

Promoting competition and investment in fibre networks: Wholesale Fixed Telecoms Market Review 2021-26

Volume 6: BT Regulatory Financial Reporting

Non-confidential version – redacted for publication [X]

STATEMENT:

Published date: 18 March 2021

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1. Introduction

- 1.1 We consulted on our proposed regulatory financial reporting requirements on BT in relation to the markets covered by the WFTMR review in the February 2020 Consultation. We also consulted on some amendments to our reporting proposals in relation to Area 3 in the July 2020 Consultation and made some additional private reporting proposals in the November 2020 Consultation.
- 1.2 In this volume we set out our decisions on BT's regulatory reporting requirements for the WFTMR markets. BT's regulatory reporting will be subject to these requirements for five years from April 2021.
- 1.3 Because the WFTMR covers most wholesale fixed telecoms markets we regulate and determines our regulatory approach for the next five years, we have taken the opportunity to conduct a holistic review of BT's reporting requirements. This will ensure they remain fit for purpose while making the published information more accessible and easier to understand.
- 1.4 Our decisions cover the preparation and presentation of information published by BT, and information provided privately to Ofcom.

What we have decided

We have imposed regulatory financial reporting requirements on BT which require the production of Regulatory Financial Statements (RFS).

Our main decisions in relation to the presentation of BT's published RFS are to:

- **Improve presentation of operating costs** We are aligning the operating cost categories reported in the RFS (at a market and service level) to those reported in BT's annual report. We are also improving the visibility of operating costs incurred by Openreach and those incurred elsewhere in BT and attributed to Openreach.
- **Improve reporting of the physical infrastructure (PI) market.** BT must separately report pole and duct services and we are making clear the relationship between PI and downstream markets, for example in relation to costs attributed from PI to downstream services offered by Openreach.
- **Remove the adjusted financial performance schedule.**
- **Introduce new requirements in response to changes in regulation.** For example, in relation to our Regulatory Asset Base (RAB) requirements in Area 3, we are requiring BT to report homes passed by fibre to the premise (FTTP).

Our main decisions in relation to the preparation of the RFS are to:

- **Improve transparency of attribution rules.** BT must publish diagrams showing how operating and asset costs flow through its cost allocation system.
- **Give BT flexibility to change cost components.** BT must publish a list of components used in its cost accounting system and changes can be made to this through the Change Control Notification (CCN) process. We have also made some improvements to fibre components.

- **Require BT to prepare costs for geographic SMP markets on a national unit cost basis.** This is consistent with our approach to cost modelling.

Our main decisions in relation to the information BT provides us privately are to:

- remove the requirement on BT to maintain a LRIC model.
- require BT to provide us with data and models used by its cost accounting software ('CostPerform') to produce the RFS.
- require BT to provide details of grant-funded assets.
- require BT to provide information on costs associated with PI and dark fibre.
- require BT to provide details of its investment in FTTP in Areas 2 and 3.
- require BT to provide costs for services subject to basis of charges obligations.
- remove or amend requirements to provide most of the other existing schedules.

Reporting remedies

1.5 In Volume 2 we found that BT has SMP in the following product and geographic markets:

- the supply of wholesale access to telecoms physical infrastructure for deploying a telecoms network (in the UK excluding the Hull Area);
- the supply of wholesale local access at a fixed location (Area 2¹ and Area 3²);
- the supply of leased lines access (Area 2, Area 3 and High Network Reach Area3); and
- the supply of inter-exchange connectivity services (BT Only and BT+1 exchanges).

1.6 In this Volume we explain that we have decided to apply regulatory financial reporting remedies on BT in each of these markets (which we refer to as the SMP markets) as part of our package of remedies to address the competition concerns identified in our market assessment. We also impose requirements to ensure a sustainable transition in the market for the supply of inter-exchange connectivity (IEC) services in BT+2 exchanges. For convenience, our reference to 'SMP markets' includes our requirements for IEC BT+2 where applicable.

1.7 We have previously said that, consistent with our duties, effective reporting should have the following attributes⁴:

- **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 data must be chosen and those rules need to be followed.

¹ Area 2 is defined as postcode sectors in which there is, or there is likely to be potential for, material and sustainable competition to BT in the commercial deployment of competing networks.

² Area 3 is defined as postcode sectors in which there is not, and there is unlikely to be potential for, material and sustainable competition to BT in the commercial deployment of competing networks.

³ High Network Reach Area is defined as other postcode sectors where there are two or more rival networks to BT in the provision of leased lines ('other' means other than the Central London Area, which we define as a separate market in which BT does not have SMP).

⁴ See for example our [2019 Regulatory Financial Reporting \(RFR\) Statement](#).

- **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.

- 1.8 In the 2014 Regulatory Reporting Statement⁵ we imposed an SMP condition that placed requirements on BT in relation to the basis of preparation and form and content of its RFS, taking account of the attributes above. In that document we also set out the Regulatory Accounting Principles, which are fundamental reporting principles with which BT's reporting must comply.
- 1.9 In the 2015 Directions Statement we set out detailed directions, including the Regulatory Accounting Principles Direction, in relation to the basis of preparation and form and content of BT's RFS.⁶
- 1.10 Since then, as part of each market review we have imposed reporting requirements on BT through a common SMP condition and set of directions. We briefly describe below the purpose of the SMP condition and changes to the directions imposed on BT.

SMP Condition

- 1.11 The "Regulatory Financial Reporting" SMP condition we have previously imposed on BT includes general requirements for accounting separation and cost accounting. The SMP condition also requires BT to produce the RFS and other accounting documents as directed by us.
- 1.12 The purpose of this SMP condition is to ensure that sufficient and robust information is published by BT and provided privately to Ofcom to enable us to perform our duties and for stakeholders to have confidence that BT has complied with its SMP conditions. More specifically, this SMP condition serves as a basis for imposing directions on BT that set out detailed regulatory financial reporting requirements.
- 1.13 Over the last five years we have taken steps to improve the quality and reliability of BT's RFS and increase transparency around how the RFS are prepared. For example, in 2015 we introduced a requirement for BT to publish an annual CCN setting out the changes it planned to make to each year's RFS⁷ and in 2016, as part of the business connectivity market review, we reviewed some of BT's cost attributions and proposed some changes, in particular to overhead and property allocations.⁸
- 1.14 The overlapping nature of previous market reviews has made it difficult to impose changes across all markets at the same time. Given the current SMP condition dates from 2014, and the WFTMR imposes requirements for a five-year period, we have reviewed the SMP Condition determining BT's reporting requirements to ensure it remains fit for purpose.

⁵ [Regulatory Financial Reporting](#), 20 May 2014.

⁶ [Directions for Regulatory Financial reporting](#), 30 March 2015.

⁷ [Change Control Notification](#), 31 March 2020.

⁸ [Business Connectivity Market Review](#) – Annex 28, April 2016.

Directions

- 1.15 To date, we have imposed on BT a set of nine directions to implement our detailed regulatory financial reporting requirements, though there are exceptions in some markets where certain directions may not be relevant.
- 1.16 Going forward, most of our regulation of BT will be focused on Openreach⁹ and, given our objective for this review set out in Volume 1 to promote competition and investment in gigabit-capable networks by Openreach and other providers, we have reviewed the directions imposed under the SMP Condition to ensure the information we require BT to provide continues to meet the reporting attributes set out above.
- 1.17 We have decided to impose six directions on BT, as summarised in Table 1.1.

Table 1.1: Regulatory reporting directions

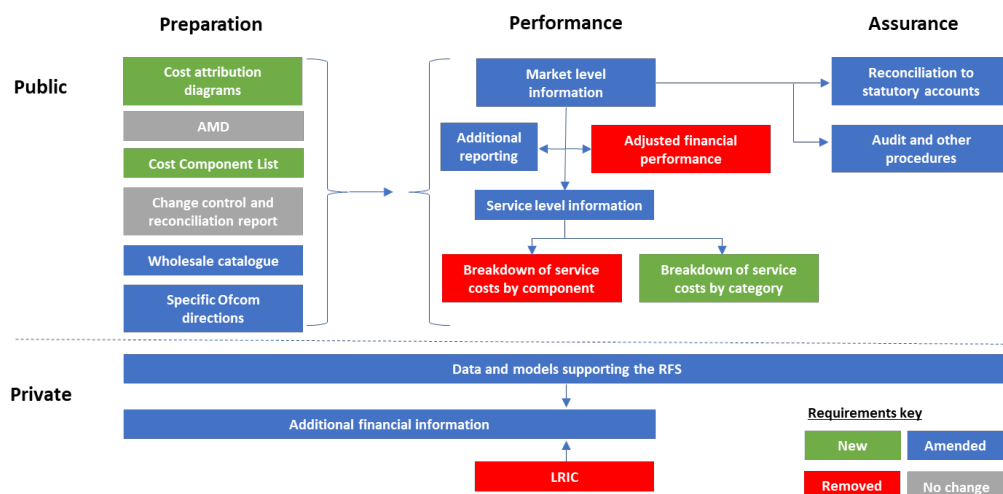
Current direction	Decision in this statement
Regulatory Accounting Principles Direction	Retain, with amendments
Consistency with Regulatory Decisions and Regulatory Asset Value Direction	Retain, with amendments
Transparency Direction	Remove
Audit of the RFS Direction	Retain
Reconciliation Report Direction	Retain
Adjusted Financial Performance Direction	Remove
Preparation, Delivery, Publication, Form and Content Direction	Retain, with amendments
Network Components Direction	Retain, with amendments
Electricity Direction	Remove

Structure of this document

- 1.18 To date, we have required BT to publish information relating to the preparation of the RFS, the financial performance of regulated markets and assurance over the RFS. We have also required BT to provide us with information privately.
- 1.19 The diagram below illustrates the changes we have made to the main documents and schedules we are requiring BT to publish and provide to us in terms of preparation, performance and assurance. The colour coding indicates whether we are introducing new requirements (green), amending previous requirements (blue), removing requirements (red) or maintaining previous requirements (grey).

⁹ BT's 2019/20 RFS indicate that 96% of SMP market returns sit in Openreach.

Figure 1.1: Illustration of public and private reporting requirements by comparison with the previous review period



1.20 We discuss each of these requirements below, setting out our consultation proposals, stakeholder responses and our decisions. We are imposing SMP conditions supported by six directions as follows:

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

1.21 We explain why we consider our decisions are appropriate by reference to the reporting attributes and the approach to regulation set out in this Statement.

1.22 The rest of this Volume is structured as follows.

- **Section 2: Regulatory reporting remedies.** This section sets out our decisions to impose an accounting separation and cost accounting remedy (together the “regulatory financial reporting remedies”), together with associated directions, on the SMP markets identified in Volume 2.
- **Section 3: Published performance schedules.** This section sets out our decisions on the market and service level schedules published in the RFS (the ‘performance’ category in the diagram above) for each of the SMP markets. These decisions will be imposed via the Preparation, Delivery, Publication, Form and Content Direction (‘Form and Content Direction’).
- **Section 4: Preparation and assurance requirements.** This section sets out our decisions on the reports and schedules we require BT to publish to demonstrate how the RFS have been prepared and provide assurance to stakeholders (the ‘preparation’ and ‘assurance’ categories in the diagram above). This section also includes decisions on how financial information should be prepared for each of the SMP markets to ensure

consistency with regulatory decisions.¹⁰ It covers the Regulatory Accounting Principles Direction, the Consistency with Regulatory Decisions and Regulatory Asset Value Direction ('Consistency Direction'), the Audit of the RFS Direction ('Audit Direction'), the Reconciliation Report Direction and the Network Components Direction. It also addresses a few points that are implemented via the Form and Content Direction.

- **Section 5: Information provided to Ofcom.** This section sets out our decisions on the information BT is required to provide Ofcom privately (the 'private' category in the diagram above). These decisions will be imposed via the Form and Content Direction.
- **Section 6: Legal tests.** This section sets out the directions we have decided to apply to each of the SMP markets under the SMP condition. It also sets out why we consider our decisions to impose SMP conditions and associated directions meet the relevant legal tests set out in the Communication Act 2003 (the Act). The SMP Conditions and associated directions are set out in Volume 7.

¹⁰ For example, where we have made adjustments to BT's costs in our cost modelling we have reviewed whether we need to direct BT to change how the RFS are prepared.

2. Regulatory reporting remedies

Regulatory framework

- 2.1 Sections 87(7) and 87(8) of the Act allow us to impose accounting separation conditions on a dominant provider relating to network access to the relevant networks or the availability of relevant facilities, including requirements about the accounting methods to be used in maintaining the separation.
- 2.2 Section 87(6)(b) of the Act authorises us to set SMP conditions which require a dominant provider to publish, in such manner as we may direct, such information as we may direct, for the purpose of securing transparency in relation to matters connected with network access to the relevant network or with the availability of the relevant facilities.
- 2.3 Section 87(9)(c) authorises us to set conditions imposing on the dominant provider such rules as we may make about the use of cost accounting systems for the purposes of price controls in relation to matters connected with the provision of network access to the relevant network, or with the availability of the relevant facilities; and such rules as we may make in relation to those matters about the recovery of costs and cost orientation.
- 2.4 Under section 87(10) this can include conditions requiring the application of presumptions in the fixing and determination of costs for the purposes of the price controls, recovery of costs and cost orientation rules, and the cost accounting system. Where such conditions are imposed, section 87(11) imposes a duty on us to set an SMP condition which requires the dominant provider to publish a description of the cost accounting system and to include in that description details of:
- the main categories under which costs are accounted for; and
 - the rules applied for the purposes of that system with respect to the allocation of costs.
- 2.5 As explained in Volume 1, we may still also take due account of relevant recommendations, although we are no longer required to do so. We consider the 2005 EC Recommendation on accounting separation and cost accounting systems¹¹ to be particularly relevant.
- 2.6 We also consider the 2013 EC Recommendation on consistent non-discrimination obligations and costing methodologies to promote competition and enhance the broadband investment environment.¹²

¹¹ [Commission Recommendation of 19 September 2005](#) on accounting separation and cost accounting systems under the regulatory framework for electronic communications (2005/698/EC) (the “2005 EC Recommendation”)

¹² [Commission Recommendation of 11 September 2013](#) on consistent non-discrimination obligations and costing methodologies to promote competition and enhance the broadband investment environment (2013/466/EU)

Purpose of regulatory reporting

- 2.7 BT is subject to regulatory financial reporting requirements across all of the wholesale fixed telecoms markets in which it is regulated. These requirements are imposed on BT by way of an SMP condition set in each regulated market, and 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.
- 2.8 As part of these requirements, each year BT must prepare its RFS according to a defined framework and methodology. The RFS include published statements as well as information that is not published but submitted to Ofcom privately.
- 2.9 BT's regulatory financial reporting obligations secure the creation and retention of the information needed for our regulation of SMP markets, particularly price controls, to be, and be seen to be, effective. They provide us with the information necessary to help us make informed regulatory decisions, for example cost information to support price controls on an ongoing basis, and information necessary to assess the impact and effectiveness of our decisions, for example, trends in the usage and returns associated with regulated services. They also enable us to monitor and, if necessary, enforce no undue discrimination and some price control regulations.
- 2.10 Publication of some information helps inform stakeholders so they can have confidence that BT is complying with its obligations and that regulation is effective and appropriate to achieve its purpose. It enables them to identify and bring issues to our attention and effectively contribute to the regulatory regime. This promotes confidence in the market, which in turn creates the conditions for effective competition.
- 2.11 Respondents to our consultation agreed that the RFS is an important tool for assessing BT's compliance with some of its SMP conditions. Vodafone said that the availability of reliable, unbiased regulatory accounting information remains key to identifying the correct basis of pricing and understanding the workings of the market. It said that stakeholders need to have confidence in the regulatory system and the regulatory accounts are at the heart of that system.¹³
- 2.12 Two respondents said the RFS was also important for identifying potential anti-competitive behaviour and assessing BT's compliance with ex-post competition law.¹⁴ We consider that while there may be some overlap, ex-post competition law is a separate legal regime.

¹³ Vodafone response to February Reporting Consultation, paragraph 1.3.

¹⁴ [Frontier report for Vodafone](#), page 21 and Vodafone response to February Reporting Consultation, paragraph 2.1 (iv).

Regulatory financial reporting remedies

- 2.13 In the February 2020 Consultation we proposed to impose accounting separation and cost accounting obligations on BT in each of the SMP markets.
- 2.14 No respondents to the consultation disagreed with our proposal. Responses to our consultation focused on the detailed reporting obligations considered in Sections 3, 4 and 5 of this document.
- 2.15 We have therefore decided to impose accounting separation and cost accounting obligations on BT in each of the SMP markets and implemented these obligations by way of a single SMP Condition and associated directions (see Volume 7) which specify what information we require BT to prepare and provide for each market. Further details of the accounting separation and cost accounting obligations as a whole are set out below, with reasoning on specific aspects of them in the following sections.

Accounting separation

- 2.16 We have decided to impose an accounting separation obligation on BT in each of the SMP markets. We consider that this obligation is necessary to monitor the overall impact and effectiveness of our remedies and, in particular, to monitor BT's activities with regard to its no undue discrimination obligations.¹⁵ The obligation is also necessary to give transparency to stakeholders that BT has complied with its SMP conditions and that robust information is being created and retained during the current period, in order to secure that SMP regulation remains appropriate and that it can continue to be imposed if there is a need to do so at the end of the current period, a reassurance which promotes competition in the markets concerned and enables Ofcom to benefit from stakeholder input in monitoring compliance.
- 2.17 Requiring BT to produce financial statements on each regulated wholesale market, combined with an obligation to attribute costs in a fair, objective and transparent way (via the cost accounting obligation – see below) can also help prevent unfair cross-subsidy by ensuring that costs are not inappropriately loaded onto one set of regulated products to the benefit of another set of regulated products or unregulated products. We consider that this helps ensure that competition develops fairly, which ultimately benefits consumers, and is the least onerous obligation necessary to ensure a mechanism exists to allow us and stakeholders to monitor potentially discriminatory behaviour by BT.
- 2.18 We consider that imposing an accounting separation obligation, together with a cost accounting obligation (see below), will help ensure the regulatory reporting objectives described above are met.

¹⁵ The accounting separation obligation requires BT to account separately for internal and external sales, which helps Ofcom and stakeholders monitor the activities of BT to ensure it does not discriminate unduly in favour of its own downstream business. In Volume 3 we explain our decision to apply no undue discrimination obligations on BT in each of the SMP markets, including alongside an equivalence of inputs obligation in some markets.

Cost accounting

- 2.19 Cost accounting obligations require the dominant provider to maintain a cost accounting system (a set of processes and systems) to capture the costs, revenues, assets and liabilities associated with the provision of services and to attribute them in a fair, objective and transparent manner to individual services in order that the costs of individual services may be determined.¹⁶
- 2.20 We have decided to impose a cost accounting obligation in the SMP markets to ensure that the processes and rules used by BT to attribute revenues and costs to individual markets and services are fair, objective and transparent. The cost accounting obligation is an important means of ensuring that:
- we have the necessary information to monitor and assess the effectiveness of price controls, in particular to ensure that the pricing remedies we impose continue to address the competition problems identified and to enable our timely intervention should such intervention be needed;
 - costs are attributed across markets (and the individual services within them) in a fair, objective, transparent and consistent manner. This mitigates the risk of cost over-recovery or that costs might be unfairly loaded onto particular products or markets, promoting confidence in the market;
 - there is transparency (via publication of the processes and rules followed by BT), which allows us to effectively challenge attribution processes and rules which we do not consider to be fair and objective;
 - publication (i.e. reporting) of cost accounting information aids transparency, providing assurance to stakeholders about compliance with SMP obligations, allowing stakeholders to support Ofcom's monitoring of compliance and more generally promoting competition by providing reassurance that regulatory conditions are complied with;
 - BT records all information necessary for the purposes listed above at the time that relevant transactions occur, on an ongoing basis. Absent such a requirement, there is a possibility that the necessary information would not be available when it was required for monitoring and enforcement purposes, and in the necessary form and manner.
- 2.21 Absent such a requirement, some of our price controls in the current regulatory period would be likely to be ineffective to address BT's SMP, as stakeholders could not be confident that the controls were effective to enable them to compete against BT on a fair basis. Price regulation generally would be likely to be less effective, because stakeholders would not have confidence that if regulation continued to be required in the next regulatory period, the necessary information would be available for Ofcom to implement it. Finally, ongoing provision of information allows Ofcom and stakeholders to monitor, within the review period, the appropriateness of the assumptions made in setting charges

¹⁶ Paragraph 2 of Point 1 of the 2005 EC Recommendation says "the purpose of imposing an obligation to implement a cost accounting system is to ensure that fair, objective and transparent criteria are followed by notified operators in allocating their costs to services in situations where they are subject to obligations for price controls or cost-oriented prices."

and therefore enables a better ongoing understanding of the effectiveness of the remedies.

Directions

2.22 We have decided to impose six directions on BT under the SMP Condition as follows. The detailed requirements under each of these directions are set out in the following sections.

- Regulatory Accounting Principles Direction. The regulatory accounting principles are needed as a set of guiding principles with which BT's regulatory financial reporting must comply to ensure it achieves the objectives of regulation. The requirements are set out in Section 4.
- Form and Content Direction. This direction is needed to provide full details of the financial information to be included in the published RFS and to be provided to us privately. The requirements are set out in Sections 3, 4 and 5.
- Consistency Direction: This direction is needed to specify how BT should prepare the RFS to be consistent with our regulatory decisions. The requirements are set out in section 4.
- Audit Direction. This direction specifies the audit requirements on the RFS, which are needed to give users confidence that the information provides a fair reflection of financial performance, is free from error and has been prepared following the accounting methodology statements published by BT and relevant directions issued by Ofcom. The requirements are set out in Section 4.
- Reconciliation Report Direction. This direction requires BT to publish the impact of all material changes and errors each year with an accompanying assurance report from its regulatory auditors. The direction is needed to ensure the impact of changes in methodology and error corrections are transparent. The requirements are set out in Section 4.
- Network Components Direction. This direction specifies the cost components to be used by BT to prepare the RFS as at 1 April 2021. To preserve the integrity and consistency of BT's Regulatory Financial Reporting it is important that there is a single list of components used to attribute costs to services in regulated markets. The requirements are set out in Section 4.

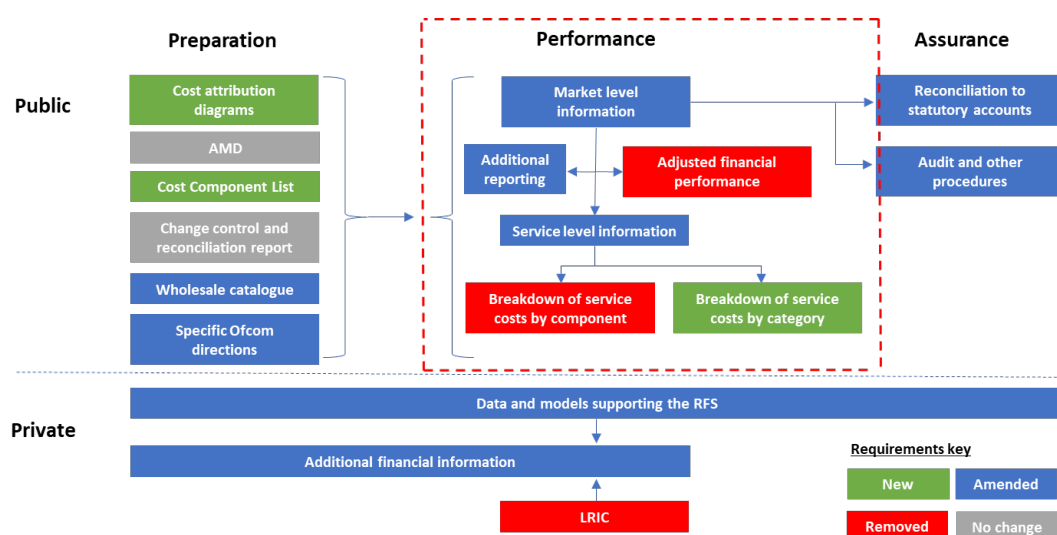
2.23 We have decided not to reimpose the Transparency Direction, Adjusted Financial Performance Direction and Electricity Direction as explained in the sections below.

3. Published performance schedules

Introduction

- 3.1 Publication of financial information contributes to an open and competitive market and helps create an effective regulatory regime.¹⁷ In the February 2020 Consultation, we proposed to make broad changes to the information presented in the RFS to ensure they remained relevant throughout this five-year review period and help secure that SMP regulation is and remains effective.
- 3.2 In this section we discuss the format of the ‘performance’ schedules highlighted in the diagram below and set out specific requirements for each of the SMP markets.

Figure 3.1: Illustration of public and private reporting requirements by comparison with the previous review period



- 3.3 In the published RFS, most of the financial information we have required BT to publish to date, and are requiring BT to publish in this review period, can be classified as follows:
- **Market level information.** This is information on the revenues, operating costs, capital employed and returns on MCE for SMP markets and for BT Group overall. To date, BT has also been required to publish an ‘adjusted financial performance schedule’.
 - **Service level information.** This can include the revenue, volume, price and costs of specific services or groups of services reported within SMP markets.
 - **Breakdown of service level costs.** To date, we have required BT to publish a split of service level fully allocated costs (FAC) by cost component alongside a schedule showing how cost component unit FAC has been calculated.¹⁸

¹⁷ The Annex to the 2005 EC Recommendation says “regulatory accounting information serves national regulatory authorities and other parties that may be affected by regulatory decisions based on that information, such as competitors, investors and consumers. In this context, publication of information may contribute to an open and competitive market and also add credibility to the regulatory accounting system”.

¹⁸ In BT’s cost attribution system, costs are attributed to cost components which in turn are attributed to services.

- 3.4 We set out our decisions on each of these areas below before setting out what the specific schedules will look like for each of the SMP markets.

Market level information

Our main decisions for market level information require BT to:

- **split operating costs to i) align with cost categories in BT’s annual report ii) provide information on costs important to SMP markets (e.g. cumulo) and iii) show operating costs incurred within Openreach and costs attributed from other BT divisions** (affecting the summary of market performance and attribution of operating cost schedules);
- **provide a revised breakdown of asset costs including poles, electronics and software** (affecting the attribution of operating cost and attribution of MCE schedules);
- **improve visibility of relationship between PI and downstream markets** (affecting each market schedule);
- **remove the adjusted financial performance schedule.**

Overall approach

Our proposals

- 3.5 To date, BT has been required to publish three market performance schedules:¹⁹
- **Performance summary by market:** this shows revenues, operating costs, returns, MCE and return on MCE for each SMP market as well as Openreach, the rest of BT and BT Group overall.
 - **Attribution of operating costs.** This shows a breakdown of operating costs and depreciation by cost category for each SMP market as well as Openreach, the rest of BT and BT Group overall.
 - **Attribution of MCE.** This shows a breakdown of MCE by asset category for each SMP market as well as Openreach, the rest of BT and BT Group overall.
- 3.6 In the February 2020 Consultation, we proposed to continue to require BT to provide these three market performance schedules. We said we had considered how to improve the market schedules by reference to the following general themes:
- **Openreach focus:** Openreach represents the vast majority of markets that we regulate, including all the SMP markets subject to the WFTMR.²⁰ We said the WFTMR offered an opportunity to consider how to present financial information in the RFS with a focus on the services provided by Openreach, to improve the visibility of operating costs

¹⁹ Pages 25 to 37 of the 2019/20 RFS.

²⁰ BT’s 2019/20 RFS indicate that 96% of SMP market returns sit in Openreach.

incurred by Openreach compared to those attributed to it from other parts of BT and to improve the reporting of assets used to provide Openreach services.²¹

- **PI:** The 2019/20 RFS reported financial information on the PI market for the first time. This is an upstream market for duct and pole access that provides inputs to downstream services in, for example, the WLA market. We considered that the market schedules should ensure the relationship between PI and downstream markets was clear to help show i) the extent to which downstream markets are consuming PI, ii) how this compares to external purchases and iii) that attributions of PI costs are transparent, helping stakeholders assess if they are fair and objective. We thought this would help promote confidence in the market, which in turn creates the conditions for effective competition.
- **Specific items.** In previous reviews, as well as this one, we have made adjustments to costs attributed to SMP markets which were presented under 'specific items' in the statutory financial statements.²² We considered that there should be greater visibility about if and how these have been attributed to SMP markets to help provide assurance that costs have been appropriately attributed. In the past, specific items reported in the statutory financial statements have included EE acquisition costs, restructuring costs and regulatory fines.²³

3.7 We also proposed to require BT to publish aggregate information on non-SMP parts of Openreach and rest of BT.

Stakeholder responses

3.8 No stakeholders disagreed with our proposal for BT to publish these market performance schedules. Stakeholder responses generally focused on our detailed proposals for each of the three market schedules, for which we set out reasoning and our decisions below.

3.9 Competition Finance Ltd (CFL) said that the RFS should only be concerned with Openreach and not include other parts of BT (except for allocations of central services).²⁴ It also said we should require BT to publish a cashflow statement for Openreach in the RFS, arguing that modelling Openreach cashflows is an important part of our regulatory approach and stakeholders could use it to assess the accuracy of predictions and modelling in future (e.g. cashflows associated with fibre investment).²⁵

²¹ In the February 2020 Consultation we noted that the March 2019 RFR Statement made some presentational changes to the market performance schedules, for example by making it clear which SMP markets are provided by Openreach and the rest of BT (paragraphs 3.45 to 3.55 of the March 2019 RFR Statement). We also noted that under the commitments given to Ofcom in March 2017, BT committed to provide certain information on Openreach in the RFS (Paragraph 20.5, Commitments of BT Plc and Openreach Limited to Ofcom, Issue 3, 4 March 2019).

²² See note 9 to [BT's 2019/20 statutory accounts](#).

²³ In Annex 14 we make an adjustment to restructuring costs which are reported under specific items in BT's annual report.

²⁴ CFL response to February 2020 Consultation, page 27.

²⁵ CFL response to February 2020 Consultation, page 19.

Our reasoning and decisions

- 3.10 We have decided to continue to require BT to provide the three market performance schedules because they provide an overview of the SMP markets and demonstrate that BT is providing the information required under its reporting obligations. They also help us and stakeholders assess the ongoing impact and effectiveness of the remedies imposed on each market, e.g. by reference to trends in revenues, costs and returns which have been prepared on a consistent basis across all markets. These schedules also show the outcome of BT's cost attribution decisions.²⁶ Specifically:
- **The performance summary by market schedule** gives an overview of the performance of each SMP market, allowing stakeholders to assess the impact of our remedies on the performance of these markets (e.g. in terms of revenues and returns earned by Openreach in each market). It also gives confidence to stakeholders that BT is providing the required data under its reporting obligations and that the reporting regime overall is working as planned.
 - **The attribution of operating costs and MCE schedules** provide further information on the operating costs and MCE reported in the performance summary by market schedule. This helps stakeholders understand the main categories of operating costs and MCE in SMP markets, how these have been allocated between regulated and unregulated markets and how these relate to service costs (discussed below). This provides confidence to stakeholders that operating costs and MCE are being attributed on a fair and objective basis and enables them to challenge the basis of attribution where necessary.
- 3.11 We have also decided to require BT to publish aggregate information on non-SMP parts of Openreach and rest of BT to ensure the overall coherence of the RFS and that Openreach and BT Group information can be reconciled to the BT Group statutory financial statements. This is consistent with our requirements to date.
- 3.12 We consider our decisions below on the format of these schedules takes account of the themes set out above in relation to a focus on Openreach, PI reporting and the inclusion of specific items.
- 3.13 While we consider the RFS should have a focus on Openreach as the BT division providing services in the vast majority of SMP markets, we do not agree that the RFS should only be concerned with Openreach. This is because the SMP obligations fall on BT rather than Openreach and other parts of BT outside of Openreach have SMP and associated reporting obligations.²⁷ We consider our decisions set out below would allow stakeholders to understand SMP market performance in the context of both Openreach and BT, and improve the visibility of costs incurred by Openreach versus those attributed from other parts of BT.

²⁶ The 2005 EC Recommendation annex says that, subject to confidentiality considerations, profit and loss statements and capital employed statements should be published for relevant markets and services.

²⁷ For example, those markets subject to the Voice Market Review.

- 3.14 We do not consider it is necessary to impose an SMP obligation on BT to publish a cashflow statement for Openreach. Our cost modelling using BT's RFS information generally references operating and capital costs rather than cashflows and more broadly we are interested in BT's ability to recover its efficiently incurred cost over the life of an investment. While we reference some specific Openreach cashflows in the WLA Area 3 RAB calculation, this is part of a long-run calculation and relates to costs that will be recovered across multiple charge control periods. We do not therefore consider that publishing Openreach's annual cashflows would help stakeholders assess the impact and effectiveness of the SMP remedies imposed on each market.²⁸ Given no clear link to our SMP remedies, we do not consider a cashflow statement for Openreach division is appropriate.²⁹
- 3.15 The next sections set out our decisions on each market performance schedule.

Performance summary by market schedule

Our proposals

- 3.16 Our proposed performance summary by market schedule was shown in Table 4.1 of the February 2020 Consultation.
- 3.17 We said each of the proposed SMP markets would be reported in a separate column, including a separate column for those ancillaries which are shared across SMP markets such as accommodation and power.
- 3.18 The proposed schedule had sections for revenues, operating costs, CCA adjustments and mean capital employed. Operating costs were broken down by attribution of PI costs, operating costs incurred by Openreach, operating costs incurred by the rest of BT and depreciation.
- 3.19 We also proposed to require BT to include a note below this schedule showing which 'specific items' reported in the BT Group statutory financial statements had been attributed to SMP markets.

Stakeholder responses

- 3.20 Stakeholder responses on the performance summary by market schedule covered the following themes:
- **Format of the schedule:** CFL suggested consolidating some of the revenue and operating cost rows and including additional rows for EBITDA and specific items.³⁰ BT suggested replacing the Openreach and rest of BT operating cost rows with a single 'operating cost' line, with the details provided in the 'attribution of wholesale current costs' schedule.³¹

²⁸ We set out reporting requirements in relation to WLA Area 3 below.

²⁹ We also note that a cashflow statement is not a schedule required under the 2005 EC Recommendation.

³⁰ Competition Financial Ltd response to February 2020 Consultation, section 4.3.

³¹ BT second response to February 2020 consultation, paragraph 2.5.

- **Shared ancillaries:** BT agreed with our proposal separately to report ancillaries shared across SMP markets, saying it would provide transparency to stakeholders on costs without requiring complex allocations (which might be necessary if these ancillaries were reported in each SMP market).³²
- **Specific items note:** BT asked if this requirement could be postponed to 2022/23 (a delay of one year) as the introduction of a new corporate accounting system would allow it to identify specific items allocated to SMP markets and make this requirement easier to implement.³³ BT said that ‘specific items’ could be included as a row item in the ‘attribution of wholesale current costs’ schedule.³⁴ CFL proposed to include specific items as a row rather than a note under the schedule.

Our reasoning and decisions

3.21 We have decided to require BT to publish the performance summary by market schedule as set out below. This includes minor changes from the schedule we proposed.

