Virgin Media's response to Ofcom's Review of BT's Cost Attribution Methodologies Consultation

10 August 2015

Non-Confidential Version

Review of BT's cost attribution methodologies

Summary

1.1 Virgin Media welcomes Ofcom's review of BT's cost attribution systems. The review has identified a number of erroneous attribution bases as well as areas for improvement in BT's documentation and reporting. It is also important, in Virgin Media's view, that Ofcom develops a good understanding of the structure and operation of REFINE.

1.2 However, Virgin Media believes the changes proposed following this review are not appropriate. We have principled and practical concerns about the proposed changes to the attribution methodologies that Ofcom labelled as "clearly inappropriate". We do not believe these should be adopted.

1.3 Virgin Media believes that in defining a prescriptive set of attribution methodology changes, Ofcom has gone beyond what is necessary and appropriate. At the same time as Ofcom confirms that BT is responsible for the preparation and accuracy of the RFS analysis and that board-level sign-off is required, it seeks to inject specific changes into REFINE and become the ultimate arbiter of attribution methodologies. Virgin Media believes that BT should be responsible for these choices and that Ofcom should confine itself to a review of the principles underpinning the methodologies and to providing guidance, rather than comparing and selecting which spreadsheet or system-generated report is most appropriate for a particular base.

1.4 On the substance of the proposed changes, Virgin Media does not agree that Ofcom's reasoning, or the supporting analysis provided by Cartesian, demonstrate that these methodologies could be considered "clearly inappropriate". In Virgin Media's view, the bases applied by BT appear entirely appropriate.

1.5 The methodologies Ofcom has identified as "clearly inappropriate" relate to the attribution of overhead-like costs. Applying Activity Based Costing (ABC) principles such as objectivity and causality to such costs will always be challenging as they are, by their nature, to an extent arbitrary. In this regard we note that all of Ofcom's proposed changes have an element of arbitrariness about them.[1]

[1] Even in cases where Virgin Media agrees that the proposed changes may lead to a partial improvement in alignment to the Regulatory Accounting Principles, these methodologies are still, to an extent, arbitrary selections.

1.6 Virgin Media has concerns with the specific changes that Ofcom has proposed. In many cases, when compared to BT's current methodology, the adjusted rules are less transparent and do not improve the attribution methodology in terms of causality or objectivity. We believe that the proposed changes will make it more difficult for OCPs to review and understand how overhead costs impact on service costs and provide no, or limited, improvement in fulfilling the Regulatory Accounting Principles. We are also concerned that in some cases it appears that Ofcom does not have a complete or clear view of the underlying costs being allocated or the design and operations of REFINE.

1.7 Overall, Virgin Media considers that the changes proposed to "clearly inappropriate" attribution methodologies should not be imposed. We agree that the errors identified should be corrected, but believe that Ofcom should focus its oversight and review on providing principle-based guidance on how best to fulfil the Regulatory Accounting Principles and allow BT to maintain responsibility for the preparation and accuracy of regulatory financial data.

Question 4.1: Do you have any comments on the scope and approach to this review? Specifically, do you agree with our decision to determine whether BT's attribution methodologies were clearly inappropriate by reference to the Regulatory Accounting Principles?

While Virgin Media is broadly in agreement with the scope and approach of the review undertaken by Ofcom in a number of areas of this consultation, we have concerns about the specificity of Ofcom's findings and the implications of these findings in relation to BT's approach to cost attribution. In particular, Virgin Media believes the Ofcom is overly prescriptive in mandating alternative cost attribution approaches to particular bases, where Ofcom believes these approaches are "clearly inappropriate by reference to the Regulatory Accounting Principles". Virgin Media holds this concern primarily due to three reasons.

