategic Policy Position).

<sup>4</sup> We held a workshop with industry on 8 October 2018 to discuss future regulatory financial reporting regime on BT and will continue to engage with industry as we develop our proposals.

### What we have decided – in brief

**Consistency with regulatory decisions:** we have decided to update the requirements to reflect regulatory and commercial changes that impact regulatory financial reporting.

**Audit of the RFS:** we have removed the option to require BT to obtain a Fairly Presents In Accordance with opinion on its RFS from its regulatory auditors. In future, BT will only be required to obtain an opinion that the RFS are Properly Prepared In Accordance with its Accounting Methodology Documents.

**Reconciliation Report:** we have decided to remove the requirement to publish certain schedules within the RFS which over time have led to some duplication of information and publication of information that is no longer necessary.

**Preparation, delivery, publication, form and content of the RFS:** we have decided to reduce some reporting requirements and increase the prominence of Openreach reporting. We have also updated a number of schedules that BT publishes.

**Network components:** we have updated the list of network components to ensure they remain relevant and up-to-date.

**This overview is a simplified high-level summary only. The decisions we have taken and our reasoning are set out in the full document.**

## Background

- 1.1 BT is subject to regulatory financial reporting requirements across all of the fixed telecoms markets in which it is regulated, comprising:
  - wholesale local access;
  - the business connectivity markets;
  - the narrowband markets; and
  - wholesale broadband access.
- 1.2 These requirements are imposed on BT by way of an SMP condition set in each regulated market and a suite of directions imposed in each market pursuant to the associated SMP condition. The SMP condition sets out our general regulatory financial reporting requirements, including accounting separation and cost accounting. The directions then set out our detailed regulatory financial reporting requirements.
- 1.3 Broadly, the SMP condition and directions are the same across all regulated markets.<sup>5</sup> However, they are implemented separately for each regulated market and we have introduced some detailed requirements that are specific for individual markets.

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<sup>5</sup> The Consistency with Regulatory Decisions and RAV Direction only applies to the narrowband and wholesale broadband access markets in relation to the requirement that BT prepares the RFS on a RAV basis. The Adjusted Financial Performance Direction does not apply to the narrowband and wholesale broadband access markets.

- 1.4 Our market reviews so far have been mostly consecutive with one market review commencing when another has been completed.<sup>6</sup> Changes to BT's regulatory financial reporting that impact all regulated markets have been first introduced in the market under review and later transposed to all other markets. This has created temporary misalignment in BT's regulatory financial reporting requirements which we aim to address with this review.
- 1.5 On 4 December we published the 2018 BT RFR Consultation. That consultation set out proposals to improve BT's reporting obligations which are common across all regulated markets (including new markets we proposed to identify under the physical infrastructure market review and the business connectivity market review). The proposals were intended to ensure that BT continues to provide up-to-date information to Ofcom and stakeholders as part of its regulatory financial reporting, and to better align the directions in all regulated markets.<sup>7</sup> The purpose of this statement is to impose these reporting obligations across the wholesale local access, narrowband and wholesale broadband access markets for 2018/19 onwards. Under our consultation proposals we will extend these requirements to the physical infrastructure and business connectivity markets when our statements in these market reviews are published later this year.
- 1.6 In the 2018 BT RFR Consultation we also proposed market-specific requirements arising out of the recent physical infrastructure and business connectivity market review consultations.<sup>8</sup> We have not at this stage taken any decisions in relation to these proposals. We will publish our decisions later this year when our statements for these market reviews are published.
- 1.7 Finally, the 2018 BT RFR Consultation included a proposal to impose a direction on BT to implement regulatory financial reporting requirements related to network components for the wholesale broadband access market. We did not impose such direction on BT as part of our last review of this market. The reasons for this were set out in our 2018 WBA Statement.<sup>9</sup> We are now closing this gap by imposing a revised list of network components for 2018/19 for the wholesale broadband access market.

## Summary of decisions

- 1.8 We have decided to revoke existing directions across the wholesale local access, narrowband and wholesale broadband access markets and impose a new set of directions.

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<sup>6</sup> For example, in 2018 we completed our WLA market review and started our review of the business connectivity markets.

<sup>7</sup> We received nine responses to the 2018 BT RFR Consultation. Non-confidential responses are available at <https://www.ofcom.org.uk/consultations-and-statements/category-1/bt-regulatory-financial-reporting>.

<sup>8</sup> Ofcom, *Physical Infrastructure Market Review: Access to ducts and poles to support investment*, 2 November 2018, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0014/125420/PIMR-consultation.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0014/125420/PIMR-consultation.pdf), (2018 PIMR Consultation) and Ofcom, *Business Connectivity Market Review*, 2 November 2018, <https://www.ofcom.org.uk/consultations-and-statements/category-1/business-connectivity-market-review>, (2018 BCMR Consultation). In particular, see Section 4 of the 2018 PIMR Consultation and Section 11, Volume 1 of the 2018 BCMR Consultation.

<sup>9</sup> 2018 WBA Statement, paragraphs 7.44-7.50.

These new directions relate to the following elements of BT's regulatory financial reporting:

- a) regulatory accounting principles;
- b) consistency with regulatory decisions;<sup>10</sup>
- c) transparency;
- d) audit of the RFS;
- e) Reconciliation Report;
- f) adjusted financial performance;
- g) preparation, delivery, publication, form and content of the RFS; and
- h) network components.

1.9 In relation to existing business connectivity markets, BT is currently bound by regulatory reporting requirements under the 2016 BCMR and the 2017 Temporary Conditions. We are not revoking and re-imposing these requirements at this point, for the reasons set out in Section 2. However, we expect BT to prepare the 2018/19 RFS in accordance with the new directions.

1.10 The directions we are giving are substantially the same as those on which we consulted in the 2018 BT RFR Consultation, although we have made a small number of changes in response to stakeholders' comments to our consultation. We have also made a change to the audit of the RFS direction – which reflects the way changes in international accounting standards will affect the audit opinion provided on BT's RFS – which we had not considered at the time of our consultation. We took an identical approach in our recent 2019 KCOM RFR Statement.<sup>11</sup>

1.11 Overall, our decisions in this statement ensure consistent regulatory financial reporting requirements apply across the abovementioned markets, reduce the amount of information that BT is required to publish, and makes the RFS more useful to us and stakeholders when considered against our current and future regulatory requirements.

1.12 We summarise, at a high-level, the main changes to BT's directions below.

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<sup>10</sup> We have not revoked all previous directions specifying the requirements in relation to consistency with regulatory decisions and regulatory asset value. This is because these tend to be point in time directions with continuing effect which are not amenable to consolidation.

<sup>11</sup> Ofcom, *KCOM Regulatory Financial Reporting: Statement on new regulatory financial reporting directions covering all regulated fixed telecoms markets*, 6 February 2019, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0032/135869/Statement-Regulatory-Financial-Reporting-new-regulatory-financial-reporting-directions-for-KCOM.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0032/135869/Statement-Regulatory-Financial-Reporting-new-regulatory-financial-reporting-directions-for-KCOM.pdf) (2019 KCOM RFR Statement).

## Consistency with regulatory decisions

- 1.13 We have issued a new direction to account for the new business unit BT created in April 2018 called “BT Enterprise”. In substance, this new direction is the same as the direction it replaces but it has been updated to reflect the name of this new business unit.

## Audit of the RFS

- 1.14 In the 2018 BT RFR Consultation we explained that the direction provides for two types of opinion for the regulatory audit of BT’s RFS: “Properly Prepared In Accordance with” (PPIA) and “Fairly Presents In Accordance with” (FPIA).<sup>12</sup>
- 1.15 For the last four years BT’s auditors have provided a PPIA audit opinion on BTs RFS. Due to changes in the international auditing standards, and consistent with our recent decision relating to KCOM’s regulatory financial reporting, we have decided that it would no longer be appropriate to require BT to obtain a FPIA opinion on its RFS from its regulatory auditors. We have therefore decided to remove the reference to this type of audit opinion from the direction.

## Reconciliation Report

- 1.16 We have decided to remove the requirement for BT to publish several schedules in the Reconciliation Report section of the RFS that we consider to be obsolete. The information was either duplicated in other schedules contained in the Reconciliation Report or could be easily calculated by an informed user of the RFS.

## Preparation, delivery, publication, form and content of the RFS

- 1.17 We have decided that some of the schedules that BT has been required to produce (and, in some cases, publish) are no longer relevant, and that it would no longer be proportionate to continue to require BT to produce (or publish) these in the current format. We have therefore issued a new direction which contains the following changes:
- a) a formatting change to the “Performance Summary by Market”, “Attribution of Wholesale Current Costs” and “Attribution of Wholesale Current Cost Mean Capital Employed” schedules;
  - b) combining certain cost categories in the “Attribution of Wholesale Current Costs” and “Attribution of Wholesale Current Cost Mean Capital Employed” schedules;
  - c) removal of inter-market revenues and costs from the “BT Reconciliation Statement – Consolidated Profit and Loss Account” and their inclusion within the “Summary of Market Performance” schedule;

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<sup>12</sup> Both types of opinion consider the ‘rules’. The ‘rules’ in this case refer to the BT’s published Accounting Methodology Document, as well as our regulatory financial reporting obligations surrounding the RFS. However, the PPIA opinion represents a view on whether the rules have been followed, whereas the FPIA opinion provides some additional assurance on whether those rules are reasonable.

- d) changes to the schedules that reconcile the RFS to BT's financial statements as a public limited company; and
- e) changes to "Market Review Summary" schedules to include IFRS 15 disclosures in relation to revenue.

1.18 Within the direction we have also decided to remove the requirement for BT to provide certain schedules in private to us as "Additional Financial Information" (AFIs) schedules as the information is now included within the Data File.<sup>13</sup>

## Network components

1.19 We have decided to direct BT to use a new list of network components that includes network components directed in the 2018 WLA Statement, network components that BT is using in the RFS but were not in the old direction, and that removes redundant network components.<sup>14</sup> The new list of network components will also apply to the wholesale broadband access markets.

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<sup>13</sup> BT provides the Data File as part of AFI 12.

<sup>14</sup> The new list does not include any New Duct and Pole infrastructure components or any New dark fibre components consulted on in the 2018 BT RFR Consultation. We will set out our decisions relating to these in the upcoming PIMR and BCMR statements.



## 2. Introduction

### The purpose of regulatory financial reporting

2.1 In the 2014 Regulatory Financial Reporting Statement<sup>15</sup> we explained that BT's "Regulatory Financial Reporting should provide us with the information necessary to:

- make informed regulatory decisions;
- monitor compliance with SMP conditions;
- ensure that those SMP conditions continue to address the underlying competition issues; and
- investigate potential breaches of SMP conditions and anti-competitive practices."<sup>16</sup>

2.2 We also said, "Published Regulatory Financial Reporting should provide reasonable confidence to stakeholders that the SMP provider has complied with its SMP conditions and add credibility to the Regulatory Financial Reporting Regime."<sup>17</sup>

2.3 We explained in the 2014 Regulatory Financial Reporting Statement that "effective Regulatory Financial Reporting should have the following attributes:

- **Relevance.** The information needs to answer the right questions, in the right way and at the right time.
  - **Reliability.** The underlying data must be reliable, suitable rules for treatment of those data must be chosen and those rules need to be followed.
  - **Transparency.** The basis of preparation should be understood by the users of the reports and the presentation of the data should be clear.
  - **Proportionality.** The reporting requirements should be proportionate to the benefits."<sup>18</sup>
- In the 2014 Regulatory Financial Reporting Statement we set out the SMP condition that sought to ensure that the basis of preparation of BT's Regulatory Financial Statements (RFS) and the scope and format of reporting continued to provide the information we need and that it had the attributes of good reporting.

2.4 In the 2014 Regulatory Financial Reporting Statement we also set out the Regulatory Accounting Principles.<sup>19</sup> These are fundamental reporting principles with which BT's regulatory financial reporting must comply.

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<sup>15</sup> Ofcom, *Regulatory Financial Reporting*, 20 May 2014, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0025/78460/financial-reporting-statement-may14.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0025/78460/financial-reporting-statement-may14.pdf) (2014 Regulatory Financial Reporting Statement).

<sup>16</sup> 2014 Regulatory Financial Reporting Statement, paragraph 2.28.

<sup>17</sup> 2014 Regulatory Financial Reporting Statement, paragraph 2.41.

<sup>18</sup> 2014 Regulatory Financial Reporting Statement, paragraph 2.42.

<sup>19</sup> 2014 Regulatory Financial Reporting Statement, Section 3 and Annex 3.

2.5 In the 2015 Directions Statement<sup>20</sup> we set out a set of detailed directions, including the Regulatory Accounting Principles Direction, that sought to ensure that the basis of preparation of the RFS and the scope and format of reporting continued to provide the information we needed and that it had the attributes of good reporting.