Format of the schedule

- 3.22 Each of the SMP markets will be reported in a separate column in the ‘Openreach’ section, along with a column for ancillaries which are shared across SMP markets, like accommodation and power.³⁵ There will be a single column for the rest of BT.
- 3.23 Our proposed performance summary by market schedule aimed to increase the visibility of costs incurred within Openreach and costs attributed to it from other parts of BT by having separate operating cost lines (‘Operating costs – Openreach’ and ‘Operating costs – Rest of BT’). While we consider this is important, we agree with BT and CFL that this split can be provided in the attribution of operating costs schedule. We have therefore consolidated these two rows into a single operating cost line in the performance summary by market schedule.
- 3.24 For the PI market, the schedule summarises how revenues and costs are treated, especially attributions of PI costs to downstream services. For PI revenues, the schedule shows external sales of PI, internal sales of PI (e.g. to other parts of BT such as Global Services) and inputs to downstream services (the balancing figure to be attributed to downstream Openreach services which use PI).³⁶ The schedule also includes an operating cost row called ‘attribution of PI costs’. This row is blank for the PI market column but for other markets it will show the attribution of PI costs (i.e. those from the ‘inputs to downstream services’ revenue entry) from the PI market to other downstream markets. This would mean that

³² BT response to February 2020 Consultation, paragraph 4.9.

³³ BT response to February 2020 Consultation, paragraph 4.32 and 4.33.

³⁴ BT second response to February 2020 consultation, paragraph 2.10.

³⁵ BT will only be required to separately identify the IEC BT+2 market in the 2021/22 financial year, consistent with the transitional arrangements. As regulation on WFAEL, ISDN2, ISDN30 and WBA has been removed, these will no longer be separately reported in the RFS.

³⁶ The ‘inputs to downstream services’ item includes a return on capital employed.

downstream markets will not include assets associated with duct and poles, but instead include an operating cost attribution from the PI market.³⁷

- 3.25 We consider the reporting of PI in this schedule is consistent with our approach to PI pricing (Volume 4) and guidance on no undue discrimination in relating to pricing (Annex 8). As explained in Annex 8, Openreach is not required to pay for PI services on the same basis as other telecoms providers. However, there needs to be an attribution of PI costs (net of external sales) to downstream SMP markets for using the PI assets.
- 3.26 We do not agree with CFL's consolidation proposals in relation to PI as we consider our proposed schedule meets our objectives to ensure the relationship between PI and downstream Openreach markets is clear. We also do not consider it necessary to additionally separate out EBITDA as the CCA return and ROCE provide a benchmark estimate of the returns BT is earning in these SMP markets.³⁸ As set out below, we have decided to require BT to include a row for specific items in this schedule from 2022/23.
- 3.27 The schedule also shows a single line for CCA adjustments with the detail (i.e. holding gains/losses, supplementary depreciation and other CCA adjustments) reported in the attribution of operating costs schedule (discussed in the next section) to avoid duplication.

Shared ancillaries

- 3.28 We have decided to require BT to report on ancillaries shared across Openreach SMP markets. We agree with BT that this would provide transparency to stakeholders on the revenues and costs associated with these services and avoid complex allocations to individual SMP markets. As explained later in this section, 'shared ancillaries' includes accommodation, cablelink and electricity charges.

Specific items

- 3.29 Given that specific items can include unusual or one-off items, and in this and previous reviews we have adjusted such costs, we consider it is proportionate to require BT to report whether these have been attributed to SMP markets. We have therefore decided to require BT to include specific items as a row in the schedule from 2022/23 when the data is available from BT's accounting systems. Per our proposal, as the nature and size of specific items can change significantly year to year, we also require BT to include a note below the summary of market performance schedule explaining which specific items reported in the BT Group statutory financial statements have been attributed to SMP markets. This latter requirement also applies from 2022/23.

Schedule

- 3.30 The performance summary by market schedule is set out below.

³⁷ This is consistent with how the PI market is currently reported.

³⁸ Stakeholders could estimate EBITDA by subtracting CCA adjustments and depreciation from the CCA return.

Table 3.1: Performance summary by market schedule

Section		Openreach				Rest of BT	BT Group		
		Physical Infrastructure	SMP markets (additional column for each market)	Non-SMP	Eliminations	Total	Total	Eliminations	Roundings
PI revenues									
External purchases	£m								
Internal purchases	£m								
Inputs to downstream services	£m								
Total PI revenues	£m								
Other revenues									
External revenue	£m								
Internal revenue	£m								
Total other revenues	£m								
Total revenue	£m								
Attribution of PI costs	£m								
Operating costs	£m								
Depreciation	£m								
Specific items*	£m								
Total HCA operating costs	£m								
CCA adjustments	£m								
Total CCA operating costs	£m								
CCA Return	£m								
Mean capital employed	£m								
Return on MCE %	%								

*specific items row required from 2022/23.

Attribution of operating costs schedule

3.31 To date, the attribution of operating costs schedule has shown a breakdown of operating costs by the following categories: provision/maintenance, network support, general support, general management, accommodation and other costs. It has also provided a breakdown of depreciation by the following asset categories: land and buildings, duct, access copper and access fibre, switch and transmission and 'other related'.³⁹

Our proposals

3.32 Our proposed attribution of operating costs schedule was set out in Table 4.2 of the February 2020 Consultation.

3.33 Consistent with our proposals for the performance summary by market schedule, we proposed to require BT to provide a breakdown of operating costs incurred by Openreach and those attributed to it from other parts of BT.

3.34 We also proposed to identify costs that we typically consider when setting charges controls and which are important to Openreach SMP services (e.g. cumulo, SLGs and lever costs).

3.35 We proposed a breakdown of Openreach operating costs into service and network delivery, Openreach central functions, lever costs, SLG payments and other costs. For Rest of BT operating costs, we proposed a breakdown of costs into exchanges, other

³⁹ See page 28 of the 2019/20 RFS.

property, cumulo, central functions – Technology, central functions – group, and other costs.

- 3.36 We proposed that depreciation should be shown for the following asset categories: duct, poles, other PI assets (where applicable), copper, fibre, electronics, software, land and buildings, other depreciation and funded assets (e.g. BDUK).
- 3.37 We said we would not expect ‘other’ operating costs to be significant, but given there could be material changes to the costs or structure of BT’s business during the control period we proposed to require BT to provide a further breakdown of ‘other’ operating costs where these exceed 10% of total Openreach operating costs.
- 3.38 We also proposed that CCA adjustments would be split by holding gains/losses, supplementary depreciation and other CCA adjustments as they are currently.

Stakeholder responses

- 3.39 Vodafone supported our proposals and said the operating cost schedule would provide an appropriate classification of the types of costs incurred and the distribution of costs across Openreach and the rest of BT. Vodafone said it would be particularly helpful to have cumulo costs reported.⁴⁰
- 3.40 CFL suggested that operating costs should be presented on the same basis as in BT’s annual report. It considered this would remove any need for BT to maintain different account mapping tables for statutory and regulatory reporting and provide a clear link between information used to make decisions by management, investors and the regulator.⁴¹ It said that additional breakdowns should be given where costs are important for regulatory analysis, giving the example of cumulo and SLGs.⁴² CFL proposed including additional columns to show whether these operating costs were incurred by Openreach or attributed from other parts of BT, and that a separate schedule would be required for each individual SMP market. It also proposed including a breakdown of holding gains/losses for duct, copper and electronics.
- 3.41 BT also proposed that the breakdown of operating costs should use headings from its annual report.⁴³ It considered this would better align with internal reporting, be easier for it to maintain and produce and make it easier for stakeholders to compare the RFS with its annual report.⁴⁴
- 3.42 BT said that two additional breakdowns of operating costs should be included showing the following:
- Further information on particular costs: BT suggested this could include cumulo, Openreach SLGs, specific items and leaver costs (if needed – see BT’s comment below).

⁴⁰ Vodafone response to February 2020 Consultation, paragraphs 4.2 and 4.3.

⁴¹ CFL response to February 2020 Consultation, sections 4.2 and 4.4.

⁴² CFL response to February 2020 Consultation, section 4.4.

⁴³ BT second response to February 2020 Consultation, table under paragraph 2.5.

⁴⁴ BT second response to February 2020 Consultation, paragraph 1.2.

BT said the main operating cost schedule would then align to reporting in its annual report, with this further breakdown providing granular reporting on areas of Ofcom focus.⁴⁵

- Organisational breakdown. BT said this would provide a split of operating costs by division and ensure that costs are analysed by type and by organisation separately (rather than combining them as in our proposal). For Openreach this would show costs for 'service and network delivery' and 'Openreach support functions'. For the rest of BT, a breakdown by division would be provided (Group centre, Property and facilities, Technology, and a single line for 'Consumer, Global and Enterprise' which allocate fewer costs to SMP markets).⁴⁶

- 3.43 BT said that leaver costs should not be disclosed as i) they reveal the forward-looking strategy of the company and are commercially sensitive, ii) they are not being adjusted separately for the purpose of setting the charge control remedy so would not help stakeholders assess the effectiveness of the control and iii) they are small and reporting them separately would involve additional work and further complication.⁴⁷
- 3.44 BT said that post IFRS16, the proposed 'Exchanges' and 'Other Property cost' categories will primarily relate to depreciation (as leases are capitalised under IFRS16).⁴⁸ It considered these should be reported under a 'Right of use assets' category.⁴⁹
- 3.45 CityFibre said that we should require BT to split out product development costs between internal and external services and between PI and downstream SMP markets. For PI, CityFibre said this would give stakeholders an indication of Openreach's investment in product development and if it is investing in a non-discriminatory way. CityFibre said that presenting product development costs for active and passive service would indicate whether Openreach is seeking to deliver better product results for more profitable services.⁵⁰

Our reasoning and decisions

- 3.46 Most stakeholder comments focused on the breakdown of operating costs in this schedule, which we discuss below. Stakeholder comments on which asset categories to include under depreciation are discussed in the next section on the attribution of MCE schedule.
- 3.47 We agree with BT and CFL that there are benefits of having the same operating cost headings in the RFS as in BT's annual report, so stakeholders will be able to directly compare operating costs in SMP markets with operating costs in BT's annual report. We consider this will make the RFS easier to understand and help stakeholders assess the impact of BT's attribution decisions, enabling them to bring issues to our attention.⁵¹

⁴⁵ BT second response to February 2020 Consultation, paragraphs 2.9 and 2.10.

⁴⁶ BT second response to February 2020 Consultation, paragraph 2.11.

⁴⁷ BT response to February 2020 Consultation, paragraph 4.30.

⁴⁸ BT response to February 2020 Consultation, paragraph 4.31.

⁴⁹ BT second response to February 2020 Consultation, paragraph 2.6.

⁵⁰ CityFibre response to February 2020 Consultation, paragraphs 1.48 to 1.50.

⁵¹ e.g. where stakeholders consider a category of costs has inappropriately been allocated to one or more SMP markets

- 3.48 However, as per our proposals, we consider it is also important to require BT to publish operating costs that we typically consider when setting charges controls and which are important to Openreach SMP services (e.g. cumulo). Vodafone agreed with this view and the suggestions from BT and CFL both included additional details on some costs.
- 3.49 In line with our proposals, we also consider it is important to improve the visibility of operating costs incurred by Openreach compared to those attributed to it from other parts of BT. However, we agree with BT that it would be better to separate the analysis of costs by type and by organisation rather than combining them as this is likely to be easier for BT to prepare and for stakeholders to understand.
- 3.50 For the breakdown of operating costs, we have therefore decided broadly to adopt the format proposed by BT with some amendments as described below. We consider this would improve the visibility of the costs associated with each SMP market per our proposals, while ensuring the schedule is practicable for BT to prepare. The attribution of operating costs schedules are shown below. Table 3.2 shows a breakdown of operating costs by type, with cost categories aligned with those used in the BT annual report, supplemented by an additional split of costs which are important to Openreach SMP services. Table 3.3 shows a breakdown of operating costs by division.⁵²

⁵² As set out below, where a breakdown of service costs is required, both schedules will be required.

Table 3.2: Attribution of operating costs schedule – operating costs by type

£m	Openreach					Total	RoBT	BT Group		
	Physical Infrastructure	SMP markets (additional column for each market)	Non-SMP	Eliminations	Total		Total	Eliminations	Roundings	Total
Section										
EOI input prices (if applicable)										
Attribution of PI costs										
Net labour costs										
Product costs & sales commissions										
Payments to telecommunications operators										
Property & energy costs										
Network operating and IT costs										
TV programme rights charges										
Provision and Installation										
Marketing and sales										
Other operating costs										
Other operating income										
Total operating costs before depreciation										
Depreciation										
Duct										
Poles										
Copper										
Fibre										
Electronics										
Software										
Right of use assets										
Land and buildings										
Other assets										
Less funded assets (BDUK, etc)										
Total depreciation										
Specific items										
Total HCA operating costs										
CCA adjustments										
Holding gains										
Supplementary depreciation										
Other CCA adjustments										
Roundings										
Total CCA operating costs										
Total CCA operating costs includes the following:										
Cumulo charges										
Openreach SLGs										
Leaver costs										

*specific items row required from 2022/23.

Table 3.3: Attribution of operating costs schedule - operating costs by division

£m	Openreach					Total	RoBT	BT Group		
	Physical Infrastructure	SMP markets (additional column for each market)	Non-SMP	Eliminations	Total		Total	Eliminations	Roundings	Total
Section										
Openreach										
Service and network delivery										
Openreach support functions										
Openreach total										
Rest of BT										
Group centre										
Property and facilities										
Technology										
Consumer, Global & Enterprise										
Rest of BT total										
Operating costs before depreciation										

Operating costs aligned with BT annual report

- 3.51 BT and CFL both said cost category headings should be aligned with those presented in BT's annual report.⁵³ The only exception was that BT proposed a single heading for labour costs of 'wages and salaries' while CFL proposed including more detail on labour costs such as direct labour, indirect labour and capitalised labour. We have decided to use the heading 'net labour costs', consistent with BT's annual report, which equates to BT's direct and indirect labour costs (including pay, social security and pensions) net of any capitalised labour. This will ensure the labour cost category used in the RFS is directly comparable to the category used in BT's annual report.
- 3.52 The attribution of operating costs schedule includes an 'other operating costs' line consistent with our proposals and BT's annual report. As other operating costs in BT's annual report have not exceeded 5% of total operating costs in the last three years,⁵⁴ we do not consider it is necessary to require BT to provide a further breakdown of costs where other operating costs exceed 10% of the total and we have not implemented this proposal.
- 3.53 As the cost categories used in BT's annual report could change over time, the requirement on BT is to use the same headings as set out in the notes to its annual report.
- 3.54 Consistent with our approach to specific items in the performance summary by market schedule, these will be reported as a separate row in the attribution of wholesale current costs schedule from 2022/23.

Additional split of costs important to Openreach SMP services

- 3.55 We have decided to require BT to show the costs for cumulo, Openreach SLGs and leaver costs separately.
- **Cumulo:** Cumulo costs have increased in recent years and are often considered separately in our cost modelling. In Annex 14 we separately forecast BT's cumulo rates for the purposes of our modelling. Given the importance of cumulo to Openreach SMP services, we are requiring BT to separately report these costs. No respondents disagreed with this proposal.
 - **Openreach SLGs:** SLGs represent the compensation Openreach pays to customers if it fails to meet agreed performance criteria – such as time taken to complete an installation – as set out in service level agreements. We have decided to require BT to publish SLG payments to help stakeholders assess the impact and effectiveness of our remedies in relation to quality of service and, given we have removed component level reporting below (which includes SLG components) we consider it proportionate to include SLG payments in this schedule.
 - **Leaver costs:** leaver costs are often adjusted in our cost modelling as they can be lumpy from year to year. We disagree with BT's reasons for not disclosing leaver costs. These are reported in BT's KPIs⁵⁵ so we do not consider showing how they have been allocated to SMP markets would be commercially sensitive. While leaver costs were relatively small across BT in 2019/20, they have been higher in the past and in Annex

⁵³ See note 6 of BT's 2019/20 annual report.

⁵⁴ See note 6 to BT's 2019/20 annual report.

⁵⁵ For example, page 4 of BT's Q4 2020 [Key performance indicators](#).

14 we adjust for them in our modelling. We consider it would help stakeholders assess the effectiveness of our charge controls for these costs to be separately reported.

- 3.56 In the February 2020 Consultation we also proposed to show operating costs for exchanges and other property costs. However, following the introduction of IFRS16 (treatment of leases), most property costs are now reported on BT's balance sheet as 'right of use' assets. We agree with BT that right of use assets should be shown instead as an asset category in the attribution of mean capital employed schedule, as set out in the next section.
- 3.57 We have considered CityFibre's suggestion to require BT to publish product development costs. Our approach set out above is to align operating cost categories reported in the RFS with those published in BT's annual report, with additional detail on costs that are important for Openreach SMP services and for our cost modelling (e.g. cumulo). We recognise that some stakeholders may be interested in additional service cost detail but we do not consider that there is a clear link to our approach to pricing or any other SMP obligations we are imposing, which would make the disclosure of product development costs appropriate. We consider that the cost information we are requiring BT to provide strikes a balance between helping stakeholders understand the main categories of cost and what is proportionate and appropriate for BT to publish.
- 3.58 We do not consider it would be proportionate to include additional columns in the attribution of wholesale current costs schedule showing a split of the cost categories from BT's annual report between Openreach and other parts of BT, as CFL suggested, because we consider Tables 3.2 and 3.3 together would give stakeholders sufficient information to understand the type of costs allocated to SMP markets and which division they come from.

Operating costs by division

- 3.59 We consider that a breakdown of operating costs by division would meet our objective to improve the visibility of operating costs incurred by Openreach compared to those attributed to it from other parts of BT. For Openreach, consistent with our proposals, we have decided to require BT to report two categories for 'service and network delivery' and 'Openreach support functions'.⁵⁶
- 3.60 For other divisions we agree with BT that a breakdown of operating costs from Group Centre (excluding property and facilities), Property and Facilities, Technology and 'Consumer, Global and Enterprise' (i.e. one line aggregating costs from these three divisions) will help stakeholders understand which other divisions contribute costs to SMP services and identify changes in cost allocations from other divisions over time.
- 3.61 As the names of BT's divisions could change during the review period, the direction provides for the row names in the operating costs by division schedule to change to align with these names. Any changes must be explained below the schedule.

⁵⁶ We consider 'service and network delivery' would largely capture the operating costs of Openreach's Service Delivery, Fibre and Network Delivery and Strategic Infrastructure Development teams while 'Openreach support functions' would capture the 'headquarters' team described on its website: <https://www.openreach.com/about-us/who-we-are>

CCA adjustments

- 3.62 We have decided to require BT to show a split of CCA adjustments by holding gains/losses, supplementary depreciation and other CCA adjustments. This is consistent with requirements to date. We do not agree with CFL that a breakdown of holding gains by asset category is required as stakeholders can see the index used by BT to revalue assets in its AMD.⁵⁷ Further, in 2019/20, holding gains/losses were only significant for the PI market⁵⁸ and we consider stakeholders will understand that going forward, the holding gains reported in this market will represent the impact of indexing duct and pole assets by RPI (as set out in section 4).

Attribution of mean capital employed schedule

Our proposals

- 3.63 We proposed that the asset category breakdown should be the same as that proposed for depreciation in the attribution of operating costs schedule: duct, poles, other PI assets (where applicable), copper, fibre, electronics, software, land and buildings, other depreciation and funded assets (e.g. BDUK). We also proposed to simplify the reporting of current assets, current liabilities and provisions by having a single heading for each. Our proposed schedule was set out in Table 4.3 of the February 2020 Consultation.

Stakeholder comments

- 3.64 BT agreed with most of our asset categories although its suggested schedule i) omitted a land and buildings category and ii) included a 'right of use' asset, reflecting the adoption of IFRS16.⁵⁹
- 3.65 CFL considered the schedule should follow the format used in BT's annual report, with an additional breakdown where items are important for regulatory analysis.⁶⁰ CFL agreed with most of our asset categories but its suggested schedule i) split software between purchased and internally developed software (as reported in BT's annual report), ii) had a more detailed breakdown of current assets and liabilities and iii) omitted an explicit category for funded assets.⁶¹ CFL also said the schedule should distinguish between Openreach division assets and assets held in the rest of BT.
- 3.66 CFL also suggested two schedules are shown for opening and closing balances, with the MCE being the average.

⁵⁷ See for example Annex 7 of BT's 2019/20 AMD.

⁵⁸ In 2019/20 holding gains were £155m in the PI market (c50% of operating costs before holding gains) and £55m in the WLA market (c3% of operating costs before holding gains). Around £60m of holding gains were also reported in WFAEL but this market will not be reported going forward following our decision to deregulate WFAEL.

⁵⁹ BT second response, paragraph 2.12 and table after paragraph 2.12.

⁶⁰ CFL response to February 2020 Consultation, page 22.

⁶¹ CFL response to February 2020 Consultation, table on page 25.

Our reasoning and decisions

- 3.67 While we think it is helpful to reference BT's annual report when considering the cost categories used to provide a breakdown of operating costs, we consider it less useful for a breakdown of MCE. We consider that asset categories in the attribution of wholesale MCE should reflect the major assets used to provide services in the WFTMR markets. There was general agreement that this should include duct, poles, copper, fibre, electronics and software, none of which, apart from software, are disclosed in BT's annual report.
- 3.68 As a significant asset, we consider it is important to show how software costs have been attributed to SMP markets, but we do not consider a split between externally purchased and internally developed software would give stakeholders a greater understanding of the costs attributed to SMP markets.⁶² We also note that BT itself does not appear to distinguish software between these categories for the purposes of cost allocation in the RFS.⁶³
- 3.69 We agree with BT that a 'right of use' asset should be included in the schedule to reflect the adoption of IFRS16. The majority of BT's 'right of use' assets relate to its leased properties like exchanges.⁶⁴ We disagree with BT's suggested removal of a 'land and buildings' asset category as this currently remains a significant asset.⁶⁵ We have therefore included asset categories for 'land and buildings' and 'right of use' assets in this schedule.
- 3.70 We consider it is important to show the levels of funding received by BT for network rollout (e.g. from BDUK) in this schedule, consistent with the current RFS, as we take account of such funding in our cost modelling. The 2019/20 RFS shows that grant funding was particularly important for the WLA market, so we have decided to retain an asset category to net off funded assets.
- 3.71 We disagree with CFL that more detail on current assets and liabilities is required. In net terms these broadly offset each other, meaning they have a small impact on the MCE attributed to SMP markets.⁶⁶ We do not consider the extra detail proposed by CFL would help stakeholders understand the costs attributed to SMP markets. We have therefore included single rows for current assets and liabilities in the schedule, as per our proposals.
- 3.72 The table below shows the attribution of MCE schedule that BT will be required to publish.

⁶² Note 13 to BT's 2019/20 annual report indicates that around 70% of software assets were internally developed.

⁶³ For example, the SOFTCAP and SOFTDEP methodologies in BT's 2019/20 AMD indicate that BT does not distinguish between externally purchased and internally developed software when allocating costs.

⁶⁴ BT's 2019/20 annual report (page 156) says "most of our right of use assets are associated with our leased property portfolio, specifically our office, retail and exchange estate". The disclosure on this page indicates that 90% of BT's right of use assets relate to land and buildings.

⁶⁵ BT's 2019/20 annual report (note 14) indicates that the net book value for land and buildings was close to £1bn.

⁶⁶ The 2019/20 RFS shows that current assets less current liabilities were -£47m in 2019/20 and +£185m in 2018/19 for Openreach SMP markets, representing less than 1.5% of non-current assets.

Table 3.4: Attribution of MCE

£m	Openreach					Total	RoBT	BT Group		
	Physical Infrastructure	SMP markets (additional column for each market)	Non-SMP	Eliminations	Total			Eliminations	Roundings	Total
Section										
Non-current assets										
- Duct										
- Poles										
- Copper										
- Fibre										
- Electronics										
- Software										
- Land and buildings										
- Right of use assets										
- Other assets										
- Less funded assets (BDUK, etc)										
Total non-current assets										
Current assets										
Current liabilities										
Provisions										
Roundings										
Total MCE										

3.73 While it is important that this schedule shows how assets have been allocated to SMP markets (and therefore how asset costs are recovered from the charges that stakeholders face), we disagree with CFL that it is necessary to show whether assets sit in Openreach division or other parts of BT. We consider that doing so would make the schedule overly complicated and would not necessarily align with how assets are held and operated in BT.⁶⁷

3.74 We also disagree with CFL that it is necessary to show separate schedules for the opening and closing balances as the focus of our cost modelling is on MCE and this schedule is intended to provide further information on the MCE presented in the performance summary by market schedule. BT will be required to show how MCE relates to opening and closing asset values in its reconciliation statement (see section 4) consistent with current requirements.

Adjusted financial performance schedule

Our proposals

3.75 To date, we have required BT to adjust SMP market returns in the Adjusted Financial Performance Schedule to estimate the impact of changes that we made to certain costs when setting prices. It was introduced in the 2014/15 RFS at a time when some large and longstanding adjustments were made to prices which were not reflected the RFS.⁶⁸ To provide stakeholders with a better understanding of the impact of regulatory decisions at a market review level and to help them interpret published returns, we required BT to

⁶⁷ We note that Openreach Ltd does not own any non-current assets (as can be seen from Openreach Limited's 2020 statutory accounts). Openreach division manages assets on behalf of BT as set out in the [Commitments of BT Plc and Openreach Ltd to Ofcom](#). Further, the BT annual report does not report a balance sheet for Openreach division, though note 4 of the BT Group financial statements discloses the capital expenditure incurred within Openreach division.

⁶⁸ Examples include the RAV (regulatory asset value) adjustment (affecting the valuation of duct) and the HON (hypothetical ongoing network) adjustment (which typically increased the value of BT's asset base in relevant markets to the level we would expect for an ongoing network).

illustrate the impact of some the larger adjustments on the reported returns in the Adjusted Financial Performance Schedule.

- 3.76 In the February 2020 Consultation we considered that the original justification for the schedule no longer as applied as the number of significant differences between the way we set prices and the way costs are reported had reduced,⁶⁹ the adjustments shown in the schedule were small⁷⁰ and there was a risk of giving the impression that we were somehow “fine-tuning” the reported returns, rather than trying to help stakeholders interpret the published numbers.
- 3.77 We therefore proposed to remove the requirement on BT to produce the Adjusted Financial Performance Schedule.

Stakeholders responses

- 3.78 BT and CFL agreed with our proposal.⁷¹ TalkTalk said the effects of adjustments such as the HON on returns should still be noted, where they are used.⁷²

Our reasoning and decisions

- 3.79 We have decided to remove the requirement on BT to produce the Adjusted Financial Performance Schedule for the reasons set out in the February 2020 Consultation and summarised above.
- 3.80 We recognise that in some circumstances there may be a difference between how the RFS is prepared and our approach to pricing. We draw attention to some of these differences in section 4 (e.g. accelerated copper depreciation) but note we have not made any HON adjustments in this review.

Implementation

- 3.81 The market level schedules are included in the ‘form and content’ direction in Volume 7. We have removed references to the Adjusted Financial Performance Schedule from the SMP condition and associated directions in Volume 7.

Service level information

Proposals

- 3.82 We proposed to require BT to publish service level information on SMP markets.
- 3.83 We said this information currently consists of internal and external revenues, volumes, prices and, for some services, FAC. We proposed to require BT to publish operating costs,

⁶⁹ For example, the RFS are now prepared on a RAV basis, while we have not used HON adjustments in this review.

⁷⁰ In the 2019/20 RFS the impact was to reduce WLA returns from 7.1% to 6.7% and business connectivity returns from 10.0% to 9.9%.

⁷¹ BT response to February 2020 Consultation, paragraph 4.8 and CFL response to February 2020 Consultation, page 23

⁷² TalkTalk response to the February 2020 Consultation, paragraph 5.3.

MCE and return on MCE (ROCE) instead of FAC as we considered it would be more meaningful to stakeholders and allow a direct comparison to cost information published in the market level schedules.

Stakeholder responses

- 3.84 Most stakeholder comments focused on the detailed service level reporting requirements for each SMP market, which are discussed below.
- 3.85 BT considered that ROCE should only be reported by market. BT said our proposals gave undue prominence to service returns which it considered were not meaningful, giving the example of our proposal in the January 2020 Consultation to move some shared costs from MPF to FTTC. BT said this means the RFS could show over-recovery on one service and under-recovery on another.⁷³
- 3.86 Vodafone said that BT's SMP is remedied at a service level in each SMP market and it is important the RFS presents information at a service level. It considered that summary results for the SMP market alone would not demonstrate if Ofcom's remedies have addressed the identified SMP.⁷⁴
- 3.87 Vodafone agreed that publishing service operating costs, capital employed and ROCE would be more helpful than the current cost information.⁷⁵ CFL also agreed that presenting ROCE would be useful to stakeholders. However, it considered that unit costs should be published for ease of comparison with prices.⁷⁶

Our reasoning and decisions

- 3.88 We have decided to require BT to publish service level information because it can help demonstrate BT's compliance with remedies (e.g. safeguard caps, basis of charges obligations and no undue discrimination), show the impact of our decisions on the performance of services in SMP markets (e.g. trends in usage and returns associated with regulated services) and, in some cases, illustrate the effectiveness of the remedies imposed (e.g. by comparing trends in costs against charges set by reference to BT's costs).
- 3.89 We consider information on internal and external revenues, volumes and prices should continue to be provided where this will help stakeholders assess BT's compliance with, and the overall impact and effectiveness of, our remedies on particular services or groups of services.
- 3.90 In line with our proposals, we consider that it would be more meaningful if service costs, where required, were presented on the same basis as market level costs discussed above, i.e. operating costs, MCE and a ROCE, so that they could be directly compared across markets. It would also make the ROCE earned by each reported service transparent which

⁷³ BT response to February 2020 Consultation, paragraphs 4.10 to 4.13. BT.

⁷⁴ Vodafone response to February 2020 Consultation, paragraph 4.1.

⁷⁵ Vodafone response to February 2020 Consultation, paragraph 4.3.

⁷⁶ CFL response to February 2020 Consultation, page 30.

would make it clearer which services contribute to market returns and allow an assessment of the impact and effectiveness of remedies imposed.⁷⁷ For these reasons, and noting some stakeholders supported our proposals, we disagree with BT that service level returns are not meaningful. Although we sometimes make adjustments to BT's costs for the purposes of setting prices which are not reflected in the RFS, we consider the resulting service returns would be consistent with stakeholder expectations given our pricing approach and allow them to assess the effectiveness of remedies by reference to trends in costs and returns that have been prepared on a consistent basis between across services and SMP markets. Further, where BT considers its cost attribution methodology could be amended to provide a fairer reflection of service costs, it can propose changes through the annual CCN process discussed in section 4.

- 3.91 We have therefore decided to require BT to report separately internal and external operating costs, MCE and ROCE for each service where cost reporting is required. This replaces service FAC reporting. This is reflected in the market summary schedules set out below.
- 3.92 We have decided that cost information should be published on a total (£m) basis rather than a unit cost basis as it will ensure cost information is published even where reported services have no clear volume measure, or where they aggregate costs for multiple services with different volume measures. However, we note that where volume information is published, estimates of unit costs could be derived by combining cost and volume information.⁷⁸
- 3.93 Later in this section we set out our decisions on which combination of services and baskets BT will be required to publish for each SMP market.

Implementation

- 3.94 The service level schedules are included in the 'form and content' direction in Volume 7.

Breakdown of service level costs

Proposals

- 3.95 To date, where we have required BT to publish service level FAC, we have also required it to provide a breakdown of service FAC by cost component and a schedule showing how the unit cost of each cost component is calculated (the 'Network Activity Statements').⁷⁹

⁷⁷ For example, while comparing revenues to FAC can indicate whether or not returns are above the cost of capital, it is not straightforward to assess the extent to which returns exceed WACC.

⁷⁸ As costs in service level schedules are rounded to £0.1m, estimated unit costs could differ from actual unit costs, especially for low cost services.

⁷⁹ See Appendix 1 on page 125 of the 2019/20 RFS. BT's cost attribution system attributes costs through several layers of cost pools and they ultimately end up in cost components. These cost components are then attributed to services using volumes and usage factors.

- 3.96 We proposed to remove the requirement to publish component cost information and instead require BT to provide a breakdown of service operating costs and MCE on the same basis as our proposal for market level costs.

Stakeholder comments

- 3.97 No stakeholders disagreed with our proposal to require BT to publish a breakdown of service level costs. CFL and Frontier supported our proposals.⁸⁰ CFL also said that where we set prices by reference to BT's costs, we should require BT to publish an analysis of actual costs against our price modelling assumptions, alongside an explanation of any variances.⁸¹

Our reasoning and decisions

- 3.98 We have decided to require BT to publish a breakdown of service level costs because it can help stakeholders assess the extent to which our remedies are addressing some of the underlying competition concerns and how service costs have developed since our decision. Publishing this information will also help stakeholders understand the impact of BT's cost attribution decisions and provide assurance that attributions have been made appropriately and that the RFS are reliable.
- 3.99 While cost components represent the building blocks used by BT to prepare its RFS, we consider it would be more helpful to present service cost breakdowns using cost categories consistent with the market level breakdowns. Service cost breakdowns would then be directly comparable across markets, which we consider would help stakeholder understand the impact of BT's cost attribution decisions.⁸² We have therefore decided to require BT to provide a breakdown of service operating costs and MCE on the same basis as the market level costs (see Tables 3.2, 3.3 and 3.4 above).
- 3.100 We do not consider we can require BT to explain why our price modelling assumptions have not been borne out, since BT is not in control of our price modelling assumptions. Therefore, where we have set prices by reference to BT's costs, we do not think it would be appropriate or proportionate to require BT to publish an analysis of its actual costs against our price modelling assumptions. We have published our cost models alongside this Statement in as much detail as possible which will give stakeholders some ability to compare our assumptions with actual costs during the review period.⁸³

⁸⁰ Competition Financial Ltd response to February 2020 Consultation, page 31 and Frontier response to February 2020 Consultation, page 25.

⁸¹ Competition Financial Ltd response to February 2020 Consultation, page 32. CityFibre made a similar point regarding actuals vs forecasts in relation to the PI market in paragraphs 1.57 to 1.60 of its response to the February 2020 Consultation.

⁸² This is difficult at the moment since while some cost components are shared across markets, many are specific to particular markets.

⁸³ Though the RFS is not always prepared on a basis consistent with our approach to pricing, and changes in BT's business and attribution methodologies during the review period may mean that actuals are not directly comparable with our forecasts. In section 4 we set out some requirements on BT to prepare the RFS on a basis consistent with our cost modelling.

Implementation

3.101 The proposed service level schedules are included in the ‘form and content’ direction in Volume 7.

Requirements for each SMP market

3.102 This section focuses on the specific requirements for each SMP market in terms of information to be published in the RFS. Given our decisions above, published information broadly falls into three categories: market level information, service level information, and any additional market specific reporting. Below we set out our decisions in relation to:

- The market level information to be published in the RFS;
- The service level information to be published for each SMP market; and
- Any additional reporting required for each SMP market.

Our main decisions for each SMP market are to require:

- Market level information for all SMP markets and shared ancillaries
- Some service level reporting for all SMP markets and shared ancillaries
- Additional reporting for PI (network adjustments) and WLA Area 3 (FTTP roll out).

Market level information to be published in the RFS

3.103 Market level information refers to the performance summary by market, attribution of wholesale current costs and attribution of wholesale MCE schedules.

Proposals

3.104 We proposed to require BT to publish market level information for each of the SMP markets and shared ancillaries.

Stakeholder responses

3.105 No stakeholders commented on our proposal to require market level schedules for each SMP market and shared ancillaries. Comments generally focused on the service level information discussed in the next section.