Principled concern on the degree of intervention

Virgin Media has a principled concern that the findings and proposed actions mandated by Ofcom are overly prescriptive. Requiring BT to make the proposed specific changes to individual cost allocation bases (which did not contain logical errors) seems to infringe on the third theme established by Ofcom in the Financial Reporting Statement.[2] Ofcom appears to tacitly acknowledge this, by labelling the attribution methodologies it intends to require BT to change as "clearly inappropriate". However, having reviewed the allocations it is not at all clear to Virgin Media that these attribution methodologies could be considered "clearly inappropriate", particularly when Ofcom's ultimate proposed changes in many cases mimic the current method, albeit in often in a less transparent way. Virgin Media considers BT's existing approach to be entirely appropriate and it would be inappropriate to mandate prescriptive changes to these.

Practical concern on Ofcom's familiarity with REFINE

[2] "We proposed that responsibility for the preparation and accuracy of BT's regulatory financial data should remain with BT.", 2014 Financial Reporting, Final Statement, Ofcom paragraph 3.3

Virgin Media has concerns about how practical it is for Ofcom to mandate such changes at this level of detail. As Ofcom notes in the introduction to this consultation, BT's cost attribution systems are complex and challenging to understand. Identifying key attribution methodologies and the resulting impacts on costs attributed is also complex. Cartesian also note the scale and complexity of these systems. Equally, the relative integrity and reliability of various alternative sets of input data is also likely to be complex. After reviewing the proposed changes it appears that even in this specific and focused review, Ofcom has misinterpreted the content of cost pools and proposed inappropriate attribution methodologies. This underlines our concern that Ofcom's prescriptive changes are not the right approach. Virgin Media believes that with appropriate oversight, transparency and documented justification, this should be a choice for BT's cost attribution team to make, except in the case of mathematical/formula logic errors.

In mandating these precise changes, Ofcom implicitly adopts responsibility for undertaking such review exercises in the future to the same or greater degree of detail, to ensure these approaches are still valid. The communications market is in a constant process of innovation and adaptation. In response, BT is likely to be continually changing the way it operates its network, uses its resources and manages its company; in establishing Ofcom's role as the arbiter of the most appropriate specific cost allocation methodologies it would appear to have adopted a material increase in the degree of regulatory cost attribution oversight. This is also a significant commitment of additional on-going resources required by Ofcom to undertake this task. In the context of the review, which found that BT's approach was free from bias, this appears heavy-handed.

Virgin Media is particularly concerned about Ofcom setting this precedent in the context of §1.18 of Ofcom's consultation, where it states that "*We expect that as a result of our review, […], there will be less need to make further adjustments to the Regulatory Financial Statements in our future market review and investigations."* Virgin Media believes this simultaneously reduces BT's ownership and responsibility for selecting methodologies but at the same time envisages limiting Ofcom's future activity in such decisions. Restricting these comments and changes to "clearly inappropriate" in no way lessens Ofcom's implied role that it is establishing by mandating the proposed changes. This also appears to be in conflict with requiring board-level sign-off and reaffirming BT's role as being responsible for the preparation and accuracy of regulatory financial data. Prescribing the changes that Ofcom has and the role that it has implicitly adopted would appear to be incompatible with the role defined for BT.

Due to changing availability of data, changing operational practices and the continued evolution of the market, this is anticipated to be an ongoing process. If Ofcom intends to make such prescriptive changes, Virgin Media believes that Ofcom should intend to maintain the same level of oversight and responsibility for methodology selection going forward, as it seeks to adopt as part of this review.

Appropriateness of proposed changes

Virgin Media is concerned that the cost attribution methodologies mandated by Ofcom for bases "clearly inappropriate by reference to the Regulatory Accounting Principles", appear to

have many of the same deficiencies to those issues flagged by Ofcom in the in the pre-existing bases methodologies. Equally, many of the proposed changes appear to introduce new concerns for CPs in reviewing the underlying methodologies – particularly in the area of transparency. As a consequence, Virgin Media does not believe a number of the attribution rules identified by Ofcom are "clearly inappropriate" and it is also, in Virgin Media's view, not apparent that the proposed alternatives are any more appropriate.[3]

Virgin Media believes the needs of consumers and of OCPs would be better served by a less prescriptive set of recommendations on BT's cost attribution methodologies, if these are not found to contain errors; not to be inherently biased; and BT can provide reasonable justification these methodologies are most closely aligned to the Regulatory Accounting Principles.