## BT's regulatory financial reporting framework

2.6 Following the 2014 Regulatory Financial Reporting Statement, as part of each market review, we have imposed regulatory financial reporting requirements on BT through a common set of SMP conditions and directions.<sup>21</sup> This preserves the integrity and consistency of BT's regulatory financial reporting.

2.7 We describe below the contents and the purpose of the SMP condition and directions that we typically impose on BT.

### SMP condition

2.8 The "Regulatory Financial Reporting" SMP condition we impose on BT in relation to its regulatory financial reporting includes general requirements for accounting separation and cost accounting.<sup>22</sup> The SMP condition also requires BT to produce the RFS and other accounting documents as directed by Ofcom.

2.9 The purpose of this SMP condition is to ensure that sufficient and robust information is provided by BT both publicly and privately for Ofcom to enable us to perform our duties and for stakeholders to gain confidence that the SMP provider has complied with its SMP

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<sup>20</sup> Ofcom, *Directions for Regulatory Financial Reporting: Final Statement*, 30 March 2015, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0018/59112/statement.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0018/59112/statement.pdf)

<sup>21</sup> The latest SMP conditions and directions that impose on BT regulatory financial reporting requirements for each regulated market are set out respectively in the following statements:

- Ofcom, *Wholesale Local Access Market Review: Statement*, 28 March 2018, <https://www.ofcom.org.uk/consultations-and-statements/category-1/wholesale-local-access-market-review>, (2018 WLA Statement);
- Ofcom, *Business Connectivity Market Review: Temporary SMP conditions in relation to business connectivity services*, 23 November 2017, <https://www.ofcom.org.uk/consultations-and-statements/category-1/business-connectivity-market-review-2016>, (2017 BCMR Temporary Conditions Statement); See also Ofcom, *Business Connectivity Market Review*, 28 April 2016, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0015/72303/bcmr-final-statement-volume-one.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0015/72303/bcmr-final-statement-volume-one.pdf) (2016 BCMR Statement);
- Ofcom, *Narrowband Market Review: Statement*, 30 November 2017, <https://www.ofcom.org.uk/consultations-and-statements/category-1/narrowband-market-review>, (2017 NMR Statement); and
- Ofcom, *Wholesale Broadband Access Market Review 2018*, 31 July 2018, <https://www.ofcom.org.uk/consultations-and-statements/category-1/wholesale-broadband-access-market-review>, (2018 WBA Statement).

<sup>22</sup> See Condition 11 in the 2016 BCMR Statement legal instruments (to the extent still in force), [https://www.ofcom.org.uk/data/assets/pdf\\_file/0023/47840/final-annex-35.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0023/47840/final-annex-35.pdf); Condition 10 in the 2017 BCMR Temporary Conditions Statement legal instruments, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0020/108137/Annex-1-Legal-instruments.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0020/108137/Annex-1-Legal-instruments.pdf); Condition 9 in the 2017 NMR Statement legal instruments, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0022/108355/final-statement-narrowband-market-review-annexes-9-10.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0022/108355/final-statement-narrowband-market-review-annexes-9-10.pdf); Condition 12 in the 2018 WLA Statement legal instruments, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0024/112488/wla-statement-annex-33.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0024/112488/wla-statement-annex-33.pdf); and Condition 7 in the 2018 WBA legal instruments, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0032/116996/wba-annex-1.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0032/116996/wba-annex-1.pdf).

conditions. More specifically, this SMP condition serves as a basis for imposing directions to BT that set out detailed regulatory financial reporting requirements.

## Directions

2.10 Typically, we impose on BT a set of eight directions in order to implement our detailed regulatory financial reporting requirements. There are exceptions in some of the markets where certain directions are not relevant. We discuss these in turn below.

### Regulatory Accounting Principles Direction

2.11 The Regulatory Accounting Principles (RAP) are guiding principles with which BT's Regulatory Financial Reporting must comply. The principles and the order in which they apply are:

- i) Completeness;
- ii) Accuracy;
- iii) Objectivity;
- iv) Consistency with regulatory decisions;
- v) Causality;
- vi) Compliance with the statutory accounting standards; and
- vii) Consistency of the RFS as a whole and from one period to another.<sup>23</sup>

2.12 The RAP establishes the basic attributes for BT's regulatory financial reporting and provide a necessary reference point in the absence of more specific guidance. To preserve the integrity and consistency of the RFS we consider that the RAP should be implemented across all regulated markets as there are significant advantages to BT and other stakeholders of BT applying one set of principles across all markets.

### Consistency with Regulatory Decisions and Regulatory Asset Value Direction

2.13 This direction is based on principle four of the RAP which requires that regulatory financial reporting is consistent with our regulatory decisions.<sup>24</sup> The direction specifies which regulatory decisions should be reflected in the RFS. In general, we would expect regulatory decisions to be reflected in the RFS unless there were good reasons not to.

2.14 We do not consider that the requirement for consistency means that all regulatory decisions must be reflected in the RFS. For example, when we set prices, we may include adjustments to cost calculations that do not strictly reflect BT's costs (for reasons that we

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<sup>23</sup> 2014 Regulatory Financial Reporting Statement, Section 3 and Annex 3.

<sup>24</sup> In the 2014 Regulatory Financial Reporting Statement and the 2015 Directions Statement we explained why Regulatory Financial Reporting should, as far as possible, be consistent with our regulatory decisions as set out in Regulatory Accounting Principle number four. See 2014 Regulatory Financial Reporting Statement, Annex 3, available at [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0025/78460/financial-reporting-statement-may14.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0025/78460/financial-reporting-statement-may14.pdf) and 2015 Directions Statement, Section 3, [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0018/59112/statement.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0018/59112/statement.pdf)

disclose and consult upon). Also, attempting to model the impact of some 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 we might approach these costs on an ongoing basis.

- 2.15 This direction also encompasses the RFS being prepared on a Regulatory Asset Value (RAV) basis. 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. The value of RAV is based on the historical cost accounting value for the pre-1997 assets, indexed each year in line with the Retail Price Index. Over time the RAV will gradually disappear as the pre-1997 assets are gradually replaced with new ones. It now only affects Access Duct as the pre-1997 copper assets, which had an accounting life of 20 years, are all fully depreciated.<sup>25</sup>
- 2.16 The direction ensures that regulatory financial reporting continues to provide the information necessary for us to make informed regulatory decisions.

### Transparency Direction

- 2.17 This direction requires BT to ensure that any information, material or explanatory document it prepares in respect of the RFS is sufficiently transparent, such that a suitably informed reader can gain a clear understanding of the information presented.
- 2.18 The direction provides confidence to stakeholders that BT has complied with its SMP conditions and adds credibility to the regulatory financial reporting regime. It allows stakeholders to better contribute to the regulatory regime, for example by providing more informed inputs during consultation periods.

### Audit of the RFS Direction

- 2.19 This direction sets out the standard of audit review that BT is required to obtain for the financial information contained in the RFS.
- 2.20 Audit of the RFS gives confidence that the RFS provides a fair reflection of BT's financial performance, is free from material error and has been prepared following the accounting methodology statements published by BT and relevant directions issued by Ofcom.<sup>26</sup>
- 2.21 The direction ensures that regulatory financial reporting gives confidence to stakeholders that BT has complied with its SMP conditions and adds credibility to the regulatory financial reporting regime.

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<sup>25</sup> For further details see 2014 Regulatory Financial Reporting Statement, paragraphs 3.87-3.91 and Section 6.2.5 of BT's 2015/16 Accounting Methodology Document.

<sup>26</sup> 2014 Regulatory Financial Reporting Statement, Section 5.

### Reconciliation Report Direction

- 2.22 This direction requires BT to publish a reconciliation report which sets out the impact of all material changes and errors discovered in the RFS with an accompanying assurance report from their regulatory auditors.
- 2.23 The reconciliation report provides stakeholders with transparency of changes that BT makes to the RFS. It aids the understanding of and promotes confidence in regulatory financial reporting and allows stakeholders to contribute to the regulatory regime.

### Adjusted Financial Performance Direction

- 2.24 In the 2015 Directions Statement, we said that if not all regulatory decisions were reflected in the RFS, differences could arise between the reported view of BT's financial performance and the view we took when making regulatory decisions.<sup>27</sup> We therefore decided that BT must prepare the Adjusted Financial Performance Schedule to show the impact of certain regulatory decisions not reflected in the RFS.
- 2.25 The direction ensures that regulatory financial reporting continues to provide the information necessary for us to make informed regulatory decisions. It allows stakeholders to better contribute to the regulatory regime, for example by providing more informed inputs during consultation periods.

### Preparation, Delivery, Publication, Form and Content of the RFS Direction

- 2.26 This direction sets out what financial information BT is required to provide for each regulated market in the published RFS and in private to Ofcom.<sup>28</sup> Some elements of this financial information relate to all markets, while others relate only to specific markets.<sup>29</sup>
- 2.27 This direction plays an important role in ensuring that the RFS provides relevant information to stakeholders. It ensures that that regulatory financial reporting gives confidence to stakeholders. The direction also ensures that information is provided to us in the published RFS and in private that is needed for monitoring of compliance with remedies (for example verifying volume weights used in compliance basket submissions).

### Network Components Direction

- 2.28 This direction specifies all network components used by BT to prepare the RFS. Network components are used by BT to attribute costs to services in regulated markets.
- 2.29 This direction ensures that regulatory financial reporting continues to provide information necessary for us to make informed regulatory decisions (for example we use network component inputs in our top down cost modelling in relation to charge controls). The direction also ensures that we obtain information to monitor compliance with remedies

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<sup>27</sup> 2015 Directions Statement, paragraph 3.36.

<sup>28</sup> Private information provided to Ofcom under this direction includes Additional Financial Information (AFI) schedules and Compliance schedule.

<sup>29</sup> For example, the reconciliation of the RFS to BT Group's statutory accounts.

(for example on non-discrimination, checking the attribution rules on network components allows us to see how costs are attributed to internal as well as external services).

## Scope of this document

- 2.30 As mentioned above, our 2018 RFR Consultation covered regulatory financial reporting in the wholesale local access market, narrowband and wholesale broadband access markets, as well as regulatory financial reporting in the business connectivity and physical infrastructure markets that we consulted on in November 2018.
- 2.31 The focus of this statement is on regulatory financial reporting across the wholesale local access, narrowband and wholesale broadband access markets.
- 2.32 As noted above, we do not consider the regulatory reporting obligations in relation to the full set of proposals in the 2018 PIMR Consultation and the 2018 BCMR Consultation that were consulted on in the 2018 BT RFR Consultation. We will address these later this year when our statements for these market reviews are published.

## Summary of changes to directions

- 2.33 We summarise the changes we have made to the directions currently imposed in the wholesale local access, narrowband and wholesale broadband access markets in Table 2.1 overleaf.

Table 2.1: Summary of directions

	Directions in place		
	WLA 18	NB 17	WBA 18
Regulatory Accounting Principles	No change	No change	No change
Consistency with Regulatory Decisions and RAV	General changes	General changes <sup>30</sup>	General changes <sup>31</sup>
Transparency	No change	No change	No change
Audit of the RFS	General change	General change	General change
Reconciliation Report	General changes	General changes	General changes
Adjusted Financial Performance	No change	No change <sup>32</sup>	No change <sup>33</sup>
Preparation, Delivery, Publication, Form and Content of the RFS	General changes	General changes	General changes
Network Components	General changes	General changes	New <sup>34</sup>

- **New:** A new direction is imposed because the direction does not exist in this market or will soon expire.
- **General changes:** Changes to general reporting requirements.
- **No change:** Current requirements continue with no changes.

Source: Ofcom.

## Implementation of our decisions

2.34 We consider that the simplest way in which to implement the decisions referred to above is to withdraw (subject to the exception below) the existing directions in the wholesale local access,<sup>35</sup> narrowband and wholesale broadband access markets and impose new updated directions. This ensures that there is a comprehensive set of regulatory financial

<sup>30</sup> The Consistency with Regulatory Decisions Direction and RAV only applies to the narrowband markets in relation to the requirement that BT prepares the RFS on a RAV basis. This is because in the 2017 NMR Statement we did not make any regulatory decisions that needed to be reflected in the additional financial performance schedule.

<sup>31</sup> The Consistency with Regulatory Decisions Direction and RAV only applies to the wholesale broadband access markets in relation to the requirement that BT prepares the RFS on a RAV basis. This is because in the 2018 WBA Statement we did not impose any charge controls for these markets.

<sup>32</sup> The Adjusted Financial Performance Direction does not apply to any of the narrowband markets. This is because in the 2017 NMR Statement we did not make any regulatory decisions that needed to be reflected in the additional financial performance schedule.

<sup>33</sup> The Adjusted Financial Performance Direction does not apply to the wholesale broadband access markets. This is because in the 2018 WBA Statement we did not impose any charge controls in these markets.

<sup>34</sup> In the 2018 WBA Statement we decided to delay the imposition of the Network Components Direction because we needed to further review the list of network components.