Our reasoning and decisions

3.106 We consider that where we find BT has SMP in a market, and we impose regulatory reporting obligations, it is important to require BT to publish some information relating to that market. In our view, information on market revenues, costs and returns would generally represent the minimum level of detail on SMP markets that would allow stakeholders to have reasonable confidence that BT has complied with its SMP conditions,

is providing the required data to Ofcom and the reporting regime overall is working as planned.⁸⁴

- 3.107 The market level schedules show the results of BT's cost allocations between individual regulated markets and between regulated and unregulated markets. We consider that providing stakeholders with the opportunity to assess the outcome of cost attributions provides reasonable assurance to stakeholders that such costs have been allocated consistently and appropriately. It can also mitigate the risk that costs might be unreasonably loaded onto particular markets (and services) since it allows stakeholders to scrutinise and challenge the outcomes of the bases of attribution.
- 3.108 Publication of market level information also allows stakeholders to assess the impact and effectiveness of the remedies imposed, for example by reference to trends in revenues, costs and returns that have been prepared on a consistent basis. This enables stakeholders to contribute to the regulatory regime, bring issues to our attention and ultimately ensure that SMP conditions including our price controls continue to address underlying competition issues.
- 3.109 For these reasons, we have decided to require BT to publish market level information for each of the SMP markets and shared ancillaries.

Service level information to be published in the RFS

- 3.110 Service level information includes the revenue, volume, price and costs of specific services or groups of services associated with relevant markets.

Proposals

- 3.111 In the February 2020 Consultation we said the objectives of publishing service level information included assessing compliance with remedies, assessing the impact and effectiveness of remedies, understanding the impact of BT's cost attribution decisions and contributing to an open and competitive market.
- 3.112 We said that, in general, we considered that service level information should be published at the level at which prices are regulated (e.g. basket, sub-basket or individual service level) but we may require BT to publish more detail or group services together depending on the circumstances.
- 3.113 For each service or group of services, we proposed that BT must publish internal and external volumes, revenues and prices. Where appropriate, we also proposed that BT must report service level operating cost, MCE and returns information and a breakdown of these costs.

⁸⁴ Publication of market level information is also consistent with the 2005 EC Recommendation which recommends that such information is published for relevant markets.

Stakeholder responses

- 3.114 CFL said that information should be provided for all services, or basket of services, where a cost-based price cap or cost orientation obligation applies. It said other service reporting may also be appropriate depending on the nature of regulation.⁸⁵
- 3.115 Other responses focused on the service reporting for individual SMP markets, discussed below, rather than the objectives and principles set out in this section.

Our reasoning and decisions

- 3.116 We have decided to adopt our consultation proposals when considering what service level information to require BT to publish. The objectives of publishing service level information include:
- **Assessing compliance with remedies.** For example, publishing internal and external service level information helps demonstrate compliance with no undue discrimination obligations (e.g. by showing differences between internal and external prices) and provides information to help assess compliance with charge controls and their ongoing effectiveness.⁸⁶ It also helps demonstrate that BT is complying with its accounting separation obligations.
 - **Assessing impact and effectiveness of remedies.** Service level information helps assess the extent to which our remedies are addressing some of the underlying competition concerns and provides financial indicators that help stakeholders understand how regulated services develop over the review period. For example i) where charge controls are cost based and designed to allow BT the opportunity to recover its costs, publishing cost information helps assess the effectiveness of those controls and ii) where there are concerns about discriminatory behaviour, service level information provides transparency about the relative usage of services by BT and external telecoms providers which could help assess if those concerns have been addressed.
 - **Understand the impact of BT's cost attribution decisions.** Where costs are shared with services in the same market or in other markets, enabling stakeholders to see the effects of BT's attribution of costs on different services provides reasonable assurance that attributions have been made appropriately and that the RFS are reliable.
 - **Contribute to an open and competitive market.** Publishing service level information allows stakeholders to identify and bring issues to our attention which adds credibility to the regulatory accounting regime and ultimately contributes to an open and competitive market.
- 3.117 In general, we consider that service level information should be published at the level at which prices are controlled (e.g. basket, sub-basket or individual service level). However, in some circumstances we may require BT to publish information on individual services within a basket where this meets any of the objectives above. Similarly, we may require BT to

⁸⁵ CFL response to February 2020 Consultation, page 31.

⁸⁶ For example, cost information where services are subject to basis of charges obligations, revenue information used in basket weightings and price information to compare average prices to price caps.

report groups of services rather than individual services where it would not be proportionate to require detailed service reporting⁸⁷ or to ensure the overall coherence of the RFS.⁸⁸

- 3.118 In the rest of this section, we set out our decisions for service level information to be published in the RFS for each SMP market and shared ancillaries.
- 3.119 For each service or group of services we identify, BT must publish internal and external volumes, revenues and prices. Where appropriate, BT must also report service level cost information (operating costs, MCE and ROCE), and a breakdown of service level operating cost and MCE.
- 3.120 For some markets we also require additional reporting to monitor the impact and effectiveness of particular remedies e.g. network adjustments for PI and FTTP roll out in WLA Area 3.⁸⁹

Physical infrastructure

Proposals

PI rentals

- 3.121 We proposed that BT must publish revenue, volume, average price and cost information for PI services, split between internal and external customers, at the level that they are regulated (i.e. each duct, footway box and pole charge). We also proposed that BT separately report PI rentals (i.e. external purchases) and those rentals provided as inputs to downstream services, consistent with current requirements.
- 3.122 In relation to lead-in duct, we proposed that BT publishes information on the simplified lead-in product consulted on in the January 2020 Consultation.⁹⁰

Network adjustments and other ancillaries

- 3.123 We proposed that BT must publish revenue, volume, average price and cost information for network adjustments above the financial limit, split between internal and external customers. We also proposed that BT should publish:
- A schedule showing the operating costs and MCE associated with network adjustments and how these are split between those below and above the financial limit. Of those below the limit, the schedule should show whether they have been included in the

⁸⁷ For example where the remedy is at the individual service level but each service is relatively small it may be proportionate to limit the number of services reported in the RFS by aggregating some services.

⁸⁸ For example, where only some services in a market are subject to charge controls we may require an aggregation of 'other services' in that market to be reported so that service totals reconcile to market totals.

⁸⁹ In line with our decisions in this section, BT is not required to publish component cost information.

⁹⁰ See paragraphs 5.45 to 5.55, Volume 4, January 2020 Consultation. The simplified lead-in product would replace the existing lead-in duct, lead-in link duct and associated facility hosting products.

‘inputs into existing downstream services’ or ‘PI rentals’ categories. This proposal was consistent with the requirements imposed to date.

- An appendix showing cumulative internal and external network adjustments, both above and below the limit, on an MCE basis.

3.124 We also proposed that BT publish a single line to capture ancillaries required specifically for PI. We said we would expect this to capture PI-specific ancillary services purchased on a one-off basis and would not include any ancillaries included in network adjustments.

3.125 We consulted on three tables showing i) our proposed PI service level schedule; ii) our proposed note on network adjustments; and iii) our proposed appendix on network adjustments.⁹¹

Stakeholder responses

PI rentals

3.126 TalkTalk and CityFibre said that our proposals would enable monitoring of PIA costs and allow stakeholders to see how PIA services are consumed by downstream products.⁹²

3.127 In relation to PI rentals, stakeholders commented on the following themes:

- **Internal PI prices and revenue:** several stakeholders said that, for consistency with the NUD obligation, the charge for Openreach’s internal use of PIA rentals should be based on external PIA charges rather than a ‘balancing charge’.⁹³ CFL noted that our proposed approach would mean the PI market ROCE would always equal the Openreach cost of capital.⁹⁴ CFL considered that not applying external prices to internal transfer charges would also be inconsistent with the accounting separation remedy as the PI market would not be accounted for as if it were a separate business and users would not be able to assess the performance of the PI market.⁹⁵
- **Pole service detail:** BT said the pole service detail was unnecessary and that this information should be provided privately to Ofcom instead.⁹⁶ However it said that it could estimate the costs of these pole services using an apportionment mechanism (based on operational data relating to the type of pole equipment, year of preservation and estimated unit cost) and was happy to report costs on this basis.⁹⁷

Network adjustments and other ancillaries

3.128 CityFibre said it agreed that our proposals on network adjustments would help demonstrate BT’s compliance with the no-undue discrimination requirements and provide

⁹¹ See Tables 4.4 to 4.6 of the February 2020 Consultation.

⁹² Responses from TalkTalk (paragraph 3.6) and CityFibre (paragraph 1.56) to the February 2020 Consultation.

⁹³ The following responses to the February 2020 Consultation made this point: CFL (section 5.1), CityFibre (paragraphs 1.34 – 1.38 and 1.41 – 1.43), Frontier (page 27).

⁹⁴ CFL response to February 2020 Consultation, section 5.1.

⁹⁵ CFL response to February 2020 Consultation, section 5.1.

⁹⁶ BT response to February 2020 Consultation, paragraph 4.4.

⁹⁷ BT response to February 2020 Consultation, paragraph 4.17.

confidence to stakeholders that it is accounting for these separately.⁹⁸ CityFibre considered that internal network adjustments should be charged on the same basis as external network adjustments.⁹⁹

Other comments

3.129 CFL questioned why some duct assets appeared to be reported outside of the PI market in the RFS and whether some duct assets had been double counted in Openreach and the rest of BT.¹⁰⁰

Our reasoning and decisions

Summary of remedies imposed

- 3.130 We first summarise some of the other remedies imposed in the PI market as reporting information could be used to assess the impact and effectiveness of these, as well as monitor BT's compliance.
- 3.131 In Volume 4 we set cost-based controls on PI rentals for duct, footway box and pole services. We have only set charges for external customers, based on what we considered to be a fair contribution from external customers to total PI costs. We also imposed a basis of charges obligation on PIA ancillaries.
- 3.132 In Volume 3 we also imposed a no undue discrimination requirement on BT in the PI markets and in Annex 8 we explain how we interpret this requirement in relation to pricing for PI rentals and ancillary charges such as network adjustments.

PI rentals

Format of the PI market schedule

- 3.133 We have decided that BT must publish revenue, volume, average price and cost information for PI rentals, split between internal and external customers, at the level they are regulated (i.e. each duct, footway box and pole charge). We have also decided that BT must separately report external purchases of PI rentals and those rentals provided as inputs to downstream Openreach services.
- 3.134 We consider that publishing this information will demonstrate the impact and effectiveness of the remedies imposed on the PI market, in particular:
- Publishing cost information will help Ofcom and stakeholders assess the effectiveness of the cost-based charge control remedy, for example by showing trends in costs over time.
 - Publishing internal and external revenues and volumes provides transparency about the relative usage of PI services by BT and external telecoms providers and indicates

⁹⁸ CityFibre response to February 2020 Consultation, paragraph 1.46.

⁹⁹ CityFibre response to February 2020 Consultation, paragraph 1.47.

¹⁰⁰ CFL response to February 2020 Consultation, pages 37 and 39.

how take up of PI is developing. In turn, this helps stakeholders assess the effectiveness of our remedies and contributes to an open and competitive market by allowing stakeholders to bring issues to our attention.

- Showing external average prices allows stakeholders to see how these compare to the charge controls and, where non-Openreach parts of BT purchase PI rentals, that this meets no undue-discrimination requirements.
- Showing the same service headings under 'PI rentals' and 'inputs to downstream Openreach services' helps demonstrate and promote confidence that BT is attributing PI costs to downstream markets, including charge-controlled services, on a fair and objective basis, in turn providing reasonable assurance that our charge control of PI services is effective to enable fair and effective competition.

Internal PI rental prices and revenue

- 3.135 We explained in Volume 4 that we have set charges for external PI rentals based on what we think is a fair contribution to total PI costs. We have not set 'internal' PI prices – i.e. prices that Openreach should charge itself for using PI.
- 3.136 We said in Annex 8 that any concerns about discrimination between the level of rental charges paid by external customers and what Openreach pays for its use of the PI infrastructure are sufficiently addressed by our approach to setting external PI rental charges – i.e. in relation to PI rental prices we do not have a concern relating to undue discrimination. However, we were clear that we expect downstream divisions of Openreach (e.g. BT Enterprise) to pay the external PIA price where they purchase PI services.
- 3.137 We consider our reporting requirements in relation to internal PI prices and revenue, described below, are consistent with our approach to setting PI rental prices and our explanation of how the no undue discrimination obligation will be interpreted for PI rental prices.
- 3.138 Openreach recovers the balance of costs not recovered from external users of PI from its downstream services. The PI cost to be attributed to downstream Openreach services represents total PI rental costs (including a return on capital employed) net of any external purchases of PI (e.g. from sales to external customers and other parts of BT like BT Enterprise). The PI cost transferred to downstream Openreach markets, along with the corresponding 'internal revenue', is captured by the PI rental services reported under the 'inputs to downstream services' heading.
- 3.139 Within this PI schedule, we expect the price for 'PI rental' services (external purchases) to reflect the regulated prices we have set and revenue for PI rentals will equal the regulated price multiplied by volumes. However, revenue for the 'inputs to downstream Openreach markets' cannot be calculated by multiplying price and volume as there is no internal price. Instead, we would expect internal prices for 'inputs to downstream Openreach markets' to be imputed from internal revenues and volumes (where internal revenue is set equal to the balance of PI rental costs as described above).

3.140 This approach to estimating internal PI rental revenue will mean that the reported ROCE for total PI rentals should equal the ‘Openreach’ WACC determined in this review (which is the WACC applicable to PI services).¹⁰¹ However, we disagree with CFL that this means it will not be possible to assess the performance of the PI market. Users of the RFS will be able to assess aspects of performance such as the returns on external PI purchases, the take up of PI services, trends in total PI costs and the proportion of PI costs attributed to downstream Openreach services.¹⁰²

Pole service detail

3.141 We consider it is important that BT reports financial information on each pole rental product for which we have set prices, for the same reasons given above in relation to all PI services. We recognise that BT may not record cost information on each individual pole service and expect it to use an apportionment methodology to allocate total pole costs to individual pole services.

Reporting of duct assets

3.142 As CFL noted, in 2019/20 the RFS reported some duct assets outside of the PI market, as follows.

Table 3.5: Duct assets in 2019/20 RFS

Market	Value, £m	% of total
PI	4,837	88%
WLA	464	8%
Openreach residual	215	4%
Rest of BT residual	8	0.1%
Total	5,524	100%

Source: page 34, 2019/20 RFS.

3.143 BT said that duct assets reported in the WLA market related to cabinet connectivity (e.g. cabinets and connecting duct), the duct in Openreach residual related to repayment works and the small amount of duct against rest of BT residual was a mapping error and did not actually relate to duct.¹⁰³

3.144 While in principle the remedies in the PI market apply to all duct, we recognise that in practice some duct assets may not be shareable (or useful in the case of small pieces of duct). For the purposes of reporting duct assets in the RFS, we consider BT’s approach is

¹⁰¹ This is because the internal revenue for ‘inputs to downstream Openreach markets’ is set equal to total PI rental costs (including a return on capital) less external PI rental revenue. Therefore, total PI rental revenue will always equal total PI rental costs (including a return on capital), such that the reported ROCE will equal the relevant WACC.

¹⁰² We are not specifying how PI costs should be allocated to downstream Openreach services, but they should be attributed on a basis consistent with the Regulatory Accounting Principles (e.g. using objective and cost causal methodologies). Further, as set out in this volume, we are requiring BT publish a diagram illustrating how PI costs are allocated to downstream SMP markets. Any changes to BT’s approach must be set out in its annual CCN along with the impact of the changes. We consider that these points will help stakeholders identify any concerns with BT’s cost allocations.

¹⁰³ BT response dated 17 December 2020 to Q26 of the s135 notice dated 18 November 2020.

generally reasonable¹⁰⁴, but we consider it should provide an explanation for any duct and pole assets reported outside of the PI market in future to ensure this is visible to stakeholders. We have added a requirement for BT to do this.¹⁰⁵

- 3.145 CFL also questioned whether some duct assets had been double counted in Openreach and rest of BT, as BT's 2019/20 CCN¹⁰⁶ indicated that the creation of the PI market gave rise to an elimination of £331m for duct assets.¹⁰⁷ BT told us this elimination related to the treatment of 'e-PPCs' (element partial private circuits), which are Openreach internally supplied 'part services' that provide the access network and backhaul network elements for the rest of BT to provide downstream services.¹⁰⁸ In 2019/19, BT said duct assets for these part services were reported in Openreach residual and also in downstream markets (e.g. TISBO and WBA), with an elimination needed to avoid any double counting in the RFS overall. BT said that when the PI market was created, part services no longer included duct assets, so the 2019/20 CCN showed the impact of reversing these entries.

Network adjustments and other ancillaries

- 3.146 Network adjustments are undertaken by Openreach to make its physical infrastructure accessible and ready for use by other telecommunications providers. As set out in Volume 4, costs associated with network adjustments should be included in the cost base of PI rental services, except where they exceed a financial limit of £4,750 (per km of spine duct). Ancillaries are additional services which are necessary to make use of PI.
- 3.147 In Annex 8 we explain that, under the no undue discrimination requirement, BT should charge itself internal transfer charges for PI ancillaries and network adjustments which are consistent with those faced by competing telecoms providers (to the extent that a different approach cannot be justified). This means that costs of network adjustments above the financial limit which are incurred to support BT's own deployments should be attributed entirely to Openreach's downstream products, and not spread across all users of the physical infrastructure.
- 3.148 We have decided that BT must publish revenue, volume, average price and cost information for network adjustments above the financial limit, split between internal and external customers. This will help demonstrate BT's compliance with the no-undue discrimination requirements and provide reasonable assurance to stakeholders that it is accounting for these separately.
- 3.149 In addition, BT must publish a single line to capture ancillaries required specifically for PI. We expect this to capture PI-specific ancillary services purchased on a one-off basis and exclude any ancillaries included in network adjustments.

¹⁰⁴ Though we expect the mapping error affecting Rest of BT residual to be corrected.

¹⁰⁵ We have added this requirement to the Attribution of Mean Capital Employed Schedule in the form and content direction in Volume 7.

¹⁰⁶ The CCN is a document published by BT setting out all the methodology changes it intends to make in its RFS. We discuss the CCN in Section 4.

¹⁰⁷ See page 10 of BT's 2019/20 CCN.

¹⁰⁸ BT response dated 17 December 2020 to Q27 of the s135 notice dated 18 November 2020.

- 3.150 We have also decided to require BT to publish a note showing the operating costs and MCE associated with network adjustments and how these are split between those below and above the financial limit. Of those below the limit, the schedule should show whether they have been included in the ‘inputs into existing downstream services’ or ‘PI rentals’ categories. We consider that this schedule will help demonstrate BT’s compliance with the requirements for accounting for network adjustments set out in section 4.
- 3.151 Finally, we have decided to require BT to publish an appendix showing cumulative internal and external network adjustments, both above and below the financial limit, on an MCE basis. This would mean that, regardless of the treatment of network adjustments in the RFS,¹⁰⁹ stakeholders could compare network adjustments on a consistent basis, and it would help provide assurance that BT was complying with its no undue discrimination obligations.

Format of schedules

- 3.152 The table below shows what the service level information in the published RFS will look like.¹¹⁰ For each service a breakdown of operating costs and MCE will also need to be provided as per our decisions above.

Table 3.6: Format of service level information for PI

Detailed service analysis	Internal Revenue	External Revenue	Total Revenue	Internal Volume	External Volume	Measure	Internal Average Price	External Average Price	Internal opex	External opex	Internal MCE	External MCE	Internal ROCE	External ROCE
	£m	£m	£m				£	£	£m	£m	£m	£m	%	%
Inputs to downstream services														
Lead-in duct														
Spine duct - 1 bore														
Spine duct - 2 bore														
Spine duct - 3+ bore														
Footway box - manholes														
Footway box - joint boxes														
Poles - multi-end-user attachment														
Poles - single-end-user attachment														
Pole top equipment														
Cable up a pole														
Other PI rentals (if applicable)														
Total														
PI Rentals														
Lead-in duct														
Spine duct - 1 bore														
Spine duct - 2 bore														
Spine duct - 3+ bore														
Footway box - manholes														
Footway box - joint boxes														
Poles - multi-end-user attachment														
Poles - single-end-user attachment														
Pole top equipment														
Cable up a pole														
Other PI rentals (if applicable)														
Total														
Ancillary Charges (excl. network adjustments)														
Network adjustments above financial limit														
Other PI Charges (if applicable)														
Total Physical Infrastructure														

¹⁰⁹ For example, all network adjustments below the financial limit are capitalised in the PI market, while external network adjustments above the limit will be expensed in the PI market and internal network adjustments above the limit could be expensed or capitalised in downstream markets.

¹¹⁰ “If applicable” after a service indicates that this row is only needed where necessary to completely report financial information related to the market. For all service level schedules BT can also add rows associated with IFRS15 where applicable as noted above.

3.153 The table below shows the format of the note on network adjustments.¹¹¹

Table 3.7: Note on network adjustments

	Internal opex	External opex	Internal MCE	External MCE
Gross network adjustments				
Less network adjustments above financial limit				
Network adjustments below the limit				
- of which, included in downstream services				
- of which included in PI rentals				

3.154 The table below shows the format of the appendix on network adjustments.

Table 3.8: Appendix on network adjustments restated on an MCE basis

	MCE £m		
	Internal	External	Total
Above the financial limit			
Below the financial limit			
Total			

Wholesale local access

Proposals

WLA service level schedules

3.155 In the February and July 2020 Consultations we proposed that BT must publish revenue, volume, average price, and cost information for the following services, split between internal and external customers in each of Area 2 and Area 3:

- MPF SML1 rentals (charge controlled only)
- FTTC 40/10 rentals (charge controlled only)¹¹²
- FTTC other rentals
- FTTP 40/10 rentals (split between charge controlled and non-charge controlled where applicable)
- FTTP other bandwidth rentals
- Fibre Voice Access (where charge controlled)
- GEA-FTTP Transition (where charge controlled)
- WLA – specific ancillaries (CPI-0%) – separately list each controlled ancillary where total revenue exceeds £5m
- WLA specific ancillaries (£0 cap) – aggregate of all zero capped ancillaries

¹¹¹ Some entries in this table could be blank (e.g. if network adjustments above the limit are expensed) but the appendix (see below) will present these on a comparable basis.

¹¹² FTTC includes G.fast.

- Other ancillaries (all other ancillaries, including those capped at CPI-0% where total revenues less than £5m).
- Other WLA Area 2/Area 3 services (if applicable)

3.156 We published tables showing the proposed format of the WLA Area 2 and WLA Area 3 service level schedules.¹¹³

FTTP rollout in WLA Area 3

3.157 In the July 2020 Consultation we proposed to require BT to publish a note for WLA Area 3 summarising the number of non-subsidised homes passed with FTTP. We proposed the note would show additional homes passed during the year and a cumulative total as at 31 March. We published a table showing the format of the proposed note.¹¹⁴

Special Fault Investigations

3.158 In the February 2020 Consultation we proposed to remove an existing appendix from the RFS showing costs associated with Special Fault Investigations (SFIs) as, under our proposals, total SFI costs would be reported in the WLA market schedules where SFI revenue was above £5m (which we noted was currently the case).

Stakeholder responses

WLA service level schedules

3.159 BT disagreed with our proposal to publish FTTP service cost, revenue and volumes in Areas 2 and 3. BT said it would be commercially sensitive to disclose volume information, which, combined with information on FTTP homes passed, could be used to determine take-up profiles for FTTP. BT said this could inform competitors of the viability of their investments and give them an unfair advantage.¹¹⁵ BT also said that the information could reveal information about the mix of bandwidths supplied, the average discounts customers were receiving and the costs Openreach was incurring in building its FTTP network each year, which it argued would commercially benefit network rivals.¹¹⁶ On this basis, BT proposed to report WLA information on a national basis, rather than split by Area 2 and Area 3.

3.160 BT further argued that:¹¹⁷

- The FTTP 40/10 control is not based on FTTP costs, so monitoring compliance with the control does not require detailed reporting.
- Ofcom's objective is to promote investment in fibre networks. The effectiveness of this policy will be assessed by tracking build volumes over time. Reporting price, volume and cost data will not provide insight into the effectiveness of Ofcom's policies.

¹¹³ See Table 4.7 of the February 2020 Consultation (for WLA Area 2) and Table 5.2 of the July 2020 Consultation (for WLA Area 3).

¹¹⁴ See Table 5.3 of the July 2020 Consultation.

¹¹⁵ BT response to July 2020 Consultation, paragraph 5.2.

¹¹⁶ BT response to February 2020 Consultation, paragraph 4.26

¹¹⁷ BT response to February 2020 Consultation, paragraph 4.27

- Even if Ofcom was concerned about excessive pricing for FTTP, reporting annual costs and revenues for FTTP will not provide insight as the performance of its investment can only be assessed over the long run.
- 3.161 On the other hand, Vodafone said our proposed service level detail was insufficient. In particular, Vodafone said all speeds of FTTC should be reported individually, noting that Openreach had introduced discounted prices for some operators and it was not sufficient to have summary service level information where BT has SMP.¹¹⁸
- 3.162 TalkTalk argued that revenues and costs for MPF and FTTC should be split between regulated services and unregulated services (i.e. where the MPF and FTTC charge controls have been removed) so stakeholders could see the impact of the change in regulation.¹¹⁹

FTTP rollout in Area 3

- 3.163 BT said it was happy to provide a note on FTTP premises passed in line with our proposal.¹²⁰
- 3.164 TalkTalk said information on FTTP losses that the RAB is designed to cover should be published so stakeholders can assess if there is under or over remuneration of Openreach's FTTP rollout.¹²¹

Special Fault Investigations

- 3.165 No stakeholders commented on our proposals.

Our reasoning and decisions

Summary of remedies imposed

- 3.166 We first summarise some of the other remedies imposed in the WLA Area 2 and WLA Area 3 markets as regulatory reporting information could be used to assess the impact and effectiveness of these, as well as monitor BT's compliance.
- 3.167 In Volume 4 we decided to impose the following controls in these markets:
- **MPF and FTTC in Area 2 and Area 3:** Charge control on MPF SML1 rentals and FTTC 40/10 rentals, inflation-adjusted from 2021 levels (CPI-0%). Once ultrafast coverage exceeds 75% of an exchange area, BT will no longer be required to offer new copper services (a 'stop sell') at those premises where fibre is available and a control on FTTP 40/10 rentals will be introduced (based on the FTTC 40/10 rental price plus a fibre premium). Once ultrafast coverage in an exchange area is complete and after a minimum of two years has passed since the introduction of the 'stop sell', the controls on MPF and FTTC 40/10 will be removed.
 - **FTTP controls where FTTC is not available:** Where an FTTC 40/10 service is not available in either Area 2 or Area 3, we imposed a charge control on the FTTP 40/10

¹¹⁸ Vodafone response to February 2020 Consultation, paragraph 4.6.

¹¹⁹ TalkTalk response to February 2020 Consultation, paragraph 3.7.

¹²⁰ BT response to July 2020 Consultation, paragraph 5.1

¹²¹ TalkTalk response to February 2020 Consultation, paragraph 3.7.

rental. The control will be equal to the charge controlled MPF plus GEA FTTC 40/10 price including the 40/10 fibre premium.¹²²

- **SOGEA 40/10 rentals in Area 2 and Area 3:** The first year maximum charge is equal to the MPF plus FTTC 40/10 charge, with subsequent charges inflation adjusted (CPI-0%).¹²³
- **WLA-specific ancillaries.** Single product or basket controls of CPI-0% on around 25 WLA-specific ancillaries across Area 2 and Area 3. Several ancillary charges capped at £0 (MPF soft ceases, GEA (FTTC and FTTP) ceases, GEA Cablelink rentals (1Gbit/s and 10Gbit/s) and, in some circumstances, FTTP 40/10 connections.¹²⁴
- **Fair and reasonable charges:** All other WLA services are subject to a fair and reasonable charging condition.¹²⁵

3.168 In Volume 4, we decided to set charge controls in Area 3 for MPF and GEA FTTC 40/10 services at CPI-0% as part of a forecast-RAB approach.

3.169 In Volume 3 we also imposed a no undue discrimination obligation on BT in relation to services in each of these markets.

WLA service level schedules

3.170 In each of WLA Area 2 and WLA Area 3 we have decided that BT must publish revenue, volume, average price and cost information for the following services, split between internal and external customers:

- MPF SML1 rentals (charge controlled)
- MPF other rentals
- FTTC 40/10 rentals (charge controlled)
- FTTC other rentals
- FTTP 40/10 rentals (charge controlled, where applicable)
- FTTP 40/10 rentals (non-charge controlled, where applicable)
- FTTP other rentals
- SOGEA 40/10 rentals (charge controlled)
- SOGEA other rentals
- WLA – specific ancillaries (CPI – 0%) – separately list each controlled ancillary where total revenue exceeds £5m
- WLA specific ancillaries (£0 cap) – aggregate of all zero capped ancillaries
- Other ancillaries (all other ancillaries, including those capped at CPI-0% where total revenues less than £5m).
- Other WLA services (if applicable)

¹²² In Volume 4 we explain this was a change to our proposal to impose controls on FVA and GEA-FTTP Transition Services as those products are no longer available.

¹²³ The November 2020 Consultation explained that this was a change from our January 2020 Consultation proposal to apply fair and reasonable charges to SOGEA.

¹²⁴ See section 5 of Volume 4 for details of the controls on ancillary products.

¹²⁵ See Volume 4.

- 3.171 We consider that requiring BT to publish information on these services is consistent with the level that charges are regulated (e.g. individual controls on MPF, FTTC, SOGEA and FTTP rentals as well as ancillaries).
- 3.172 We are requiring BT to publish information on all MPF and FTTC rentals (split between charge controlled MPF SML1 and FTTC 40/10 rentals and other MPF and FTTC rentals) to enable a comparison of these services across Area 2 and Area 3 and allow stakeholders to assess the outcome of BT's cost attributions between these products and between areas.¹²⁶
- 3.173 In addition, the 'other' MPF and FTTC rental services will include information on non-charge controlled services¹²⁷ and we agree with TalkTalk that this could help demonstrate the impact of our regulation, showing, for example, how the mix of charge controlled and other MFP/FTTC rentals changes over time as ultrafast coverage develops. We are therefore requiring BT to publish information on 'MPF other rentals' for consistency with our proposal for BT to publish 'FTTC other rentals'.
- 3.174 We generally consider that service level information should be published at the level which charges are controlled but may require BT to publish additional services where it meets one of the objectives above. As we have imposed a charge control on the FTTC 40/10 product we consider it is reasonable to require BT to report on this, as well as all other FTTC rentals in aggregate. We disagree with Vodafone that we should require BT to publish information on each FTTC rental speed. Vodafone did not explain why such a requirement is necessary to achieve our objectives, although it stated that "Openreach have implemented a complex system of offers in this area and has discounted prices for certain operators for specific products in certain circumstances". If Vodafone is seeking further transparency around these offers, we consider that the requirement set out in Volume 3 for BT to notify changes to charges, terms and conditions, including any discounts offered, already provides sufficient transparency. We do not consider that the availability of discounts on FTTC rentals justify additional service level reporting in the RFS in this case. We also note that while 'other FTTC rentals' would aggregate information for multiple bandwidths, ISPs' forecasts suggest that the majority of these will relate to FTTC 80/20 over this review period (see Volume 2, Section 2).
- 3.175 We disagree with BT that reporting of FTTP services is unnecessary. While FTTP 40/10 rentals may not initially be subject to a charge control (except where FTTC is not available), they are subject to no undue discrimination obligations and take-up of FTTP, and the controlled 40/10 product in particular, is an important test of the impact of our SMP

¹²⁶ The 'charge controlled' qualification is required since, once ultrafast rollout is complete and a minimum of two years after the stop sell (triggered by ultrafast coverage exceeded 75% in an exchange area) controls on MPF and FTTC 40/10 rentals will be removed. This means that when ultrafast coverage in an exchange is complete, Openreach will have pricing freedom on copper services where FTTP is available (and hence it could be selling non-charge controlled MPF or FTTC in some exchange areas).

¹²⁷ For example, other MPF rentals will include information on MPF SML2 rentals and non-charge controlled MPF SML1 rentals, and other FTTC rentals will include information on bandwidths other than 40/10 and non-charge controlled 40/10 rentals.

remedies in Area 2 and Area 3, including our charge controls.¹²⁸ Further, separately reporting FTTP rentals allows stakeholders to see the outcome of BT's cost attributions between FTTP and FTTC across Areas 2 and 3. While we agree with BT that the performance of its FTTP investment can only be assessed over the long run, we consider that it is important to publish cost and returns on a regular basis to help assess the impact of the remedies imposed on the performance of these services and help stakeholders understand BT's cost attribution decisions between fibre services and between geographic markets (as noted below).

- 3.176 The information published on FTTP services in WLA Area 2 and 3 will be limited to 40/10 rentals and an aggregate total of all other FTTP rentals. We do not consider this would unfairly benefit other network operators for the reasons argued by BT as:
- While some information on the mix of bandwidths would be provided (i.e. 40/10), we consider this is the minimum requirement consistent with the level of the charge control.
 - Although reporting average price information could allow stakeholders to assess the level of any discounts offered across Area 2 and Area 3 as a whole, individual discounts would not be revealed and we consider it is important to publish average prices to allow stakeholders to compare these to the charge controls and assess compliance with no undue discrimination obligations (as noted below).
 - While cost information will be reported, this is based on an attribution of operating costs and mean capital employed and will not reveal BT's capital expenditure or forward-looking investment plans. Further, as set out in section 4, the cost information will be prepared on a national unit cost basis, and as such will not reveal build costs specifically related to either Area 2 or Area 3.
 - No information on homes passed with FTTP will be published for Area 2 so take up profiles could not be derived by comparing this with FTTP rental volumes. While, stakeholders could estimate historical take up profiles for Area 3 (as information on homes passed with FTTP will be published as set out below), this would be aggregated across Area 3 as a whole and would not reveal information about take up in localised areas.
- 3.177 We have therefore decided to require BT to report FTTP 40/10 rentals separately, split between charge controlled and non-charge-controlled variants, plus an aggregate line for all other FTTP rental services, as per our consultation proposals.
- 3.178 We are not requiring BT to publish information on Fibre Voice Access or GEA FTTP Transition services as these services have been discontinued and in Volume 4 we decided to control FTTP 40/10 rentals where FTTC is not available, rather than these products. We are requiring BT to publish information on FTTP 40/10 rentals (split between charge controlled and non-charge controlled services) as set out above.

¹²⁸ For example, as noted below, publishing revenues and volumes provide transparency about trends and relative usage of these services by BT and external telecoms providers and indicates how take up of these services is developing.