Virgin Media agrees that where mathematical or input errors are identified, these changes should be adopted.

Virgin Media further believes that better transparency on the methodology selection process that BT uses and better documentation of the adopted method would support industry in reviewing these methodology selections and it is on this topic that Ofcom could most appropriately direct BT in defining areas to for improved reporting. We note the additional reporting obligations defined by Ofcom in the LLCC consultation.

Question 6.1: Are there any specific issues that we do not identify in Section 6 that you consider should be reviewed further? If so, please identify those methodologies and explain why you consider the current methodology might not be appropriate.

Virgin Media believes that in designing its review, Ofcom should not have necessarily restricted its review of the cost attribution system to only c.90% coverage of costs across all regulated markets. To ensure completeness of the review and to avoid skewed adjustments, Ofcom should have also considered material cost attributions that only had non-regulated services as the ultimate destination (in addition to the c.90% cost coverage of regulated markets). It is conceivable that attribution rules also contained errors, which may lead to BT under-recovering costs from regulated services.[4]

On the basis of the design of this review (restricted to only rules that allocate to regulated products), and in accepting the independent review found no systematic bias, the fact that Ofcom's proposed mandated changes lead to a net-outflow from regulated markets is not surprising.

Question 7.1: Do you have any comments on the errors we have identified in Section 7 and how we have addressed them?

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[3] Virgin Media recognises that it does not have access to the underlying cost allocation system, allocation bases or the full extent of analysis undertaken by BT, Ofcom or Cartesian about the alternative input data available.

[4] The same holds for "clearly inappropriate" rules, under the specification of this consultation review.

Virgin Media has no specific comments on the errors identified or the proposed changes. Virgin Media is disappointed that the errors were not identified as part of any of BT's internal controls or quality review processes. The adjustments appear appropriate; BT has recognised these errors and appears to have undertaken to adopt all adjustments.

Question 8.1: Do you agree with our assessment that BT's use of attribution methodologies based on pay and return on assets for general overheads is clearly inappropriate? Please provide your reasons.

Virgin Media does not believe the approach currently adopted by BT is clearly inappropriate. Ofcom concludes this on the basis that it raises concerns on the grounds of the objectivity and causality principles defined in the Regulatory Accounting Principles.

Corporate costs

Virgin Media notes that in general it is inherently challenging to develop a method of attribution for overhead-like costs that rigorously reflects the Regulatory Accounting Principles such as objectivity and causality; by their nature these pools of costs are often not specifically attributable to activities that can have a clear pathway to services. Nevertheless, BT states that the activities undertaken by these functions are the management of "employees within the company, and assets in the company to create a return". It therefore appears entirely appropriate that these costs are attributed based on the applicable employee cost and a measure of the effective return on applicable assets in the regulatory statement period.

- Cartesian suggest that head office activities may not correlate with the value of assets. Without any specific data to confirm this, Virgin Media would be inclined to believe it is more likely that these would in fact correlate than not. It is, in Virgin Media's view, highly likely that as a financial valuable and strategically valuable asset, the allocation of material costs to services that use BT's duct assets (the example offered) is entirely in line with the cost this allocation basis implies.

- Cartesian also contend that as employees in the head office are also working to achieve returns on the company's assets and therefore combining Pay and ROA may lead to double-counting. *A priori*, this would not be expected to be the case. If BT has a significant proportion of its human capital and physical capital deployed undertaking a specific area of activity, it follows this is likely to be a material source of the company's returns and therefore it is reasonable to expect this will occupy the time and physical resources of head office staff in ensuring effective returns are generated from these costs.

Ofcom believes the approach does not follow the Regulatory Accounting Principles of Causality or Objectivity as the allocation basis allocates too large a pool of cost, uses the Pay and ROA 'combined' approach and the underlying rules may not comply with these principles.

Virgin Media does not believe that the use of a single allocation rule to attribute a large pool of costs inherently risks invalidating the principle of Objectivity or Causality and the

methodology of using Pay and ROA does not raise concerns for Virgin Media in relation to these principles.