<sup>35</sup> There is an additional direction for regulatory financial reporting of electricity charges in the WLA market.

reporting directions collected together in one document. We are updating the directions by making specific amendments to five directions, which are explained in the next section.

- 2.35 However, we have not revoked all previous directions specifying the requirements in relation to consistency with regulatory decisions and regulatory asset value. This is because these tend to be point-in-time directions with continuing effect which are not amenable to consolidation.
- 2.36 The decisions set out in this section will take effect immediately. Our decisions will therefore impact the preparation of the 2018/19 RFS, to be delivered in July 2019.
- 2.37 BT is also subject to reporting requirements which will impact the preparation of the 2018/19 RFS in relation to existing business connectivity markets:
- a) In the 2016 BCMR Ofcom identified and found BT to have SMP in a national market (excluding Hull) for traditional interface services up to and including 8Mbit/s.<sup>36</sup> In relation to this market, BT is subject to regulatory reporting requirements set out in directions made under Condition 11.4 of the 2016 BCMR Notification. These requirements remain in place until revoked. As such BT remains bound by them for the purposes of the 2018/19 RFS. We have consulted on revoking these requirements later this year when our final statement in the BCMR 2019 is published.
  - b) In the 2017 Temporary Conditions Statement, Ofcom identified and found BT to have SMP in various geographic markets for lower bandwidth contemporary interface services.<sup>37</sup> As we explained in our 2018 BT RFR Consultation,<sup>38</sup> these requirements apply to the preparation of the 2018/19 RFS and expire on 31 March 2019. In light of this, we do not consider it proportionate to amend these requirements. However, we expect that BT will prepare its 2018/19 RFS in accordance with the new directions.

## Regulatory framework

- 2.38 The regulatory framework for market reviews is set out in UK legislation and is transposed from five EU Directives. These Directives impose several obligations on relevant regulatory authorities, such as Ofcom, one of which is to carry out periodic reviews of certain electronic communications markets.

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<sup>36</sup> The “Wholesale market for low bandwidth traditional interface symmetric broadband origination in the United Kingdom excluding the Hull Area, at bandwidths up to and including 8Mbit/s”. See para 14 of the 2016 BCMR Notification: [https://www.ofcom.org.uk/data/assets/pdf\\_file/0023/47840/final-annex-35.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0023/47840/final-annex-35.pdf). The remaining markets set out therein were revoked on 23 November 2017: [https://www.ofcom.org.uk/data/assets/pdf\\_file/0018/108018/BCMR-Revocation-Notification.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0018/108018/BCMR-Revocation-Notification.pdf).

<sup>37</sup> The “Wholesale market for Lower Bandwidth CISBO Services in the London Periphery”; the “Wholesale market for Lower Bandwidth CISBO services in the Central Business District of Bristol”; the “Wholesale market for Lower Bandwidth CISBO Services in the Central Business District of Manchester”; and the “Wholesale market for Lower Bandwidth CISBO Services in the Rest of UK”. See para 10 of the 2017 Temporary Conditions Notification: [https://www.ofcom.org.uk/data/assets/pdf\\_file/0020/108137/Annex-1-Legal-instruments.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0020/108137/Annex-1-Legal-instruments.pdf)

<sup>38</sup> 2018 BT RFR Consultation, paragraph 3.5.



- 2.39 We set out the relevant regulatory framework in our statements for each market review, including our 2018 WLA Statement, the 2017 NMR Statement, 2016 BCMR Statement and the 2018 WBA Statement.

## Impact assessment and equality impact assessment

### Impact assessment

- 2.40 Impact assessments provide a valuable way of assessing the options for regulation and showing why the chosen option was preferred. They form part of best practice policy-making. This is reflected in section 7 of the Act, which means that, generally, we have to carry out impact assessments in cases where our conclusions would be likely to have a significant effect on businesses or the general public, or where there is a major change in Ofcom's activities. However, as a matter of policy Ofcom is committed to carrying out impact assessments in relation to the great majority of our policy decisions.
- 2.41 We set out our impact assessment in relation to those proposals on which we are making a final decision in the 2018 BT RFR Consultation. In this document we consider relevant responses and set out our conclusions on the impact of those changes.

### Equality impact assessment

- 2.42 Ofcom is required by statute to assess the potential impact of all our functions, policies, projects and practices on equality. EIAs also 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.
- 2.43 It is not apparent to us that the outcome of our review is likely to have any particular impact on any particular equality group. More generally, we do not envisage the impact of any outcome to be to the detriment of any group of society.

## 3. Regulatory financial reporting in relation to all regulated markets

3.1 In this section, we set out our conclusions on BT's regulatory financial reporting obligations which have an impact on the following markets:

- wholesale local access market;<sup>39</sup>
- narrowband markets;<sup>40</sup> and
- wholesale broadband access market.<sup>41 42</sup>

3.2 We have made changes to five of the eight directions imposed on BT in these markets:

- Consistency with Regulatory Decisions and Regulatory Asset Value Direction;
- Audit of the RFS Direction;
- Reconciliation Report Direction;
- Preparation, Delivery, Publication, Form and Content of the RFS Direction; and
- Network Components Direction.

### General comments in relation to BT's RFS

#### 2018 BT RFR Consultation

3.3 In the 2018 BT RFS Consultation we explained that the purpose of regulatory financial reporting, as set out in the 2014 Regulatory Financial Reporting Statement, was to provide us with "the information necessary to, make informed regulatory decisions, monitor compliance with SMP conditions, ensure that those SMP conditions continue to address the underlying competition issues and investigate potential breaches of SMP conditions and anti-competitive practices".<sup>43</sup>

3.4 We also said that "Published Regulatory Financial Reporting should provide reasonable confidence to stakeholders that the SMP provider has complied with its SMP conditions

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<sup>39</sup> In Section 4 of the 2018 WLA Statement we found that BT has SMP in the supply of wholesale local access at a fixed location in the UK excluding the Hull Area.

<sup>40</sup> In Section 6 of the 2017 NMR Statement we found that BT has SMP in four markets in the UK excluding the Hull Area: Wholesale Fixed Analogue Exchange Lines, Wholesale Call Origination, Wholesale ISDN30 and Wholesale ISDN2. In Section 12 of the same statement we found that BT also has SMP in the market for call termination to geographic numbers in the area it serves.

<sup>41</sup> In Section 5 of the 2018 WBA Statement we found that BT has SMP in the provision of Wholesale Broadband Services in Market A, comprising areas in the UK (excluding the Hull Area) where there is limited or no competition in WBA (i.e. exchange areas which are BT-only or BT + 1 Principal Operator).

<sup>42</sup> The Adjusted Financial Performance Direction was not previously applied to the WBA market (Market A). Also, the Consistency with Regulatory Decisions and RAV Direction only applied to the WBA market (Market A) in relation to the requirement that BT prepares the RFS on a RAV basis. This is because in the 2018 WBA Statement we did not impose any charge controls for this market.

<sup>43</sup> 2014 Regulatory Financial Reporting Statement, paragraph 2.28.

and add credibility to the Regulatory Financial Reporting Regime”.<sup>44</sup> Finally, we explained that in the 2014 Regulatory Financial Reporting Statement we set out the Regulatory Accounting Principles which are fundamental reporting principles with which BT’s regulatory financial reporting must comply.<sup>45</sup>

## Stakeholder responses

- 3.5 Whilst agreeing with the purposes of regulatory financial reporting, BT suggested that Ofcom implements a single regulatory financial reporting framework for BT and KCOM. BT made the same suggestion in its response to the 2018 KCOM RFR Consultation<sup>46</sup> where it said that a single regulatory reporting framework would be based on four key principles:
- a) “The framework should apply consistently across all market reviews;
  - b) It should apply consistently to all UK operators on which SMP obligations are imposed;
  - c) Information required to be provided should clearly correlate to the pricing (and other) remedies imposed; and
  - d) Information required to be reported should be proportionate to the benefit and, to be proportionate, the requirement must go no further than necessary (i.e. no more onerous than necessary)”.<sup>47</sup>
- 3.6 In its response to the 2018 BT RFR Consultation, BT reiterated point d) above and noted that the proposals in the 2018 BT RFR Consultation are generally in accordance with the above framework.<sup>48</sup>
- 3.7 TalkTalk suggested that there should be stronger rules on double recovery, noting “[d]ouble recovery has happened on several occasions before – for example, in the case of ECC costs and certain co-mingling connection costs the cost was recovered up front and then capitalised and recovered again in rental charges. One such approach to mitigate double recovery risk would be to require BT to warrant that, in light of Ofcom’s approach to setting charges, that its costs will not be recovered twice (e.g. in connection and rental charges)”.<sup>49</sup>
- 3.8 TalkTalk stated that the information presented within the market level information schedule<sup>50</sup> and the service level information schedules<sup>51</sup> was inconsistent and that “[i]t would be useful if the service level information were to provide a split of costs by

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<sup>44</sup> 2014 Regulatory Financial Reporting Statement, paragraph 2.41.

<sup>45</sup> 2014 Regulatory Financial Reporting Statement, Section 3 and Annex 3.

<sup>46</sup> Ofcom, *KCOM Regulatory Financial Reporting: Consultation on proposed regulatory financial reporting directions for KCOM*, 7 August 2018, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0017/117413/consultation-kcom-regulatory-financial-reporting.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0017/117413/consultation-kcom-regulatory-financial-reporting.pdf) (2018 KCOM RFR Consultation). BT response to the 2018 KCOM RFR Consultation, paragraph 3.2.4.

<sup>47</sup> BT response to the 2018, KCOM RFR Consultation, paragraph 3.2.

<sup>48</sup> BT response to the 2018 BT RFR Consultation, paragraph 3.4 and 3.6.

<sup>49</sup> TalkTalk response to the 2018 BT RFR Consultation, paragraph 12.

<sup>50</sup> Found on page 22 of the 2017/18 BT RFS.

<sup>51</sup> E.g. the WLA service level information which can be found on page 32 of the BT 2017/18 RFS.

depreciation, operating costs and MCE (or RoCE) so that the same data is provided in both market level information and service level information”.<sup>52</sup> TalkTalk further stated that the two data sets were arithmetically inconsistent. In particular, TalkTalk, noted that in 2017/18 RFS for the wholesale local access market (Tables 5.1 and 7.1), according to the market level information the total FAC is £1.947bn,<sup>53</sup> whereas according to the service level information the total FAC is £1.983bn.<sup>54</sup>

- 3.9 Vodafone wanted more focus on “excessive returns” within the RFS. It stated that “[o]ne of the fundamental functions of the RFS is to report the overall level of profitability that BT is making in all regulated SMP markets, not simply charge controlled markets. This gives a high-level view as to whether BT’s market power is being constrained in the market or whether they are able to use it to profit maximise. The RFS has shown that BT’s profitability has remained significantly above the determined cost of capital since 2006”.<sup>55</sup>

## Our reasoning and decision

- 3.10 In response to BT’s point on a single reporting framework for BT and KCOM, we consider that regulatory financial reporting is already subject to a single framework. The regulatory financial reporting obligations to which BT and KCOM are subject have both been imposed in accordance with the same legal framework (specifically, in accordance with the Communications Act 2003 and the 2005 EC Directive<sup>56</sup>) and by reference to the same overarching attributes (namely, that any financial reporting should be relevant, reliable, transparent and proportionate).
- 3.11 We have also considered the specific framework put forward by BT in Table 3.1 of its response to the consultation which proposes that regulatory financial reporting is tied to the pricing remedies imposed. The case for such a framework has been put forward by both BT and Openreach in previous market reviews and Ofcom has explained as part of those market reviews why it disagrees with BT’s suggestion. As we articulated in the 2017 NMR Statement, whilst we broadly agree with BT’s suggestion that regulatory financial reporting obligations should be consistent with the remedies imposed, and we agree with BT that any reporting requirements imposed on UK operators should be proportionate and consistent, we do not consider that pricing remedies are the only factor to take account of when considering the requirements for public reporting.<sup>57</sup> While pricing remedies are a relevant factor when considering the services or level of cost information to report, more generally it is important to ensure that sufficient information is published to achieve the objectives of public reporting, i.e. to enable stakeholders to have reasonable confidence that BT has complied with its SMP conditions, allow them to contribute to the regulatory

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<sup>52</sup> TalkTalk response to the 2018 BT RFR Consultation, paragraph 10.

<sup>53</sup> Total FAC = CCA op costs (£1.462bn) + MCE (£5.637bn) x WACC (8.6%).

<sup>54</sup> TalkTalk response to the 2018 BT RFR Consultation, paragraph 9.

<sup>55</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 23.

<sup>56</sup> Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications, recital 4. [http://www.akos-rs.si/files/APEK\\_eng/Legislation/I26620051011en00640069.pdf](http://www.akos-rs.si/files/APEK_eng/Legislation/I26620051011en00640069.pdf)

<sup>57</sup> 2017 NMR Statement, paragraph 20.37.

regime and add credibility to the regulatory accounting system. We therefore continue to consider that appropriate reporting requirements should be determined as part of each market review, so we can assess what a sufficient level of detail would be in respect of each market in light of our competition concerns, taking account of stakeholder representations and other factors relevant to the particular market.