- 3.179 We have also decided to require BT to report SOGEA 40/10 rentals as it is subject to a charge control. For consistency with our approach to charge controlled MPF, FTTC and FTTP products, we are requiring BT to publish an aggregate row for all other SOGEA rentals to enable a comparison of these services across Area 2 and Area 3 and allow stakeholders to assess the outcome of BT's cost attributions between these products and between areas.
- 3.180 Given the large number of WLA ancillaries we consider it would be proportionate, consistent with our consultation proposal, to only require BT to disclose those ancillary services capped at CPI-0% where total revenue exceeds £5m.¹²⁹
- 3.181 We consider that publishing information on the above services in WLA Area 2 and Area 3 promotes confidence in these markets, which in turn creates the conditions for effective competition. For example, it will provide assurance to stakeholders that BT is complying with its obligations and demonstrate the impact and effectiveness of the remedies imposed. In particular, we consider that:
- Publishing internal and external prices helps demonstrate compliance with non-discrimination obligations (e.g. by showing differences between internal and external prices).
 - Publishing internal and external prices allows stakeholders to see how these compare to price caps, where these apply, and enables effective monitoring for enforcement purposes.
 - Publishing cost and returns information will help stakeholders assess the impact of the remedies imposed on the performance of WLA services¹³⁰ and, in some cases, assess their effectiveness (e.g. by comparing trends in costs against charges set by reference to BT's costs). Publication of this information will also help stakeholders understand how service information relates to market level information. Since BT is required to publish the same service level cost information in each of WLA Area 2 and Area 3, it will help stakeholders understand the impact of BT's cost attribution decisions (e.g. how it has implemented its cost accounting obligations for the purposes of allocating costs associated with WLA services between geographic markets).
 - Publishing internal and external revenues and volumes provides transparency about trends and relative usage of these services by BT and external telecoms providers and indicates how take up of these services is developing. This helps stakeholders assess the impact of the remedies imposed.
- 3.182 The table below shows the WLA Area 2 and WLA Area 3 service level information to be published in the RFS from 2021/22. For each service a breakdown of operating costs and MCE will also need to be provided as set out above (see 'Breakdown of service level costs' section).

¹²⁹ For example, in the 2019/20 RFS, the following services reported revenue greater than £5m: MPF New Provides, MPF Single Migrations and Hard Ceases.

¹³⁰ Including by reference to our estimate of Openreach's cost recovery on MPF and FTTC in WLA Area 3 in Annex 16.

Table 3.9 Service level schedule for each of WLA – Area 2 and WLA – Area 3

Detailed service analysis														
Service	Internal Revenue £m	External Revenue £m	Total Revenue £m	Internal Volume	External Volume	Measure	Internal Average Price £	External Average Price £	Internal opex £m	External opex £m	Internal MCE £m	External MCE £m	Internal ROCE %	External ROCE %
MPF rentals (SML1) (charge controlled)														
MPF other rentals														
FTTC 40/10 rentals (charge controlled)														
FTTC other rentals														
FTTP 40/10 rentals (charge controlled) (if applicable)														
FTTP 40/10 rentals (non-charge controlled)														
FTTP other rentals														
SOGEA 40/10 rental (charge controlled)														
SOGEA other rentals														
Ancillaries (CPI-0%) (list each service where total revenue > £5m)														
Ancillaries (£0 cap) (aggregate in a single line)														
Other ancillaries														
Other WLA services														
Rounding														
Total WLA Area 2/Area 3 (as applicable)														

FTTP rollout in WLA Area 3

- 3.183 We have decided to require BT to publish a note for WLA Area 3 summarising the number of non-subsidised homes passed with FTTP as it would help us and stakeholders assess how FTTP rollout is developing against the BT Commitment during the review period.
- 3.184 As per our proposals, the FTTP homes passed data must show the additions for the year and a cumulative total as at 31 March each year. We consider that a premise is passed by FTTP if Openreach's GEA FTTP product is available for connection and supply at that premise. Alongside this note BT must confirm the definition used of homes passed by FTTP.
- 3.185 As the BT Commitment relates to the commercial deployment of fibre to at least 3.2m homes, i.e. net of any government subsidies or other grants, the data published must relate to non-subsidised homes passed with FTTP.
- 3.186 The table below shows what this note will look like.

Table 3.10: Note on FTTP rollout in Area 3

	Measure	Additions for the year	Cumulative total as at 31 March 20XX
Non-subsidised homes passed with FTTP	000s		

- 3.187 In response to TalkTalk's request for us to require publication of BT's 'FTTP losses' that the RAB is designed to cover, in Volume 4 we explained how the RAB will work in this review period, and how we expect it to work going forward. Our approach is designed to give BT the expectation of cost recovery on copper and fibre investments in Area 3 across the life of the assets. Although there will be differences between how the RFS are prepared and how the RAB has been designed (e.g. in relation to accelerated copper depreciation¹³¹), we

¹³¹ We discuss accelerated copper depreciation in section 4.

consider that publishing returns on copper and fibre rentals in WLA Area 3 will give stakeholders an insight into whether BT has recovered costs against these services in aggregate during this review period.

Special Fault Investigations

3.188 We have decided to remove the requirement on BT to publish an appendix showing costs associated with Special Fault Investigations (SFIs).¹³² We note that SFIs are subject to a CPI-0% price cap and given our decision above, financial information on SFIs will be reported in the WLA market schedules where total SFI revenue is above £5m (which is currently the case).¹³³

Leased lines access and inter-exchange connectivity services

Proposals

LL Access and IEC service level schedules

3.189 In the February 2020 Consultation we proposed that BT must publish revenue, volume, and average price for the following services, split between internal and external customers in each of the LL Access Area 2, LL Access Area 3, HNR Area, IEC BT Only and IEC BT+1 markets:

- Ethernet and WDM basket
 - Connections
 - Rentals, split by EAD 1 Gbit/s, Other EAD, EAD LA 1Gbit/s, Other EAD LA and Other rentals
 - Main link
 - Other services
- ECC basket
- Time related charges
- Other ancillaries - separately list each controlled ancillary where total revenue exceeds £5m.

3.190 For these services we also proposed that BT should publish cost information (including ROCE) in each of the LL Access Area 2, LL Access Area 3, IEC BT Only and IEC BT+1 markets (i.e. no cost information would be published for the HNR Area market).

3.191 For the LL Access Area 3 and IEC BT only markets we additionally proposed that BT must publish revenue, volume, average price, cost and ROCE information for the following dark fibre services, split between internal and external customers:

- Dark fibre access

¹³² See page 113 of the 2019/20 RFS.

¹³³ Total SFI revenue in the 2019/20 RFS was almost £20m.

- Connections, split by single and dual fibre
- Rentals, split by single and dual fibre
- Main link
- Patch panels – customer premises
- Patch panels – exchanges
- Initial testing
- Cessation charges
- Right when tested charges

3.192 We published tables showing the proposed format of the LL Access Area 2, LL Access Area 3 and HNR Area service level schedules.¹³⁴ We said that the services reported in the IEC BT Only service level schedule would be the same as that for LL Access Area 3, and that the services reporting in the IEC BT+1 service level schedule would be the same as that for LL Access Area 2.

Time related charges appendix

3.193 BT currently reports some information on time related charges (TRCs) for ethernet services as an appendix to the RFS. We proposed to remove this requirement, noting TRC would be separately reported in the LL Access and IEC market schedules under our proposals.

ECCs note

3.194 We proposed to require BT to include a note under each of the LL Access and IEC market summary schedules of the ECC costs expensed in the year.

Stakeholder responses

3.195 Stakeholder responses focused on the services to be reported in LL Access and IEC market.

3.196 No stakeholders commented on our proposals relating to the TRCs appendix or the ECCs note.

Ethernet and WDM basket

3.197 Vodafone considered that BT should be required to report each EAD service by speed. In particular, Vodafone said that in addition to EAD 1Gbit/s services, EAD 100Mbit/s services should be reported as they are currently the mass market product and EAD 10Gbit/s services should be reported as they will become increasingly used by mobile operators and larger businesses over the review period.¹³⁵ Vodafone said that not reporting these services individually would impair stakeholder's understanding of the development of these markets where BT has SMP.¹³⁶

¹³⁴ See Tables 4.10, 4.11 and 4.12 of the February 2020 Consultation.

¹³⁵ Vodafone response to February 2020 Consultation, paragraph 4.7.

¹³⁶ Vodafone response to February 2020 Consultation, paragraph 4.7.

- 3.198 Vodafone argued that reporting on product lines and understanding profitability as demand moves up the bandwidth ladder will enable the market to understand if competition is providing a constraint and ensuring prices are at the competitive level.

Dark fibre services

- 3.199 Vodafone agreed with our proposal, saying it was important that LL Access dark fibre and IEC dark fibre was separately reported as they serve different purposes and address different forms of market failure.¹³⁷
- 3.200 TalkTalk said that where Ofcom has based prices on bottom up estimates (e.g. patch panels), the costs for these should be reported to identify how accurate the projections were.¹³⁸ It also considered that dark fibre should be reported as an input to leased lines services, similar to how PI costs are an input to downstream services.¹³⁹
- 3.201 BT indicated that it could report costs for patch panels and initial testing services using an apportionment approach.¹⁴⁰

Other comments

- 3.202 CFL said that i) fibre used for core connectivity was supplied by Openreach and ii) core connectivity is part of 'trunk connectivity' and hence should be classified in the IEC markets, but that iii) as core nodes would likely be situated at exchanges where at least two or more other operators are present, core connectivity would sit in the non-SMP IEC market.¹⁴¹ CFL said this meant core fibre should be accounted for within 'Openreach non-SMP' activities in the RFS as a supply of dark fibre to the rest of BT.¹⁴² CFL said its suggestion would not alter the costs reported in any SMP markets but it could affect the results of Openreach division overall, which is reported in the RFS under the requirements of BT's Commitments.¹⁴³

Our reasoning and decisions

Summary of remedies imposed

- 3.203 We first summarise some of the other remedies imposed in the LL Access and IEC markets as regulatory reporting information could be used to assess the impact and effectiveness of these, as well as monitor BT's compliance.

¹³⁷ Vodafone response to February 2020 Consultation, paragraph 4.9

¹³⁸ TalkTalk response to February 2020 Consultation, paragraph 3.7.

¹³⁹ TalkTalk response to February 2020 Consultation, paragraph 3.6. On page 38 of its response, CFL also said that it may be appropriate for downstream BT to purchase dark fibre services from the IEC market rather than PI.

¹⁴⁰ BT response to February 2020 Consultation, paragraphs 4.40 and 7.17.5.

¹⁴¹ CFL supplementary response to the February 2020 Consultation, pages 1 and 2.

¹⁴² CFL supplementary response to the February 2020 Consultation, page 2.

¹⁴³ CFL supplementary response to the February 2020 Consultation, page 2.

- 3.204 In Volume 4 we decided to impose the following controls in these markets. Note that references to IEC BT+2 relate only to the deregulated BT Only and BT+1 exchanges for the transitional period in place until 31 March 2022.¹⁴⁴
- **Dark fibre:** Cost based charge control on rentals, connections and dark fibre ancillaries in LL Access Area 3 and IEC BT only markets. The dark fibre controls also apply to the IEC BT+1 market in 2021/22 under the transitional arrangements. The dark fibre rental prices were derived from costs associated with EAD 1Gbit/s services and EAD LA 1Gbit/s services;¹⁴⁵
 - **Ethernet basket:** A basket subject to a cap of CPI-0% consisting of Ethernet services (across all bandwidths including rentals, connections and main link) across the LL Access Area 2, LL Access Area 3, IEC BT only, IEC BT+1 and IEC BT+2 markets.¹⁴⁶ Main link is subject to a sub-cap of CPI-0% within this basket;
 - **Optical services:** a CPI-0% control on each optical service module component (including rentals, connections, and main link) across the LL Access Area 2, LL Access Area 3, IEC BT only, IEC BT+1 and IEC BT+2 markets.
 - **Excess Construction Charges (ECCs):** Direct ECC basket subject to a CPI-0% cap, and a sub-cap of CPI+5% on individual charges across LL Access Area 2, LL Access 3, IEC BT only, IEC BT+1 and IEC BT+2 markets. There is also a basis of charges obligation on contractor ECCs;
 - **Ethernet Time Related Charges (TRCs):** cap of CPI-0% on each Ethernet TRC across the LL Access Area 2, LL Access Area 3, IEC BT only, IEC BT+1 and IEC BT+2 markets;
 - **Other ancillaries:** cap of CPI-0% for each charge across LL Access Area 2, LL Access Area 3, IEC BT only, IEC BT+1 and IEC BT+2 markets.
 - **Fair and reasonable charging:** applies to services in the LL Access – HNR market and any other services that are not charge controlled or subject to a basis of charges obligation. We said this would help protect customers against a price squeeze.
- 3.205 In Volume 3 we also imposed a no undue discrimination obligation on BT in relation to services in each of these markets.

LL Access and IEC services to be reported

- 3.206 As the controls on different services are similar across LL Access and IEC markets we consider below the services to be reported in the RFS for each category of controlled service before summarising what the service level schedules will look like for each market.

Dark fibre services

- 3.207 Consistent with our proposal, we have decided that BT must publish revenue, volume, average price, cost and ROCE information for the following services, split between internal and external customers):

¹⁴⁴ See Volume 4 Section 3.

¹⁴⁵ See Annex 17.

¹⁴⁶ In the January 2020 Consultation we proposed an Ethernet and WDM (optical) services basket but in Volume 4 we split this into an Ethernet services basket and a separate control on each optical service.

- Connections, split by single and dual fibre
 - Rentals, split by single and dual fibre
 - Main link
 - Patch panels – customer premises
 - Patch panels – exchanges
 - Initial testing
 - Cessation charges
 - Right when tested charges
- 3.208 This information will be published in each of service level schedules for the LL Access Area 3 and IEC BT only markets where BT is required to provide dark fibre services. This information will also be published in the IEC BT+1 market in 2021/22 only, under the transitional arrangements.
- 3.209 As main link could be required as part of an access circuit or an interexchange circuit, we are requiring BT to describe how it has determined where to report main link in the RFS.¹⁴⁷
- 3.210 We consider that publishing information on each of these dark fibre services is consistent with the level of the regulation as each of these services is subject to a cost-based charge control. We consider publishing this information is justified because:
- Publishing internal and external prices helps demonstrate compliance with non-discrimination obligations (i.e. by showing differences between internal and external prices) and allows stakeholders to see how these compare to individual service price caps.
 - Publishing revenue, cost and ROCE information will help stakeholders assess the effectiveness of the cost-based charge controls on dark fibre services.
 - Since we have decided to publish cost information on dark fibre in each of the LL Access Area 3 and IEC BT only markets, it would help stakeholders assess the impact of BT's cost attribution decisions (e.g. how it has implemented its cost accounting obligations when allocating costs of dark fibre between geographic markets).
 - Publishing internal and external revenues and volumes provides transparency about trends and relative usage of dark fibre services by BT and external telecoms providers and indicates how take up of these services is developing (e.g. dark fibre vs active services). This helps stakeholders assess the effectiveness of the remedies.
- 3.211 In response to BT's comments on patch panels and initial testing, we set out in section 4 that BT can prepare costs for these services using an apportionment approach.
- 3.212 We disagree with TalkTalk that dark fibre should be reported as an input to active leased lines services. As explained in Section 3 of Volume 3, we have exempted Openreach from the application of the EOI obligation where dark fibre is used by Openreach as an input to its active services. This means that Openreach is not required to use dark fibre as an input to active leased lines. The reporting obligations on BT are consistent with this.

¹⁴⁷ That is, whether to report main link in the LL Access and/or IEC markets. This requirement also applies to the main link service provided as part of the ethernet and optical services baskets.

Ethernet services basket

- 3.213 Consistent with our proposal, we have decided that BT must publish revenue, volume, average price, cost and ROCE information for the following services, split between internal and external customers (this is consistent with our proposal):
- Ethernet services basket
 - Connections
 - EAD 1Gbit/s rentals
 - Other EAD rentals
 - EAD LA 1Gbit/s rentals
 - Other EAD LA rentals
 - Other rentals
 - Main link
 - Other services (if applicable)
- 3.214 This information will be published in each of the service level schedules for the LL Access Area 2, LL Access Area 3, IEC BT only and IEC BT +1 markets.¹⁴⁸ This information will also be published in the IEC BT+2 market in 2021/22 only, under the transitional arrangements.
- 3.215 We consider that publishing this information is consistent with the level of the regulation (i.e. a basket level control on Ethernet services with a sub-cap on the main link service).
- 3.216 For rentals within the Ethernet services basket, we consider that requiring BT to report EAD, EAD LA, main link and other rentals separately will help provide assurance to stakeholders that they are not subject to undue discrimination.¹⁴⁹ Within EAD and EAD LA, we have decided to require BT to separately report 1Gbit/s rentals and other rentals. This is because the EAD and EAD LA 1Gbit/s variants were used as reference services for our dark fibre rental prices and reporting information on these services could help stakeholders assess the effectiveness of those controls.
- 3.217 While we consider it is proportionate to require BT to publish information on some services within the Ethernet basket for the reasons given above, we disagree with Vodafone that stakeholders will only be able to understand the development of these markets if we require BT to publish information on all EAD services included in the Ethernet basket. We consider that the revenue, cost and returns information we are requiring BT to publish on Ethernet services will allow stakeholders to assess how each LL Access and IEC market is developing (for example in terms of trends in revenue, cost and returns), and to compare performance across markets (as information on the same services will be published in each of these markets).
- 3.218 We also disagree that information is required on all Ethernet services to enable stakeholders to understand if competition is providing a constraint and ensuring prices are at the competitive level. In Volume 4 we recognised that, although the Ethernet basket

¹⁴⁸ As explained below, information on these Ethernet services will also be published for the HNR Area market, omitting cost and ROCE information.

¹⁴⁹ This is also consistent with our approach in the July 2019 RFR Statement - see paragraph 5.64 of that statement.

control would constrain overall prices in the basket, BT could increase prices where competition was weaker. We considered this risk was mitigated due to the presence of PIA nationally and dark fibre in Area 3. Where BT does increase prices significantly, stakeholders will be able to see this in the Openreach price list and understand the impact on revenue and returns for the Ethernet basket from information reported in each LL Access and IEC market.

3.219 We consider that publishing information on these Ethernet services will help stakeholders assess compliance and demonstrate the impact and effectiveness of the remedies imposed, in particular:

- Publishing internal and external prices helps demonstrate compliance with non-discrimination obligations (e.g. by showing differences between internal and external prices) and allows stakeholders to see how these compare to basket and individual service controls.
- Revenue is used to weight price changes in the Ethernet services basket so publishing this information helps show that the information used by BT to demonstrate compliance is reliable.
- Publishing revenue, cost and ROCE information will help stakeholders assess the impact of the remedies imposed on the performance of Ethernet services.
- Publishing cost information for the same services in each of the LL Access and IEC markets will help stakeholders assess the impact of BT's cost attribution decisions (e.g. how it has implemented its cost accounting obligations for the purposes of allocating costs associated with Ethernet services between geographic markets).
- Publishing internal and external revenues and volumes provides transparency about trends and relative usage of these services by BT and external telecoms providers and indicates how take up of these services is developing (e.g. dark fibre vs active services). This helps us and stakeholders assess the effectiveness of the remedies imposed.

Optical services

3.220 As explained in Volume 4, we have decided to impose a CPI-0% control on each rental, connection and main link optical service module component across LL Access Area 2, LL Access Area 3, IEC BT only and IEC BT+1.

3.221 Given the large number of optical services subject to the control, we consider that it is proportionate to require BT only to disclose information on rental, connection and main link optical services. Therefore, we have decided to require BT to publish revenue, volume, average price and cost information, split between internal and external customers, for rental, connection and main link optical service charges.¹⁵⁰

3.222 This information will be published in each of service level schedules for the LL Access Area 2, LL Access Area 3, IEC BT only and IEC BT +1 markets. This information will also be published in the IEC BT+2 market in 2021/22 only, under the transitional arrangements.

¹⁵⁰ Average price and volume information may not be available where services with different volume measures are combined into a single reporting line.

- 3.223 We consider that publishing information on these optical services is consistent with the level of the regulation (i.e. a control on rental, connection and main link optical charges).
- 3.224 We consider that publishing information on optical services will help stakeholders assess compliance and demonstrate the impact and effectiveness of the remedies imposed, in particular:
- Publishing internal and external prices helps demonstrate compliance with non-discrimination obligations (e.g. by showing differences between internal and external prices) and allows stakeholders to see how these compare to the price cap.
 - Publishing revenue, cost and ROCE information will help stakeholders assess the impact of the remedies on the performance of these services.
 - Publishing cost information for the same services in each of the LL Access and IEC markets will help stakeholders assess the impact of BT's cost attribution decisions (e.g. how it has implemented its cost accounting obligations for the purposes of allocating costs associated with optical services between geographic markets).
 - Publishing internal and external revenues and volumes provides transparency about trends and relative usage of these services by BT and external telecoms providers and indicates how take up of these services is developing. This helps stakeholders assess the effectiveness of the remedies imposed.

Direct ECC basket, TRCs and other ancillaries

- 3.225 No stakeholders commented on our proposals and we have decided to require BT to publish revenue, volume, average price and cost information for the following baskets and groups of services, split between internal and external customers¹⁵¹:
- Direct ECC basket
 - Time related charges
 - Other ancillaries – separately list each controlled ancillary where total revenue exceeds £5m
- 3.226 This information will be published in each of the service level schedules for the LL Access Area 2, LL Access Area 3, IEC BT only and IEC BT +1 markets. This information will also be published in the IEC BT+2 market in 2021/22 only, under the transitional arrangements.
- 3.227 We consider that publishing information on these services is consistent with the level of the regulation (i.e. each charge controlled basket or service). Consistent with our approach in WLA markets, we consider that it is proportionate to only require BT to disclose individual ancillaries capped at CPI-0% where total revenue exceeds £5m.
- 3.228 We consider that publishing information on the these groups of services will help stakeholders assess compliance and demonstrate the impact and effectiveness of the remedies imposed, in particular:

¹⁵¹ Average price and volume information may not be available where services with different volume measures are combined into a single reporting line.

- Publishing internal and external prices for some services helps demonstrate compliance with non-discrimination obligations (e.g. by showing differences between internal and external prices) and allows stakeholders to see how these compare to price caps.
- Revenue is used to weight price changes in the ECC basket so publishing this information helps show that the information used by BT to demonstrate compliance is reliable.
- Publishing revenue, cost and ROCE information will help stakeholders assess the impact of the remedies imposed on the performance of these services.
- Publishing cost information for the same services in each of the LL Access and IEC markets will allow stakeholders to assess the impact of BT's cost attribution decisions (e.g. how it has implemented its cost accounting obligations for the purposes of allocating costs associated with optical services between geographic markets).
- Publishing internal and external revenues and volumes provides transparency about trends and relative usage of these services by BT and external telecoms providers. This helps stakeholders assess the effectiveness of the remedies imposed.

HNR Area

- 3.229 Services in the HNR Area are not charge controlled but subject to no-undue discrimination and fair and reasonable charging obligations (compliance with which will be assessed by reference to whether a price squeeze has occurred).
- 3.230 No stakeholders commented on our proposed approach to service level reporting in this market. We have decided that BT must publish service level information on internal and external prices, volumes and revenues to help provide assurance that BT is complying with its no undue discrimination obligations (e.g. by showing differences between internal and external prices, with revenue reconciling to the performance summary by market schedule). Publishing internal and external revenues and volumes provides transparency about trends and relative usage of leased lines services by BT and external telecoms providers and indicates how take up of these services is developing. This helps stakeholders assess the effectiveness of the remedies imposed.
- 3.231 As HNR Area services are not charge controlled, we have decided not to require BT to publish service level cost information for this market.
- 3.232 In line with our proposals, we have decided to require BT to publish information on the same services as in other LL Access markets to enable stakeholders to make comparisons across these markets. Therefore, BT must publish revenue, volume and average price information for the following services, split between internal and external customers:
- Ethernet services:
 - Connections
 - EAD 1Gbit/s rentals
 - Other EAD rentals
 - EAD LA 1Gbit/s rentals

- Other EAD LA rentals
 - Other rentals
 - Main link
 - Other services (if applicable)
- Optical services – rentals
 - Optical services – connections
 - Optical services – main link
 - Direct ECCs
 - Time related charges
 - Other ancillaries (separately listing each ancillary where total revenue exceeds £5m)
 - Other services (if applicable)

Format of LL Access and IEC service level schedules

3.233 This section summarises the service level schedules for each of the LL Access and IEC markets.

LL Access Area 2 and IEC BT+1

3.234 The LL Access Area 2 and IEC BT+1 service level schedules will show the ethernet, optical, ECC, TRC and ancillary service requirements set out above. This information will also be published in the IEC BT+2 market in 2021/22 only, under the transitional arrangements. Note that in 2021/22 the IEC BT+1 market will also include dark fibre services under the transition arrangements.

Table 3.11: Service level schedule for LL Access Area 2 and IEC BT+1

Detailed service analysis	Internal	External	Total	Internal	External	Internal	External	Internal	External	Internal	External	Internal	External
	Revenue	Revenue	Revenue	Volume	Volume Measure	Average Price	Average Price	opex	opex	MCE	MCE	ROCE	ROCE
Service	£m	£m	£m			£	£	£m	£m	£m	£m	%	%
Ethernet services basket													
Connections													
EAD 1Gbit/s rentals													
Other EAD rentals													
EAD LA 1Gbit/s rentals													
Other EAD LA rentals													
Other rentals													
Main link													
Other services (if applicable)													
Total basket													
Optical services - rentals													
Optical services - connections													
Optical services - main link													
Direct ECC basket													
Time related charges													
Ancillaries (list each ancillary where revenue > £5m)													
Other ancillaries													
Other services (if applicable)													
Total													

LL Access Area 3 and IEC BT only

3.235 The LL Access Area 3 and IEC BT only service level schedules will show the dark fibre, ethernet, optical, ECC, TRC and ancillary service requirements set out above.

Table 3.12: Service level schedule for LL Access Area 3 and IEC BT only

Detailed service analysis				Internal	External	Internal	External	Internal	External	Internal	External	Internal	External
Service	Revenue	Revenue	Revenue	Volume	Volume Measure	Average Price	Average Price	opex	opex	MCE	MCE	ROCE	ROCE
	£m	£m	£m			£	£	£m	£m	£m	£m	%	%
Dark fibre services													
Connections - single fibre													
Connections - dual fibre													
Rentals - single fibre													
Rentals - dual fibre													
Main link													
Patch panels - customer premises													
Patch panels - exchanges													
Initial testing													
Cessation charges													
Right when tested charges													
Ethernet services basket													
Connections													
EAD 1Gbit/s rentals													
Other EAD rentals													
EAD LA 1Gbit/s rentals													
Other EAD LA rentals													
Other rentals													
Main link													
Other services													
Total basket													
Optical services													
Optical services - rentals													
Optical services - connections													
Optical services - main link													
Direct ECC basket													
Time related charges													
Ancillaries (list each ancillary where revenue > £5m)													
Other ancillaries													
Other services (if applicable)													
Total													

HNR Area

3.236 The HNR Area service level schedule will show the Ethernet, optical, ECC, TRC and ancillary service requirements set out above. The HNR Area service level schedule will not include cost information.

Table 3.13: Service level schedule for HNR Area

Detailed service analysis	Internal	External	Total	Internal	External	Internal	External
	Revenue	Revenue	Revenue	Volume	Volume		
Service	£m	£m	£m		Measure	Price	Price
						£	£
Ethernet services							
Connections							
EAD 1Gbit/s rentals							
Other EAD rentals							
EAD LA 1Gbit/s rentals							
Other EAD LA rentals							
Other rentals							
Main link							
Other services							
Optical services - rentals							
Optical services - connections							
Optical services - main link							
Direct ECCs							
Time related charges							
Ancillaries (list each ancillary where revenue > £5m)							
Other ancillaries							
Other services (if applicable)							
Total							

Core fibre connectivity

- 3.237 BT's regulatory accounting system has historically distinguished between fibre used for access, backhaul and core connectivity.¹⁵² In Volume 2 we distinguish between access and trunk connectivity.
- 3.238 We agree with CFL that what BT calls 'core fibre' mainly corresponds to the non-SMP IEC market as core nodes are predominantly situated at exchanges where at least two or more other operators are present.¹⁵³
- 3.239 Where core connectivity is provided by Openreach we agree that 'core fibre' should be reported within 'Openreach non-SMP' activities in the RFS. However, we consider that this will be determined by the BT commitments, which set out which assets are operated and managed by Openreach.¹⁵⁴
- 3.240 A requirement of the cost accounting obligation is that BT allocates costs to SMP markets on a fair and objective basis. To improve the transparency of its allocation process, in section 4 we are imposing requirements for BT to publish diagrams showing how costs, including fibre, are allocated to SMP markets. We consider this will improve the visibility of

¹⁵² For example, BT's 2019/20 AMD explains how it allocates 'access fibre' (page 44) and 'backhaul and core fibre' (page 34)

¹⁵³ See Volume 3, section 3.

¹⁵⁴ See Commitments of BT plc and Openreach Ltd to Ofcom, available on BT's website: [Publications and DCR Documents](#)

how BT allocates fibre costs, and where it treats fibre differently depending on whether it categorises the fibre as being used for access, backhaul or core circuits.

TRCs appendix

3.241 No stakeholders commented on our proposal and we have therefore decided to remove the requirement on BT to publish an appendix showing information on TRC hours and direct cost per hour. Revenue and cost information on TRCs will be included in each LL Access and IEC service level schedule as set out above.

ECCs note

3.242 In its 2019/20 RFS BT expensed all costs associated with ECCs. Any ECC costs that were previously capitalised have been decapitalised and in its 2019/20 CCN BT said that no ECC costs will be capitalised in future.¹⁵⁵ These changes were consistent with our decisions in the 2019 RFR Statement.¹⁵⁶

3.243 These changes to the RFS ensure that revenues and costs of ECCs are recognised in the year they are incurred and help prevent over-recovery of ECC costs which have been funded by up front revenues.

3.244 To ensure this practice continues in this review period, in section 4 we explain we have imposed a requirement on BT to identify all costs associated with excess construction charges which have been capitalised in the year and write these off as an expense in LL Access and IEC markets.

3.245 Given that BT is required to expense all ECC costs in its RFS, consistent with current practice, we do not consider BT also needs to include a note of the ECC costs expensed in the year as this will duplicate information in the market summary schedules.¹⁵⁷ We have therefore decided not to require this note on ECC expenses.

Shared ancillaries

Proposals

3.246 In the January 2020 Consultation we proposed controls on the following shared ancillaries: cablelink, accommodation and electricity.

3.247 In the February 2020 Consultation we proposed that BT must publish revenue, volume, average price and cost information for these shared ancillaries, split between internal and external customers, at the level that they are regulated (e.g. at the basket level).¹⁵⁸

¹⁵⁵ BT 2019/20 CCN, section 3.08.

¹⁵⁶ Table 5.4, 2019 RFR Statement.

¹⁵⁷ This is because operating costs and MCE for the ECC basket will be reported in LL Access and IEC markets.

¹⁵⁸ Table 4.14 of the February 2020 Consultation showed our proposed service level schedule.

Stakeholder responses

3.248 TalkTalk said that revenues and costs for electricity must be reported separately. It said that wholesale electricity costs should be separately noted, rather than combined with other operating costs, splitting the cost of purchasing electricity from wholesale energy suppliers and other costs.¹⁵⁹

Our reasoning and decisions

3.249 In Volume 4 we set out the following controls on shared ancillaries:

Table 3.14: Controls for shared ancillary services

Ancillary	Services	Control
Cablelink ¹⁶⁰	<ul style="list-style-type: none"> External cablelink Internal cablelink 	CPI-0%
Accommodation	<ul style="list-style-type: none"> Co-location and co-mingling for PI, MPF, VULA and leased lines¹⁶¹ 	CPI-0%
Electricity charge		Basis of charges

3.250 Where we have kept prices constant in real terms, such as for Accommodation and Cablelink, we said in Volume 4 that we expected this to allow BT to recover its costs over time and protect consumers.

3.251 The electricity charge refers to the charge on a usage per kWh basis that telecommunication providers pay BT to provide power for their equipment. The basis of charges obligation requires BT to set electricity charges that are derived from its relevant electricity purchase costs plus a small mark up to reflect its own internal costs relating to purchasing and administering electricity activities.

3.252 We have decided that BT must publish revenue, volume, average price and cost information for these shared ancillaries, split between internal and external customers, at the level that they are regulated.

3.253 We consider that this information will help stakeholders assess the impact and effectiveness of our remedies. In particular, it will show how average prices compare to the price cap and allow a comparison of revenues to costs to understand if BT is recovering its costs. Publishing internal and external information will also help assess the relative usage of these ancillaries, how important they are in supporting network access and demonstrate compliance with no undue discrimination obligations where these apply.

¹⁵⁹ TalkTalk response to February reporting consultation, paragraph 4.6.

¹⁶⁰ The Cablelink control applies to cablelink services previously considered Ethernet ancillary services. In Volume 4 we said that we consider these products are likely to be used as an interconnection service in several markets and not exclusively for Ethernet. The cablelink control excludes GEA cablelink.

¹⁶¹ For example Access Locate, LLU Co-mingling and PI Co-mingling products.

- 3.254 We consider that requiring BT to publish information on revenues and costs (including a breakdown of operating costs) improves the information available to stakeholders on electricity and will allow them to assess if BT is recovering its costs under the basis of charges obligation. Given this, we have decided not to renew the ‘electricity direction’ requiring BT to explain its approach to setting the electricity charges in its AMD.¹⁶²
- 3.255 We consider that requiring BT to publish total revenues and costs for electricity charges will allow stakeholders to assess how revenues compare to costs. We do not consider it would be proportionate to require BT to separately report its wholesale electricity costs¹⁶³, though we note that at least 90% of the electricity charge relates to the cost of raw power.¹⁶⁴
- 3.256 The service level schedule for shared ancillaries is shown below.

Table 3.15: Service level information for shared ancillaries

Detailed service analysis	Internal	External	Total	Internal	External	Internal	External	Internal	External	Internal	External	Internal	External
	Revenue	Revenue	Revenue	Volume	Volume	Average	Average	opex	opex	MCE	MCE	ROCE	ROCE
Service	£m	£m	£m		Measure	Price	Price	£m	£m	£m	£m	%	%
Cablelink													
Accommodation													
Electricity charges													
Total Shared Ancillaries													

Implementation

- 3.257 The schedules for each SMP market are included in the ‘form and content’ direction in Volume 7.

¹⁶² As set out in section 5, BT will be required to provide us with full details of its electricity charge calculation to help us assess its compliance with the basis of charges obligation.

¹⁶³ In paragraph A8.333 of the 2018 WLA Statement we said this information could allow third parties to derive the underlying purchase costs which are likely to be commercially sensitive.