To the extent head office activities cannot meaningfully be separated into coherent sub-pools of cost, the current basis appears objective. Artificially sub-categorising the cost pool and allocating on distinct bases for the appearance of greater granularity would appear to reduce the fidelity of this objectivity and would make it less transparent for OCPs to review and understand the basis of these cost allocations.

TSO Support Function

Ofcom and Cartesian raise the same concerns for TSO support function costs as for Corporate Cost, namely the use of a single rule to allocate a large pool of costs and the combination of pay and asset costs, using a measure of ROA for assets.

Similarly, Virgin Media has the same concerns regarding Ofcom's proposed changes and also does not believe that the use of a single rule, nor the basis of the rule itself are contrary to the principles of objectivity or causality.

Openreach Common Costs

Virgin Media has no comments on the Openreach Common Costs at this time.

Question 8.2: Where we have proposed alternative methodologies to attribute general overheads in Section 8, do you agree that they provide an appropriate and practicable basis? Please provide reasons to support your answer.

Corporate costs

As part of the proposed alternative approach, Ofcom has sought to undertake this sub-categorisation identified above. Each alternative sub-categorisation is discussed below. In general, while there is merit in adjusting some methodologies to the approach suggested by Ofcom, Virgin Media is concerned by the use of "all previously allocated total cost" in a number of instances. This would result in making the attribution bases more opaque for these costs as compared to the previous approach.[5] Furthermore, a number of alternative approaches appear to replace a higher-level cost attribution driver with more granular drivers which, in many cases, do not appear to uphold or improve on the principles of objectivity and causality.

The table below presents a summary of Virgin Media's view of the proposed new approach. The views below demonstrate that while Virgin agrees with some changes, in other cases it appears the approach is no better, or potentially worse.

[5] While Transparency is not a principle explicitly defined in the Regulatory Accounting Principles, it is nevertheless a positive feature of one allocation methodology compared to another.

In commenting, we seek to demonstrate that BT should retain its existing freedom to define these attribution methodologies itself, but that greater explanation of the method and of alternative data sets should be made available, rather than Ofcom determining this basis. If Ofcom views BT's pre-existing approach to be "clearly inappropriate", it is Virgin's view that the proposed changes would not appear to materially alleviate these concerns.

Sub-category	Virgin Media comment
Employer's Liability Insurance	While agreeing that this may be an improvement in terms of objectivity, the underlying issue that the new proposed base does not account for the underlying risk the insurer will likely consider (namely the likelihood of accident), appears to make this non-causal. As Ofcom appear to acknowledge, this will likely under allocate costs to network related activities. Virgin Media does not consider this to be a material improvement in attribution.
Employee practice liability insurance	No specific concerns, the allocation basis of number of employees appears to improve objectivity and causality, as compared to the pre-existing allocation.
Employee healthcare insurance	As in the response to employer's liability insurance, the proposed change is expected to increase objectivity but by not taking account of the profile of different grades of healthcare (and therefore per employee cost) across OUCs limits causality and may lead to misallocation to services.
Employee broadband offer	Number of employees would be expected to be casual and objective. If the data is available to match employees that actually use this offer to OUCs, this would be expected to be a more causal and objective attribution basis than that proposed by Ofcom.
Employee death in service benefit insurance	No specific concerns, the allocation basis of previously allocated pay cost appears to improve objectivity and causality as compared to the pre-existing allocation. However this methodology is less transparent for OCPs in terms understanding the destinations of the resulting attribution.
Business interruption insurance	Virgin Media notes that business interruption insurance typically is associated with losses in the event of operational interruption and therefore may not be directly related to property costs. If this is the case, this underlines Virgin Media's concerns that Ofcom does not have sufficient knowledge of BT's systems and cost categorisation to mandate such prescriptive changes to BT's methodology. Nevertheless, Virgin Media does not have access to the details of BT's insurance policy or costs associated with this item. In the event that these costs are property-specific the allocation basis of previously allocated property cost appears to improve objectivity and causality as compared to the pre-existing allocation.
Motor vehicle insurance	No specific concerns, the allocation basis of previously allocated fleet cost appears to improve objectivity and causality as compared to the pre-existing allocation.