- 3.12 In response to TalkTalk's point on double recovery, we understand this to relate to instances where revenues have been recognised upfront by BT in relation to costs which have been capitalised as an asset. The concern on double recovery is that if charge controls are set on costs, and those costs include depreciation charges in relation to capitalised assets, that depreciation charge may have already been recovered through the upfront revenue. Whilst this is a charge control issue rather than a reporting one, we have on several occasions, as part of the market review process, introduced new financial reporting directions to ensure that the accounting treatment for revenues and costs matches the way costs are recovered in the charge control.<sup>58</sup> We do not consider this to be a frequent occurrence. When it does occur, we take steps to address it. Nevertheless, we consider that this is a good suggestion worthy of further attention. We have not had the chance to seek stakeholders' views on if and how this might be addressed. We therefore do not propose to require changes in time for the 18/19 accounts. Instead we will consider this issue as part of the wider review of BT's regulatory financial reporting across all regulated markets from 2021.
- 3.13 In relation to TalkTalk's comment that the service level reporting and market level reporting should be consistent, we note that the two schedules within the RFS were designed to answer different questions. The service level reporting shows the FAC cost stacks (which includes a return on MCE) in a manner that reflects the way prices have been set. The market level information shows, amongst other things, the profitability across the regulated markets. The schedules therefore have different purposes and the basis for the cost disaggregation in each is not the same. Therefore, while the difference between the numbers might not be helpful for some stakeholders, this is not an issue to be corrected in the 18/19 RFS. We will be considering the purpose of all schedules in the current RFS as part of the wider review of BT's regulatory financial reporting across all regulated markets from 2021 and will seek stakeholders' views as to what information they consider to be of best use to them in the RFS in the future.
- 3.14 The apparent arithmetical inconsistency raised by TalkTalk in relation to the two data sets is due to two factors. First, TalkTalk has assumed a single WACC rate when in reality the return on MCE in the WLA market will be a mix of the Openreach copper access WACC rate, the Other UK telecoms WACC rate and the WACC rate for revenue receivables. Second, TalkTalk seems to have assumed an outdated single WACC rate of 8.6%, whereas

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<sup>58</sup> The most recent example of this is in relation to Excess Construction Charges (ECCs). In the 2018 Regulatory Financial Reporting Consultation we consulted on requiring BT to expense the costs relating to ECCs so that the costs would be recognised in the same period as the revenues.

the WACC rates used within the service level reporting are the most recent WACC rates published by Ofcom.

- 3.15 In relation to Vodafone’s profitability proposal, we disagree that reporting the returns in unregulated markets is a “fundamental” purpose of the RFS. We have set out the purpose of the RFS in the 2014 Regulatory Financial Reporting Statement. We repeat these in paragraphs 2.1 and 2.2 above. As noted above, we have started a wider review of BT’s regulatory financial reporting to reflect potential changes to its regulation from 2021. As part of this review, we will also reconsider the purpose of BT’s regulatory financial reporting.

## Consistency with Regulatory Decisions and Regulatory Asset Value Direction

### 2018 BT RFR Consultation

- 3.16 In the 2018 BT RFR Consultation we proposed a new schedule to the Consistency with Regulatory Decisions and Regulatory Asset Value Direction in relation to the allocation of general overheads. In the 2016 BCMR Statement and, later, the 2017 BCMR Temporary Conditions Statement, we directed BT to allocate general overheads using a Previously Allocated Cost (PAC) attribution.<sup>59</sup> We also said that the PAC rule should only include costs relevant to the line of business associated with the cost category. Recently BT created a unit called BT Enterprise which brought the Business and Public Sector and Wholesale and Ventures units into one team.<sup>60</sup> Therefore we proposed changing all references from BT Wholesale to BT Enterprise.
- 3.17 In the 2018 BT RFR Consultation we also proposed a new schedule in relation to Cumulo. However, for this statement we have considered the allocation of general overheads only. The proposal in relation to Cumulo is dependent upon decisions to be taken as part of the upcoming PIMR and BCMR Statements. Therefore, we will take a decision on these changes in the upcoming statements on these market reviews.

### Stakeholder responses

- 3.18 Only BT responded to our proposals on the allocation of general overheads. It suggested that BT Enterprise overheads should not be attributed to SMP markets because the amount which would be allocated to regulated markets is estimated to be only £100k in 2018/19.<sup>61</sup>

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<sup>59</sup> 2016 BCMR Statement, Annex 28. For the definition of a PAC attribution see paragraphs 2.85-2.107 of Annex 28 of the 2016 BCMR Statement.

<sup>60</sup> See BT, *BT forms new business unit BT Enterprise*, 18 April 2018, <https://www.btplc.com/News/#/pressreleases/bt-forms-new-business-unit-bt-enterprise-2480484>.

<sup>61</sup> BT response to the 2018 BT RFR Consultation, paragraph 3.18.

## Our reasoning and decision

- 3.19 We have decided to implement our proposal by imposing a new direction where all references to BT Wholesale<sup>62</sup> are changed to BT Enterprise. This ensures that the direction remains up to date.
- 3.20 If BT wishes to no longer attribute the BT Enterprise overheads to SMP markets on the grounds that they are not material, then BT can include this methodology change in the Change Control Notification (CCN) and we will consider it in accordance with the usual process. The new Consistency with Regulatory Decisions and Regulatory Asset Value Direction and the Change Control Notification ensures BT has the ability to propose this change.

## Audit of the RFS Direction

### 2018 BT RFR Consultation

- 3.21 In the 2018 BT RFR Consultation, we did not propose any changes to the audit arrangements around BT's RFS. The purpose of the current arrangements is to promote the consistent application of the audit opinion directions across all the markets in which BT is regulated.
- 3.22 The current arrangements allow for two types of opinion to be used for the regulatory audit: "Fairly Presents In Accordance with" (FPIA) and "Properly Prepared In Accordance with" (PPIA) opinion. Both types of opinion would consider BT's compliance, when preparing its regulatory financial reports, with the published Accounting Methodology Documents prepared by BT,<sup>63</sup> as well as our regulatory financial reporting obligations surrounding the RFS. However, the scope of the two types of opinion is different: the PPIA opinion represents a view on whether the rules have been followed, whereas the FPIA opinion provides some additional assurance on whether those rules are reasonable. An FPIA opinion therefore involves more judgement (and more work) by the auditor.

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<sup>62</sup> Current regulatory reporting requirements do not refer to Business and Public Sector.

<sup>63</sup> For the 2017/18 RFS see BT, *Accounting Methodology Document 2018, relating to the Regulatory Financial Statements*, <https://btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2018/AMD2017-18.pdf>

## Introduction of ISA 800

- 3.23 In October 2016, the Financial Reporting Council<sup>64</sup> introduced a new auditing standard named ISA 800<sup>65</sup> that applies from 1 January 2017. As a result, auditors are now required to undertake their audit of given RFS in accordance with this new standard. ISA 800 identifies financial reporting provisions established by a regulator to meet the requirements of that regulator as a “special purpose framework” (even where they are based on a GAAP framework). According to ISA 800, a suitable opinion framework for financial statements subject to special purpose frameworks would be a PPIA opinion in accordance with the identified special purpose framework.<sup>66</sup>
- 3.24 In the 2019 KCOM RFR Statement, we noted that KCOM’s RFS are considered by its auditors to be a special purpose framework and decided to remove the requirement for KCOM to obtain a FPIA opinion on its RFS from its regulatory auditors. In future, KCOM is required to obtain only an opinion that the RFS are PPIA with its Primary Accounting Documents.<sup>67</sup>
- 3.25 Like KCOM, BT’s RFS are produced under a special purpose framework, based on its Accounting Methodology Document (AMD)<sup>68</sup> but with a difference relating to Ofcom’s role in the process. Since the publication of the 2014 Regulatory Financial Reporting Statement, we have taken a greater role in determining the appropriate base for attributing costs within BT’s RFS. The imposition of the RAP (see above) with the hierarchy of principles means that BT’s RFS must comply with the principle that they are consistent with our regulatory decisions in priority to be consistent with GAAP. In practice this has meant that we have imposed on BT, by way of directions through the market review process, changes to the way BT attributes costs within the RFS that it would not necessarily have done itself. BT has also reflected these changes within its AMD. As a result, we have only directed BT to provide PPIA opinions on the RFS. Removing the requirement to provide an FPIA opinion will therefore have no practical consequence on BTs RFS.<sup>69</sup>

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<sup>64</sup> The Financial Reporting Council (FRC), is the regulator for auditors, accountants and actuaries and sets the UK’s Corporate Governance and Stewardship Codes. These codes include the publication of auditing standards (whilst set internationally they are published in the UK under the guise of the FRC). The FRC aims to promote transparency and integrity in business, its stakeholders include investors and others who rely on company reports, audit and high-quality risk management.

<sup>65</sup> Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks (“ISA (UK) 800”) issued by the Financial Reporting Council, effective for audits of financial statements for periods commencing on or after 1 January 2017. See [https://www.frc.org.uk/getattachment/80f8bb7f-1763-4e7e-a7c1-b54cb1bba2a7/ISA-\(UK\)-800\\_Revised.pdf](https://www.frc.org.uk/getattachment/80f8bb7f-1763-4e7e-a7c1-b54cb1bba2a7/ISA-(UK)-800_Revised.pdf)

<sup>66</sup> KCOM response to the 2018 KCOM RFR Consultation, paragraph 2.10.

<sup>67</sup> 2019 KCOM RFR Statement, paragraph 3.62.

<sup>68</sup> For the 2017/18 RFS see BT, *Accounting Methodology Document 2018, relating to the Regulatory Financial Statements*, <https://btplc.com/Thegroup/RegulatoryandPublicAffairs/FinancialStatements/2018/AMD2017-18.pdf>

<sup>69</sup> In the 2014 Regulatory Financial Reporting Statement (paragraph 5.63) we said that “[b]oth BT and the regulatory auditor have told us that our proposals to take a greater role in the basis of preparation will impact on the level which is appropriate for the audit. The regulatory auditor has told us that an FPIA opinion would not be appropriate in respect of markets impacted by allocation methodologies which are covered by the Regulatory Accounting Guidelines from the 2016/17 Regulatory Financial Statements onwards.”



## Our reasoning and decision

3.26 Having considered the introduction of ISA 800, the fact that BT's RFS must be consistent with our regulatory decisions (in priority to being consistent with GAAP), and that we have decided to remove the FPIA audit requirement from KCOM, we believe that it is no longer appropriate to require BT to obtain an FPIA opinion on its RFS. We believe that a PPIA opinion will continue to be sufficient. We have therefore decided to implement the proposed PPIA Audit Direction and not the FPIA Audit Direction.

## Reconciliation Report Direction

3.27 In the 2018 BT RFR Consultation we proposed two changes to the Reconciliation Report Direction that impact all regulated markets, as follows:

- an increase in the materiality threshold; and
- the removal of schedules included in the RFS that were previously in the Reconciliation Report annex, including the removal of the % change tables.

## The materiality threshold

### 2018 BT RFR Consultation

3.28 The current direction relating to the materiality threshold requires disclosure within the Reconciliation Report of all "material errors" or "material changes" of any figure within the Regulatory Financial Statements. Material errors and material changes are defined as those exceeding the higher of £1m or 5%. Errors and changes below the threshold are also disclosed but are aggregated into a single figure.

3.29 In the 2018 BT RFR Consultation we proposed to increase the absolute materiality threshold used in the Reconciliation Report from £1m to £5m. We considered that the errors or methodology changes that would not have been separately disclosed, had the higher materiality threshold been in place, would not have been of significant interest to stakeholders. We also noted that all methodology changes, no matter the magnitude, are included within BT's Change Control Notification (CCN).

### Stakeholder responses

3.30 One confidential respondent, [X], disagreed with the increase in the absolute materiality threshold. It stated that the increase [X].<sup>70</sup> The confidential respondent also stated that [X].<sup>71</sup>

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<sup>70</sup> [X] Confidential response to the 2018 BT RFR Consultation, page 5.

<sup>71</sup> [X] Confidential response to the 2018 BT RFR Consultation, page 5.