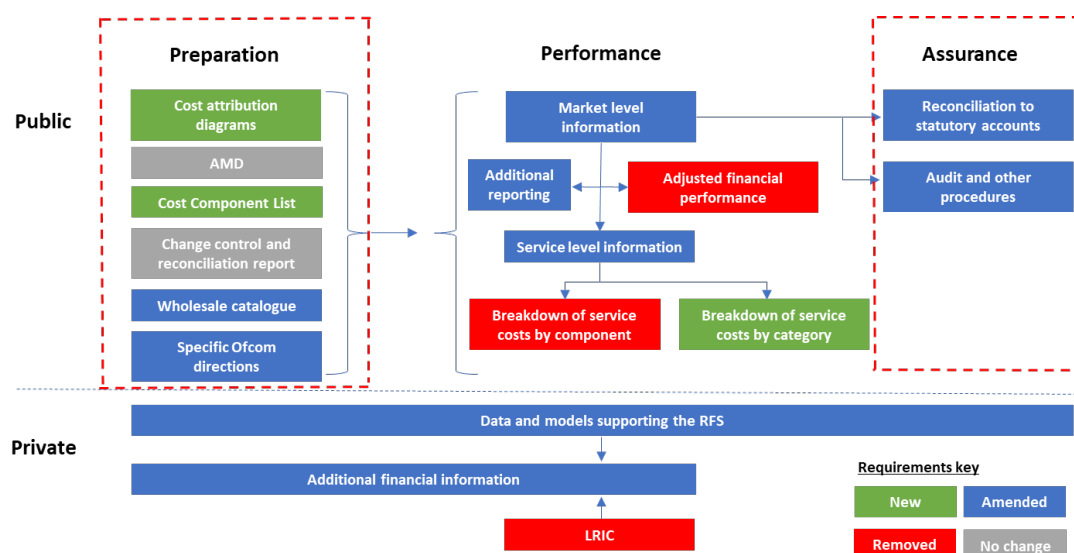
¹⁶⁴ As set out in each of BT’s AMDs 2014/15 to 2019/20

4. Preparation and assurance requirements

Introduction

- 4.1 In the February 2020 Consultation we made proposals in relation to the preparation and assurance requirements highlighted in the diagram below.
- 4.2 Preparation requirements include i) requiring BT to disclose how it has prepared the RFS, e.g. in relation to cost attribution methods used and ii) requiring BT to prepare the RFS, or individual markets, in a particular way, e.g. the use of specific cost attribution rules to be consistent with how we have taken regulatory decisions.¹⁶⁵
- 4.3 Assurance requirements include requiring BT to reconcile its RFS to annual report and to obtain an audit opinion on whether the RFS have been prepared following the documentation published by BT and relevant directions issued by Ofcom.

Figure 4.1: Illustration of how the public and private reporting requirements imposed in this decision compare to current requirements



- 4.4 In the February 2020 Consultation we set out proposals on the following:

- Publication requirements relating to preparation of the RFS
- Basis of preparation – directions applicable to all markets
- Basis of preparation – directions applicable to specific markets
- Assurance

¹⁶⁵ We have the power to impose consistency directions on BT under the SMP condition. BT is required to comply with the Consistency Direction while it is in force. Otherwise, BT is able to make changes to its attribution methods or policies, subject to compliance with the regulatory accounting principles, but must put those changes through the annual CCN process. BT cannot propose a change that conflicts with a consistency direction.

- 4.5 In the rest of this section we summarise our proposals and stakeholder comments before setting out our decisions on each of these areas. We also explain some other small changes we have made to the SMP condition in relation to preparation and assurance.

Summary of decisions

Publication requirements relating to preparation of the RFS

- BT to publish diagrams showing attribution rules applied to main cost categories
- BT to publish a Cost Component List describing components used to prepare the RFS. This includes improved components used to allocate fibre, but BT can make changes to this list through the CCN process
- Wholesale Catalogue to include a mapping to services in the price list

Basis of preparation – directions applicable to all markets

- BT to prepare costs in geographic SMP markets using national unit costs
- BT to ensure it does not capitalise costs recovered from upfront revenues and costs should not be allocated to SMP markets where corresponding revenue is in residual
- BT to identify externally funded assets separately in its regulatory accounting system
- BT must not attribute costs to SMP markets which are not relevant to those markets, or are not required to provide services in those markets

Basis of preparation – directions applicable to specific markets

- BT to improve the reporting of poles, including identifying the cost of poles separately from other assets
- BT to attribute duct costs to PI services on a basis consistent with our approach to setting prices (different attributions for pre- and post-March 2018 duct)
- BT to identify separately certain costs associated with dark fibre

Publication requirements relating to preparation of the RFS

- 4.6 In the February 2020 Consultation we proposed that BT should continue to be required to publish the following documents that set out the rules that are followed in the preparation of the RFS and any changes made to those rules:

- Wholesale Catalogue
- Accounting Methodology Document (AMD)
- Change control notification
- Reconciliation report

- 4.7 We also proposed two additional publications requirements relating to i) the impact of attribution rules used by BT and ii) the cost components used in BT's cost accounting system.

- 4.8 We set out our decisions on each of these below.

Wholesale Catalogue

Proposals

4.9 The Wholesale Catalogue describes each service published in the RFS, arranged by the SMP market the service relates to.¹⁶⁶ It also includes a mapping of services published in the RFS (and their service codes) to the services as they appear in BT's regulatory accounting system. However, it does not include a mapping to price list services. We proposed that BT should continue to provide the Wholesale Catalogue and include an additional mapping from RFS services to price list services.

Stakeholder comments

4.10 No stakeholders commented on our proposals.

Our reasoning and decisions

4.11 We consider that the Wholesale Catalogue aids stakeholders' understanding of the RFS by providing descriptions of each service published in the RFS. We also consider that providing a further mapping between services in the RFS and services on published price lists would help stakeholders understand where the regulated services they buy are reported in the RFS. We have therefore decided to implement our proposals.

Implementation

4.12 The SMP condition in Volume 7 reflects our decisions on the Wholesale Catalogue.

AMD

Proposals

4.13 The AMD describes the attribution methods and policies BT has applied in its cost attribution system. We proposed to direct that BT be required to continue to publish the AMD as per the existing requirement.

Stakeholder comments

4.14 TalkTalk did not think the current AMD helped stakeholders understand BT's attributions.¹⁶⁷ It considered that the AMD could be improved by including a better description of costs, an indication of the materiality of each cost category and an indication of what proportion of costs is attributed to Openreach products.¹⁶⁸

4.15 BT recognised that the AMD was relatively complex and said it was working on making the AMD clearer.¹⁶⁹

¹⁶⁶ It can be found on BT's website here: [Regulatory financial statements](#).

¹⁶⁷ TalkTalk response to February 2020 Consultation, paragraph 3.2.

¹⁶⁸ TalkTalk response to February 2020 Consultation, paragraph 3.5.

¹⁶⁹ BT response to February 2020 Consultation, paragraphs 1.6 and 4.22.

Our reasoning and decisions

- 4.16 Where Ofcom imposes an obligation relating to rules about the use of cost attribution systems, it is required also to impose an obligation to provide a description of the cost attribution system.¹⁷⁰ We consider that requiring BT to publish the AMD contributes to an effective regulatory regime because it allows us to benefit from stakeholders' insights in considering compliance, assessing the effectiveness of remedies and considering whether any adjustments may be needed to the basis of preparation to ensure BT's RFS are reliable. It is also one of the main documents used to audit the RFS.¹⁷¹ We have therefore decided to require BT to continue publishing an AMD describing the attribution methods and policies it has applied in its cost attribution system.
- 4.17 We recognise that the AMD is relatively complex and we welcome BT's plans to improve the clarity of the AMD. We also recognise TalkTalk's point that it is currently difficult to assess the materiality of each cost category and the proportion of costs ending up in SMP markets as a result. Our decisions set out in the next section (headed 'impact of attribution rules') will require BT to illustrate by means of diagrams in the RFS how the cost categories reported in the RFS have been allocated, in addition to describing its allocation rules in the AMD. We expect the publication of allocation diagrams to help stakeholders identify the attribution rules that have the biggest impact on the costs of SMP markets they are interested in and refer them to the relevant section of the AMD for additional information. Alongside BT's plans for a revised AMD, we consider this will improve visibility of the methodologies used to attribute key costs to SMP markets and help address the points raised by TalkTalk.

Implementation

- 4.18 The requirement to produce the AMD is in the SMP condition in Volume 7.

Impact of attribution rules

Proposals

- 4.19 We considered how to improve the transparency of the attribution rules applied to operating costs and MCE to enable stakeholders to better understand how BT has complied with its cost accounting obligations.
- 4.20 For operating costs, we proposed to require BT to show the attribution rules applied to each of the operating cost categories published in the RFS. For each cost category we proposed that information on the following attribution rules be provided, alongside a brief description of each rule: direct to Openreach products, direct to rest of BT, pay driver, PAC (previously allocated costs) driver and additional rows for any rule applied to 10% or more of the relevant cost category.

¹⁷⁰ Section 87(11) Communications Act 2003.

¹⁷¹ See for example the KPMG audit report on pages 19-23 of the 2019/20 RFS.

- 4.21 We said that BT should publish a table in the RFS for each operating cost category showing for each attribution rule i) the amount of operating cost attributed; ii) the proportion of total operating cost attributed and iii) the percentage of costs that are attributed to Openreach SMP markets.
- 4.22 For MCE (and associated depreciation) we proposed that for each asset published in the RFS (duct, copper, fibre, etc) BT should publish a diagram showing the principal cost pools used in the cost attribution system alongside a description of the basis of allocation and the associated allocation percentages.

Stakeholder responses

- 4.23 Vodafone agreed with our proposal, saying it was vital that BT publishes the attribution rules applied to cost categories.¹⁷²
- 4.24 Frontier made a general comment that the approach to allocating costs in the RFS should be clear, saying it was particularly important to identify how fibre costs are allocated.¹⁷³
- 4.25 BT considered that our proposals could be a helpful way of giving transparency to the allocation process but that due to the multi-layer nature of its allocation system, our proposals may not be the clearest way to present its methodologies.¹⁷⁴ BT considered that the attribution of both operating costs and MCE would be better illustrated with ‘Sankey’ diagrams, where individual flows represent the apportionment of cost through the various layers in its allocation system.¹⁷⁵ BT said these diagrams would provide a simplified overview of methodologies, supplementing the detailed explanations in the AMD, and help stakeholders understand the main drivers applied to cost categories and which are the most significant methodologies.¹⁷⁶
- 4.26 BT proposed to show diagrams for the ‘majority’ of operating costs and MCE. To make the diagrams easier to understand, BT also proposed several simplifications, such as amalgamating minor cost allocations to an ‘other’ category and excluding negative balances and transfer charges in the rest of BT residual.¹⁷⁷
- 4.27 BT requested some flexibility in how the diagrams were presented to allow it to improve the format over the review period. It also considered that the diagrams should not be subject to the annual audit.¹⁷⁸
- 4.28 BT provided an example in its response of how such a diagram could look.¹⁷⁹

¹⁷² Vodafone response to February 2020 Consultation, paragraph 5.1(i).

¹⁷³ Frontier response to February 2020 Consultation, page 32.

¹⁷⁴ BT second response to February 2020 consultation, paragraph 2.13.

¹⁷⁵ BT response to February 2020 Consultation, paragraph 4.34 and BT second response to February 2020 consultation, paragraph 2.14.

¹⁷⁶ BT second response to February 2020 consultation, paragraphs 2.15 and 2.16.

¹⁷⁷ BT second response to February 2020 consultation, paragraphs 2.16 to 2.19.

¹⁷⁸ BT second response to February 2020 consultation, paragraph 2.20.

¹⁷⁹ BT second response to February 2020 consultation, paragraph 2.21. BT used fibre as an example, illustrating how costs were allocated from fibre classes of work, through intermediate cost pools, to SMP markets.

Our reasoning and decisions

- 4.29 While the AMD describes the attribution rules used by BT, it can be hard to identify the most important attribution rules and the impact these have on the costs allocated to SMP markets. This can make it difficult for stakeholders to understand how BT has complied with its cost accounting obligations. We consider that improving the transparency of the cost attribution rules would increase the reliability of the RFS and improve confidence in the regulatory regime.
- 4.30 We agree with BT that our proposal to require it to publish a table showing the attribution rules applied to operating cost categories would not capture the multi-layer nature of its cost allocation system.¹⁸⁰ For operating costs, we agree that a diagram, like that we proposed for MCE, would better illustrate how these costs flow through the different layers in BT's allocation system.
- 4.31 We consider that diagrams would meet our objective to improve the transparency of the attribution rules applied to operating costs and MCE and be capable of identifying the main cost drivers applied to each operating cost and asset category, and the percentage of costs attributed at each stage in the cost accounting system.
- 4.32 We have therefore decided that BT must provide diagrams for each operating cost and asset category published in the market performance schedules in the RFS.¹⁸¹ We recognise that some flexibility may be needed in how the diagrams are presented. To achieve this, we have provided for more than one way for BT to show the main cost pools, as explained below.
- 4.33 For each operating cost and asset category published in the market performance schedules in the RFS, we have decided that the diagrams must show the following:
- the key allocation stages, including as a minimum the following allocation stages: i) initial cost associated with the cost category, ii) activity group (where relevant¹⁸²) and/or plant group, iii) component and iv) SMP and non-SMP markets (with each SMP market being identified))
 - the main cost pools at each allocation stage, to include either the five largest cost pools, or any cost pool representing 20% or more of the total cost associated with the relevant operating cost or MCE category at that stage. Other cost pools can be aggregated together into an 'other' cost pool to make the diagrams easier to read and interpret.
 - the cost drivers associated with each identified cost pool at each stage;
 - the percentage allocation using those cost drivers at each stage; and
 - the percentage of cost allocated to each Openreach SMP market, Openreach residual and rest of BT.

¹⁸⁰ Different attribution rules can apply at each layer in BT's cost allocation system. Our proposed table would have only captured the attribution rules applying at a single layer. This would not accurately represent BT's cost allocation system.

¹⁸¹ That is, the operating cost and asset categories shown in Tables 3.2 to 3.4 above. For operating costs, this includes operating costs by type as well as operating costs by division.

¹⁸² Not all costs are allocated to activity groups – some costs go direct to plant groups.

- 4.34 BT must also publish a narrative to help stakeholders understand the diagram and explain where information on each cost driver can be found in the AMD. Any assumptions made must also be published.¹⁸³
- 4.35 For fibre, we agree with Frontier that it is important for stakeholders to understand how BT has attributed these costs as regulated services are increasingly being provided using fibre. As identified in section 3, to date BT has broadly categorised fibre as access, backhaul and core in its cost accounting system. Where it continues to do so, we are requiring it to separately identify the treatment of these categories of fibre in the fibre attribution diagram to help stakeholders understand how fibre is attributed to SMP services.
- 4.36 While the precise format of the diagram is up to BT, we consider that the illustrative Sankey diagram provided in its second response to the February 2020 Consultation could meet these requirements. We would expect the format of the diagram to evolve over time to reflect feedback from stakeholders. These diagrams can be published as a separate appendix to the RFS on BT's website.
- 4.37 We consider that these diagrams will make it easier to understand which attribution rules are most important when allocating costs to services and help ensure BT does not unfairly load costs onto SMP markets. In turn, we think this will increase the reliability of the RFS and improve confidence in the regulatory regime.

Implementation

- 4.38 We have included the requirements in the 'form and content' direction in Volume 7 under the heading 'Attribution diagrams for operating costs and Mean Capital Employed'.

Change control notification and reconciliation report

- 4.39 The annual CCN report sets out the methodology changes BT intends to make to the RFS, including the estimated impact of these changes based on prior year figures. The CCN is published in March each year.
- 4.40 The reconciliation report is published alongside the RFS and sets out the changes that were actually made, the impact of those changes together with any material errors that were also corrected.¹⁸⁴ The reconciliation report is currently audited.

Proposals

- 4.41 We proposed to require BT to continue publishing the CCN and reconciliation report (and the accompanying audit opinion on the reconciliation report).

¹⁸³ This could include the treatment of negative balances and transfer charges noted in BT's response.

¹⁸⁴ The impacts of material errors are calculated based on prior year figures only.

- 4.42 We noted that there was not currently a materiality threshold for methodology changes¹⁸⁵ included in the CCN and sought stakeholder views as to whether a materiality threshold would be helpful.
- 4.43 The reconciliation report requires disclosure of all “material errors” and “material changes”, which are defined as those affecting any figure in the RFS by the higher of £1m or 5%. An explanation of non-material changes is provided but the estimated impact is aggregated into a single figure. We did not propose any changes to the materiality threshold for the reconciliation report, though we noted that in the March 2019 RFR Statement, we said that we may consider an increase to the materiality threshold in future.¹⁸⁶

Stakeholder comments

- 4.44 BT argued it would be reasonable and proportionate to increase the materiality threshold to the higher of £5m (from £1m) or 5% (no change) for any reported errors and methodology changes, and to apply this to both the CCN and reconciliation report.¹⁸⁷ It argued that errors or methodology changes below this are not of significant interest to stakeholders but require time and effort to analyse and report.¹⁸⁸

Our reasoning and decisions

- 4.45 No stakeholders disagreed that there is an ongoing need for the CCN and reconciliation report. We have decided to require BT to continue publishing these reports to provide transparency on how BT has prepared the RFS, the methodology changes included in the RFS and the impact of these.
- 4.46 Below, we consider whether to introduce a materiality threshold for the CCN and increase it for the reconciliation report.

CCN materiality

- 4.47 The CCN provides stakeholders with notice of changes that BT is planning to make in the RFS and sets out the estimated impact of these changes at a market level based on the prior year RFS. This information allows stakeholders to raise any concerns with Ofcom. We can direct BT (after consultation) not to apply a methodology change where we disagree with the proposals.
- 4.48 While we accept it takes time and effort for BT to identify and evaluate its proposed methodology changes, we consider it is important that all changes are visible to stakeholders so that they can raise concerns with us and, if necessary, we can consult and direct BT not to implement a change in the RFS.

¹⁸⁵ Although, as part of the audit of the reconciliation report, the auditors must report on whether all material changes were included in the CCN and whether the description of them in the CCN was accurate.

¹⁸⁶ 2019 RFR Statement, paragraph 3.35.

¹⁸⁷ BT response to February Consultation, paragraph 5.38.

¹⁸⁸ BT response to February Consultation, paragraph 5.37.

- 4.49 It is important to show all changes as, while some market level impacts could be small, they could result in significant service level impacts (e.g. where costs are being reattributed between services in a market)¹⁸⁹ or become more significant over time (e.g. where the methodology change applies to a nascent service or where changes occur between the CCN and publication of the RFS¹⁹⁰).
- 4.50 Showing all changes in the CCN is also consistent with our decision to give BT flexibility to change cost components, as long as these are visible in the CCN. As cost components are the building blocks of SMP service costs, we consider it is important for stakeholders to have visibility over any proposed changes.
- 4.51 Finally, we consider that requiring BT to publish its planned methodology changes provides assurance to stakeholders that BT is complying with its reporting obligations and that changes are aligned to the RAP.
- 4.52 We have therefore decided not to introduce a materiality threshold for the CCN.

Reconciliation report materiality

- 4.53 The reconciliation report provides stakeholders with information on the actual impact, at a market level, of material methodology changes and any material errors corrected. A material change and material error are currently defined as changes or errors affecting any figure in the RFS by the higher of £1m or 5%. All methodology changes set out in the CCN (including any changes expected to have no impact) are included in the reconciliation report but the impacts of changes which are not material are aggregated into a single row. The reconciliation report also includes any methodology changes made to the RFS following the publication of the CCN, e.g. changes arising as a result of audit work.
- 4.54 Regardless of the materiality threshold, BT would need to do work to identify each change or error and calculate its impact on any figure in the RFS. The main consequence of a higher materiality threshold is that fewer individual changes and errors would be reported at a market level in the reconciliation report.
- 4.55 Although BT did not quantify the ‘time and effort’ it takes to report on material changes and errors, we recognise that it does require resource to estimate and audit the impacts, which is why we have previously imposed a materiality threshold so BT only needs to report on the most significant impacts. Although the impacts are presented at a market level, we think it is important to define materiality in relation to any figure in the RFS because changes and errors can be significant at, for example, a service level even if at a market level they appear small.¹⁹¹

¹⁸⁹ For example, as part of the 2018 WLA, we directed BT to change the attribution of costs between FTTC and FTTP (See Paragraphs A8.82 – A8.87 of the 2018 WLA Statement). This resulted in a reduction in the cost of FTTC rentals and an increase in the cost of FTTP rentals. However, section 3.06 of BT’s 2019 CCN showed no movement at the WLA market level as the change only moved costs between services in that market.

¹⁹⁰ For example, in BT’s 2020 CCN, no revenue impact was associated with the changes for ‘Ethernet Cablelink Cost Allocations’ and ‘Copper CCA separation’. However, in the reconciliation report Ethernet Cablelink Cost Allocations reduced revenue by £1m in the WFAEL market whilst Copper CCA separation added £2m in the PIA market.

¹⁹¹ For example, a methodology change resulting in a £1m movement in FAC would represent a 10% impact for half of the services reported in the WLA market in 2019/20.

- 4.56 We therefore disagree with BT that errors or methodology changes below its proposed £5m threshold are not of significant interest to stakeholders. As seen in section 3, several stakeholders commented on our proposals for information to be published below market level (e.g. service level information) and we consider methodology changes which impact that information would be of interest to stakeholders.
- 4.57 Evidence from BT's 2019/20 reconciliation report¹⁹² indicates that a higher materiality threshold would have only had a small impact on the number of individual impacts reported. We consider there are benefits to stakeholders of reporting impacts between £1m and £5m and do not consider that the time and effort of doing so is disproportionate.
- 4.58 We have therefore decided to maintain the current materiality threshold in the Reconciliation Report.

Implementation

- 4.59 The requirements to produce the CCN and the reconciliation report are in the SMP condition and further requirements on the preparation and audit of the reconciliation report are in the Reconciliation Report Direction in Volume 7.

Cost components

- 4.60 Network cost components are intended to represent the building blocks of regulated services. As noted in BT's AMD, they should represent discrete parts of the network.¹⁹³ In BT's RFS, costs are attributed through various cost pools to cost components. These cost components are then attributed to regulated services by reference to volumes and usage factors.
- 4.61 In the previous market review period, we directed BT to use certain components in its cost attribution system since, to preserve the integrity and consistency of BT's reporting, it is important that there is a single list of components used to attribute costs to services in regulated markets. However, over time some components can become obsolete and new components are required.
- 4.62 Given that the WFTMR covers a five-year review period we considered how to give BT more flexibility to change the components used in its cost accounting system while ensuring these changes are justified and visible to stakeholders. We also considered how fibre components could be improved in the review period, as they previously did not reflect how the Openreach network is planned or built.

¹⁹² In the 2019/20 reconciliation report BT reported 27 individual methodology changes and 8 errors. Assuming that the market impact is a good proxy for the impact on any number in the RFS, if the materiality was £5m rather than £1m, we estimate that only 2 changes and 2 errors would not have been separately reported.

¹⁹³ Section 11.1 of BT's 2018/19 AMD.

Proposals

Flexibility for BT to change components

- 4.63 We proposed to require BT to publish an annual list of cost components used in its cost accounting system and allow changes to this via the annual CCN process. We proposed to retain the ability to direct BT to use specific components where we considered BT's components were inappropriate.
- 4.64 We proposed the cost component list must include a list of components used to prepare the RFS, a description of each component and diagrams showing which part of the network, or which activity, each component represents.
- 4.65 Finally, we proposed that the list of components on 1 April 2021 must consist of those directed by Ofcom, but BT could subsequently make changes to this directed list through the CCN process.

Fibre components

- 4.66 We did not consider that existing fibre components reflected how the Openreach network was planned or built.¹⁹⁴ We considered that improving fibre components would help ensure that costs were appropriately attributed to services and improve the reliability of the RFS.
- 4.67 Informed by a report from EY to BT, we proposed that the initial list of components on 1 April 2021 must include new fibre cost components. Our proposed fibre components reflected the principal elements of the main fibre networks used to supply services in Openreach SMP markets, as shown in the table below.

Table 4.1: Proposed new fibre components

Legacy FTTC	Legacy ethernet	One fibre network	Inter-exchange
OLT	Ethernet electronics	Ethernet electronics	Inter-exchange fibre
Spine fibre	Spine fibre	Headend electronics FTTP	
Distribution fibre	Distribution fibre	Spine fibre	
DSLAM		Distribution fibre	
Tie cable		Final drop	
Final drop		Terminating equipment	

- 4.68 We proposed a simplified view of the elements making up BT's fibre networks as we recognised that the way costs were currently captured and recorded in Openreach could make it difficult to associate costs with some parts of the network. This meant that some

¹⁹⁴ We said that i) many fibre components shared the same name as fibre services rather than representing discrete parts of the network ii) there were no components for distribution and spine fibre and iii) older fibre tends to be dedicated to specific services while newer fibre was shared across multiple services (which was not reflected in the current cost components).

discrete parts of the network could be included in our proposed components, e.g. racks and aggregation nodes could be included in the spine fibre components and connectorised block terminals could be included in distribution fibre components. We said that under our proposals to give BT flexibility over components, where additional information became available, it could introduce new components to provide more detail on particular parts of the fibre network.

Stakeholder responses

- 4.69 BT welcomed the flexibility to change cost components.¹⁹⁵ BT said that the component list should only be provided to Ofcom as it would not be useful to stakeholders as it relates to cost components which are not published.¹⁹⁶
- 4.70 Vodafone agreed with the proposed publication of a component list and diagrams, saying it was important for stakeholders to have transparency of these as the cost accounting system is constructed using components.¹⁹⁷ Vodafone said that without this, stakeholders will not be able to understand how costs flow and how cost stacks are constructed.
- 4.71 BT said that producing diagrams showing which part of the network each component represents would be difficult as there is not necessarily a ‘pre-existing consensus’ on how to represent the network. BT said the fibre diagram produced by EY took three months and there were many components that did not represent discrete parts of the network which could add a layer of complexity. As Ofcom proposed that component costs would no longer be reported in the RFS, BT said it was unclear how stakeholders could make use of these diagrams and it considered Ofcom already understood the make-up of the components, so such diagrams were unnecessary.¹⁹⁸
- 4.72 No stakeholders specifically commented on our proposed fibre cost components, though Vodafone said that, as Openreach is investing significantly in fibre, it was important to understand how these costs will be accounted for in BT’s cost accounting system.¹⁹⁹

Our reasoning and decisions

Cost component list

- 4.73 We have decided to require BT to publish an annual list of cost components used in its cost accounting system.²⁰⁰ As of 1 April 2021, the cost component list must consist of those components directed by Ofcom, but BT can make changes to this through the CCN process. This initial list will be consistent with the existing component direction, with the addition of the fibre components discussed below.

¹⁹⁵ BT response to February 2020 Consultation, paragraph 5.14.

¹⁹⁶ BT response to February 2020 Consultation, paragraph 4.19.

¹⁹⁷ Vodafone response to February 2020 Consultation, paragraph 5.1(ii).

¹⁹⁸ BT response to February 2020 Consultation, paragraph 4.19

¹⁹⁹ Vodafone response to February 2020 Consultation, paragraph 5.1(ii).

²⁰⁰ This cost component list could be published separately or as part of the AMD.

- 4.74 This approach will give BT more flexibility to change components while ensuring they remain visible to stakeholders. We will retain the ability to direct BT to use specific components where we consider the components used by BT are inappropriate, e.g. where they do not reflect discrete parts of the network, are obsolete or risk attributing costs to regulated markets that are not associated with those markets.
- 4.75 The cost accounting obligation requires BT to describe how it has attributed costs to regulated markets. As cost components are fundamental building blocks of BT's cost accounting system, we consider it is important that stakeholders, including Ofcom, understand which components BT is using to attribute costs and what those components represent. We agree with Vodafone that this will help stakeholders understand how cost stacks are constructed, and ensure that only costs of relevant components are attributed to regulated services.
- 4.76 In line with our proposals, the cost component list must include a list of components used to prepare the RFS, a description of each component and diagrams showing which part of the network, or which activity, each component represents.
- 4.77 We disagree with BT that diagrams are unnecessary. While this may be a challenging exercise for BT in some cases, we think it is important to be clear what each cost component represents, especially where BT has the flexibility to change them in future. The diagrams will help us and stakeholders understand which components represent parts of the physical network (e.g. duct, fibre, copper, electronics) and which components relate to activities or other costs (e.g. provisioning, product management, SLG payments).
- 4.78 For components representing physical parts of the network, we would expect BT to be able to produce a diagram similar to the one EY produced for the proposed new fibre diagrams.²⁰¹ BT could illustrate components which do not represent physical parts of the network by function (e.g. components relating to maintenance, provisioning and product management).

Fibre components

- 4.79 We agree with Vodafone that, as Openreach is investing significantly in fibre, it is important to understand how costs of the fibre networks are attributed to services. For the reasons given above, we have decided to require that the cost component list on 1 April 2021 must include the fibre components from Table 4.1.

Implementation

- 4.80 The SMP condition and the network components direction in Volume 7 reflect our decisions.

²⁰¹ See Figure 5.2 of the February 2020 Consultation.

Basis of preparation – all markets

- 4.81 In the previous market review period, we directed BT to prepare the RFS following a set of regulatory accounting principles and, in some circumstances, on a specific basis so that BT's reporting was, as far as possible, consistent with our regulatory decisions. This allowed us to assess the impact and effectiveness of our remedies and provided assurance to stakeholders that information was being created and retained such that appropriate regulation could continue to be maintained in future.
- 4.82 In the February 2020 Consultation we set out proposals on the basis of preparation relating to all SMP markets in relation to the following:
- Regulatory Accounting Principles
 - Externally funded network build
 - Geographic markets
 - Cumulo
 - Asset valuation
 - IFRS16 (treatment of leases)
 - SLGs
 - Cost of capital.

Regulatory Accounting Principles

- 4.83 In the previous accounting period, we directed BT to prepare the RFS following a set of regulatory accounting principles. The Regulatory Accounting Principles (RAP) were introduced in the 2014 Regulatory Financial Reporting Statement.²⁰² The RAP represent the fundamental principles with which BT's regulatory financial reporting must comply. In order of priority, we said that the RAP should be:
- a) **Completeness:** Regulatory Financial Reporting must encompass all revenues, costs, assets and liabilities of the Markets, together with residual activities (including wholesale and retail).
 - b) **Accuracy:** Regulatory Financial Reporting must maintain an adequate degree of accuracy, such that the information included in the Regulatory Financial Statements is free from material errors and double counting. [the definition of materiality is set out in the direction].
 - c) **Objectivity:** Each element of Regulatory Financial Reporting, so far as is possible, must take account of all the available financial and operational data that is relevant to that element. Where an element of Regulatory Financial Reporting is based on assumptions, those assumptions must be justified and supported by all available relevant empirical data. The assumptions must not be formulated in a manner which

²⁰² See [2014 Regulatory Financial Reporting Statement](#)

unfairly benefits BT or any other operator or entity or creates undue bias towards any part of BT's or any other operator's business or product.

- d) **Consistency with regulatory decisions:** Regulatory financial reporting must be consistent with Ofcom's regulatory decisions as directed by Ofcom.
- e) **Causality:** Regulatory Financial Reporting must ensure that i) revenues (including revenues resulting from transfer charges); ii) costs (including costs resulting from transfer charges); iii) assets; and iv) liabilities, are attributed in accordance with the activities which cause the revenues to be earned, or costs to be incurred, or assets to be acquired, or liabilities to be incurred respectively.
- f) **Compliance with statutory accounting standards:** Regulatory Financial Reporting must comply with the accounting standards applied in BT's statutory financial statements; with the exception of any departures as Ofcom may direct from time to time.
- g) **Consistency of the Regulatory Financial Statements as a whole and from one period to another:** Regulatory Financial Reporting must be applied consistently in all the Regulatory Financial Statements relating to the same period. Regulatory Financial Reporting must be applied consistently from one period to another. All the changes in Regulatory Financial Reporting from one period to another must be justified by reference to the Regulatory Accounting Principles. If there are material changes in Regulatory Financial Reporting from one period to another, BT must restate the previous period's Regulatory Financial Statements, applying the changes to the Regulatory Financial Statements for that period.

Proposals

- 4.84 We proposed to continue to require BT to prepare its RFS in accordance with the RAP to ensure an absence of bias, and consistency with regulatory decisions. We did however propose changes in relation to the order of the priority of the principles, the objectivity principle and the causality principle.

Order of priority

- 4.85 BT has been required to apply the RAP in the order of priority set out in the directions. We proposed to retain this obligation but to amend the order so that the "Consistency with regulatory decisions" principle is the highest priority because it requires BT to comply with our directions in relation to consistency with regulatory decisions.
- 4.86 We also proposed a minor change to move the text relating to the order of the RAP to the front of the direction.

Objectivity principle

- 4.87 We proposed to amend the objectivity principle to include a requirement for BT to take account of the way in which services are charged, and how service revenue has been recorded, when considering how to treat costs. In particular, where costs are recovered

from upfront revenues, we said these costs should not be capitalised in the RFS²⁰³ and where revenue is allocated to residual, associated costs must not be included within SMP markets.

Causality principle

- 4.88 We proposed to amend the wording of the causality principle to help ensure BT does not attribute costs to SMP markets which are not relevant to those markets or are not required to provide services in those markets.

Stakeholder comments

- 4.89 TalkTalk did not think it was necessary to amend the objectivity or causality principles as it considered some of the issues we identified would already be captured by the existing text. TalkTalk said we should focus on enforcement, fine BT for breaches of the RAP and require it to repay excess historical charges. It said without this BT will have incentives to engage in regulatory gaming.²⁰⁴
- 4.90 TalkTalk also recommended imposing an obligation on BT to identify any concerns it has that attributions may lead to cost over-recovery.

Our reasoning and decisions

Order of priority

- 4.91 We have decided to change the order of priority in line with our proposals, so that the “Consistency with regulatory decisions” principle has the highest priority. This change clarifies that BT cannot decline to comply with a consistency direction by reference to other principles.

Objectivity principle

- 4.92 We have decided to adopt our proposal and amend the objectivity principle to include a requirement for BT to take account of the way in which services are charged, and how service revenue has been recorded, when considering how to treat costs. In particular: i) where costs are recovered from upfront revenues, they must not be capitalised and attributed to rental services; and ii) where revenue is allocated to residual, associated costs must not be included in SMP markets.
- 4.93 There are two reasons for making this change. First, in recent charge controls, including this one, we found BT was capitalising costs which had been recovered from upfront revenues.²⁰⁵ Second, in the January 2020 Consultation we made an adjustment to remove

²⁰³ In the March 2019 RFR Statement we said we would consider this issue as part of this review. See paragraph 3.12 of that document.

²⁰⁴ TalkTalk response to February 2020 Consultation, paragraph 2.5.

²⁰⁵ For example, in the 2018 WLA statement we found BT was capitalising costs associated with tie cables and comingling and in the 2019 BCMR we found BT was capitalising costs associated with ECCs (see 2018 WLA Statement, Annex 12, paragraphs A12.47-A12.80 and 2019 BCMR Statement, Annex 19, paragraphs A19.58 – A19.63). In the January 2020 Consultation we also proposed an adjustment to excess construction charges (ECCs) to address this issue. See paragraphs A16.38 to A16.39, Annex 16, January 2020 Consultation

costs from SMP markets relating to repayment works.²⁰⁶ This was because all revenues associated with these works were recorded in residual but SMP markets included an attribution of cost. The repayment works adjustment ensured revenues were matched to cost in residual markets.²⁰⁷

- 4.94 These examples could lead to cost over-recovery if charge controls on rental products are i) based on costs which include depreciation charges in relation to capitalised assets and ii) those capitalised assets have already been recovered through upfront revenue (e.g. from connection charges or repayment works). Whilst we have addressed these and similar cases in previous market reviews by imposing directions, we cannot know if we have identified all such cases. To ensure the RFS remains objective and reliable we consider it is proportionate to amend the direction to ensure that the RFS does not report costs on this basis in future.