Sub-category	Virgin Media comment
BT TSO Research & Innovation	As in the response to employer's liability insurance, the proposed change is expected to increase objectivity but the proposed methodology does not take account of the profile of asset usage across OUCs, nor of variations in the cost of equipment used by employees in different divisions of BT. This may lead to a material misallocations.
BT TSO Architecture & Global IT Platforms	Ofcom's proposed attribution method does not appear to be any more causal or objective than BT's pre-existing methodology. Without any specific knowledge of which previously allocated IT costs have reached this object in the model, it is not clear that there is any link between these costs and the proposed attribution rule. This is an example of why Virgin Media has concerns about Ofcom's proposed disaggregation of the corporate costs. The new approach is more opaque to OCPs in terms of what is actually being used to allocate these costs, the destinations objects and their relative weighting.
Group Finance	BT's proposed approach appears to be conceptually clearer and more transparent than the approach proposed by Ofcom. The use of Pay and ROA is clearer to an outside observer. Without access to the model or the allocation bases, Virgin Media would have no clarity about which destinations and in what proportions the non-residual costs would be allocated under Ofcom's proposed approach. BT's proposed approach also appears to be more causal and objective; Group Finance costs would reasonably be expected to be attributed on the basis of managing pay and non-pay costs.
BT TSO Chief Information Office for Group	As in response to BT TSO Architecture & Global IT Platforms, Virgin Media is concerned that the proposed approach sacrifices a simpler, and albeit higher-level approach, with a less transparent attribution method without any improvement in terms of fulfilling Regulatory Financial Reporting Principles.
Group Human Resources	No specific concerns, the allocation basis of number of employees appears to improve objectivity and causality as compared to the pre-existing allocation.
Corporate Communications; Group Legal; and Reporting Planning Analysis	As in response to previous methodologies, Virgin Media is concerned that the proposed approach sacrifices a simpler, and albeit higher-level approach, with a less transparent attribution method without any improvement in terms of fulfilling Regulatory Financial Reporting Principles.
Corporate Special Projects	As in response to previous methodologies, Virgin Media is concerned that the proposed approach sacrifices a simpler, and albeit higher-level approach, with a less transparent attribution method without any improvement in terms of fulfilling Regulatory Financial Reporting Principles. Virgin Media notes that Ofcom presents the logic that higher costs in a division should lead to a greater attribution of cost from activities

Sub-category	Virgin Media comment
	associated with cost-reduction. This runs counter to the argument put forward that financial management activities are not linked to the relative value of assets and staff being managed.
Learning Academy	No specific concerns, the allocation basis of direct pay appears to improve objectivity and causality, to a degree, as compared to the pre-existing allocation. Causality and objectivity would likely be increased further if budgeted (or preferably actual) training spend per OUC were used as a basis. This would take account of variations in training need across BT's organisation.
Strategy, Policy and Portfolio	No specific concerns, the allocation basis of revenue appears to improve objectivity and causality as compared to the pre-existing allocation.
BT TSO Chief Information Office for BT Wholesale; and BT TSO Chief Information Office for Retail	No specific concerns or comments.
Other costs	As in response to previous methodologies, Virgin Media is concerned that the proposed approach sacrifices a simpler, and albeit higher-level approach, with a less transparent attribution method without any improvement in terms of fulfilling Regulatory Financial Reporting Principles.

Virgin Media does not believe that BT's current approach is "clearly inappropriate". Virgin Media has material concerns with a number of the proposed alternative approaches proposed by Ofcom will make it more difficult for CPs to analyse the allocation of BT's costs. However, some changes appear to be an improvement in terms of Regulatory Financial Reporting Principles. As Virgin Media does not believe the current approach is not "clearly inappropriate", we do not believe it is appropriate to intervene and mandate these changes. Further, we consider some of the proposed approaches to be less causal or less transparent and believe this counteracts any improvements in objectivity that Ofcom's analysis has identified.

Instead Virgin Media believes it would be more proportionate and more valuable to OCPs for Ofcom to issue guidance/instructions at a higher level on how BT should best align its methodology to the Regulatory Financial Reporting Principles.