- 3.31 Vodafone disagreed with our proposal to increase the materiality threshold as it “markedly changes the perception of the RFS and covers up a number of important issues that CP’s would very much like highlighted. For example, removing this threshold would have excluded the working capital methodology change in 2017/18 that reduced the mean capital employed by a staggering £182million, although Ofcom state this only effected the FAC of regulated markets by £18m it is nevertheless a change that CP’s are interested in.”<sup>72</sup> Vodafone also pointed to the following additional examples of changes they considered important that would not have been disclosed under the higher materiality threshold: a £12m increase in costs in respect of ‘Remote Testing Platform’; and a £31m increase in respect of both ‘CPE Switch’ and ‘Group Property’.
- 3.32 BT agreed with our proposal to increase the materiality threshold.<sup>73</sup>

### Our reasoning and decision

- 3.33 The publication of the Reconciliation Report is closely linked to BT’s publication of the CCN. The CCN is published in March before July’s RFS and shows the estimated impact of BT’s material methodology changes based on the prior year’s RFS. The Reconciliation Report is published as part of the RFS in July and shows the actual impact of those changes on the current years RFS together with the impact of material errors that BT has discovered and corrected in its RFS.
- 3.34 The purpose of the CCN is to provide us and stakeholders early sight of any changes that BT is making to the RFS, allow stakeholders to make representations to us and enable us to seek clarity from BT on those changes. If we are fundamentally opposed to the changes BT is making, following a consultation process, we can ‘veto’ that change from going into the RFS, i.e. require BT to re publish the RFS. The purpose of the Reconciliation Report on the other hand is to show stakeholders and ourselves the actual impact of any changes, to provide data to allow for more robust time series analysis, as well as provide a check as to the accuracy of BT’s estimate of the changes in the CCN.
- 3.35 Both the CCN and the Reconciliation Report have been published since 2015 and so far, we have not received any stakeholder comments (negative or otherwise) in regard to any changes BT has proposed in the CCN. However, we appreciate that this apparent satisfaction with the methodology changes presented in the CCN should not be taken to mean that stakeholders do not value the information in the Reconciliation Report given their different purposes. Whilst we still hold the view that the current materiality threshold may be capturing relatively trivial changes and errors, we have decided not to increase the current materiality threshold and will continue to monitor the size of the aggregated errors and methodology changes that fall between £1m and £5m. We may consider proposing an increase to the materiality threshold again in the future if the volume and aggregated amount of these changes and errors remain at their current levels.

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<sup>72</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 60.

<sup>73</sup> BT’s response to the 2018 BT RFR Consultation, paragraph 3.19.

## Removal of schedules included in the RFS that were previously in the reconciliation report appendix including the removal of the % change tables

### 2018 BT RFR Consultation

- 3.36 In the 2018 BT RFR Consultation we proposed to remove a number of schedules from the Reconciliation Report that we considered to be obsolete.
- 3.37 The first set of schedules we proposed to remove set out the impact of methodology changes and errors in percentages.<sup>74</sup> These schedules do not provide information to the users of the RFS which they could not calculate for themselves<sup>75</sup> but add additional complexity to the report.
- 3.38 The second set of schedules we proposed to remove cover the performance summary by market, attribution of wholesale current costs and attribution of MCE, all prepared on the basis that methodology changes do not have effect (i.e. are “reversed”).<sup>76</sup> We reviewed these schedules and considered that they duplicated information presented within other schedules that BT is required to include within the Reconciliation Report.

### Stakeholder Responses

- 3.39 Vodafone raised a concern that, although the first set of schedules do not provide any additional information which can’t be self-calculated, they do “provide an easy and simple way to scan the reconciliation report and see what the changes with the largest percentage impact are. Without these the users must perform several calculations, which considering the RFS is published in excel is not that unreasonable, however the percentage tables do simplify the RFS and make review easier, thus correspondingly removing them adds complexity for the reader and makes review more time consuming”.<sup>77</sup>
- 3.40 One confidential respondent, [redacted], commented that [redacted].<sup>78</sup>
- 3.41 Stakeholders did not raise any concerns with the proposed removal of the second set of schedules to the Reconciliation Report.

### Our reasoning and decision

- 3.42 We continue to believe that the information presented in the first set of schedules is not necessary. Specifically, we consider that the calculations showing the impact of methodology changes and errors in percentages are not complex or difficult for a reasonably informed reader of the RFS. We have therefore decided to remove the requirement on BT to publish the first set of schedules to the Reconciliation Report.

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<sup>74</sup> These schedules can currently be found on pages 117, 119, 121, 124, 127 and 130 in the 2017/18 RFS.

<sup>75</sup> The absolute values of the changes can be found in the changes on pages 116, 117 And 118 of the 2017/18 RFS. These can be used to manually calculate the percentage changes if required.

<sup>76</sup> These schedules can currently be found on pages p122, 123, 125, 126, 128, and 129 in the 2017/18 RFS.

<sup>77</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 62.

<sup>78</sup> [redacted] Confidential response to the 2018 BT RFR Consultation.

- 3.43 We have also decided to remove the second set of schedules to the Reconciliation Report that cover the performance summary by market, attribution of wholesale current costs and attribution of MCE, all prepared on the basis that methodology changes do not have effect (i.e. are “reversed”).
- 3.44 Consistent with our proposal, we have decided that the schedules that will remain in the Reconciliation Report appendix are:
- Reconciliation Report: Impact of Methodology Changes and Errors (Introduction, description of methodology changes and description of errors)<sup>79</sup>
  - Reconciliation Report: Impact of Methodology Changes (restating the current year using the old methodologies),<sup>80</sup> and
  - Reconciliation Report: Impact of Methodology Changes on Revenue (restating the prior year for methodology changes and errors arising in the current year).<sup>81</sup>

## Preparation, Delivery, Publication, Form and Content of the RFS Direction

- 3.45 In the 2018 BT RFR Consultation we proposed several changes to the Preparation, Delivery, Publication, Form and Content of the RFS Direction that impact all regulated markets. These relate to BT’s requirements for public and private reporting.

### Requirements relating to public information in the RFS

- 3.46 This is information that we consider should be published in BT’s RFS on the basis that it gives stakeholders reasonable confidence that BT has complied with its SMP conditions, allows them to contribute to the regulatory regime and is consistent with the other remedies imposed. For example, if the remedy is in the form of a charge control on individual services or baskets of services, information should be published relating to those services or baskets of services.<sup>82</sup>
- 3.47 In the published RFS, financial information on regulated markets broadly falls into four categories: BT level information, market level information, service level information and cost components for reported services. For this statement, we have only considered our proposals regarding BT level information as they impact all regulated markets. BT level

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<sup>79</sup> Currently found on pages p109, 113 to 115 and 131 in the 2017/18 RFS.

<sup>80</sup> Currently found on pages p116, 118 and 120 in the 2017/18 RFS. These are used to disclose the changes to Regulatory Accounting Methodology.

<sup>81</sup> Currently found on pages p110, 111 and 112 in the 2017/18 RFS. These are used to disclose the methodology changes and errors corrected in the prior year comparatives.

<sup>82</sup> In certain circumstances, we may decide that BT needs to publish regulatory financial data that goes beyond the level of the remedy to give stakeholders reasonable confidence that BT has complied with its SMP conditions and allow them to contribute to the regulatory regime. For example, in the 2016 BCMR Statement, given the broad baskets used in that charge control, we decided that BT must publish financial information on certain individual services (see paragraphs 16.44 - 16.46 and 16.52 – 16.61). For the WBA Market A, we consider that all the information we propose that BT should publish is consistent with the level of the remedy.

information shows how regulated markets fit within the BT business and reconciles to the statutory accounts and Openreach information.

- 3.48 In the 2018 BT RFR Consultation we proposed several changes to the BT level information published in the RFS which were originally requested by BT in a letter to Ofcom.<sup>83</sup>:
- a) a formatting change to the “Performance Summary by Market”, “Attribution of Wholesale Current Costs” and “Attribution of Wholesale Current Cost Mean Capital Employed” schedules;
  - b) combining certain cost categories in the “Attribution of Wholesale Current Costs” and “Attribution of Wholesale Current Cost Mean Capital Employed” schedules;
  - c) the removal of inter-market revenues and costs from the “BT Reconciliation Statement – Consolidated Profit and Loss Account” and inclusion within the “Summary of Market Performance” schedule;
  - d) changes to the schedules that reconcile the RFS to BT’s plc financial statements; and
  - e) how to reflect IFRS 15 within the RFS.
- 3.49 Below we set out each proposal, any relevant stakeholder responses, and our reasoning and decision.

*Formatting changes to the “Performance Summary by Market”, “Attribution of Wholesale Current Costs” and “Attribution of Wholesale Current Cost Mean Capital Employed” schedules*

### **2018 BT RFR Consultation**

- 3.50 We proposed that within the “Performance Summary by Market”,<sup>84</sup> “Attribution of Wholesale Current Costs”<sup>85</sup> and “Attribution of Wholesale Current Cost Mean Capital Employed”<sup>86</sup> schedules, the market review headings and market sub headings be pivoted and re-ordered to show which markets reside in Openreach and which reside in the rest of BT. Under the proposal, ‘Openreach Residual’ will be separately published, while the remainder of what is now ‘Wholesale Residual’ and ‘Retail Residual’ will be combined as ‘Rest of BT Residual’. The Openreach income statement and MCE statement<sup>87</sup> will no longer be published as the information in these will be obtainable in the proposed “Performance Summary by Market”, “Attribution of Wholesale Current Costs” and “Attribution of Wholesale Current Costs Mean Capital Employed” schedules.

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<sup>83</sup> Letter from [BT] (BT) to [Ofcom] (Ofcom), dated 28 September 2018, entitled ‘BT Regulatory Financial Statement simplification proposals’.

<sup>84</sup> Set out on page 22 of the 2017/18 RFS.

<sup>85</sup> Set out on page 88 of the 2017/18 RFS.

<sup>86</sup> Set out on page 91 of the 2017/18 RFS.

<sup>87</sup> Set out on pages 26-29 of the 2017/18 RFS.

## Stakeholder responses

- 3.51 Vodafone considered these sensible revisions, and that combining ‘Wholesale Residual’ and ‘Retail Residual’ does not reduce reporting transparency. However, Vodafone requested reassurance that the detail currently published on pages 26 to 28 of the 2017/18 RFS (titled “Openreach Information”) will still be published at the current level of granularity, albeit in a different place.<sup>88</sup>
- 3.52 In its response to the consultation BT requested that, for the new ‘Rest of BT Residual’ it only discloses costs at the subtotal levels, i.e. the bold rows currently in the 2017/18 RFS on pages 88 and 91. BT stated that our current proposed requirement would be “inappropriate and disproportionate as it would require disclosure beyond the SMP markets and at a greater level of detail than in the BT Group plc statutory financial statements”.<sup>89</sup>

## Our reasoning and decision

- 3.53 In response to Vodafone, we consider that our proposal results in very small loss of detail in the current internal revenue split. Under the proposal the residual markets will no longer separately disclose ‘ePPC’s’, ‘Other – externally available’ and ‘Other – internally available only’. In our view, this is not an informative revenue split. As this information does not relate to markets where we have found BT to have SMP, we do not consider it to be relevant to other stakeholders.
- 3.54 Under our proposed changes what is currently ‘Wholesale Residual’ and ‘Retail Residual’ will be aggregated under the proposed ‘Rest of BT Residual’. There is currently no detailed disclosure of ‘Retail Residual’ on its own. However, we do not think that this amalgamated disclosure represents new information and at this level it is not commercially sensitive. This line it is likely to be the largest aggregate line within the RFS. Although this line relates to BT’s unregulated business, the level of detail should allow stakeholders to compare BT’s costs and assets between its regulated markets and its unregulated businesses, in order to give them context as to how the regulated and unregulated businesses compare to each other. As such, we do not agree with BT’s response that the disclosure for ‘Rest of BT Residual’ should be less than that we proposed in our consultation.
- 3.55 We consider that the above changes will simplify the RFS and make it easier for stakeholders to analyse it without reducing the transparency of BT’s regulatory financial reporting. We therefore require these formatting changes within the RFS from 2018/19.

*Combining certain cost categories in the “Attribution of Wholesale Current Costs” and “Attribution of Wholesale Current Cost Mean Capital Employed” schedules*

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<sup>88</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 63.