Causality Principle

- 4.95 We have decided to amend the wording of the causality principle to ensure BT does not attribute costs to SMP markets which are not relevant to those markets or are not required to provide services in those markets. This will help reinforce the existing principle and avoid some of the issues in relation costs being incorrectly included within services – e.g. in relation to cabling on poles discussed later in this section.
- 4.96 In response to TalkTalk, we consider these changes to the RAP help clarify the principles with which BT should comply when preparing the RFS.
- 4.97 Our approach to investigating compliance with regulatory requirements is set out in our Enforcement Guidelines.²⁰⁸ We will take enforcement action in respect of non-compliance with statutory or regulatory requirements to prevent harm to consumers and competition, and to remedy this where we can. We may also impose a penalty to deter non-compliance. We decide whether to open an investigation on a case by case basis, taking account of the seriousness of the conduct (for example, whether it is repeated or intentional) the potential harm, the strategic significance of addressing the alleged conduct and whether alternative proceedings are likely to achieve the same ends.
- 4.98 We will continue to take action in the most serious cases, but we also want to foster an environment where BT can bring issues to our attention (as it has done in a number of cases) and respond to new information or propose improvements to the way data is recorded and reported. It is not always appropriate to punish every error.
- 4.99 Since the introduction of the annual reconciliation report there is greater visibility of any error corrections that BT puts through the RFS. This helps stakeholders draw our attention to any issues they are concerned about and we can act where appropriate. We note that

²⁰⁶ Annex 16, January 2020 Consultation. Repayment works relate to repayment alterations (pre-planned jobs requested by external parties to alter the Openreach network due to projects like HS2) and repayment damages (repair of the Openreach network caused by third party damage).

²⁰⁷ We note that BT amended its 2019/20 RFS so that costs of repayment works are allocated to residual. See section 3.09 of its 2019/20 CCN.

²⁰⁸ [Enforcement Guidelines for regulatory investigations](#), Ofcom, June 2017.

the correction of errors can lead to costs in SMP markets going up or down, and evidence from recent reconciliation reports published in the RFS does not indicate a pattern of errors systematically increasing costs (which could benefit BT were they to lead to higher regulated prices).²⁰⁹

- 4.100 We do not consider it is necessary to impose an obligation on BT to identify where its attributions may lead to cost over-recovery. From a reporting perspective, we do not consider this requirement adds to the existing requirements for BT to prepare the RFS in accordance with the RAP, which includes requirements for the reporting to be objective and accurate and for costs to be attributed in accordance with the activities which cause them to be incurred.
- 4.101 If BT's reporting was not prepared in accordance with the RAP, we would consider enforcement action. As noted above, in deciding on any enforcement action (and any penalty), we would consider the seriousness of the conduct and the potential harm caused. In the event that BT knew about an issue and its potential impact on cost-recovery in deciding on the appropriate action, yet did not bring this to our attention, it is likely that we would take this into account.
- 4.102 From a pricing perspective, we do not consider that BT should be required to identify attribution rules that comply with the RAP but might in due course be considered by Ofcom not to provide an appropriate basis for setting prices. A requirement along the lines envisaged by TalkTalk linked to the potential impact on cost recovery presumes that BT could anticipate how we might use the information to set prices in future and would therefore require BT to take a view on Ofcom's future regulatory judgment as well as matters of fact.
- 4.103 Where information is explicitly used for the purpose of setting prices (and therefore its purpose and potential implications for cost recovery are clear), the information will be collected and confirmed under statutory powers, which already impose significant obligations on BT in terms of the accuracy of the data.

Implementation

- 4.104 We have imposed the RAP Direction in Volume 7 which includes amendments to the text of the RAP direction currently in force to reflect our decisions above.

Externally funded network build

- 4.105 Some parts of BT's network are funded by external entities. These include:
- **BDUK:** Building Digital UK – a DCMS scheme where Openreach is provided with 'gap' funding to deploy broadband (mainly FTTC) in areas that were not commercially viable.
 - **Network adjustments in the PI market** – where telecoms providers are required to pay for certain activities to enable the deployment of FTTP utilising BT's duct. Telecoms

²⁰⁹ For example, in the 2019/20 RFS the errors identified and corrected by BT in its reconciliation report tended to remove costs from Openreach SMP markets.

providers are required to pay where the cost of network adjustments exceeds £4,750 per km of spine duct.²¹⁰

- **Excess construction charges** – where telecoms providers request an EAD or EAD LA connection and the construction work in providing that connection is above £2,800, they are required to pay the additional amount.

4.106 We expect further examples in future. For example, we published a Statement in May 2020 setting out how an industry fund could contribute to the cost of BT's Broadband Universal Service Obligations.²¹¹ The UK and devolved governments are also actively working to design several schemes to help improve coverage of broadband.

4.107 While externally funded assets can be attributed to relevant SMP markets, for the purposes of setting prices we take account of the associated funding when assessing the cost base of regulated prices. For example, in the January 2020 Consultation we removed BDUK funding (reducing the asset base of FTTC and FTTP) to take account of externally funded assets.²¹² It is therefore important that externally funded assets and the associated funding can be identified so we can take steps when setting prices to ensure BT does not over recover the costs of such assets.

Proposals

4.108 We proposed to require BT to separately identify externally funded assets and associated funding in its regulatory accounting system, consistent with our modelling approach in the January 2020 Consultation.

Stakeholder comments

4.109 Vodafone agreed that BT should separately identify all externally funded assets.

4.110 In relation to BDUK, Vodafone said it was important to understand which assets were funded by BDUK and where the funding was reported in the RFS. It also asked if BT had additionally recovered BDUK funds from regulated services.²¹³ In response to our July 2020 Consultation, where we discussed reporting proposals relating to FTTP rollout and investment, Mike Kiely commented that these were ok provided BDUK activity is taken into account (in particular BT's capital contribution to allowable costs and the utilisation of the capital deferral).²¹⁴

4.111 In relation to ECCs, Vodafone said a proportion of the upfront connection cost is used to fund fibre to businesses and asked where these assets were reported in the regulated accounts.²¹⁵

²¹⁰ In the case of BT, it recovers the cost of network adjustments above the limit from downstream products.

²¹¹ [Compensating providers delivering universal services](#), 22 May 2020

²¹² See Annex 16 of the January 2020 Consultation.

²¹³ Vodafone response to February 2020 Consultation, paragraph 5.2(iii)

²¹⁴ Mike Kiely response to July 2020 Consultation page 2.

²¹⁵ Vodafone response to February 2020 Consultation, paragraph 5.2(iii)

Our reasoning and decisions

- 4.112 In Annex 14 we explain that in our cost modelling we reduced the asset base of relevant services to take account of grant funding received by BT. This ensures that BT will not additionally recover asset costs funded by grants. Further, in Volume 4, we explain that BT's FTTP rollout commitment in Area 3 relates only to commercial build and excludes any build funded by government grants and other subsidies.
- 4.113 We have decided to require BT to separately identify externally funded network build and corresponding funding within its regulatory accounting system. This will help build industry confidence that BT is treating grant funding appropriately in its RFS during this review period and ensure such amounts can be deducted when setting charge controls where relevant, avoiding additional recovery of network build costs funded by grants (e.g. BDUK) or customer charges (e.g. network adjustments and ECCs). We have included text in the Consistency Direction in Volume 7 to capture this requirement and allow us to monitor how BT accounts for and reports externally funded network build.
- 4.114 In response to the points on BDUK funding, in section 3 we explained that a 'grant funding' asset category will be included in the RFS. We expect funding received from BDUK to be included in this category, alongside other relevant grants. This will offset the amounts reported in other asset categories (e.g. fibre) and have the effect of reducing the asset base in SMP markets. The requirement discussed in this section will ensure BT can report information on this basis while retaining additional information on assets and associated funding that we can take account of in charge controls (including monitoring FTTP rollout and investment discussed in sections 3 and 5). In section 5 we also require BT to provide us with information on grants received, including from BDUK. This will include details of the assets funded by grants, the level of grant funding for each asset and an explanation of how the grant arrangements work.
- 4.115 Vodafone also asked about the treatment of ECC costs and where these are reported in the RFS. When providing a connection for services like EAD, Openreach is sometimes required to carry out construction to extend its network to the end-users' premises. In such cases, it charges ECCs. To simplify the provisioning process, the first £2,800 of the cost of this work is not charged for; the customer only pays for any ECCs above this limit. To recover costs associated with ECCs below the £2,800 limit Openreach adds a 'balancing charge' (currently £589²¹⁶) to the standard connection charge for EAD.²¹⁷
- 4.116 Later in this section we explain that BT is required to expense (rather than capitalise) costs associated with ECCs in the year they were incurred. This will match the cost with ECC revenue received from customers and is consistent with how the 2019/20 RFS were prepared.²¹⁸ This means there should not be any assets associated with ECCs reported in the RFS going forward.

²¹⁶ See [Openreach EAD price list](#) [accessed 10 March 2021]. We explain how the ECC balancing charge is regulated in volume 4.

²¹⁷ See for example [Excess Construction Charges for Openreach Ethernet Access Direct](#), Ofcom, 16 May 2014.

²¹⁸ BT decapitalised all ECC costs in its 2019/20 RFS. See section 3.08 of BT's 2019/20 CCN.

Geographic markets

- 4.117 The January 2020 Consultation proposed to find that BT had SMP in various separate geographic markets for WLA, LL Access and IEC product markets.
- 4.118 In our cost modelling for WLA Area 3 (for MPF and FTTC), LL Access Area 3 (for dark fibre) and IEC BT Only (for dark fibre), we proposed to base charges on Openreach's national costs.²¹⁹

Proposals

- 4.119 We proposed to require BT to prepare costs in geographic markets on a national unit cost basis for consistency with our modelling. By national unit costs, we meant a unit cost per service that does not take account of any differences in circuit lengths – total costs in a geographic market would then be estimated by multiplying the national unit cost per service by the volume of services in the geographic market.

Stakeholder comments

- 4.120 Vodafone agreed with our proposal on national unit costs, saying it was a pragmatic approach which limits the complexity of the RFS.²²⁰ However, TalkTalk said it was important that the 'genuine' costs are shown for each geographic area rather than some averaged cost.²²¹
- 4.121 Frontier said there should be clarity on how costs have been attributed by geography and queried the treatment of geographically focussed subsidies such as BDUK and any funding associated with the Universal Service Obligation.²²²

Our reasoning and decisions

National unit costs

- 4.122 In Annex 14 and Annex 17 we explain that our cost modelling has been done by reference to national unit costs, though in the case of dark fibre, we have excluded CLA costs (where we found no SMP) using information from BT's RFS.
- 4.123 Although costs could vary by geography (i.e. between Area 2 and Area 3)²²³ we have decided to require BT to prepare costs in geographic SMP markets on a national unit cost basis (as defined above). This would allow us to monitor BT's performance in geographic SMP markets on a basis consistent with how we have set prices.²²⁴

²¹⁹ See January 2020 Consultation Annex 18 and 19 and November 2020 Consultation, paragraph 4.3.

²²⁰ Vodafone response to February 2020 Consultation, paragraph 5.2.

²²¹ TalkTalk response to February 2020 Consultation, paragraph 5.4.

²²² Frontier response to February 2020 Consultation, section 3.2.3, page 35

²²³ For example, differences in cable size, cable length, network density and input costs (e.g. pay rates, wayleaves, traffic management) could result in unit costs varying between geographic SMP markets.

²²⁴ Note that for LL Access this means that BT could continue to estimate CLA costs using its current approach. Any changes to how it attributes costs between different LL Access markets must be published in its CCN.

- 4.124 Having different geographic markets for WLA, LL Access and IEC also means that BT will need to attribute PI costs between these downstream markets. The allocation diagrams BT is required to produce will illustrate how it has done this, supplemented by an appropriate explanation in its AMD.

BDUK funding

- 4.125 For the purpose of our cost modelling in geographic SMP markets, we have treated all costs on a national unit cost basis, including BDUK (and other grant) funding.
- 4.126 Given this, we have decided not to make a special case for geographic reporting in connection with BDUK funding, i.e. all costs, including BDUK and other funding, should be reported on a national unit cost basis in geographic SMP markets. This to ensure the RFS are prepared on a basis consistent with our cost modelling. Although BDUK funding is provided to enable the roll out of broadband in specified geographies, and in principle could be reported on a geographic basis, we consider that the corresponding assets and operating costs would also need to be reported on a geographic basis if the RFS were to fairly reflect the impact of grants on market costs and returns. For this market review period, we consider presenting all costs on a national unit basis would be consistent with our modelling approach and less likely to distort market costs and returns than selective reporting of geographic costs.

Implementation

- 4.127 Volume 7 includes the 'consistency' direction which requires BT to prepare costs in geographic markets by reference to national unit costs.

Cumulo

- 4.128 Cumulo rates are the non-domestic rates BT pays on its rateable assets (primarily passive assets such as duct, fibre, copper and exchange buildings) in the UK.

Proposals

- 4.129 In the January 2020 Consultation we proposed to forecast cumulo costs separately in our cost modelling and attributed these to services in a similar way to previous reviews.²²⁵
- 4.130 While we proposed that cumulo costs should be separately disclosed in the RFS we did not propose to direct BT to allocate cumulo costs to services in a specific way, as we had done in previous reviews. We said BT should set out any changes to its cumulo attribution methodology through its annual CCN process.

Stakeholder responses

- 4.131 BT agreed with our proposal to allow it flexibility in how to attribute cumulo costs.²²⁶

²²⁵ See paragraphs A16.108 to A16.116 of the January 2020 Consultation.

²²⁶ BT response to February 2020 Consultation, paragraph 5.14.

- 4.132 TalkTalk agreed that BT should put changes through the CCN as long as any change is consulted upon and BT provides sufficient information to allow CPs to properly understand the proposals and reasoning.²²⁷

Our reasoning and decisions

- 4.133 We have decided not to direct BT to allocate cumulo services in a specific way because the appropriate approach to allocating cumulo costs could change over the period, depending on, for example, domestic rates policy and assessments by rating authorities. We consider it would be appropriate to give BT the flexibility to change its attribution approach in response to any changes.
- 4.134 As TalkTalk noted, we expect BT to set out, through the annual CCN process, any changes to the treatment of cumulo costs in its RFS. As explained above, BT is required to publish its CCN in March each year, in advance of publishing the RFS in July.
- 4.135 We would expect any changes to the cumulo attribution to reflect up to date information on how cumulo is calculated and factors which could affect allocations to services. This approach will ensure that changes to BT's cumulo methodology are visible, that stakeholders can challenge BT's proposals, and that we can veto proposals if necessary (subject to consultation via the CCN process).

Asset valuation

- 4.136 The RFS are prepared on a current cost accounting (CCA) basis, which means assets are valued using an estimate of their current replacement cost rather than historical cost.
- 4.137 Where BT values an asset on a CCA basis in the RFS, this is generally done by applying an inflation index to its historical cost.²²⁸ We currently direct BT how to value certain assets, for example duct must be valued on a RAV adjusted basis²²⁹ and fibre held constant in nominal terms.²³⁰

Proposals

- 4.138 We proposed to continue requiring BT to prepare the RFS on a CCA basis since it was consistent with our cost modelling in the January 2020 Consultation.²³¹

²²⁷ TalkTalk response to February 2020 Consultation, paragraph 5.5.

²²⁸ In the past the current cost valuation of some assets was based on an 'absolute valuation' which could be volatile. The move to revaluing assets using indexation approaches has removed much of this fluctuation.

²²⁹ The RAV adjustment refers to the value placed on duct used for access cables installed prior to 1 August 1997. These assets are indexed using RPI based on the historical cost value as at 1 April 2005. BT currently values all other duct by indexing historical spend by RPI.

²³⁰ For fibre, see Table 5.4 of the July 2019 RFR Statement.

²³¹ In Annex 16 of that consultation we said the use of current cost valuations give better signals for efficient investment and entry than historical costs.

- 4.139 We said that duct, poles, fibre and copper represent the majority of assets in Openreach SMP markets.²³² In our cost modelling for the January 2020 Consultation, we valued duct and fibre on the basis noted above and copper and poles were indexed using RPI.²³³
- 4.140 For the purposes of preparing the RFS we proposed to require BT to value these assets on this basis to ensure consistency with our cost modelling. We said this was generally consistent with BT's current approach in the RFS.

Stakeholder responses

- 4.141 No stakeholders commented on our proposals.

Our reasoning and decisions

- 4.142 For the purposes of preparing the RFS we have decided to implement our proposals for the valuation of duct, poles, copper and fibre to ensure consistency with our cost modelling. These assets will be valued as follows:
- **Duct:** RAV adjusted basis;
 - Copper and poles: indexed using RPI;
 - Fibre: held constant in nominal terms (this is the same as the historical cost valuation)

Implementation

- 4.143 We have included text in the 'consistency' direction in Volume 7 which requires BT to value duct, poles, fibre and copper on the basis set out above.

IFRS16 – treatment of leases

- 4.144 A new lease accounting standard, IFRS16, became mandatory in the UK for accounting periods commencing on or after 1 January 2019. Leases are brought onto the balance sheet under IFRS16.
- 4.145 In BT's annual report the effect of IFRS16 was to replace the operating lease expense in the income statement with i) a new lease asset and liability on the balance sheet and ii) a depreciation and finance charge in the income statement.²³⁴
- 4.146 IFRS16 changes how leases are presented in statutory financial statements, but it does not affect the underlying cash flows associated with leases. Where we have previously set regulated prices by reference to BT's costs, we have done so using operating lease expenses (principally in relation to property) and this was also the approach proposed in Annex 16 of the January 2020 Consultation for some services.

²³² The schedule on page 34 of the 2019/20 RFS indicates they represent 90% of non-current assets. Note that pole assets are mainly included within copper in this schedule.

²³³ See Annexes 16 and 20, January 2020 Consultation.

²³⁴ See page 129 of BT's [2019/20 annual report](#) for an explanation of BT's treatment of IFRS16.

Proposal

- 4.147 Given the underlying nature of leases had not changed and our proposed approach to cost modelling was consistent with previous reviews, we considered that IFRS16 should be implemented in the RFS in a way that minimised the impact on reported returns.
- 4.148 We considered IFRS16 could be implemented in the RFS while having a minimal impact on reported returns if all P&L and balance sheet entries associated with IFRS16 were included in the RFS. We said this would mean that, over the life of a leased asset, the P&L entries (depreciation plus finance charge) would be equal to the underlying lease expense, while the lease asset and liability would broadly net off.²³⁵ We said we expected BT to implement an approach in its 2019/20 RFS which minimised the impact of IFRS16 on reported returns and explain it in its AMD. We therefore did not propose to direct BT how to deal with IFRS16 in the RFS.

Stakeholder responses

- 4.149 No stakeholders commented on our proposal.

Our reasoning and decisions

- 4.150 In Annex 14 we explain that, for the purposes of cost modelling, we have treated leases on a basis consistent with our previous reviews, i.e. using an estimate of the operating lease expense rather than the IFRS16 approach. This was to help maintain a stable approach to pricing and minimise the risk that BT could over recover costs associated with leases.
- 4.151 In its 2019/20 CCN BT explained its treatment of leases in its 2019/20 RFS.²³⁶ It said that implementation of IFRS16 had significantly increased the asset base in the RFS. However, to maintain comparability between the ROCE reported in the RFS and Ofcom's approach to setting prices, BT said it had also included the liability relating to the Telereal property lease in RFS asset base, as it represents the biggest lease item.²³⁷
- 4.152 We consider that BT's approach in the 2019/20 RFS is a reasonable approach to ensure the reported returns are comparable to our cost modelling approach. In line with our consultation proposals, we have therefore decided not to direct BT how to deal with IFRS16 in the RFS but expect BT to explain its treatment of leases in its AMD. Any changes to BT's approach to leases in the RFS will be visible via the annual CCN process. As explained above, we can, after consultation, direct BT not to make a change set out in the CCN where we disagree with it (this might be the case, for example, if BT proposed a change to its treatment of IFRS 16 in the RFS which significantly impacted reported returns in SMP markets).

²³⁵ There will be some timing differences – for example the lease asset and liability do not amortise in exactly the same way. However, we do not consider these timing differences will significantly impact the returns reported in the RFS.

²³⁶ See page 27 of BT's [March 2020 CCN](#).

²³⁷ Long term liabilities are not usually included in the RFS (e.g. long term debt). However, if none of the lease liability was included in the RFS, the asset base would be higher and the ROCE lower, other things equal.

SLGs

4.153 In our cost modelling for the January 2020 Consultation we treated service level guarantee (SLG) payments as operating costs.²³⁸ In the March 2019 RFR Statement we noted that the introduction of the IFRS15 accounting standard (dealing with recognising revenue from contracts with customers) would mean that SLG payments would be recognised as a reduction to revenue rather than an operating cost in statutory financial statements.²³⁹ In that document we decided that SLG payments should appear as operating costs for individual services in the RFS.

Proposals

- 4.154 For consistency with our cost modelling, and reflecting the current treatment in the RFS, we proposed to require BT to present SLG payments as operating costs in the RFS.
- 4.155 We also proposed that, in line with current practice, BT can include reconciling items relating to IFRS15 in the RFS where required.

Stakeholder responses

4.156 No stakeholders commented on this proposal.

Our reasoning and decisions

- 4.157 In Annex 14 we say that SLG payments have been treated as operating costs in our cost modelling.
- 4.158 We consider it is important that SLG payments are visible in the RFS and that it makes sense to continue to report them under operating costs for comparability with our modelling approach. This is also consistent with the existing RFS treatment.
- 4.159 We recognise that categorising SLG payments as an operating cost differs from the treatment under IFRS15. To ensure that overall revenue recognition in the RFS is consistent with statutory financial statements, BT currently includes reconciling line items for IFRS15 in the summary schedules for each market. For example, in the WLA market it includes the following items:
- WLA IFRS 15. This row captures the impact of deferring revenue under IFRS15.²⁴⁰
 - WLA SLG: This recognises SLG payments as a credit to revenue rather than an operating cost.²⁴¹
- 4.160 Consistent with current practice in the RFS, BT can continue to include such row items to show how the RFS differs from statutory financial statements in relation to IFRS15.

²³⁸ See paragraphs A16.117 to A16.119, Annex 16, January 2020 Consultation.

²³⁹ See paragraphs 3.72 to 3.81, March 2019 RFR Statement.

²⁴⁰ A negative revenue in this row would indicate that under IFRS15 some revenue has been deferred, e.g. in relation to a customer contract spanning several years.

²⁴¹ SLGs are recognised as operating costs in the cost stack for each service. This SLG row then reverses this and credits revenue for consistency with IFRS15.

Implementation

- 4.161 We have included text in the ‘consistency’ direction in Volume 7 which requires BT to present SLG payments as operating costs in the RFS.
- 4.162 We have also included text in the form and content direction saying that BT can include reconciling items for IFRS15 in each market summary where required, as per current practice.

Cost of capital

- 4.163 In the January 2020 Consultation we estimated the cost of capital (WACC) for BT Group, Openreach, ‘Other UK telecoms’ and rest of BT. We proposed to use the Openreach and Other UK telecoms WACCs to set allowed returns on capital employed for the purpose of setting regulated prices.
- 4.164 BT’s regulatory accounting system sometimes needs to use WACCs to attribute costs, e.g. when using PAC or cumulo methodologies. BT’s 2019/20 AMD sets out the WACC percentages BT has associated with different cost pools.²⁴²
- 4.165 There is no current requirement for BT to use particular WACCs in its cost accounting system. Generally, BT has tended to use the WACCs determined in whichever market review statement was published prior to the start of the financial year or those published in statements relevant to particular markets.²⁴³

Proposals

- 4.166 We considered BT’s current approach was reasonable. We said although BT had occasionally applied WACCs we considered inappropriate, we understood this only had a very small effect on costs in regulated markets.²⁴⁴
- 4.167 We said that:
- where a WACC was required to attribute costs to a cost pool, we would expect a WACC to be used which reflects the part of BT to which that cost pool relates, i.e. the Openreach, Other UK telecoms or Rest or Rest of BT WACC.
 - it may be reasonable to use the BT Group WACC when attributing costs early in the cost allocation process where it is not possible to associate these with particular parts of BT.
 - BT should continue to explain its approach in its AMD, as it does now.
- 4.168 We therefore did not propose to direct BT to use specific WACCs when preparing the RFS.

²⁴² See pages 88 and 172 – 178 of the 2018/19 AMD.

²⁴³ In its 2019/20 AMD BT references the WACCs published in the 2018 WLA Statement and 2019 BCMR Statement. See page 13.

²⁴⁴ For example on page 106 of the 2018/19 AMD, BT notes it has used the 13.3% Rest of BT WACC from 2018 WLA Statement for some cost pools. We would not have expected this WACC rate to be used since it only applies to BT’s ICT operations in divisions such as Global Services.

Stakeholder comments

4.169 No stakeholders commented on our proposal.

Our reasoning and decisions

4.170 In Annex 21 we associate the Openreach, Other UK telecoms and rest of BT WACCs with the following services, markets and parts of BT:

- **Openreach:** PI, WLA (excluding FTTP), dark fibre used for leased lines access and IEC services.
- **Other UK telecoms:** FTTP, active leased lines access and IEC services, all other SMP markets, wholesale markets, retail markets and parts of BT excluding those in Rest of BT.
- **Rest of BT:** ICT services provided by Global Services and Enterprise divisions.

4.171 In line with our proposals, we are not directing BT to use specific WACCs when preparing the RFS. However, in general, we would expect to see either the Openreach or Other UK telecoms WACCs used in BT's cost accounting system, although as noted above, it may be reasonable to use the BT Group WACC in some circumstances. We would also expect BT to use the WACCs set out in Annexes 20 and 21 where a cost of capital is required to attribute costs to services in the RFS (e.g. in relation to cumulo), to take account of the services each WACC is associated with, as summarised above, and to explain its approach in its AMD.

Preparation of the RFS – market specific requirements

4.172 In this section we set out requirements on BT in relation to specific SMP markets which we consider are required to maintain consistency with our regulatory decisions. These requirements are included in the Consistency Direction in Volume 7. This direction ensures the RFS are prepared on a basis that allows us to assess the impact and effectiveness of our remedies and provides assurance to stakeholders that information is being created and retained such that appropriate regulation can continue to be maintained in future.

Physical infrastructure

Poles

Proposals

4.173 We proposed two requirements in relation to poles

- **Identification of pole costs:** we proposed to require BT to account for pole assets separately in the RFS. We said this would include separately identifying the volume and costs of new poles and establishing an appropriate asset life for pole assets. We proposed to require BT to provide assurance in the form of agreed upon procedures (AUP) that it had properly separated pole assets from other assets and that the asset life was reasonable.

- **Exclusion of cabling activities:** we proposed that BT should exclude costs associated with cabling from the poles cost base for consistency with our proposed pricing approach. We considered this was captured by our proposed change to the causality principle so did not propose a separate consistency direction.

Stakeholder responses

- 4.174 In relation to the identification of pole costs, BT considered that prescribing the financial recording of poles source data is unnecessary.²⁴⁵ BT accepted that sometimes it may need to make changes to record-keeping to produce the reporting that Ofcom specifies, but that it could generally meet our requirements using cost attributions.²⁴⁶ BT said that changing underlying accounting systems is often slow and costly, likely to be disproportionate to the benefit and potentially less flexible [than an attribution approach].²⁴⁷ BT proposed that references to ‘record’ in the direction are replaced with ‘report’ to allow BT flexibility to find the most effective way of meeting Ofcom’s requirements.²⁴⁸
- 4.175 Regarding the requirement to provide assurance in the form of AUP on the separation of pole assets and setting an asset life. BT suggested that if the aim of this was “to obtain an independent opinion on the appropriateness of the methodologies applied, agreed upon procedures would not achieve this aim – the auditors can only conduct specific tests without an opinion”.²⁴⁹
- 4.176 No stakeholders commented on our proposals relating to the exclusion of cabling activities.

Our reasoning and decisions

Identification of pole costs

- 4.177 BT has historically recorded the cost of poles under several different classes of work (COWs), such as copper, fibre and drop wires. To ensure that cost data for poles is available and robust we consider it is important that BT can separately identify volumes and financial information relating to poles.
- 4.178 However, we agree with BT that it does not need to change the way it records information on poles to do this. We recognised this in our consultation when we said it could be difficult to extract information on historical poles from existing records, and that a modelling approach could be required to estimate costs associated with older poles.²⁵⁰
- 4.179 We have therefore decided to require BT to separately identify and report (rather than ‘record’) the volumes and capital costs of pole assets. BT is intending to introduce a new

²⁴⁵ BT response to February Consultation, paragraph 4.4

²⁴⁶ BT response to February Consultation, paragraph 5.12.

²⁴⁷ BT response to February Consultation, paragraph 5.13.

²⁴⁸ BT response to February Consultation, paragraph 5.15.

²⁴⁹ BT response to February 2020 Consultation, paragraph 5.10.

²⁵⁰ February 2020 Consultation, paragraph 5.100.

pole class of work from April 2021²⁵¹ which will help meet this requirement and support the reporting of pole services set out in section 3.

- 4.180 We recognise that under AUP the auditors carry out specific tests without giving an opinion. However, we think it is important to obtain assurance that where BT has moved assets out of other classes of work (e.g. copper) into a new pole asset category, or where it has followed a modelling approach to separately identify pole assets, it has followed a methodology and done so without error – an assurance that AUP or similar procedures could provide. Other procedures such as those described in the document ‘International Standard on Assurance Engagements (UK) 3000’ (ISAE 3000)²⁵², which includes assurance engagements that allow for an opinion to be provided, are also part of the wider set of procedures through which BT could comply with the assurance requirement. We have therefore included a requirement for BT to provide assurance on this requirement in the Consistency Direction, but we note that the definition of Additional Procedures on which we consulted, and which we have not changed, allows flexibility in how this assurance is provided.²⁵³ As the implementation of a new pole class of work should be a one off piece of work for BT, we have limited the provision of this assurance to the 2021/22 financial year (the first year this requirement will take effect).²⁵⁴ BT must put any subsequent changes to the treatment of pole assets through the CCN process.
- 4.181 In Volume 4 we also explained that poles had previously been recorded under different classes of work, and, as a result, were associated with different asset lives.²⁵⁵ We decided to apply a 40 year asset life to poles going forward.
- 4.182 Going forward, we consider that BT should depreciate capitalised pole costs over 40 years consistent with our approach to pricing. This will ensure pole costs reported in the RFS are comparable with the basis for setting prices. However, we recognise that other evidence on the economic life of poles could become available during the review period so, to give BT flexibility, we have decided to require the asset life for poles to be 40 years as at 1 April 2021. BT will therefore need to put any subsequent changes to the pole asset life through the CCN process. As we are directing BT to use a 40 year asset life initially, we do not consider additional assurance is required at this stage, so we have not imposed a requirement for AUP.

Exclusion of cabling activities

- 4.183 In Volume 4 we set prices for pole products which excluded any costs associated with cabling activities. To ensure the costs presented in the RFS are consistent with this, we

²⁵¹ BT response dated 18 February 2021 to Q1 of the section 135 notice dated 8 February 2021.

²⁵² [International standards on assurance engagements \(UK\) 3000 \(July 2020\)](#), Financial Reporting Council

²⁵³ The legal instruments in Volume 7 define ‘additional procedures’ (which could include AUP) as “an engagement under which the Regulatory Auditor or another independent third party performs a set of procedures required by Ofcom and based on Ofcom’s specific requirements in relation to the Regulatory Financial Statements, and reports the findings of that work to Ofcom”.

²⁵⁴ We note that the regulatory reporting SMP condition allows us to require BT to commission additional procedures, such as AUP, at any time.

²⁵⁵ For example, to the extent poles were previously recorded alongside copper assets, they will have been associated with an asset life of 18 years. However, some poles are significantly older.

consider that BT should exclude costs associated with cabling from the poles cost base. We consider this is captured by our change to the causality principle (i.e. that costs should only be attributed to services where they are relevant to the provision of this service) so we have decided not to impose a separate consistency direction.

Duct

Proposals

- 4.184 We made two proposals in relation to duct:
- **Lead in duct identification:** we proposed that BT must identify and record the volume (by length in metres and by number of connections) and capital cost of lead-in duct installed after April 2021.
 - **Attribution of duct to PI services:** we proposed that BT should attribute duct installed before and after March 2018 on a basis consistent with the way we set prices.

Stakeholder responses

Lead-in duct identification

- 4.185 BT said that while it currently records volumes associated with new lead-in duct, it did not have the ability to separately identify and record the associated capital costs due to the way it plans and builds new sites with third party developers. BT said it provides developers with details of the infrastructure to build on a single job/estimate and this does not break down the cost of the various individual requirements.²⁵⁶
- 4.186 BT added that changing the process would require a fundamental rebuild of its systems and proposed that it should be required to 'report', rather than 'record' the capital costs of lead in duct. It said it could do this using an apportionment methodology.²⁵⁷

Attribution of duct to PI services

- 4.187 In its response BT said, while it could separately identify the net replacement cost and associated depreciation of duct installed before and after 31 March 2018, it would not be practicable to separately record the individual assets at source. BT proposed to use an apportionment approach to achieve the required reporting outcome.²⁵⁸

Our reasoning and decisions

Lead-in duct identification

- 4.188 In Volume 4 we set charges for a simplified lead-in duct product using assumptions and sampling information from BT. We noted that Openreach did not routinely keep records of lead-in duct infrastructure.

²⁵⁶ BT response to February 2020 Consultation, paragraph 5.42

²⁵⁷ BT response to February Consultation, paragraphs 5.43, 5.44 and 7.25.

²⁵⁸ BT response to February Consultation, paragraph 5.40.

- 4.189 To assess the effectiveness of the charge control it is important that BT can separately identify volumes and financial information associated with lead-in duct going forward. The purpose of the proposed requirement was to ensure that this information on lead-in duct is available and robust.
- 4.190 We agree with BT that it does not necessarily need to change the way it records information on lead-in duct to do this, and recognise that requiring it to do so could be disproportionate given the way infrastructure is planned and built. We have therefore decided to require BT separately to identify and report (rather than 'record') the volume and cost of lead-in duct.
- 4.191 Given that BT can use an apportionment approach to report the costs of lead-in duct, we consider this requirement should apply to all lead-in duct and not be limited to lead-in duct installed after 1 April 2021. As noted in the February 2020 Consultation, this apportionment could be done using a sampling approach, though we would expect this to evolve over time, especially where new lead-in duct is installed as part of the FTTP rollout.

Attribution of duct to PI services

- 4.192 In volume 4 we explained that we attributed duct costs between PI services to set charges. We said that Openreach's latest cost attribution (the 'new' methodology) would lead to significant changes in prices, notably for single bore and 3+ bore duct, compared to the approach taken in the 2018 WLA Statement (the 'old' methodology).
- 4.193 To help maintain stable prices we decided to attribute costs associated with duct assets installed before 31 March 2018 using the 'old' methodology and to attribute costs associated with duct assets installed after this date by applying the 'new' methodology. We made an adjustment to the standard unit costs used by Openreach in the 'new' methodology to ensure the allocation of duct costs reflected the charging structure for duct bores.²⁵⁹
- 4.194 To ensure the costs presented in the RFS are consistent with our approach to setting prices, we have decided to require BT to attribute duct costs to PI services on the same basis, meaning BT must:
- Separately identify the net replacement cost and associated depreciation of duct installed before and after 31 March 2018;²⁶⁰
 - Attribute costs associated with pre-March 2018 duct to PI services using the percentages set out in the Consistency Direction;
 - Attribute costs associated with post-March 2018 duct to PI services in proportion to the estimated standard cost of each PI service, where the standard cost is estimated by reference to standard unit costs and volumes. The standard unit cost of duct bore variants (single bore, 2 bore, 3+bores) must be consistent with how these are charged:

²⁵⁹ See Annex 18. For example, a length of 2-bore duct is usually formed of one 2-bore duct, but is occasionally formed of two single bore ducts. In both cases a customer would pay the 2-bore charge. To ensure consistency with this charging approach, we made an adjustment so that the standard unit costs of 2-bore duct reflect that it is sometimes formed from sections of two single bore ducts.