TSO Support Function

The table below presents a summary of Virgin Media's view of Ofcom's proposed attribution methodologies. As noted previously, Ofcom's proposed approach does not appear to lead to a material improvement in cost attribution against the defined principles. The resulting allocations are less transparent and will make it more difficult for OCPs and other interested parties to identify how costs flow to BT's services.

Sub-category	Virgin Media comment
Redundancy payments	As Ofcom acknowledges, the proposed methodology does not provide an improvement in cost causality. Current pay costs in an OUC have no clear link to the relative cost of redundancy payments in an OUC. To the extent that data is available, the last OUC an employee worked in prior to being made redundant should bear the cost. As Ofcom notes, this does not fully fulfil the causality principle, but it is anticipated to be more causal than the proposed approach as this approach would reflect the incidence of redundancy across OUCs to some extent.
IT Services Subcon Offshore SGA	Ofcom's proposed attribution method does not appear to be any more causal or objective than BT's pre-existing methodology. Without any specific knowledge of which previously allocated IT costs have reached the object in the model, it is not clear that there is any link between these costs and the proposed attribution rule.
BT TSO Human Resources & Communications; BT TSO Service, Strategy and Operations; and BT TSO Finance	As in response to previous methodologies, Virgin Media is concerned that the proposed approach sacrifices a simpler, and albeit higher-level approach, with a less transparent attribution method without any improvement in terms of fulfilling Regulatory Financial Reporting Principles. Further, it seems inconsistent with Ofcom's approach to Corporate Costs, that TSO HR, Comms and Finance etc. remain aggregated for the purpose of determining the proposed cost attribution method. It is not clear why these costs are not treated separately and allocated with attribution methods which Ofcom believes are more causal and objective.
BT TSO Chief Information Office for Global Services	As in response to previous methodologies, Virgin Media is concerned that the proposed approach sacrifices a simpler, and albeit higher-level approach, with a less transparent attribution method without any improvement in terms of fulfilling Regulatory Financial Reporting Principles.
BT TSO General Infrastructure Services	As in the case of redundancy costs, Virgin Media believes that, to the extent that data is available, the principle of causality would be better achieved by associating Transition Centre costs to OUCs that caused these costs (by no-longer requiring the staff). As with redundancy costs, these employees may have worked across multiple teams throughout their time at BT, but attributing their cost to the most recent position is an improvement on using direct pay costs – which does not appear to have any clear causal link.

Sub-category	Virgin Media comment
	This is a further example of where Virgin Media believes, after having reviewed BT's methodologies, providing higher-level guidance on the treatment of costs would be more valuable than specific, prescriptive changes. OCPs would be better placed to review and discuss a broad approach to the treatment of 'redeployed or redundant resources', rather than specific case-by-case attribution rules of the Transition Centre and corporate costs of redundancy.
BT Fleet	No specific concerns, the allocation basis of previously allocated fleet cost appears to improve objectivity and causality as compared to the pre-existing allocation.
BT TSO Global Network Services Management and Support	It is not immediately clear that all previously allocated IT costs is an allocation basis that would lead to causal cost attribution. Virgin Media does not have visibility of the categories of IT costs that would be used to attribute these costs. It may be the case that these IT costs may be unrelated and may not have a causal link, and further the implied destinations and relative attributions may also bear little resemblance. If Ofcom is satisfied that the cost pool being allocated and pool of cost used to develop the basis of allocation are comparable then this would appear to be an improvement in causality and objectivity.
Other Costs	As in response to previous methodologies, Virgin Media is concerned that the proposed approach sacrifices a simpler, and albeit higher-level approach, with a less transparent attribution method without any improvement in terms of fulfilling Regulatory Financial Reporting Principles.

Virgin Media does not believe that BT's current approach is "clearly inappropriate". Virgin Media has material concerns with a number of the proposed alternative approaches proposed by Ofcom will make it more difficult for CPs to analyse the allocation of BT's costs, though some changes appear to be an improvement in terms of Regulatory Financial Reporting Principles.

Openreach Common Costs

Virgin Media has no comments on the Openreach Common Costs at this time.