<sup>89</sup> BT response to the 2018 BT RFR Consultation, paragraph 3.24

## 2018 BT RFR Consultation

- 3.56 We proposed that, within the “Attribution of Wholesale Current Costs” schedule,<sup>90</sup> the ‘Bad Debts’ and ‘Finance and Billing’ cost categories are combined within the ‘Other’ cost category.<sup>91</sup>
- 3.57 We also proposed that, within the “Attribution of Wholesale Mean Capital Employed” schedule,<sup>92</sup> ‘Current Assets’ are aggregated into one asset category while maintaining the internal/external split.<sup>93</sup>

## Stakeholder responses

- 3.58 Vodafone agreed with our proposal and commented that combining cost categories “appear not to diminish the content in the RFS but more group similar information together and truly seek simplification which Vodafone fully supports.”<sup>94</sup>
- 3.59 BT requested several further simplifications.<sup>95</sup> In respect of the “Attribution of Wholesale Current Costs” schedule, it suggested that ‘External Revenue’ is removed from the template as the template is for costs, and that ‘General Support’ and ‘General Management’ cost categories are combined. In respect of the “Attribution of Wholesale Mean Capital Employed” schedule, BT suggested that ‘Access Duct’ is renamed ‘Duct’, and that ‘Investments’ is no longer required in the “Attribution of Wholesale Current Costs and MCE” schedule as it has not been used since 14/15.
- 3.60 TalkTalk stated that electricity charges are not reported as a separate service in the RFS. According to TalkTalk, reporting this service separately would allow telecoms providers to assess BT’s compliance with the electricity basis of charges obligation. Further, TalkTalk noted that there have been significant price increases recently quoting a 14% increase in April 2018 while wholesale electricity prices have been roughly flat.<sup>96</sup>

## Our reasoning and decision

- 3.61 We agree with BT’s suggestion to remove ‘External Revenue’ from “Attribution of Wholesale Current Costs” schedule. This was a typographical error in the 2018 BT RFR Consultation.<sup>97</sup> We also agree with BT’ suggestion to rename ‘Access Duct’ to ‘Duct’ in the “Attribution of Wholesale Mean Capital Employed” schedule. This will more accurately

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<sup>90</sup> Set out on page 88 of the 2017/18 RFS.

<sup>91</sup> Total Wholesale Markets Finance and Billing costs amounted to £19m in 2017/18 and £21m in 2016/17. Bad Debt costs for the Total Wholesale Markets amounted to £3m in both 2017/18 and 2016/17.

<sup>92</sup> Set out on page 91 of the 2017/18 RFS.

<sup>93</sup> Currently Current Assets is split into Inventories and Receivables.

<sup>94</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 64.

<sup>95</sup> BT response to the 2018 BT RFR Consultation, paragraph 3.25.

<sup>96</sup> TalkTalk response to the 2018 BT RFR Consultation, paragraphs 11.

<sup>97</sup> We have also corrected another typographical error – ‘Access Depreciation’ should be ‘Duct, Access Copper and Access Fibre’ and ‘Switch, Duct and Transmission’ should be ‘Switch and Transmission’.

reflect the asset. We also agree with BT's suggestion to remove 'Investments' from the "Attribution of Wholesale Current Costs and MCE" schedule as it is no longer needed.

- 3.62 We disagree with BT's suggestion to combine the cost categories 'General Support' and 'General Management'. The amounts included in these lines is of a magnitude higher than the ones included in 'Bad Debts' and 'Finance and Billing' which we have proposed to combine (£264m and £385m compared to £21m and £3m). The activities covered by these cost headings are also quite different.<sup>98</sup> We therefore consider that this change would present a significant loss of detail from the "Attribution of Wholesale Current Costs" schedule and have not made the suggested change.
- 3.63 We disagree with TalkTalk's suggestion for electricity charges to be reported as a separate service in the RFS. The current electricity basis of charges obligation requires BT to set electricity charges that are reasonably derived from its wholesale purchase of electricity plus an appropriate mark up, to reflect BT's own costs. We believe that the current description in the AMD and BT's current obligation to publish its kWh price provides stakeholders with reasonable assurance that BT is complying with its obligations. It also allows stakeholders to raise concerns over BT's compliance.
- 3.64 We consider it appropriate to continue to require BT to provide in private to Ofcom specific financial information, including the precise level of BT's mark up on the purchase of electricity costs. This allows us to monitor BT's compliance with the basis of charges obligation, and whether the mark-up is reasonable. However, disclosure of this information could allow third parties to derive the underlying purchase costs which we consider are likely to be confidential and commercially sensitive. Therefore, we have not required additional regulatory financial reporting in relation to electricity.

*Removing inter-market revenues and costs from the "BT Reconciliation Statement – Consolidated Profit and Loss Account" schedule*

### 2018 BT RFR Consultation

- 3.65 We proposed to amend the direction to recognise that inter-market revenue and costs are recorded under the 'Eliminations' line within the "Summary of Market Performance"<sup>99</sup> schedule rather than as a reconciling item within the "BT Reconciliation Statement – Consolidated Profit and Loss Account".<sup>100</sup>

### Stakeholder responses

- 3.66 BT agreed with our proposal. In addition, BT noted that Openreach Northern Ireland is currently included as a reconciling item in the "BT Reconciliation Statement - Consolidated Profit and Loss Account" schedule.<sup>101</sup> As Openreach Northern Ireland will be part of

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<sup>98</sup> See pages 260 to 261 of BT's 2017/18 AMD.

<sup>99</sup> Set out on page 22 of the 2017/18 RFS.

<sup>100</sup> Set out on page 94 of the 2017/18 RFS.

<sup>101</sup> BT response to the 2018 BT RFR Consultation, paragraph 3.27. BT Openreach in Northern Ireland is currently classed as BT Retail in the BT plc group accounts whilst an adjustment is made within the RFS to include BT Openreach Northern Ireland, hence the need for a reconciling item.



Openreach from 2018/19 there is no longer a need to include this line as a separate reconciling item.

### **Our reasoning and decision**

- 3.67 Consistent with our proposal in the 2018 BT RFR Consultation, we have decided that the most transparent presentation of the inter-market revenue and costs within the RFS is to include these within the ‘Eliminations’ line of the “Summary of Market Performance” schedule. We have updated the direction accordingly.
- 3.68 We also agree with BT that Openreach Northern Ireland is no longer required as a reconciling item within the reconciliation statements (as revised - see below) and have removed the requirement to separately report this information.

*Changes to the schedules that reconcile the RFS to BT’s plc financial statements*

### **2018 BT RFR Consultation**

- 3.69 Currently BT is required to prepare and publish two separate profit and loss reconciliations, the ‘Reconciliation of Openreach Income Statements’<sup>102</sup> and the ‘BT Reconciliation Statement – Consolidated Profit and Loss Account’.<sup>103</sup> We proposed combining these two reconciliations into one schedule. In this new schedule we proposed that inter-market revenue and costs are included as ‘Eliminations’ in the ‘Performance Summary by Market’ and not as a reconciling item in the profit and loss reconciliations.

### **Stakeholder responses**

- 3.70 BT was the only stakeholder to comment and agreed with our proposed approach.

### **Our reasoning and decision**

- 3.71 We consider that combining the two profit and loss reconciliations will be consistent with the new market performance and cost attribution schedules. Combining the two reconciliations should also provide greater transparency for the users of the RFS. We have therefore decided that the two profit and loss reconciliations which reconcile from BTs annual accounts to the RFS be combined into one single reconciliation covering both BT and Openreach with inter-market revenues and costs to be removed from the requirement to be included as a reconciling item.

*Disclosure of IFRS 15*

### **2018 BT RFR Consultation**

- 3.72 The International Accounting Standards Board issued a new International Accounting Standard on revenue recognition effective from 1 January 2018 (IFRS 15).<sup>104</sup> BT must

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<sup>102</sup> Set out on page 30 of the 2017/18 RFS.

<sup>103</sup> Set out on page 94 of the 2017/18 RFS.

<sup>104</sup> <https://www.ifrs.org/issued-standards/list-of-standards/ifrs-15-revenue-from-contracts-with-customers/>

comply with this standard for its 2018/19 Statutory Accounts. In applying IFRS 15, BT must recognise revenue to depict the transfer of promised services to the customer in an amount that reflects the consideration to which the BT expects to receive for those services. For BT this has implications for reporting mobile revenue (particularly in relation to ‘subsidised’ handsets) and revenue from business connectivity services, where contracts typically are greater than one year.

- 3.73 Current charge controls were set without reference to International Financial Reporting Standards 15 (IFRS 15), and in the hierarchy of the RAP, the requirement for the RFS to be consistent with how charge controls are set ranks above consistency with the statutory accounts or GAAP.<sup>105</sup>
- 3.74 In a letter to Ofcom<sup>106</sup> BT suggested producing the RFS consistent with IFRS 15<sup>107</sup> (with comparatives to be restated) from 2018/19. This would ensure the RFS remained consistent with BT’s statutory financial statements. To maintain actual in-year revenue, average prices and FAC within the individual market performance schedules consistent with the charge controls as set, BT proposed to present aggregated service level information for services impacted by IFRS consistent with the charge control, as an additional line ‘IFRS deferred revenue’ within the “Market Summary” schedule to reconcile revenue consistent with the charge control back to the revenue recorded on an FRS 15 basis.
- 3.75 Further, consistent with the new accounting standard, SLG payments would be recognised as a reduction to revenue rather than an operating cost. SLG costs will still appear in the total FAC costs for each relevant service but again there will be an additional line ‘SLG credit’ on the “Market Summary” schedule setting out the total credit against the market total cost.
- 3.76 We proposed that BT’s suggestion was a practical way of ensuring that revenues for regulated services are disclosed in a manner consistent with how charge controls are currently set whilst also ensuring that BT’s RFS would remain aligned to its statutory accounts.

### Stakeholder responses

- 3.77 BT said it does not intend to restate the prior year comparatives on an IFRS 15 basis in the 18/19 Statutory Accounts. This was because “having considered further the factors that would influence our approach (including the time, effort and cost of adopting IFRS 15 retrospectively) ... we have decided to adopt the new standard on a modified retrospective

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<sup>105</sup> Generally accepted accounting principles.

<sup>106</sup> Letter from [redacted] (BT) to [redacted] (Ofcom), dated 28 September 2018, entitled ‘BT Regulatory Financial Statement simplification proposals’.

<sup>107</sup> See IFRS 15 Revenue from Contracts with Customers, <https://www.ifrs.org/issued-standards/list-of-standards/ifrs-15-revenue-from-contracts-with-customers/>. This impacts services where the contractual agreements are typically longer than 12 months.

basis... we will not restate prior year comparatives for the effect of IFRS 15".<sup>108</sup>. BT argued that it would no longer be appropriate to restate comparatives in the 2018/19 RFS as to do so would now be inconsistent with the 2018/19 BT Group plc statutory financial statements.

- 3.78 BT agreed with our proposals to add an additional line 'IFRS deferred revenue' and to recognise SLG payments as a reduction to revenue rather than an operating cost.<sup>109</sup>

### Our reasoning and decision

- 3.79 Consistent with our proposal in the 2018 BT RFR Consultation, we have decided that BT should implement IFRS15 by disclosing an additional line 'IFRS deferred revenue' within the relevant market summary schedules to reconcile RFS revenue back to the revenue in BT's statutory accounts, recorded on an IFRS 15 basis.
- 3.80 We have also decided that BT must recognise SLG payments as a credit to revenue rather than an operating cost. SLG costs must still appear in the total FAC costs for each relevant service but, on a total market level, an additional line in the relevant market summary schedules will be included to disclose the total reduction against revenue for all relevant services and a reduction against the total cost.
- 3.81 In relation to BT's suggestion not to restate prior year comparatives, we note that BT are not required to do this under IFRS15 and therefore are entitled to not restate the prior year in the statutory accounts. We therefore agree that the prior year in the RFS should not be restated.

### Requirements for private information to be provided to Ofcom

- 3.82 In addition to the published RFS, we also require BT to provide some information to Ofcom in private. We require this information to, for example, make informed regulatory decisions, monitor compliance with SMP conditions, ensure that those SMP conditions continue to address the underlying competition issues, and investigate potential breaches of SMP conditions and anti-competitive practices.
- 3.83 BT currently provides private information to Ofcom in the form of Additional Financial Information (AFI) schedules, including a Data File.<sup>110</sup> The Data File provides detailed information on all the revenues, volumes, costs and cost categories that support the published RFS.
- 3.84 In the 2018 BT RFR Consultation we proposed changes to BT's obligations for private reporting in relation to information on incremental costs and the removal of duplicated additional financial information. We discuss these below.

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<sup>108</sup> Page 206, BT Group plc 2017-18 statutory financial statements.

<sup>109</sup> BT response to the 2018 BT RFR Consultation, paragraph 3.30

<sup>110</sup> BT provides the Data File as part of AFI 12.

### *Information on incremental costs*

3.85 In the 2018 BT RFR Consultation, we set out proposals in relation to incremental costs. As these proposals follow on from the proposed regulatory financial reporting proposals for the new physical infrastructure market, they are not covered by this statement. Decisions relating to the reporting of incremental costs will instead be included within the upcoming PIMR statement.

### *Duplicated additional financial information*

#### **2018 BT RFR Consultation**

3.86 We proposed to remove BT's obligation to provide separate AFIs where the same information can be provided to us in an appropriate format as part of the Data File. We said this would not apply to:

- information that we do not get as part of the Data File;<sup>111</sup>
- where obtaining the information from the Data File would not be straightforward and/or the information from the Data File is different to that which would have been included in the AFI; or
- where the AFI is used as a control total for information obtained from the Data File.<sup>112</sup>

3.87 The AFI's we proposed to remove were set out in a Table 3.5 of our consultation.

#### **Stakeholder responses**

3.88 UKCTA said it is unclear what detailed information is provided to Ofcom under the AFIs and how Ofcom interrogates the information. UKCTA said that "given Ofcom have failed to act on BT overcharging without CP involvement we are clear that Ofcom neither have the incentive nor the resources to do anything meaningful with the data produced".<sup>113</sup> According to UKCTA, the AFIs should be published and "[i]f there are genuine confidentiality concerns then these should be overcome through confidentiality rings to ensure stakeholders".<sup>114</sup>

3.89 BT suggested further removal of duplicated additional financial information. This information is set out in the table below.