²⁶⁰ This requirement applies to total duct assets; it does not require BT to record individual duct assets at source.

for example the standard unit cost of 2 bore duct should reflect that some of the volume consists of two single bore sections of duct. This analysis should be updated each year to take account of long-term changes in the mix of jobs (i.e. by reference to data over several years).²⁶¹

Network adjustments

Proposals

4.195 We proposed to reimpose on BT three requirements from the 2019 RFR Statement to i) identify and record network adjustment costs (both above and below the financial limit), ii) capitalise internal and external network adjustments below the limit in the PI market and iii) expense internal and external network adjustments above the limit in the PI market (the '2019 PI requirements'). We also proposed that BT must attribute all network adjustments associated with poles to the pole asset and ensure they can be separately identified.

Stakeholder responses

4.196 In relation to pole network adjustments, BT proposed to continue attributing pole network adjustments to the pole component, rather than the pole 'asset' (or class of work) to ensure they can be separately identified.²⁶²

Our reasoning and decisions

4.197 No stakeholders commented on our proposal to maintain the 2019 PI requirements so we have decided to implement these to ensure that BT reports network adjustments on a basis consistent with the PI charge control and non-discrimination obligations. These requirements also support the reporting of network adjustments set out in Section 3.

4.198 In Volume 4 we said charges for network adjustments undertaken to provide capacity on poles or to make poles useable for drop wires are capped at zero. This means that BT cannot charge for such pole network adjustments and any costs associated with them should be pooled and recorded against total pole assets costs (to be recovered across all users of the infrastructure).

4.199 We have imposed a requirement on BT to ensure it reports costs for network adjustments associated with poles required for the purposes of installing drop wires on this basis. In the February 2020 Consultation, we incorrectly said network adjustments for all poles should be spread across users of the infrastructure; the Consistency Direction has been amended to clarify that this requirement only relates to network adjustments undertaken to provide capacity on poles or to make poles useable for drop wires.

²⁶¹ For example differences in the surface mix each year (whether duct is installed under soft or hard surfaces, which can affect the cost).

²⁶² BT response to February 2020 Consultation, paragraph 5.22.

4.200 We have also amended the wording of the direction to address BT's concern that the way it has implemented this requirement in its accounting system means that these pole network adjustment costs are attributed to pole components rather than 'assets' per se. Our amendment requires BT to attribute to pole services, the pole network adjustment costs associated with installing drop wires.²⁶³

Mapping BT's physical infrastructure records and financial records

Proposals

4.201 We proposed that BT should map its physical infrastructure records to its financial records. This would maintain the current requirements imposed in the 2018 WLA Statement.²⁶⁴

Stakeholder responses

4.202 BT said that it had continued to improve the mapping of aggregated cost data within its fixed asset register to its physical asset inventory and that Ofcom was aware of the difficulties it had encountered. BT said it was happy to continue to work with Ofcom to develop a report that provides assurance.²⁶⁵

Our reasoning and decisions

4.203 The purpose of the requirement is to ensure that the asset costs recorded against PI (from the fixed asset register) capture all relevant PI assets, and that those assets exist (from the physical infrastructure records). This is important because PI rental prices are informed by information from BT's financial and physical records. PIA assets also have long asset lives enduring for several review periods, so it is important to understand how the financial and physical records relate to each other on an ongoing basis.

4.204 In the February 2020 Consultation, we recognised that parts of BT's asset base will be easier to map to financial records than others, and that, where there were significant gaps in the physical or financial records, BT could use surveys, sampling and/or bottom up modelling to fill in the information gaps. As noted in the February 2020 Consultation, we expected this mapping exercise to be one of continual improvement as PI evolves.

4.205 In response to an information request, BT used information from planning systems²⁶⁶ to show how its PI asset inventory mapped to financial records.²⁶⁷

4.206 The information provided by BT revealed the following:

- The physical asset inventory is a real-time system which does not have the ability to query historical records. Therefore, while additions to physical records²⁶⁸ can be

²⁶³ As costs are attributed to services via cost components in BT's cost accounting system, we consider this addresses BT's concern.

²⁶⁴ See paragraphs A8.93 to A8.107, 2018 WLA Statement

²⁶⁵ BT response to February 2020 Consultation, paragraph 5.18.

²⁶⁶ Specifically a system called NIMs. See page 267 of BT's 2019/20 AMD for a description of NIMs.

²⁶⁷ BT response dated 26 February 2021 to question 1 of the section 135 notice dated 12 February 2021.

²⁶⁸ Additions to physical records can be estimated by taking a snapshot of the asset inventory at two points in time.

compared to additions to financial records, it was not possible to make this comparison for historical records.

- Planning system data (from NIMS) was the only practicable way to link physical and financial records. This is because it included records of physical assets (which were subsequently included in BT's physical inventory) and cost estimates for internal and contracted activities (which could be associated with financial records in the fixed asset register).

4.207 In light of these findings we have decided to modify our proposed requirements as follows.

4.208 First, although BT was unable to map historical records robustly, we consider that mapping additions to physical and financial records would, over time, provide assurance that asset costs reported in the PI market capture relevant PI assets and that those assets exist. We have therefore amended the wording of the Consistency Direction to refer to asset additions rather than total assets and made clear that the requirement relates to duct and pole assets in the PI market.

4.209 Second, we consider that requiring BT to provide information on the results of the mapping exercise on a regular basis will ensure we have a time series of data from the same point each year and presented on a consistent basis with which we can ensure BT is complying with the requirement. We have therefore included a requirement for BT to provide this information each year alongside other information provided to Ofcom privately.²⁶⁹

4.210 We consider that these modifications will ensure that the requirement is practicable for BT to implement, provide us with regular information and help give assurance over the assets and volumes reported in the PI market.

WLA

Copper depreciation

4.211 In the January 2020 Consultation, we proposed that, to reflect copper assets no longer being used as copper retirement occurs, we would assume that, for forward looking capital expenditure on copper assets capitalised between 2017/18 and 2025/26, any additional depreciation and return on capital required to bring the assets' net book value to zero after 2030/31 would be recovered in the charge control period 2021/22 to 2025/26 (effectively meaning costs for those new copper assets would be recovered by 2030/31). Should we set cost-based controls in future periods, we said we would not allow any further recovery of this capital expenditure post-2025/26. We said the impact of this proposal was to bring forward £1,400m (across Area 2 and 3) of nominal costs into the current review period.

4.212 In the July 2020 Consultation we proposed to further accelerate the depreciation and return on capital of copper assets capitalised between 2017/18 and 2025/26 for 3.2m premises in Area 3 to allow for cost recovery by 2025/26. This means that in Area 3, the costs of new copper assets associated with premises that are part of the BT Commitment

²⁶⁹ This requirement is included in section 5 where we set out our private reporting requirements.

would be fully recovered by 2025/26 while the costs of new copper assets associated with other premises in Area 3 would be fully recovered by 2030/31. We estimated that this would bring forward a further £130m of depreciation into the review period compared with our proposals in January 2020.

Proposals

- 4.213 BT currently depreciates most copper cable assets over 18 years.²⁷⁰
- 4.214 We said that, for copper assets capitalised between 2017/18 and 2025/26, there may be a mismatch during the review period between the copper asset life in the RFS and the copper asset life assumed for the purposes of recovering costs through the proposed forecast RAB approach in WLA Area 3.
- 4.215 While we recognised that this mismatch could make it harder to interpret some aspects of the RFS, we considered that prescribing how BT should account for depreciation in the RFS for these copper assets would be inappropriately inflexible. Therefore, we did not propose to prescribe via a direction how BT should depreciate these copper assets in its RFS.

Stakeholder responses

- 4.216 BT welcomed the flexibility in how to account for copper depreciation. It said that prescribing an approach in the RFS could create challenges for stakeholders when interpreting costs with reference to statutory financial statements.²⁷¹
- 4.217 No other stakeholders commented on our proposal.

Our reasoning and decisions

- 4.218 In Annex 14 we explain how we have treated copper depreciation in our cost modelling.
- 4.219 For the reasons above, we have decided not to direct BT how to depreciate copper assets in its RFS. We note that BT could adjust its approach to copper depreciation in the RFS by making a methodological change via the annual CCN process or by making a change to group policy in its statutory financial statements (the effect of which would flow through the RFS).
- 4.220 Although this may mean there is a mismatch between the WLA costs reported in the RFS (prepared on the basis of the currently copper asset life) and the WLA costs assumed in our cost modelling (where depreciation for some copper assets has been accelerated) we have published in Annex 14 our estimate of the additional depreciation and return on capital brought forward to this review period. This could be used to assess the impact of our approach on WLA costs and returns reported in the RFS.

²⁷⁰ For example, see page 45 of BT's 2019/20 AMD. BT may assume different asset lives for different classes of copper assets.

²⁷¹ BT response to July 2020 Consultation, paragraph 5.3.

Leased lines access and inter-exchange connectivity services

ECCs

Proposals

- 4.221 In the January 2020 Consultation we said we did not agree with BT capitalising ECC costs and that these should instead be expensed in the same period revenue is recognised. We proposed to make an adjustment to this effect in our cost modelling.²⁷²
- 4.222 While our proposed amendment to the objectivity principle (discussed above) would have explicitly required BT not to capitalise costs recovered through upfront charges (like ECCs), we said that, to ensure all historically capitalised costs associated with ECCs are removed from MCE, we proposed to require BT to identify all capitalised ECCs and to treat these as if they were expensed in the year they were incurred.

Stakeholder comments

- 4.223 No stakeholders commented on our proposal

Our reasoning and decisions

- 4.224 As noted in section 3, BT expensed all costs associated with ECCs in its 2019/20 RFS, and explained this change in its 2019/20 CCN. To ensure BT continues this practice during this review period, we have decided to require BT to expense, rather than capitalise, costs associated with ECCs. This will ensure revenues and costs of ECCs are recognised in the year they were incurred and help prevent over-recovery of ECC costs which have been funded by up front revenues.

Dark fibre

Proposals

- 4.225 In the January 2020 Consultation, we proposed a cost based charge control for dark fibre services in LL Access and IEC markets. Our dark fibre cost estimates were based on the passive component costs associated with providing an EAD circuit plus some costs specific to a dark fibre circuit. We proposed the following requirements to ensure the RFS were consistent with our approach to setting prices.

Dark fibre costs derived from EAD component costs

- 4.226 In the January 2020 Consultation we calculated dark fibre costs by estimating the proportion of EAD component costs which related to dark fibre. In the February 2020 Consultation we proposed to require BT to separately identify the following to ensure data

²⁷² Paragraph A16.39. Annex 16, January 2020 Consultation. See Table A16.4 for the impact of the adjustment.

on dark fibre costs was available and help assess the effectiveness of the proposed charges:²⁷³

- systems and development costs for dark fibre services;
- SLG payments in relation to provision and assurance for dark fibre services.

Costs specific to dark fibre

- 4.227 In the January 2020 Consultation we estimated the costs of patch panels (at BT exchanges and customer premises) and initial testing.
- 4.228 We proposed to require BT separately to record the costs associated with i) patch panel equipment, ii) labour to install patch panels and iii) labour to undertake initial testing of dark fibre circuits. We said the costs associated with labour should include the hourly engineering pay and the average time taken to complete the task, including any differences between testing single and dual fibre and installing patch panels at the exchange and customer premises. We also said BT should depreciate patch panels over 7 years.

Stakeholder responses

Dark fibre costs derived from EAD component costs

- 4.229 No stakeholders commented on our proposals for BT separately to identify systems and development costs and SLG payments for dark fibre services.

Costs specific to dark fibre

- 4.230 BT said the costs for patch panels and initial testing are currently captured on single jobs associated with fibre rollout and connection activities and that meeting our proposal to record these costs separately would require significant changes to booking practices, planning processes and engineering systems.²⁷⁴
- 4.231 Rather than recording patch panel and initial testing costs separately at source, BT proposed to use an apportionment approach to report the costs of these services.²⁷⁵ BT proposed to review and update relevant inputs as part of the attribution methodology.²⁷⁶

Our reasoning and decisions

Dark fibre costs derived from EAD component costs

- 4.232 In Annex 17 we explain how we have treated EAD component costs to set dark fibre prices. Per our consultation approach, we estimated the proportion of costs relevant to dark fibre services from components relating to Openreach systems and development and SLG provision and assurance (amongst other components).

²⁷³ Table 5.6 of the February 2020 Consultation sets out our consideration of the other EAD components costs used to inform dark fibre costs.

²⁷⁴ BT response to February 2020 Consultation, paragraphs 4.39 and 4.41.

²⁷⁵ BT response to February 2020 Consultation, paragraphs 4.40 and 4.42.

²⁷⁶ For patch panels BT indicated this could include the labour rate, hours per patch panel install, equipment costs and utilisation per patch panel. For initial testing BT indicated this could include time to conduct a test and the labour rate. See BT response to February 2020 Consultation, paragraphs 4.40 and 4.42.

- 4.233 Ensuring that BT can separately identify these costs in relation to dark fibre will help assess the effectiveness of our dark fibre charge controls. We have therefore decided to impose our proposed requirements on BT in respect of dark fibre, as set out below:
- **Openreach systems and development (Ethernet):** BT must separately identify systems and development costs for dark fibre services
 - **SLG Ethernet Provision and SLG Ethernet assurance:** BT must separately identify SLG payments in relation to provision and assurance payments for dark fibre services.

Costs specific to dark fibre

- 4.234 In Annex 17 we explain that we estimated costs for patch panels (at BT exchanges and customer premises), initial testing, RWT and cessation. We estimated these costs since BT does not currently report these costs in relation to dark fibre services.
- 4.235 For patch panels we estimated the cost of the patch panel equipment and the labour cost associated with installing them at the exchange and customer premises. We capitalised this cost and depreciated it over 7 years to estimate the patch panel charge.
- 4.236 For initial testing, RWT and cessation we estimated the unit labour cost and average time to complete the task.
- 4.237 We set out in section 3 that BT will be required to publish the operating and capital costs of these dark fibre ancillary services in relevant LL Access and IEC markets. To help us assess the effectiveness of our charge controls, we consider that BT should separately identify the elements making up these costs, such as labour rate, time taken to install/test and depreciation assumptions.
- 4.238 We recognise that it could be disproportionate to require BT to separately record at source the costs of patch panels and initial testing given the way these activities are undertaken. However, we consider it is important to understand how BT has determined the costs of these services. We have therefore decided to amend the proposed Consistency Direction to require BT to separately identify the inputs and assumptions underpinning the reported costs for these dark fibre ancillary services, i.e. patch panels, initial testing, RWT and cessation. We consider it is proportionate to include RWT and cessation charges in this requirement as we estimated the costs of these ancillary services in a similar way to initial testing charges.
- 4.239 Specifically, BT will be required to separately identify the inputs and assumptions related to the cost of patch panel equipment, depreciation of patch panels and relevant labour rates for these services (cost of labour; time taken to install patch panels at exchanges and customer premises; and time taken to test and cease dark fibre circuits, including any differences between single and dual fibre).²⁷⁷ These can be derived from an apportionment approach where necessary.

²⁷⁷ In Section 5 we require BT to report information on these services to us privately. BT should explain in its AMD how it has estimated the cost of these services in the published RFS.

4.240 We consider that BT should also depreciate capitalised patch panel costs over 7 years consistent with our proposal and approach to pricing. However, we recognise that other evidence on the economic life of patch panels could become available during the review period so, to give BT flexibility, we have decided to require the asset life for patch panels to be 7 years as at 1 April 2021. BT will therefore need to put any changes to the patch panel asset life through the CCN process.

Assurance

4.241 Some reporting requirements on BT exist to provide assurance to stakeholders that the RFS have been properly prepared. In the February 2020 Consultation we made proposals in relation to the following, which we discuss further below:

- Reconciliation to statutory financial statements
- Additional procedures
- Audit of the published RFS

4.242 We also address a specific point raised by BT in respect of the wording of the proposed SMP condition that required the RFS and any audit opinion to be “fit for purpose”.

Reconciliation to statutory financial statements

Proposals

4.243 To date, we have required BT to provide a reconciliation of the RFS to the BT Group annual report for both Openreach and BT Group plc.²⁷⁸ We proposed to maintain this requirement with minor changes to the format of the reconciliation statement consistent with its presentation in the 2018/19 RFS. We also proposed that BT must include a brief description of each adjustment shown in the reconciliation statement (as it does now) and that rows could be added or removed with agreement from Ofcom.

Stakeholder responses

4.244 BT said it was comfortable with our proposal.²⁷⁹

4.245 While not specifically referring to the reconciliation statement, CFL said Openreach information in the income statement and balance sheet on statutory and regulatory bases should be fully reconciled by line item.²⁸⁰

4.246 In relation to Openreach operating costs, CFL also said that allocations and recharges from BT central functions should be analysed in detail and differences between the statutory and regulatory financial statements should be explained individually, with any specific

²⁷⁸ This is also required under the 2005 EC recommendation which states “For consistency and data integrity, it is recommended that the financial reports of the regulatory accounts be consolidated into a profit and loss statement and a statement of capital employed for the undertaking as a whole. A reconciliation of the separate regulatory accounts to the statutory accounts of the operator is also required”.

²⁷⁹ BT response to the February 2020 Consultation, paragraph 5.2.

²⁸⁰ CFL response to the February 2020 Consultation, section 4.4 and 4.5.

items attributed to Openreach explained.²⁸¹ It noted that Openreach operating costs in statutory financial statements were higher than those in the RFS and that the main reason for this difference was due to differences in cost attributions and transfer charges (currently referred to as ‘other trading differences’ in the reconciliation statement in the RFS). CFL said that no indication is given as to what these transfer charges are for, nor any reason why they should be calculated differently for regulatory and statutory reporting.²⁸²

Our reasoning and decisions

- 4.247 The reconciliation statement identifies the main differences in revenues, operating costs and returns between the RFS and the statutory financial statements for both Openreach and BT Group plc. For BT Group the reconciliation statement additionally reconciles mean capital employed.²⁸³
- 4.248 We consider that requiring BT to publish the main reconciling adjustments, alongside an explanation of what they relate to, provides some assurance that the RFS are consistent with the audited statutory financial statements. This in turn gives stakeholders confidence that the data in the RFS is properly extracted from the books and records used to prepare the audited statutory financial statements.
- 4.249 We have therefore decided to require BT to publish a reconciliation statement to provide assurance that the RFS is complete and includes all relevant financial records. The reconciliation statement has two parts – a reconciliation to the BT Group income statement and a balance sheet reconciliation.

Income statement reconciliation

- 4.250 The table below shows the format of the ‘income statement’ reconciliation statement, which shows differences in revenues, operating cost and returns for Openreach and BT Group. This uses the same adjustment headings as per BT’s 2019/20 RFS. BT must provide a brief description of each adjustment shown in the reconciliation statement (as it does now). The direction provides for BT to add or remove rows at its discretion, but a description of any such changes must be published in the RFS.
- 4.251 We note that in section 3 we explained that we are requiring BT to report ‘specific items’ separately in the RFS from 2022/23. It follows that this adjustment in the reconciliation statement will not be required from 2022/23.

²⁸¹ CFL response to the February 2020 Consultation, section 4.4 and 4.5.

²⁸² CFL response to the February 2020 Consultation, section 2.2.4.

²⁸³ Openreach division does not separately report assets and liabilities in the BT Group plc accounts.

Table 4.2: Format of income statement reconciliation

	Openreach			BT Group plc		
	Revenue	Operating Cost	Return or operating profit	Revenue	Operating Cost	Return or operating profit
	£m	£m	£m	£m	£m	£m
As in the Annual Report						
<u>Adjustments</u>						
Specific items						
Use of Technology Assets						
Other trading differences						
Net short term interest						
Share of post tax loss of associated and joint ventures						
Installations costs treated as operating expenses						
CCA adjustments						
Roundings						
As in the RFS						

- 4.252 As CFL highlighted, one of the main differences between Openreach operating costs reported in BT’s annual report and Openreach operating costs published in the RFS relates to how BT Group costs/internal transfers are attributed to Openreach. To date these have been described as ‘other trading differences’ in the Reconciliation Statement, and we use the same term in the table above.
- 4.253 The 2019/20 RFS reported operating costs for Openreach of £3,800m compared to £3,966m in the BT statutory financial statements, a net difference of £166m. ‘Other trading differences’ were the largest reconciling item, accounting for £244m.²⁸⁴ BT told us that the main differences between operating costs attributed to Openreach in the RFS compared to the statutory financial statements in 2019/20 related to property recharges, Technology depreciation and allocation of Openreach costs to the rest of BT.²⁸⁵
- 4.254 The 2019/20 ‘other trading differences’ were down compared to 2018/19, where they accounted for £561m of the difference in Openreach operating costs. BT told us that the reduction was due to a change in the allocation of overheads in the statutory financial statements, resulting in closer alignment between the RFS and annual report.²⁸⁶
- 4.255 Given that Openreach provides services in most SMP markets and our objective set out in Section 3 is to focus the RFS on Openreach, we agree with CFL that there is merit in requiring BT to provide additional details of the amounts described as “other trading differences” in the Reconciliation Statement. We set out in section 3 that BT must provide a breakdown of operating costs attributed to Openreach in the RFS using the same cost categories BT uses in its annual report. We consider that these cost categories can be used to explain the ‘other trading differences’.
- 4.256 Therefore, in addition to requiring BT to provide a description of each adjustment in the Reconciliation Statement, we have decided to require BT to show a breakdown of the ‘other trading differences’ for Openreach operating costs using the cost categories reported in the attribution of wholesale current costs schedule. Where a cost category

²⁸⁴ See page 39 of the 2019/20 RFS.

²⁸⁵ BT response dated 17 December to question 28(a) of the s135 request dated 18 November 2020.

²⁸⁶ BT response dated 17 December to question 28(b) of the s135 request dated 18 November 2020. This change in approach was referenced on page 131 of BT’s 2019/20 annual report

represents 10% of more of the 'other trading differences' reconciling item, BT must provide an explanation for the different accounting treatment between the RFS and the BT annual report.²⁸⁷

- 4.257 Together with the other changes we have made to the RFS described in this document (for example the format of the market level schedules and the allocation diagrams) we consider these requirements will provide an effective and proportionate basis for understanding the impact of the attribution rules used to prepare costs for Openreach SMP markets in the RFS and how they differ from those in statutory reporting.

Balance sheet

- 4.258 Our proposal was for the balance sheet reconciliation to be consistent with its presentation in the 2018/19 RFS. We have decided to implement this proposal, with one change to include a reconciling adjustment for IFRS16, the lease accounting standard which was introduced since our consultation. This schedule is set out in the form and content direction in Volume 7. The direction provides for BT to add or remove rows at its discretion, but a description of any such changes must be published in the RFS.
- 4.259 As explained in section 3, the asset categories used in the RFS are not the same as those presented in BT's annual report. Given this, we do not consider it would be proportionate to require a line by line reconciliation of asset categories, as proposed by CFL. Also, as BT's annual report does not report on the assets operated by Openreach, we consider this would make it difficult for BT to reconcile assets in the RFS to figures published in its annual report. Even if a line by line reconciliation was practicable and proportionate, we do not consider it would provide additional assurance that the data is consistent with BT's annual report beyond that currently required.

Implementation

- 4.260 The income statement and balance sheet reconciliation schedules are set out in the form and content direction in Volume 7.

Additional Procedures

Proposals

- 4.261 The regulatory reporting SMP condition we have imposed to date required BT to obtain an assurance statement in the form of AUP as and when we request one.²⁸⁸
- 4.262 We proposed to continue to require BT to commission work from an independent third party (including its regulatory auditor) at our request, which could include AUP as and when required by us.

²⁸⁷ We have used 10% as this would have captured the main differences in 2019/20, as described above. We note that for some cost categories the reasons could relate to our directions on how BT must prepare the RFS.

²⁸⁸ AUP means an engagement carried out in accordance with international standard (ISRS 4400) under which an independent third party performs a set of audit procedures agreed by Ofcom and based on Ofcom's specific requirements and reports the findings of that work to Ofcom.

- 4.263 The wording of the proposed SMP Condition allowed us to require BT to commission ‘Additional Procedures’, which we defined as “an engagement under which the Regulatory Auditor or another independent third party performs a set of procedures required by Ofcom and based on Ofcom’s specific requirements in relation to the Regulatory Financial Statements, and reports the findings of that work to Ofcom”.²⁸⁹ This would include engagements other than AUP.
- 4.264 We also proposed a small change to the former wording of the SMP Condition to remove an ambiguity as to whether this obligation arises under the SMP condition (as intended and as it had worked in practice to date) or whether a separate statutory direction was also required.

Stakeholder comments

- 4.265 BT suggested we should remove the reference to ‘Additional Procedures’ in the proposed SMP Condition and replace it with a reference to AUP.²⁹⁰
- 4.266 In relation to pole assets (discussed above) BT made a general point that if the objective is to obtain an independent opinion on the appropriateness of methodologies applied, AUP would not achieve this aim – the auditors can only conduct specific tests without an opinion.²⁹¹
- 4.267 TalkTalk suggested there should be a process to allow independent scrutiny of all attributions and thought this could be enabled through improved transparency or Ofcom commissioning an external review that has access to all non-public information.²⁹²

Our reasoning and decisions

- 4.268 We agree with BT that under AUP, auditors carry out specific tests without giving an opinion. In some circumstances AUP may be sufficient to meet our objectives²⁹³, but they may not be appropriate where an opinion or judgement is required.
- 4.269 That is why we proposed to broaden the requirement to include engagements other than AUP, which we considered would give us flexibility to respond to specific issues during the review period. We have therefore decided to require BT to commission ‘Additional Procedures’ as and when we request. In some circumstances this will be in the form of AUP from the regulatory auditor, but in other circumstances it could be a broader piece of work commissioned from another independent third party. The requirement is included in the SMP Condition in Volume 7
- 4.270 On Talk Talk’s suggestion for a process to allow independent scrutiny of all attributions, we consider that our requirement for BT to publish allocation diagrams, aimed at improving the transparency of the attribution rules applied to operating and asset costs will enable

²⁸⁹ February 2020 Consultation, Annex 5, Condition 11.1(d) and 11.20

²⁹⁰ BT response to February 2020 Consultation, paragraph 7.9.

²⁹¹ BT response to February 2020 Consultation, paragraph 5.10.

²⁹² TalkTalk response to February 2020 Consultation, paragraph 2.5.

²⁹³ For example, checking the calculations in a compliance submission.

stakeholders to understand better how BT has complied with its cost accounting obligations and support greater independent scrutiny of the attribution rules and their impact.

- 4.271 We agree with TalkTalk that we may wish to commission external reviews, and have done so where appropriate in the past, for example, in the 2015 Cost Attribution Review, which considered whether the attribution rules provided an appropriate basis for setting prices in the context of the 2016 Business Connectivity Market Review. However we do not consider that provision in the SMP Condition and directions is needed for this.

Audit of the published RFS

Proposals

- 4.272 The Audit Direction sets out the standard of audit review BT is required to obtain for the financial information contained in the RFS. We proposed to maintain this audit requirement and did not propose any changes. However, we asked for stakeholder views on whether there could be more effective ways to provide assurance than the current audit arrangements.

Stakeholder comments

- 4.273 Vodafone said that the current audit direction and standard of review fell short of what it expected. Vodafone considered the current audit simply gives confidence that the RFS is free from material error and has been prepared following the AMD published by BT. Vodafone suggested we benchmark the level of audit opinion used in other UK regulated industries.²⁹⁴
- 4.274 TalkTalk suggested that the audit opinion should include assurance that all attributions are consistent with the RAP.²⁹⁵
- 4.275 BT noted that the “current regulatory audit is a significant cost for BT and involves significant efforts for BT and the independent auditors. We would welcome discussion with Ofcom and relevant stakeholders if the current audit does not provide the required level of assurance and trust in the RFS.”²⁹⁶

Our reasoning and decisions

- 4.276 BT must prepare the RFS in accordance with the RAP, which includes requirements for the RFS to be prepared on an objective and accurate basis, following our consistency directions where applicable, and for costs to be attributed in accordance with the activities which cause them to be incurred. BT’s AMD must set out the rules and policies BT has used to prepare the RFS in accordance with the RAP. Therefore, we would expect BT to have

²⁹⁴ Vodafone response to February 2020 Consultation, paragraph 5.3.

²⁹⁵ TalkTalk response to February 2020 Consultation, paragraph 2.5.

²⁹⁶ BT response to February 2020 Consultation, paragraph 5.11.

adequate internal controls and procedures in place to ensure that its RFS are prepared on that basis.

- 4.277 The purpose of the audit is to give confidence that the RFS is free from material error and has been prepared following BT's AMD and relevant directions issued by Ofcom (in particular the RAP, which includes reference to the Consistency Direction). We consider the audit contributes to stakeholder confidence that BT has followed the attribution rules set out in the AMD. We have therefore decided to impose the Audit Direction as proposed, with one small amendment as described below.
- 4.278 The Audit Direction requires BT to secure an audit opinion that the RFS have been 'properly prepared' in accordance with the AMD and applicable Ofcom conditions and directions.
- 4.279 Prior to the 2019 RFR Statement, the directions on BT allowed for two types of opinion to be used for the regulatory audit – a 'properly prepared' or 'fairly presents' opinion. A 'properly prepared' opinion represents a view on whether the attribution rules have been followed (as noted above) while a 'fairly presents' opinion provides some additional assurance on whether those rules are reasonable.²⁹⁷
- 4.280 The audit opinion on the RFS has been a 'properly prepared' opinion since 2015²⁹⁸, and in the 2019 RFR Statement we said that, following the introduction of ISA 800²⁹⁹ (with which BT's auditors are required to comply³⁰⁰), only a 'properly prepared' audit opinion would be appropriate.³⁰¹ This was because, since 2014, we had taken a greater role in determining the appropriate basis for attributing costs in BT's RFS, via the imposition of the RAP and certain directions specifying which attribution rules should be used. We therefore removed the option to require BT to provide a 'fairly presents' opinion.³⁰²
- 4.281 As set out above, we have decided to require BT to prepare the RFS in accordance with the RAP and consistency directions. Given this, we consider it remains appropriate to require BT to secure a 'properly prepared' audit opinion on its RFS. However, we recognise that the auditors must comply with audit standards, which in some circumstances could limit the scope of the opinion they are able to give. Therefore, we have provided that where the auditor is unable to give an opinion on any of the matters set out in the Audit Direction because it would conflict with relevant audit standards), the reasons for this must be reported in the RFS. We have included this amendment in the Audit Direction.

²⁹⁷ See 2019 RFR Statement, paragraph 3.22.

²⁹⁸ The audit opinion published in the RFS has been a 'properly prepared' opinion since the 2014/15 RFS.

²⁹⁹ [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. The 2019 technical release from the ICAEW '[Reporting to regulators on regulatory accounts](#)' also says that a 'properly prepared' opinion should be provided where regulatory accounts are prepared on a different basis to IFRS or UK GAAP (i.e. on a different basis to statutory accounts).

³⁰⁰ The audit report presented in BT's RFS sets out the audit standards used by the auditor to form an opinion.

³⁰¹ 2019 RFR Statement, paragraphs 3.23 to 3.26.

³⁰² In the 2014 Regulatory Financial Reporting Statement (paragraph 5.63) we noted that BT and the regulatory auditor had told us that our proposals to take a greater role in the basis of preparation would impact on the opinion that the audit could deliver.

- 4.282 While we recognise that some stakeholders may prefer a ‘fairly presents’ opinion (to the extent this would comment on whether the attribution rules in the RFS are reasonable), we do not consider this is practicable given that BT is subject to requirements imposed by Ofcom in the preparation of the RFS (e.g. via the RAP and the consistency directions) and the current audit standards.³⁰³
- 4.283 While the audit can provide assurance that BT has followed the attribution rules in the AMD, it does not assess whether those rules are appropriate. The audit, however, is not the only source of assurance on how the RFS have been prepared. As set out below, we consider that steps we have taken in this and previous reviews provide assurance that i) the attribution rules in the AMD are consistent with the RAP and ii) that BT follows those rules.
- 4.284 Where we require additional assurance, for example where we are relying on BT’s RFS data for a regulatory decision, we also explain below that we can obtain additional assurance where necessary.

Assurance that BT follows the rules set out in the AMD

- 4.285 Assurance that the rules in the AMD are followed is provided primarily by the annual audit. Amongst other things, the auditors opine on whether the RFS have been properly prepared in all material respects in accordance with the procedures defined in the AMD (a “properly prepared” opinion).

Assurance that the rules in the AMD are consistent with the RAP

- 4.286 Assurance that the attribution rules in the AMD are consistent with the RAP comes from various sources, including:
- the findings of the 2015 Cost Attribution Review³⁰⁴ which considered whether the rules applying to some of the largest cost categories (e.g. overheads) were appropriate for the purposes of setting prices, and required changes to the RFS where they were not. This established a base set of attribution rules for these categories that were considered to be consistent with the RAP and which BT continues to apply to a significant extent today;³⁰⁵
 - the requirements on BT, via directions imposed by Ofcom following market reviews since 2015, to change its attribution rules where necessary to ensure consistency with our regulatory decisions (for example where we have corrected an error or adjusted the attribution used in BT’s RFS for the purpose of setting prices);

³⁰³ We note that a ‘properly prepared’ audit opinion is also provided on regulatory accounts for some other UK regulated companies. For example, a ‘properly prepared’ audit opinion under ISA800 was provided for the 2019 regulatory accounts for [NATS](#) and [Heathrow](#). Similarly, Ofwat’s 2019/20 document ‘[Audit Opinion for the Annual Performance Report 2019-20](#)’ requires water companies to secure a ‘properly prepared’ opinion under ISA800.

³⁰⁴ We published two consultations ([Review of BT’s cost attribution methodologies](#), June 2015 and [Review of BT’s cost attribution methodologies – second consultation](#), November 2015) and our findings were published as an annex to the 2016 BCMR Statement ([Base year cost adjustments to reflect the cost attribution review](#), April 2016).

³⁰⁵ For example, the 2016 BCMR Statement directed BT to attribute some overhead costs in its RFS using a previously allocated costs (PAC) rule. BT continues to use PAC rules in its RFS today.

- the CCN process, in place since 2014, which requires BT to notify Ofcom (and inform stakeholders, by publishing the CCN) of any changes it wishes to make to attribution rules in the AMD; and
 - our scrutiny of the data in the RFS and CCN on an ongoing basis, and when this data is being used to inform a regulatory decision such as setting prices.³⁰⁶ Publication of the RFS and CCN provides stakeholders with the opportunity to identify and challenge data that might appear inconsistent with the RAP.
- 4.287 These steps mean that the base set of attribution rules established following the 2015 Cost Attribution Review can be changed by BT only after we (and other stakeholders) have had the opportunity to review those changes to establish whether they appear to be consistent with the RAP, and challenge them if not.
- 4.288 Assurance over the attribution rules used by BT is also provided by:
- the requirement for a reconciliation statement to demonstrate that data in the RFS is consistent with that in BT's audited annual report. Our requirements for the reconciliation statement set out above will help identify where the RFS have been prepared on a different basis from the annual report.
 - Our decision to require BT to publish allocation diagrams, which will show how costs flow through BT's allocation system as determined by the AMD and help stakeholders assess if those rules are reasonable.
 - Our ongoing scrutiny of the data in the RFS and CCN to check the rules are being followed. Publication of the RFS and CCN also provides stakeholders with the opportunity to flag where it considers attributions rules have not been followed.