Question 9.1: Do you agree that the way BT attributes profits and losses on disposal of land and buildings is clearly inappropriate and, if so, do you agree that it should instead attribute them in the way we propose in Section 9?

Virgin Media agrees with the rationale and findings of Ofcom that profits and losses associated with disposal of land and buildings is clearly inappropriate and should be attributed as identified by Ofcom.

This (and other responses) should not be misconstrued to mean that Virgin Media is supportive of the proposed prescriptive changes Ofcom is mandating; instead Ofcom should

establish broader principle-based instructions to guide BT's selection of cost attribution rules. In this instance, and in the cases of vacant space and reclamation of copper, Ofcom should define how profits and losses of assets previously deployed in the provision of regulated services in prior accounting periods should be attributed.

Question 9.2: Do you agree that the way BT attributes non-chargeable vacant space to be clearly inappropriate and, if so, do you agree that it should instead attribute them in the way we propose in Section 9?

Virgin Media has no specific comments on the assessment at this time.

Question 9.3: Do you have any comments on our assessment of the other attribution methodologies considered in Section 9? Specifically, do you have any information that you consider being relevant to our assessment of whether the methodologies are appropriate and of any alternative attribution methodologies that might replace them?

For the same principle of causation as Ofcom applied to profits or losses associated with the disposal of buildings that were caused by BT's historical supply of regulated services, it appears the same should be true of profits or losses associated with the sale of recovered copper.

For consistency, Virgin believes that value recovered from land and buildings as well as and copper assets should be treated in the same fashion. Virgin believes that profit or losses associated with these assets disposals, previously deployed for the provision of regulated services, should be remain attributable to the regulated services that BT now provides. Given that it was these services that previously bore the cost of these assets, it holds true that these same services should benefit from the reclamation and sale of these assets. Conversely, it does not appear to be appropriate or casual for BT to recognise profits from these disposals in the residual, given they were inherently caused by the provision of regulated services in prior periods.

Question 10.1: Do you have any comments on our assessment of the supporting evidence used by BT to inform its cost attribution decisions, as described in Section 10? Specifically, do you have any suggestions for alternative data sources?

Virgin Media has no comments on the assessment at this time.

Question 11.1: Do you have any comments on our findings relating to BT's supporting documentation, as described in Section 11?

Virgin Media is supportive of greater transparency, more detailed and more precise supporting documentation of BT's cost attribution methodologies. While Virgin Media has expressed concerns about Ofcom risking an overly prescriptive approach to the selection of cost attribution rules themselves, Virgin Media believes Ofcom is well placed (with visibility both of the system and the documentation) to make specific and, if necessary, prescriptive changes to documentation. In particular, to identify specific areas of factual documentation that are not sufficiently informative or accurate for Ofcom, OCPs and other parties to make to have an informed view of the methodology adopted in the system.

Question 12.1: Do you consider it would be helpful to stakeholders if BT reduced the number of attribution levels in BT's cost attribution system? Please provide your reasons for or against such a change.

With reference to Virgin Media's understanding of REFINE and FAC systems more broadly, we believes the reduction in the number of attribution levels could materially degrade BT's and Ofcom's ability to interrogate REFINE. While simplifying the structure and design of the model would initially appear to simplify the approach, collapsing allocation levels typically increases the complexity of the underlying logic of such models, or makes the interpretation or calculation of outputs more complex to interpret.

The complexity associated with the current allocation hierarchy allows a number of benefits, which are useful to BT, OCPs and Ofcom. Similarly, reducing the number of levels raise concerns and risks to the Principles of Regulatory Financial Reporting. Without specific proposals on changes in the hierarchy of levels in REFINE, the discussion below is discusses our concerns in general. Some examples of the benefits of more granular level definition and the risks of consolidation we anticipate are as follows:

Disaggregated exhaustion levels: A greater number of exhaustion levels are expected to be useful for BT to conduct internal QA and to provide cost reporting on a more coherent basis to Ofcom and OCPs.