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<sup>111</sup> Currently LRIC and DSAC information, going forward only LRIC data.

<sup>112</sup> For example, AFIs 1-4.

<sup>113</sup> UKCTA response to the 2018 BT RFR Consultation, page 4.

<sup>114</sup> UKCTA response to the 2018 BT RFR Consultation, page 4.

**Table 3.1: BT's suggestion for further removal of duplicated additional financial information**

Additional Financial Information	Summary Description
<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>-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>
<p>Detailed WLA Service revenues, volumes and costs.</p>	<ol style="list-style-type: none"> <li>1. set out the revenues, volumes and FAC on a CCA basis of any other WLA service not publicly disclosed where the revenue from this service is above £5m;</li> <li>2. the revenues and costs should, in total, be reconciled to the revenues and costs included within the publicly reported totals for the WLA Market.</li> </ol>
<p>Detailed WLA Service Component FACs</p>	<ol style="list-style-type: none"> <li>1. set out the calculation of FAC based on component costs and usage factors for all services reported in the Detailed WLA Services schedule;</li> <li>2. the fully allocated service unit costs should reconcile to those given in the in the detailed WLA Services schedule.</li> </ol>
<p>Interconnect information at the DLE and tandem layer</p>	<p>A schedule of volumes, revenues, operating costs and MCE associated with interconnect circuits at the DLE and tandem layer combined (e.g. a similar format to the schedule on page 79 of the 2016-17 RFS)</p>

Source: BT response to the 2018 BT RFR Consultation.

### Our reasoning and decision

3.90 We disagree with UKCTA that we do not have the incentive or resources to carry out meaningful analysis of the data contained in the AFIs. Ofcom regularly uses the AFIs provided to interrogate BTs financial data, an example of this being the Cost Allocation

Review (CAR) performed by Ofcom in 2015.<sup>115</sup> Within this review the AFIs were used to investigate significant BT cost attribution methodologies and consult on changes to them. More recently, in the 2018 BCMR Consultation, we proposed a number of base year adjustments<sup>116</sup> based on our interrogation of BT’s AFIs. In relation to the Data File we have also developed TED (“Tool to Extract Data”), a SAP/ESS software tool that allows us to drill down into the detail of BT’s RFS.

- 3.91 We believe that the AFIs provided to Ofcom are too commercially sensitive to require BT to publish them. Whilst safeguards such as confidentiality rings may be used in the context of litigation, we do not think they are appropriate for the purpose of the RFS.
- 3.92 In response to BT’s suggested removal of additional AFIs, we note that the first of these suggestions was proposed by us to be removed in the 2018 BT RFR Consultation.<sup>117</sup> However, we did not correctly update the direction which resulted in this AFI remaining in the list of AFIs to be submitted. We do not intend for BT to provide this AFI and we have now correctly removed this from the direction.
- 3.93 In respect of the other suggestions, as the Data File does not currently contain information on WACC, the FAC information contained in these AFIs cannot be identified within the Data File. We have therefore decided not to remove these other AFIs.
- 3.94 We set out the duplicated AFIs we have decided to remove in Table 3.2 below.

**Table 3.2: Removal of requirement to provide information under a separate AFI where contained in the Data File**

Additional Financial Information	Summary Description
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: -HCA depreciation -CCA supplementary depreciation -Other CCA adjustments	<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>

<sup>115</sup> Ofcom, *Review of BT’s cost attribution methodologies*, 12 June 2015. <https://www.ofcom.org.uk/consultations-and-statements/category-2/cost-attribution-review>

<sup>116</sup> See Annex 19 of the 2018 BCMR Consultation.

<sup>117</sup> Ofcom 2018 BT Regulatory Financial Reporting Consultation table 3.55.

Additional Financial Information	Summary Description
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>
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>
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>
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.
Comprehensive analysis of transfer charges	<ol style="list-style-type: none"> <li>1. Allows Ofcom to check that material items have been separately disclosed in the published Regulatory Financial Statements;</li> <li>2. Allows BT to demonstrate compliance with its non-discrimination obligations.</li> </ol>

Source: Ofcom.

## The Network Components Direction

3.95 In the 2018 BT RFR Consultation we proposed several changes to the Network Components Direction that impact all regulated markets:

- New duct and pole infrastructure components;
- New dark fibre components; and
- Other network component changes.

3.96 The first two changes arise from the 2018 PIMR Consultation and the 2018 BCMR Consultation. We will make our decisions relating to these network components in the upcoming statements on these market reviews. In this statement we outline our reasoning and decisions in relation to the other network component changes.

### Other network component changes

#### 2018 BT RFR Consultation

3.97 In the 2018 BT RFR Consultation we compared the network component list set out in the most recent direction imposed on BT (in the 2018 WLA Statement) against the network components used within BT's 2017/18 RFS. We also discussed these components with BT.

3.98 As a result of this review, we identified inconsistencies between the directed network components list and the 2017/18 RFS. We proposed to resolve these by adding or removing components as listed below:

a) Components to be added:

- Ethernet Monitoring Platform;
- EAD Electronics Capital
- Ethernet Electronics Current
- Optical Ethernet Electronics Capital
- NGA Visit Assure;
- OR project services;
- Ethernet Excess Construction Capex
- Broadband MSAN access
- MSAN Access – SFBB

b) Components to be removed:

- Nominated In Span I/Connect cct (ISI) transmission;
- In Span Interconnect circuits (ISI) transmission;
- Customer Sited Interconnect cct (CSI) 2 Mbit/s link;
- Customer Sited Interconnect (CSI) 2 Mbit/s per km;<sup>118</sup>

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<sup>118</sup> These first four components have been removed as Tandem Layer is no longer regulated.



- Ethernet Electronics;<sup>119</sup>
- EES and MSAN Access – Broadband;<sup>120</sup> and
- GEA Fibre Voice Access Rental<sup>121</sup>
- GEA Fibre Voice Access Connection<sup>122</sup>

### Stakeholder responses

- 3.99 BT questioned whether the Network Components Direction is the appropriate mechanism for determining an exhaustive list of network components for the RFS. BT proposed that Ofcom allows it to add or remove network components from the network component list via the CCN process.<sup>123</sup>
- 3.100 BT also noted that the components relating to the TISBO market should be removed from the network components list as the TISBO market is no longer deemed to have SMP and as such BT no longer has reporting obligations in this area.<sup>124</sup> It also requested that we add a further 39 network components (as set out in its response and addendum):
- Pair gain
  - Expedite Provision Costs
  - Ofcom Administration Fee Wholesale
  - Ofcom Administration Fee Openreach
  - NGA E side Copper Capital
  - FTTP Development
  - SLG WLA Internal
  - SLG WLA external
  - SLG Ethernet Provision Internal
  - SLG Ethernet Provision External
  - SLG Ethernet Assurance Internal
  - SLG Ethernet Assurance External
  - SLG WLR Provision Internal
  - SLG WLR Provision External
  - SLG WLR Assurance Internal
  - SLG WLR Assurance External

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<sup>119</sup> This has been replaced with the three new electronics components introduced above.

<sup>120</sup> This has been replaced with the two components, 'Broadband MSAN access' and 'MSAN access -SFBB' introduced above.

<sup>121</sup> These components were introduced in the 2018 WLA Statement (see paragraph A8.290) to facilitate reporting of an Openreach provided VOIP service for FTTP. Since then, Openreach has informed us that it will be withdrawing this service (email from [redacted] (BT) to [redacted] (Ofcom) dated 23 November 2018). Total fully allocated costs to date that would have been attributed to these two components are [redacted]. We therefore do not think that it is proportionate to require BT to continue to work on creating these new network components.

<sup>122</sup> These components were introduced in the 2018 WLA Statement (see paragraph A8.290) to facilitate reporting of an Openreach provided VoIP service for FTTP. Since then, Openreach has informed us that it will be withdrawing this service (email from [redacted] (BT) to [redacted] (Ofcom) dated 23 November 2018). Total fully allocated costs to date that would have been attributed to these two components are [redacted]. We therefore do not think that it is proportionate to require BT to continue to work on creating these new network components.

<sup>123</sup> BT response to the 2018 BT RFR Consultation, paragraph 3.45.

<sup>124</sup> BT response to the 2018 BT RFR Consultation, paragraph 3.46.

- Cumulo Rates NGA
- Cumulo Non-NGA Non Openreach
- Cumulo Non-NGA Openreach
- GEA FTTP Access Fibre Spine
- GEA FTTP Distribution Fibre Spine
- GEA FTTC Access Fibre Spine
- GEA FTTC Distribution Fibre Spine
- GEA FTTC Electronics
- GEA DSLAM Cabinets
- GEA FTTC Customer Site Installation
- GEA FTTC Repairs
- GEA FTTP Repairs
- GEA FTTP Provisions
- GEA FTTC Provisions
- GEA FTTP Electronics
- GEA Cable Links
- GEA FTTP Customer Site Installation
- FTTP Funded Fibre Rollout Spend
- FTTP Fibre Rollout Funding
- FTTC Fibre Rollout Funding
- FTTC Funded Fibre Rollout Spend
- OR Service Centre – Provision GEA
- OR Service Centre – Assurance GEA

3.101 BT provided an addendum to its consultation response setting out why the new components are required. In summary, BT said that, of the list of new components, 26 had been specifically or broadly directed by us in the 2018 WLA Statement but had been omitted from the list in the 2018 BT RFR Consultation, ten related to Ofcom’s proposal in the 2018 BT RFR Consultation that BT publishes a network component called ‘Service Level Guarantees’, two were new network components to provide more granularity on GEA services, and one related to ‘Expedite Provision Costs’ which are required to be disclosed in the 2018/19 RFS.<sup>125</sup>

3.102 Vodafone raised a general point “that it is for Ofcom to impose, through SMP conditions suitable regulatory reporting requirements, and it is for BT to comply with those reporting requirements. It is not for BT to suggest or dictate what reporting it believes is simplest or easiest to produce given their financial systems and operational issues”.<sup>126</sup>

3.103 TalkTalk said it would be useful to stakeholders for Ofcom to explain its perspective of the role of component level reporting and why it has proposed the particular approach outlined.<sup>127</sup>

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<sup>125</sup> BT response to the 2018 BT RFR Consultation (Addendum), pages 4 and 5.

<sup>126</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 58.

<sup>127</sup> TalkTalk response to the 2018 BT RFR Consultation, paragraph 15.

## Our reasoning and decision

- 3.104 In respect of BT's request to be able to change network components through the CCN process, we can see some merit in providing BT with such flexibility. In particular, this process could ensure a timelier introduction of new network components, such as those that BT identifies after the completion of its CNN. However, changing network components using the CCN process would not require wider consultation with stakeholders, whereas currently under BT's regulatory financial reporting SMP conditions<sup>128</sup> only Ofcom can amend the list of network components through directions following a public consultation. This represents a considerable shift in policy on which we have not consulted. We will therefore consider the issue as part of our wider review of BT's regulatory financial reporting.
- 3.105 In relation to the TISBO network components, under the 2016 BCMR Statement BT remains subject to SMP regulation in this market with associated reporting obligations attached to it. BT therefore needs to report on the TISBO market using the currently prescribed TISBO network components.
- 3.106 We have reviewed BT's justification as set out in its addendum for the 39 new network components it suggested. We believe that all 39 network components improve the transparency of costs attributed to services, particularly in relation to FTTC services, Cumulo costs and SLG payments. In addition, the majority of these network components are needed for BT to comply with the regulatory financial reporting obligations imposed in the 2018 WLA Statement, for example, in relation to the obligation to split out costs between GEA FTTC and FTTP. Thus, the inclusion of these network components will add greater detail to the RFS and ensure that BT can comply with its regulatory financial reporting obligations. We have therefore decided to add the 39 additional network components identified by BT to the network component list.
- 3.107 We agree with Vodafone's view that it is for Ofcom to impose reporting requirements (following public consultation) and for BT to comply with them once imposed. BT, like other stakeholders can suggest changes to network components, which it did in the letter from BT to Ofcom.<sup>129</sup> These were reflective of ideas discussed between Ofcom and BT previously within our regular regulatory financial reporting meetings. We considered BT's suggestions and felt there was merit in setting them out for consultation, which we have done. We note that we also have discussions of a similar nature with other stakeholders, such as the recent workshop on the future of BT reporting that Vodafone attended.<sup>130</sup>

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<sup>128</sup> For example, SMP Condition 12.37 in the 2018 WLA Notification defines "Network Component" 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), specified in a direction given by Ofcom from time to time for the purposes of these Conditions".