Internal base definitions: Limiting the number of levels in the model may make some of the current bases incompatible with the logic of the model. An example of these this is expected to be the use of internal bases, where system-generated methodologies attribute costs within system. While internal bases are less transparent to outside reviewers in some cases, they can be a useful mechanism to attribute costs where this is reasonable methodology. Reducing the levels in REFINE would therefore likely lead to required changes in attribution methodologies, such as internal bases, which may not fulfil the Regulatory Financial Reporting Principles as well as the current methods used.

More granular cost apportionment: Reducing the number of levels in the cost allocation system would likely affect one or more of the following, for many attribution rules as they are currently defined:

a) reduce the opportunity of costs to be allocated from one grouping (level) of objects to another, restricting the ways in which costs can be aggregated, disaggregated and attributed on the basis of alternative categorisations (logical, functional, divisional etc.);
b) diminish the traceability of costs, by removing constraints such as exhaustion from various levels; and/or
c) simplify the cost allocation rules, with the likely result being new allocations which are less causal and less objective. Typically in cost attribution systems, additional levels are defined where cost objects may first require an initial allocation, prior to being further allocated in a fashion comparable to the rest of the objects in the level that follows, or the object should (on the basis of causality), be allocated to objects on the same level. In either case, not defining separate levels leads to iterative intra-level allocations or less causal bases.

Potential need to introduce iteration: BT's system uses a cascade approach to cost allocation. By defining the current number of levels in REFINE, BT is able to maintain relatively granular cost allocation rules, whilst avoiding intra-level allocations. To maintain the current degree of granularity, REFINE would likely need to be changed such that a number of intra-level allocation rules are introduced. This would materially reduce BT's, Ofcom's and OCP's abilities to trace the flow of costs from object to object. This would materially reduce the transparency of the model and would likely make it significantly more difficult for BT to explain the cost allocation process and to report on the exact makeup of cost pools at various points in the model.

Comparability with ASPIRE: Virgin Media understands that the current design and hierarchy of ASPIRE is broadly comparable to ASPIRE. Maintaining this link is likely to be beneficial to Ofcom and OCPs in the event that data from historical time periods are required as part of any competition or regulatory activities. Virgin Media believes breaking this link would not be beneficial and a material redesign of the attribution levels in REFINE may lead to this.

Consequently, Virgin Media is not inherently in favour of consolidating attribution levels. Without direct access to REFINE, we can conceive that the current level definition is appropriate. Reducing the available levels is not expected to improve transparency, would likely break direct cross-year comparability for historical years and would almost certainly weaken the extent to which a number of existing attribution rules best fulfil the Regulatory Financial Reporting Principles or lead to an iterative attribution process (neither of which would be positive outcomes).

Question 12.2: Do you think the current list of components or Plant Groups is appropriate? For example, do you agree that BT should report results for components, rather than super-components?

Virgin Media would welcome a move to a more disaggregated reporting of costs at the component rather than super-component level. However, Virgin is cognisant that this greater level of granularity of reported data would need to be paired with more detailed and specific documentation of the costs direct contained in each component. Without this improvement in documentation, greater granularity of costs reported would likely inhibit OCP's abilities to interrogate the data.

Question 12.3: Does reporting of costs by network component provide a sufficiently transparent way of breaking down costs for services? For example, do you think that costs for different network elements of duct, fibre and copper should be reported separately?

Virgin Media broadly supports greater transparency regarding BT's cost attribution systems and greater visibility of how costs flow from underlying source data. Virgin Media does not believe that an overly onerous reporting requirement, above and beyond BT's current financial reporting obligations is necessarily required. Virgin Media also believes there would be value in the documentation and disclosure of BT's basis for selection of attribution methodologies, including considerations of alternative approaches and the extent to which these fulfil the reporting principles.

Virgin Media however would welcome, further information on the logical pathways of REFINE, object mapping tables that associate various objects in REFINE with one and other. This approach would allow OCPs to be better informed of the attribution method[6], would not materially increase the reporting burden, or disclosure of financial data which Virgin Media believes would strike a better balance than the current requirements.

[6] This would also make selective and specific data request from Ofcom in future consultations more transparent for OCPs to review and understand.