<sup>129</sup> Letter from [redacted] (BT) to [redacted] (Ofcom), dated 28 September 2018, entitled "BT Regulatory Financial Statement simplification proposals".

<sup>130</sup> We held a workshop with industry on 8 October 2018 to discuss future regulatory financial reporting regime on BT and will continue to engage with industry as we develop our proposals.

- 3.108 In relation to TalkTalk's comments, we refer to our explanation of the role of component level reporting in Section 2. In relation to the particular approach to component level reporting as set out in the 2018 BT RFR Consultation, TalkTalk said that network components appeared to be set by BT rather than Ofcom. As explained above, the network components that we proposed to add and remove were the result of a number of exercises, including reviewing the list proposed in the 2018 BT RFR Consultation against previously directed lists and reviewing the current list of directed network components against what BT is actually using in the RFS and eliminating the discrepancies. This includes:
- a) the addition of 19 WLA network components (mainly GEA Network) that we had directed BT to use in the 2018 WLA Statement but omitted in error from the list we put for consultation;
  - b) the removal of 4 interconnect network components that are no longer needed due to Tandem layer no longer being regulated in the narrowband markets;<sup>131</sup> and
  - c) the addition of the NGA Visit Assure network component to allow BT to allocate costs to a new service of the same name which we required with the 2018 WLA Statement.<sup>132</sup>
- 3.109 In these cases (as with most of the 39 new network components) the existing list of network components is out of date compared to the regulation we have imposed on BT.
- 3.110 We have therefore decided to amend the network components list in the manner proposed in the 2018 BT RFR Consultation, and to add the 39 new network components identified by BT. This will ensure BT has the appropriate network components to prepare the 2018/19 RFS and improve the relevancy and transparency of the RFS.
- 3.111 In respect of all new network components, we believe it is for BT to determine how they are constructed and to ensure all attributions to them are in accordance with the RAP.

### **Imposing the Network Components Direction in the wholesale broadband access market**

- 3.112 As explained in the 2018 BT RFR Consultation, we decided to delay the imposition of the Network Components Direction in the 2018 WBA Statement. This was because we needed to further review the list of network components.<sup>133</sup> In order to close this gap, we have decided to impose the new Network Component Direction in relation to the wholesale broadband market (subject to the decision explained above). The new direction ensures that regulatory financial reporting continues to provide consistent information across all regulated markets that is necessary for us to make informed regulatory decisions and monitor compliance with proposed remedies.

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<sup>131</sup> We deregulated the Tandem layer in previous fixed narrowband market reviews in 2005, 2009 and 2013. See Ofcom, *Review of the Fixed narrowband services markets, Statement on the proposed markets, market power determinations and remedies*, 2013, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0014/50720/final\\_statement.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0014/50720/final_statement.pdf).

<sup>132</sup> See 2018 WLA Statement, Volume 2, paragraph A23.191-A23.194, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0020/112493/wla-statement-annexes-17-27.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0020/112493/wla-statement-annexes-17-27.pdf)

<sup>133</sup> We explained in detail the reasons for our decision in paragraphs 7.44-7.50 of the 2018 WBA Statement.

## 4. Legal tests

- 4.1 Under the “Regulatory Financial Reporting” SMP condition we have imposed on BT in each regulated market, Ofcom may from time to time make such directions as they consider appropriate in relation to BT’s reporting obligations.<sup>134</sup>
- 4.2 For the reasons set out below we consider that, for each direction discussed in this document, the relevant legal tests set out in the Act are satisfied.
- 4.3 In each case we consider that the new directions would fulfil our general duties under section 3 of the Act and meet the Community requirements set out in section 4 of the Act by promoting competition because:
- they ensure that the RFS is aligned with Ofcom’s regulatory decisions; and that that the presentation and usability of the RFS is improved, thereby increasing transparency;
  - they ensure that stakeholders have sufficient information about the products and services they purchase to provide them with reasonable confidence about BT’s compliance with its SMP conditions and that we have sufficient information necessary to carry out our functions;
  - they ensure that BT cannot leverage its market power in a way which could distort or restrict competition.
- 4.4 In giving the directions, we have taken due account of all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive, in particular the 2005 EC Recommendation.<sup>135</sup>
- 4.5 Section 49(2) of the Act further requires that Ofcom must be satisfied that any direction is objectively justifiable, non-discriminatory, proportionate and transparent.

### Stakeholder comments on whether Ofcom’s proposals satisfy the relevant legal tests

- 4.6 Vodafone commented that Ofcom’s proposals did not satisfy the legal tests for withdrawing or modifying a direction set out in 49(2).<sup>136</sup> Vodafone argued that it is “it is impossible ... to reconcile Ofcom’s proposal to relax public or private reporting in the RFS with its duties in the CRF Directives or Communications Act.” Vodafone referred in particular to the objectives set out in Article 8 of the Framework Directive, including

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<sup>134</sup> See Condition 9.4 in the 2017 NMR Statement legal instruments, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0022/108355/final-statement-narrowband-market-review-annexes-9-10.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0022/108355/final-statement-narrowband-market-review-annexes-9-10.pdf); Condition 12.4 in the 2018 WLA Statement legal instruments, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0024/112488/wla-statement-annex-33.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0024/112488/wla-statement-annex-33.pdf); Condition 7.4 in the 2018 WBA Statement legal instruments, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0032/116996/wba-annex-1.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0032/116996/wba-annex-1.pdf); Condition 11.4 in the 2018 PIMR Consultation legal instruments, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0014/125420/PIMR-consultation.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0014/125420/PIMR-consultation.pdf);

<sup>135</sup> European Commission, *Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications*, <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32005H0698&from=EN>

<sup>136</sup> Vodafone response to the 2018 BT RFR consultation, section 8.

“promot[ing] competition in the provision of electronic communications networks, electronic communications services and associated facilities and services by...ensuring that there is no distortion or restriction of competition.” Vodafone argued that BT has demonstrated that it will exercise its ability to distort competition when constraints are relaxed, and that “Ofcom has provided no evidence of a material change in BT’s position in the market or its behaviour to justify relaxing or reducing the [financial reporting obligations]”.

### Our response

4.7 We support the imposition of a robust set of regulatory financial reporting obligations reflecting the objectives set out earlier in this document and, in doing so, to take account of our duty to promote competition. However, we disagree that our proposals were insufficiently justified or would allow BT to distort competition. Moreover, we are expressly required to ensure that directions we impose are proportionate and to keep under review the extent of regulatory burdens. We explained above why we consider our decisions fulfil our general duties under section 3 of the Act and meet the Community requirements set out in section 4 of the Act, including the promotion of competition. We also explained in Section 3 why we consider specific decisions to be appropriate or necessary. In certain cases, having taken account of stakeholders’ comments we have decided it would not be appropriate to reduce the level of reported information, such as our decision to maintain the current materiality threshold in the Reconciliation Report Direction. Finally, we have explained below why we consider our decisions satisfy the tests set out in section 49(2), including why we believe they are necessary in order to give confidence to stakeholders.

### Consistency with Regulatory Decisions and Regulatory Asset Value Direction

4.8 We consider that the Consistency with Regulatory Decisions and Regulatory Asset Value Direction meets the tests set out in section 49(2) of the Act in that it is:

- a) objectively justifiable because it is necessary for us to give a direction which specifies the accounting treatment of various costs across all markets. For example, where we have already imposed some form of price regulation it is necessary to specify the accounting treatment of the various costs in order to ensure consistency with our regulatory decision to set price controls. Furthermore, the direction is objectively justifiable in that the requirements specifying the RAV methodology establish further detail and provide BT with clarity as to the requirements which BT will need to follow to ensure that the RFS are prepared on the RAV basis;
- b) not unduly discriminatory because it reflects BT’s market position in the UK excluding the Hull Area;
- c) proportionate because our proposal is no more than would be required to ensure consistency with our decisions. Further, BT retains a key role in determining the basis of preparation of the RFS; and

- d) transparent because it is clear that the intention of our proposal is to ensure that BT's RFS are consistent with our decisions in relation to the price controls proposed in the physical infrastructure and business connectivity markets, and the wider pricing obligations in other markets.

### **Audit of the RFS Direction**

- 4.9 We consider that the Audit of the RFS Direction meets the tests set out in section 49(2) of the Act in that it is:
- a) objectively justifiable because it is important for both stakeholders and Ofcom that an appropriate level of assurance is provided on the RFS;
  - b) not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
  - c) proportionate because the audit requirements are no more than is necessary to ensure that an appropriate level of assurance is provided on the RFS; and
  - d) transparent because the intention of our changes (i.e. to ensure that an appropriate level of assurance is provided on the RFS) is clear.

### **Reconciliation Report Direction**

- 4.10 We consider that the Reconciliation Reporting Direction meets the tests set out in section 49(2) of the Act in that it is:
- a) objectively justifiable because in all markets it is necessary that there is visibility in relation to errors methodology changes 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;
  - b) not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
  - c) proportionate because our proposals are no more than is required to provide visibility in relation to changes and errors both for us and for other stakeholders. We are also reducing the burden on BT by removing the requirement to publish certain schedules; and
  - d) transparent because our proposals seek 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.

### **Preparation, Delivery, Publication, Form and Content of the RFS Direction**

- 4.11 We consider that the Preparation, Delivery, Publication, Form and Content of the RFS Direction meets the tests set out in section 49(2) of the Act in that it is:

- a) objectively justifiable because the information to be provided, both in public and in private, seeks to ensure that stakeholders have sufficient information about the products and services they purchase to provide them with reasonable confidence about BT's compliance with its SMP conditions and that we have sufficient information necessary to carry out our functions;
- b) not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area. We have explained in this document the reasons for requiring relevant additional information from BT both publicly and privately;
- c) proportionate because the direction will be no more than is required to ensure the effectiveness of our decisions in recent market reviews and will ensure that Ofcom and stakeholders are provided with a sufficient level of information, and does not extend beyond these; and
- d) transparent because the intention of the direction is to make sure that the RFS remain fit for purpose and that Ofcom and stakeholders are provided with a sufficient level of information.

### **Network Components Direction**

4.12 We consider that the Network Components Direction meets the tests set out in section 49(2) of the Act in that it is:

- a) objectively justifiable because it is necessary to specify network components for BT so that it can attribute costs consistently across all markets;
- b) not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
- c) proportionate because our proposal is no more than is required to specify network components relevant to the charge controls that we have decided to impose and to resolve inconsistencies between our requirements and BT's RFS; and
- d) transparent because it is clear that our decision seeks to specify relevant network components in the light of our charge controls and to ensure that these network components remain fit for purpose.

### **Regulatory Accounting Principles Direction**

4.13 We consider that the Regulatory Accounting Principles Direction meets the tests set out in section 49(2) of the Act in that it is:

- a) The RAP direction is objectively justifiable because by specifying the RAP we will establish the attributes for BT's regulatory financial reporting;
- b) Not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull area;
- c) Proportionate because our direction requires is no more than is required to ensure an absence of bias and consistency with regulatory decisions. While we have established



the Regulatory Accounting Principles, BT retains an important role in determining the basis of preparation of the RFS, and can continue to put through methodology changes where this is in line with the RAP and such changes have been notified to Ofcom;

- d) Transparent because the intention of our direction is to ensure we take a greater role in the basis of preparation of the RFS to ensure an absence of bias and consistency with regulatory decisions.

## Adjusted Financial Performance Direction

4.14 We consider that the Adjusted Financial Performance Direction meets the tests set out in section 49(2) of the Act for the reasons set out in the 2018 WLA Statement,<sup>137</sup> i.e. it is:

- a) Objectively justifiable because some disclosure of BT's financial performance from a regulatory perspective is appropriate and the decision in relation to the calculation of the impact of the smoothing restructuring and property provision costs, residual copper proceeds and the steady state adjustments specifies the detail which will enable BT to produce the additional statement.;
- b) Not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
- c) Proportionate because our decision in relation to the Adjusted Financial Performance Schedules is 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;
- d) Transparent because the intention of our decision is to ensure that stakeholders can gain a better understanding of BT's financial performance from a regulatory perspective and that we can understand the way in which BT has prepared the published Adjusted Financial Performance Schedule.

## Transparency Direction

4.15 We consider that the Transparency direction meets the tests set out in section 49(2) of the Act in that it is:

- a) objectively justifiable because the Accounting Methodology Documents prepared by BT on this basis will provide clarity on BT's accounting methodologies;
- b) Not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
- c) Proportionate because the changes are no more than is required to ensure that presentation of the basis of preparation is clear for users;

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<sup>137</sup> 2018 WLA Statement, Annex 8, p 235-236.

- d) Transparent because the intention of our changes is to ensure that presentation of the basis of preparation is clear for users.

# A1. Directions

The directions can be accessed at the following link:

[https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0021/141357/bt-rfr-annex-directions.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0021/141357/bt-rfr-annex-directions.pdf)