Additional assurance, where necessary

- 4.289 The steps set out above provide some assurance regarding the way BT's regulatory financial data is prepared. However, where data is used to inform regulatory decisions it is subject to further scrutiny to determine whether it provides a relevant measure of costs for those decisions.
- 4.290 This additional assurance is provided by a more forensic review of specific cost items, in the context of the decisions being made.³⁰⁷ Additional assurance relating to the accuracy of this data is obtained by requiring BT to provide the information under section 135 of the Communications Act 2003. Our assessment of BT's financial data is then published and subject to scrutiny and challenge by stakeholders through consultation.
- 4.291 As set out in the previous section, in the event that any of the steps described above raise concerns, we can require BT to commission its auditor or other independent third party to perform additional procedures based on our specific requirements and report the findings of that work to us.

³⁰⁶ For example, our review of fibre cost components used in the RFS will help ensure that costs are attributed to fibre services on an objective and accurate basis and in accordance with the activities which cause them to be incurred.

³⁰⁷ Annex 14 sets out some of the adjustments we have made to BT's RFS data for the purpose of our cost modelling.

Requirement for the RFS to be “fit for purpose”

Proposals

- 4.292 The current and proposed SMP Condition requires BT to “ensure that any Regulatory Financial Statement and corresponding audit opinion that it delivers to Ofcom and/or publishes are fit for such purpose (or purposes), if any, as notified by Ofcom in writing”. The current and proposed Audit Direction includes similar wording, requiring BT to ensure that the auditor states in its opinion that “each Regulatory Financial Statement and corresponding audit opinion that BT delivers to Ofcom and/or publishes is fit for such purposes (or purposes), if any, as notified by Ofcom to BT in writing”.

Stakeholder comments

- 4.293 BT said it was not appropriate for the auditors or BT to say whether the RFS were ‘fit for purpose’.³⁰⁸
- 4.294 In relation to the audit opinion, BT said that in line with guidance in the ICAEW Technical Release ‘Reporting to Regulators on Regulatory Accounts’³⁰⁹, the audit opinion in the RFS notes that the RFS have been produced in line with a special purpose framework (i.e. the AMD), and states that “The nature, form and content of the Regulatory Financial Statements are determined by Ofcom. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable for Ofcom’s purposes.”³¹⁰
- 4.295 BT added that “for the same reasons the auditors deem it inappropriate to provide an opinion on whether the RFS are fit for purpose, it would also be inappropriate for BT to do so.”³¹¹

Our reasoning and decisions

- 4.296 As BT must comply with requirements set out in the SMP Condition and associated directions in relation to the preparation and publication of the RFS and nature of the audit opinion, we agree that it is unnecessary to include this requirement in the SMP Condition.
- 4.297 It is our role to decide whether the regulatory financial statements and audit opinion that BT provides under our requirements are fit for the purposes for which they will be used, and to take action where we consider this is not the case.³¹²
- 4.298 We have therefore removed this requirement from the SMP Condition and Audit Direction.

³⁰⁸ BT response to February 2020 Consultation, paragraphs 5.6 – 5.7.

³⁰⁹ [Reporting to regulators on regulatory accounts](#), ICAEW, June 2019

³¹⁰ BT response to February 2020 Consultation, paragraphs 5.6 – 5.7.

³¹¹ BT response to February 2020 Consultation, paragraph 5.8

³¹² For example, by investigating potential non-compliance or consulting on changes where we consider the requirements no longer meet reporting objectives.

Other reporting requirements

Proposals

- 4.299 We proposed to make a number of small changes to the regulatory reporting SMP condition and associated directions. This included adding requirements to the SMP condition to replace, simplify and modify requirements previously captured in the Transparency Direction (which we proposed to remove).

Stakeholder responses

- 4.300 No stakeholders commented on our proposals

Our reasoning and decisions

- 4.301 We have made the following changes to the SMP condition and directions in line with our proposals.
- Removed references to the 'Regulatory Accounting Guidelines' which are no longer required.³¹³
 - Removed the requirement for 'on demand' reporting. This currently requires BT to be capable of preparing regulatory financial statements in relation to any specified calendar month or months. We do not consider we require BT to maintain this capability in future.
 - Included an option for Ofcom to require BT to publish a report showing the impact of correcting any deficiencies in the RFS.
 - Clarified that BT can depart from providing prior year comparatives when this is consistent with statutory accounting standards or where agreed with Ofcom.
 - Simplified the condition requiring BT to maintain sufficient accounting records.
 - Simplified the condition requiring BT to demonstrate that its charges comply with EOI requirements, where applicable.
 - Added requirements to the SMP condition which replace, simplify and modify requirements previously captured in the Transparency Direction (which we have removed).³¹⁴ Since the wording of the existing requirement could apply to accounting records where there is neither an obligation to publish nor any reason to believe that there will often be a need for third parties to be able to understand them, we have clarified that there is only a requirement under the SMP condition for the RFS, AMD, reconciliation report and systems reconciliation reports to be drafted transparently.
 - Clarified and simplified the drafting where possible.

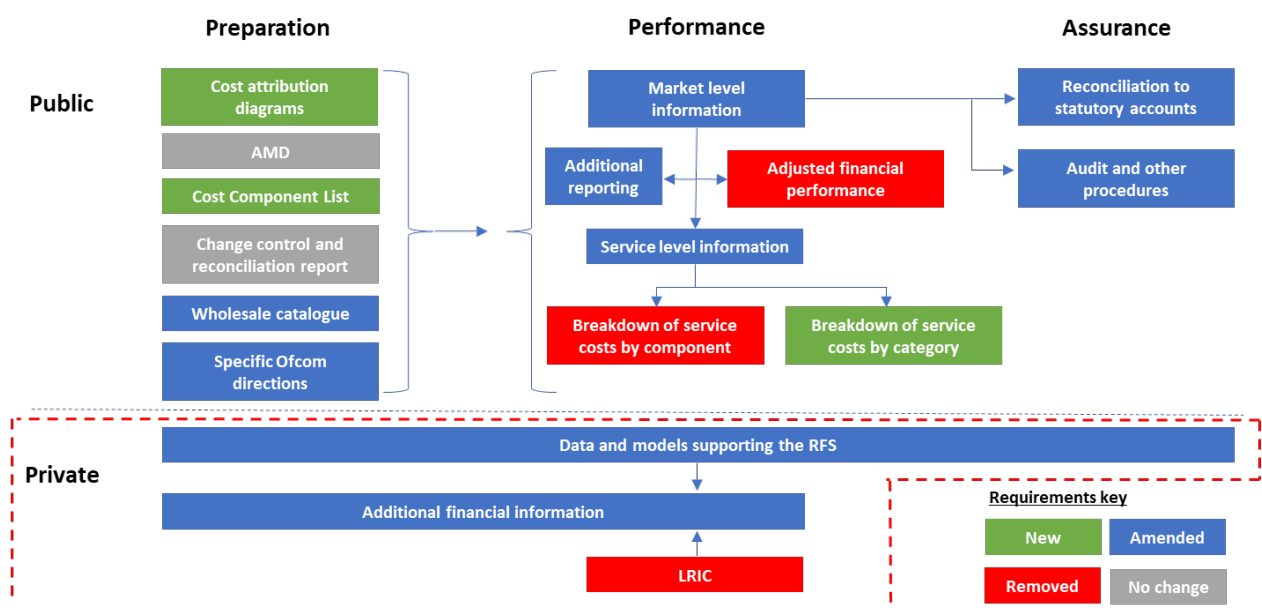
³¹³ We explained in Annex 28 of the 2016 BCMR Statement why we did not consider it necessary to impose this requirement.

³¹⁴ Requirements previously captured by the Transparency Direction are included in condition 11.9 and 11.22 in the SMP condition in volume 7.

5. Information provided to Ofcom

- 5.1 We require BT to provide us with some information privately. We require this information to make informed regulatory decisions, monitor compliance with SMP conditions and ensure that those SMP conditions continue to address the underlying competition issues.
- 5.2 In this section we discuss the private information requirements highlighted in the diagram below.

Figure 5.1: Illustration of how the public and private reporting requirements imposed in this decision compare to current requirements



- 5.3 The information currently provided privately by BT relates to LRIC, data and models supporting the RFS and 'additional financial information' (AFIs) relating to SMP markets. In this section we set out our decisions in relation to these requirements.

Our main decisions

- **LRIC:** Remove requirement on BT to provide LRIC information.
- **Data and models supporting the RFS:** BT to provide CostPerform data and models.
- **Information relating to all SMP markets:** BT to provide the following schedules i) a breakdown of costs attributed using PAC methodologies ii) a mapping between the operating cost and MCE of each cost component and the operating cost and MCE cost categories from the market performance summary and iii) a breakdown of grant funding and associated expenditure by asset category.
- **Information relating to PI:** BT to provide information on i) how it has estimated the costs of lead-in and single bore duct in the RFS, ii) how it has attributed duct costs to PI services in the RFS and iii) the unit costs of PI ancillaries.
- **Information relating to WLA:** BT to provide information on FTTP investment and rollout in Area 2 and Area 3.
- **Information relating to LL Access and IEC:** BT to provide i) information on patch panel, initial testing, RWT and cessation charges for dark fibre circuits and ii) costs for contractor ECCs.
- **Removal of information no longer required:** Remove requirement to provide most other existing schedules with minor adjustments to the remaining schedules.

LRIC

- 5.4 We currently require BT to maintain a LRIC model capability and to provide us with LRIC by component and LRIC, DLRIC and DSAC by service. The BT LRIC model is not audited.

Our proposals

- 5.5 We proposed to remove the requirement on BT to maintain a LRIC model to provide us with LRIC information.

Stakeholders responses

- 5.6 BT supported our proposal, noting that it was in line with an overall objective to simplify and condense reporting requirements.³¹⁵
- 5.7 Vodafone argued that we should keep the requirement on BT to maintain a LRIC model, with BT replacing it if necessary, to ensure we continue to understand how BT's costs change with volumes.³¹⁶

³¹⁵ BT response to February 2020 Consultation, paragraph 5.16.

³¹⁶ Vodafone response to February 2020 Consultation, paragraph 6.2.

Our reasoning and decisions

- 5.8 We do not consider it would be proportionate to continue to require BT to maintain a LRIC model to provide us with LRIC information from April 2021 because:
- **It is not required for compliance purposes:** a previous justification for requiring LRIC information was the imposition of basis of charges obligations, where BT may have needed to demonstrate that charges were below a measure such as DSAC (an output of the LRIC model). In Volume 4 we impose basis of charges obligations in limited circumstances and explain how we would expect to assess compliance. Later in this section we require BT to provide us with cost information on services subject to a basis of charges obligation. As a result, we do not consider we require BT to maintain a LRIC model for compliance purposes.
 - **There are alternative ways to estimate LRIC:** while we used information from BT's current LRIC model to inform some of our cost modelling³¹⁷ and situations may arise in future where similar data may be useful, we consider that our information requirements can be met without the need for BT to maintain a LRIC model on an ongoing basis – for example, by using bottom-up models or from an analysis of data supporting BT's cost accounting system.³¹⁸
- 5.9 We also understand that the existing LRIC model could need significant restructuring if we continue to require BT to provide us with LRIC information on a regular basis. Taking these points together we do not consider it is proportionate to require BT to maintain a LRIC model to provide us with LRIC information during this review period.
- 5.10 We have therefore removed the requirement from the form and content direction.

Data and models supporting BT's cost accounting system

Our proposals

- 5.11 We currently require BT to provide us with a 'data file' including all the accounting records in its cost attribution system which we upload into our own software.³¹⁹ We proposed to continue to require BT to provide this type of information to allow us to interrogate the information used to prepare the RFS and better understand how BT is complying with its cost accounting obligations.
- 5.12 We noted that BT had replaced its previous cost accounting system ('Refine') with a more flexible system, 'CostPerform'.³²⁰

³¹⁷ In Annex 14 we explain that we used BT's LRIC data in our top down models to inform AVEs and CVEs which are used to forecast changes in costs in response to changes in volumes.

³¹⁸ For instance, when setting charges in our 2018 Wholesale Local Access Market review we used a bottom-up model to calculate the LRIC of FTTC services.

³¹⁹ The 'data file' provides a breakdown of costs in the RFS, showing the different cost pools used in BT's cost allocation system.

³²⁰ CostPerform is used by various global regulators and regulated companies. See <https://www.costperform.com/markets>.

- 5.13 We said BT had indicated that it was willing to provide us with the data and models it uses to run CostPerform so that, if we had access to the same software, we could effectively generate the RFS. We considered that there would be several benefits to us and BT if we had this capability, including the potential to send more focused information requests to BT, save us and BT time, allow us to better understand BT's cost accounting system and reduce other data requirements where these can be extracted from CostPerform.³²¹
- 5.14 We considered that requiring provision of the data and models BT uses to run CostPerform would be a less onerous means of providing the information we need than the current obligations. We therefore proposed to require BT to provide us with the data and models used to run its cost attribution system (currently CostPerform) in current and prior years, alongside any additional spreadsheets or models used to prepare the schedules published in the RFS. We proposed that BT should provide this at the same time as the RFS is published.³²²

Stakeholders responses

- 5.15 BT said that one of the benefits of adopting CostPerform was that Ofcom could use the same allocation tool to see how costs flow through its cost attribution system. BT said it was happy to provide the supporting models to enable this.³²³

Our reasoning and decisions

- 5.16 For the reasons set out above, we have decided to require BT to provide the data and models used to run its cost attribution system alongside any additional spreadsheets or models used to prepare the schedules published in the RFS. We note that BT has already provided us with its CostPerform models for 2019/20 and 2018/19.
- 5.17 This requirement is set out in the SMP Condition and form and content direction in Volume 7.

AFIs relating to all markets

Our proposals

- 5.18 For existing AFIs, we proposed to do the following:³²⁴
- Remove AFIs associated with LRIC and the adjusted financial performance schedule, consistent with our proposal to no longer impose these requirements

³²¹ See paragraph 6.13 of the February 2020 Consultation. We also considered it would address some of the disadvantages of the 'data file' noted in paragraph 6.11 of the consultation.

³²² Currently, the data file is provided two weeks after the RFS have been published. Given the CostPerform data can be provided on a smaller file and should not require additional processing by BT, we proposed it should be provided at the same time as the RFS is published.

³²³ BT response to February 2020 Consultation, paragraph 6.7.

³²⁴ These were described in Table 6.1 of the February 2020 Consultation.

- Remove the ‘price controls in wholesale markets’ AFI, as this would be required under the charge control SMP condition
- Amend the data file AFI to require data and models supporting the cost attribution system, as explained above
- Amend the CCA fixed asset movement AFI to clarify that this must include capex and assets in the course of construction to help us fully understand the information used to prepare the RFS
- Amend the AFI on indices used to revalue assets to require BT to provide the underlying data rather than graphs
- Amend the duct RAV model AFI to ensure it includes the adjustment made to the duct valuation, all changes to gross and net book values, all calculations and an explanation of how the information has been used to allocate duct costs to PI services. We said this would allow us to assess BT’s compliance with the requirements of the RAV direction and fully understand how it has been used in the RFS
- Maintain the AFI relating to asset lives and depreciation

5.19 We also proposed that BT provide new AFIs on the following:

- **PAC breakdown:** provide a breakdown of costs attributed using PAC methodologies (e.g. BT Group PAC, Openreach PAC, Technology PAC) by two-digit OUC (Organisation Unit Code) along with a description of the activities undertaken by each OUC. This will enable us to monitor BT’s use of the PAC methodology over time and help ensure that costs are attributed using causal cost drivers where possible.
- **Cost component mapping:** Provide a mapping between the operating cost and MCE of each cost component and the operating cost and MCE cost categories from the market performance summary. This will help us understand how the results of BT’s cost accounting system (constructed using cost components) translates to the information presented in the RFS (presented using cost categories).
- **Grant funded assets:** Provide information on all grant funded investments, including BDUK.³²⁵ This breakdown would include details of the assets funded by grants, the level of grant funding for each asset and an explanation of how the grant arrangements work.

5.20 For all AFIs we proposed that, if the required information could be obtained from CostPerform (using data and models provided by BT), BT would not need to provide separate schedules to comply with its obligations.

Stakeholder responses

5.21 Vodafone said it was important for Ofcom to have access to additional data and tools but considered that more of the data could be published. Vodafone suggested that information relating to our proposals for a PAC breakdown, cost component mapping and grants should be published to enable stakeholder review.³²⁶

³²⁵ This proposal was set out in Table 6.3 of the February 2020 Consultation.

³²⁶ Vodafone response to February 2020 Consultation, paragraph 6.3.

- 5.22 BT welcomed the removal of requirements where the information was no longer needed.³²⁷ BT considered our proposal for a PAC breakdown was disproportionate and based on a biased review which only considered costs attributed using PAC and not costs which should be attributed using PAC.³²⁸

Our reasoning and decisions

- 5.23 The only substantive comments on our proposals were from BT in relation to the PAC breakdown, which we address below.
- 5.24 As no other comments were received, and for the reasons given in relation to our proposals above, we have decided to require BT to provide us with the AFIs set out in the table below. These requirements are set out in full in the form and content direction in Volume 7.

Table 5.1: Summary of AFIs applicable to all markets

AFI	Requirement
Data supporting the cost attribution system	Data and models used to run CostPerform for the current and prior year, along with any spreadsheets or models used to prepare the RFS
CCA fixed asset movement statement	For each asset category, information on changes in gross replacement costs (including capex and assets in the course of construction) and depreciation with a reconciliation to the fixed assets movement statement in BT's statutory financial statements.
Data supporting CCA valuations	Data showing the indices used by BT to revalue assets on a CCA basis
Asset lives and depreciation	Asset lives, depreciation and asset value information for each asset category
RAV adjustment applied to access duct	A breakdown of the HCA values of duct (including annual changes in capex, disposals and assets in course of construction), CCA values of duct (showing pre- and post-1997 access duct and non-access duct), the RAV adjustment made to duct and explanation of those this has been used to attribute duct to PI services.
PAC breakdown	A breakdown of costs attributed using PAC methodologies (e.g. BT Group PAC, Openreach PAC, Technology PAC) by two-digit OUC along with a description of the activities undertaken by each OUC
Cost component mapping	A mapping between the operating cost and MCE of each cost component and the operating cost and MCE cost categories from the Attribution of Wholesale Current Costs and

³²⁷ BT response to February 2020 Consultation, paragraph 6.4.

³²⁸ BT response to February 2020 Consultation, paragraph 6.8 and footnote 29.

	Attribution of Wholesale Current Cost Mean Capital Employed schedules (as set out in section 3)
Grant funded assets	details of the assets funded by grants, the level of grant funding for each asset and an explanation of how the grant arrangements work.

5.25 Where the required information can be obtained from CostPerform, BT does not need to provide separate schedules to comply with these obligations.³²⁹

PAC breakdown

5.26 We disagree with BT that it would be disproportionate for us to require a breakdown of costs attributed using PAC methodologies by two-digit OUC, alongside a description of those OUCs.

5.27 We explained in the 2016 BCMR Statement that we would only expect PAC methodologies to be used where no cost-causal allocation driver could be identified (typically the case for some overhead functions).³³⁰ The activities and level of costs recorded in BT's OUCs can change over time as its business develops and re-organisations take place. We consider it is reasonable to require the proposed information to allow us to understand where such changes have occurred and, where appropriate, challenge BT's cost attribution assumptions in light of these changes.³³¹

5.28 BT considered we should have also reviewed costs which are not attributed using PAC, but which could be. We reviewed the costs attributed using PAC as the amount of cost allocated using this rule had increased since 2014/15 and we wanted to understand whether this was due to an increase in costs for which no cost driver could be found (as we would only expect PAC to be used in these circumstances). A review of costs not currently attributed using PAC could potentially include all other methodologies employed by BT. To conclude that PAC would be a more appropriate way to allocate such costs we would need to conclude that i) the current cost driver was inappropriate and ii) there did not exist an alternative cost driver. This would be a considerable exercise. We expect BT to keep its attribution methodologies under review and where it considers there are more appropriate ways to attribute costs, it can propose changes in its annual CCN.

Publication

5.29 We have considered whether it would be necessary to require publication of the information relating to PAC breakdown, cost component mapping and grants, as requested by Vodafone. We do not think it would. We need to strike a balance between publishing enough information to give stakeholders confidence that BT is attributing costs fairly while

³²⁹ This applies to all private information schedules set out in this section. Where the information can be obtained from CostPerform, BT must explain to us how to extract it.

³³⁰ See in particular 2016 BCMR Statement, Annex 28, paragraphs 2.68 to 2.78.

³³¹ In paragraph 5.23 of the February 2020 Consultation we noted that the proportion of overheads attributed using BT Group PAC had increased since it was introduced in 2014/15, and this was partly due to changes in OUCs.

ensuring those requirements are proportionate. In relation to these points, we consider we are requiring BT to publish sufficient information to allow stakeholders to understand BT's allocation approach, for example:

- the allocation diagrams BT is required to publish (see section 4) will allow stakeholders to see where rules such as PAC are being used and how significant they are within BT's cost attribution system;
- in section 3 we explain why the new cost breakdowns (e.g. identifying costs incurred within Openreach vs the rest of BT) would better help stakeholders understand the costs allocated to SMP markets compared to the current component breakdown. The new component diagrams described in section 4 will also help stakeholders understand how components are used within BT's allocation system;
- in section 3 we set out that we are requiring BT to publish information on grants within some of the market performance schedules.

Market specific information

5.30 We proposed to require BT to provide us with AFI schedules specific to SMP markets and shared ancillaries. Our proposals, stakeholders' comments and decisions are set out below and the requirements are in the form and content direction in Volume 7.

Physical infrastructure market

Proposals

5.31 We made the following proposals in relation to the PI market:

- **Lead-in duct.** To estimate the unit cost of each type of duct in the January 2020 Consultation, total duct costs needed to be attributed. This attribution was based on the unit cost estimates provided by BT. For lead-in duct, BT assumed that the unit cost was the same as that calculated for single bore spine duct. To assess the effectiveness of our control we proposed to require BT to provide estimates of the costs of lead-in duct and single bore spine duct and reconcile these to the costs reported in the RFS. We said this could be based on sampling where BT did not separately record assets and costs associated with lead-in and single bore spine duct.
- **Attribution of duct to PI services:** We proposed to apply a consistency requirement on BT to attribute duct costs to PI services on a basis consistent with the proposed approach to setting prices (where duct installed pre and post-March 2018 was allocated on different bases). We proposed to require BT to provide a schedule demonstrating how it had attributed duct costs to PI services to comply with the Consistency Direction and explain any assumptions made. Since duct assets are also subject to the RAV adjustment, we also proposed that BT should show how the duct attribution schedule reconciles to the RAV schedule.
- **PI utilisation metrics:** We proposed to require BT to provide information on various utilisation metrics to allow us to assess the ongoing effectiveness of the PIA charge

control.³³² We proposed to require BT to report these metrics as at 30 September (i.e. the mid-point of the financial year).

- **Requirements imposed in the 2019 RFR Statement:** We proposed to remove the requirement to provide the three AFIs imposed in the 2019 RFR Statement as this information was no longer required.³³³
- **PIA ancillaries:** In the November 2020 consultation we proposed to require BT to provide us with information on the costs of PIA ancillaries used for network adjustments and other PIA ancillaries. This was to help us understand the costs of these services given they are subject to basis of charges obligations. We said BT could estimate these costs outside of its cost accounting system, but where this was the case it would need to explain any assumptions made and compare total costs to ancillary services reported in the RFS.³³⁴ We made a similar proposal in relation to contractor ECCs in the LL Access and IEC markets.

Stakeholder responses

Lead-in duct

- 5.32 In relation to lead-in duct, BT said it records length and volume to new premises but it does not currently have the ability to identify the costs of lead-in duct, including any breakdown of the cost of lead-in duct vs single bore duct.³³⁵ For the purposes of reporting lead-in duct in the RFS, BT said it would use an apportionment methodology but said it is looking to use operational data to differentiate the unit cost of lead-in duct from single bore duct and would update us on its progress.³³⁶
- 5.33 Vodafone considered information on lead-in duct costs and how these have been attributed to PI services should be published to allow stakeholder review.³³⁷

PIA ancillaries

- 5.34 Comments from stakeholders applied to this proposal as well as to our corresponding proposal relating to contractor ECCs.
- 5.35 Several stakeholders agreed with our proposal.³³⁸
- 5.36 Openreach said PIA ancillaries are not tracked individually in the RFS due to their low materiality, so it could not provide cost information on these services directly from the

³³² The metrics were: 1) kilometres of lead-in duct, 2) average occupancy (per 25mm sub-duct equivalent) for spine duct single bore, 2 bores and 3+ bores, 3) average number of sub-ducts crossing i) a joint box and ii) a manhole, 4) number of pure and mixed DP and feeder poles and number of cable poles, 5) the number of single and multi-premise attachments for cable poles and pure and mixed DP and feeder poles, and 6) the average number of cables up a pole and number of manifold attachments for all poles.

³³³ See Table 6.2 of the February 2020 Consultation.

³³⁴ November 2020 consultation, paragraphs 7.14 to 7.18.

³³⁵ BT response to the February 2020 Consultation, paragraph 5.42.

³³⁶ BT response to the February 2020 Consultation, paragraph 5.44.

³³⁷ Vodafone response to the February 2020 Consultation, paragraph 6.3.

³³⁸ Responses to the November 2020 Consultation from BUUK (page 1); Digital Landscapes (response to Q7.3), KCOM (page 3) and Virgin Media (response to Q7.3).

RFS. However, Openreach said it could provide unit cost information for PIA ancillaries (and contractor ECCs discussed later in this section) from cost models used to set prices.³³⁹

- 5.37 Openreach suggested a template which would show the unit FAC for each product broken down by third party charges, other direct third party costs (e.g. stores), overheads on third party costs, direct Openreach labour costs, overheads on direct Openreach labour costs and working capital employed. This unit FAC could be compared against prices. Openreach said third party costs would come from contracts, direct Openreach labour costs from task times and hourly labour costs³⁴⁰, and overheads on Openreach direct labour from CostPerform. Openreach said this would mean unit costs could not be reconciled to services reported in the RFS. Openreach proposed not to provide cost information for products for which it aligns price to another regulated product.³⁴¹
- 5.38 Openreach considered that the schedule would primarily function as evidence of compliance with the basis of charges obligation. It said information provided privately to Ofcom under regulatory reporting requirements are subject to BT's internal controls and sign off and assumed this would be sufficient for this schedule. Openreach also requested to provide the schedule on 31 August each year to align with its proposal for other compliance submissions.³⁴²
- 5.39 TalkTalk considered that Openreach could manipulate the mark-up for overheads and suggested this could be addressed by ensuring the mark-up is transparent and the methodology used consistent with the RFS.³⁴³

Our reasoning and decisions

- 5.40 We have decided to impose the following requirements on BT in relation to the PI market. These have been implemented in Annex B of the form and content direction in Volume 7.

Lead-in duct

- 5.41 Lead-in duct links customer premises to the main, shared, duct network. In Volume 4 we set prices for a simplified lead-in product comprising lead-in duct, lead-in link duct (single bore spine duct) and associated facility hosting. These prices were informed by unit cost estimates for each of these elements, derived from information provided by BT. For lead-in duct, BT assumed that the unit cost was the same as that calculated for single bore spine duct.
- 5.42 The purpose of our proposed requirement was to understand the unit cost of lead-in and single bore spine duct over the review period and to understand any assumptions BT has made when reporting these costs in the RFS. We recognise that BT is not currently able to

³³⁹ Openreach response to the November 2020 Consultation, paragraphs 7.3 to 7.5.

³⁴⁰ Openreach noted that few services subject to the basis of charges obligation were delivered by Openreach direct labour (i.e. most were provided by third party suppliers). See Openreach response to November 2020 Consultation, paragraph 7.5 (c).

³⁴¹ Openreach response to the November 2020 Consultation, paragraphs 7.5 and 7.6.

³⁴² Openreach response to the November 2020 Consultation, paragraphs 7.9 and 7.10.

³⁴³ TalkTalk response to November 2020 Consultation, paragraph 6.5.

identify the costs of lead-in duct separately and that for reporting requirements it may be necessary to make some assumptions about the unit cost of lead-in duct to apportion duct costs to services.³⁴⁴ This information will help us assess the effectiveness of our control.

5.43 We have therefore decided to require BT to provide us with i) the unit costs of lead-in duct and single bore spine duct supporting the costs of these services reported in the RFS, ii) any assumptions relating to these unit cost estimates (e.g. that the unit cost of lead in duct is the same as single bore spine duct) and iii) any evidence to support those assumptions. We have amended the wording of the Form and Content direction in Volume 7 to reflect our decision.

5.44 As to Vodafone's comment: the total costs of lead-in duct will be reported in the published RFS and BT's approach to attributing duct costs will be published in its AMD and allocation diagram as explained in section 3. We consider this will give stakeholders sufficient visibility of the cost of lead-in duct and how this cost was derived.

Attribution of duct to PI services

5.45 We received no comments on our proposal. We have decided to require BT to provide us with a schedule demonstrating how it has attributed duct costs to PI services in accordance with the Consistency Direction and explain any assumptions made. The schedule should include a reconciliation of duct costs reported in the PI market in the RFS to duct costs reported in the RAV schedule (which BT also provides in an AFI).

5.46 As to Vodafone's comment: BT's approach to attributing duct costs will be published in its AMD and allocation diagrams as explained in section 3. We consider this will give stakeholders sufficient visibility of how duct costs have been attributed.

PI utilisation metrics

5.47 We received no comments on our proposal. We have decided to require BT to provide information on the utilisation metrics we consulted on to allow us to assess the ongoing effectiveness of the PIA charge control. To ensure we have a time series of comparable data, BT must report these metrics as at 30 September each year (i.e. the mid-point of the financial year). BT must provide details of any assumptions made to derive these metrics.

Requirements imposed in the 2019 RFR Statement

5.48 We received no comments on our proposal and have decided to remove these requirements.

PIA ancillaries

5.49 We have decided to require BT to provide us with cost information on PIA ancillaries related to network adjustments and other PIA ancillaries to help us understand the costs associated with these services and assess BT's compliance with the basis of charges obligation.

³⁴⁴ For example, in Volume 4 we said that BT provided evidence to support its assumption that the unit cost of lead in duct was the same as the unit cost of spine duct.

- 5.50 We consider that the template suggested by Openreach would meet our requirements as it would give a breakdown of unit operating and capital costs for each relevant service and compare these to prices. While this cost information could not be directly compared to aggregate cost information reported in the RFS, much of it can be traced back to contracts with third party contractors. Where services are delivered by BT (rather than third party contractors), we consider that Openreach's proposal to derive overhead uplifts from RFS information would address TalkTalk's concern and provide comfort that the costs are reasonable and consistent with how overheads are applied to other regulated services.
- 5.51 We have therefore amended the direction to require BT to provide the price and unit cost information set out in its template, along with an explanation of how the data has been prepared, including the source of data and any assumptions, judgements, calculations or estimates made. This must include an explanation of how overhead uplifts have been estimated from RFS data alongside a comparison of how the overhead uplift compares to ancillary services reported in other SMP markets in the RFS.
- 5.52 We disagree with Openreach's proposal that it should not need to provide cost data for services where it has set price equal to another (similar) regulated service which is subject to a charge control. This is because cost information is required to help assess if BT is complying with the basis of charges obligation – i.e. even if Openreach sets price equal to another charge controlled product, it still needs to be able to demonstrate that the charge is justified given the costs of that specific product. The requirement to provide cost information therefore applies to all relevant services.
- 5.53 Openreach is correct that private reporting information is not currently subject to external assurance checks (e.g. AUP carried out by the auditor of the published RFS), though the SMP condition would allow us to request these where appropriate. Similarly, we are not requiring BT to provide additional assurance on this cost information, but may require this in future if we have concerns about the robustness of the data. In Volume 4 we decided to set an August deadline for provision of compliance information, recognising that it may take additional time to provide the external assurance requested. As we are not requiring external assurance of this cost information, we have decided that it must be provided at the end of July each year, alongside all other private reporting information.
- 5.54 As set out in the November 2020 Consultation, we recognise that the costs provided by BT under this requirement may not necessarily be those relied on by BT to demonstrate compliance with the basis of charges obligation (e.g. because prices may be set at the start of the period while cost information may only be available at the end of the period). However, given that Openreach said the cost information would be derived from its cost models supporting prices, we would expect BT to be able to explain any significant differences between the charges for relevant services and the cost information provided.

Mapping BT's physical infrastructure records and financial records

- 5.55 As discussed in section 4, we have decided to require BT to provide us with schedules demonstrating that duct and pole additions to its physical infrastructure records can be mapped to its fixed asset register. As noted in section 4, we asked BT for information

demonstrating how its physical infrastructure records mapped to financial records for PI assets in 2020. We consider that the information BT gave us in its response provides an appropriate format for demonstrating how these records map to each other.³⁴⁵ Therefore, we have decided that BT must provide the following each year:

- Physical infrastructure records schedule: an estimate of unit costs and total costs associated with duct and pole asset additions during the year, using volumes from physical infrastructure records. Additions must be broken down by the services appearing in the PI market summary. Information from planning systems can be used to derive cost estimates.
- Fixed asset register schedule: Using information from BT's fixed asset register, a breakdown of total cost associated with duct and pole asset additions during the year. Additions must be broken down by class of work and other relevant costs (providing a breakdown of any category greater than £10m).
- Reasons for any difference in total cost between the two schedules.
- A statement of any assumptions made to prepare these two schedules.

Wholesale local access markets

Our proposals

5.56 We made the following proposals in relation to the WLA markets.

- **FTTP homes passed:** we proposed that BT provide us with information on FTTP homes passed in Area 2 and Area 3, split by those funded commercially and those funded by government subsidies or other grants and also split by exchange area.³⁴⁶
- **FTTP revenues and investment:** we proposed that BT must provide us with a schedule setting out how much it has invested in FTTP networks in each of WLA Area 2 and Area 3 on an annual and cumulative basis. We said this should include capital costs (by asset type such as duct and fibre) and operating costs. We also proposed that BT should provide us with FTTP revenues in Area 2 and 3.³⁴⁷
- **TRCs and SFIs:** we proposed to require BT to provide us with hourly costs (split by direct and overheads costs) for TRCs provided in all WLA, LL Access and IEC markets. In relation to SFIs in WLA markets, we proposed to require BT to provide information on the costs per module and the hourly costs these are based on.³⁴⁸
- **Existing WLA AFI requirements:** we reviewed existing requirements and proposed to i) replace the requirement to provide information on BDUK grants for the WLA market with a broader requirement to provide information on all grants across the SMP markets (discussed above) ii) maintain the requirement to provide information on electricity charges but make this a requirement under 'shared ancillaries', iii) remove a requirement to provide certain information on WLA services which we proposed would

³⁴⁵ BT response dated 26 February to question 1 of the section 135 notice dated 12 February 2021.

³⁴⁶ July 2020 Consultation, paragraphs 5.18 to 5.21.

³⁴⁷ July 2020 Consultation, paragraphs 5.22 to 5.23.

³⁴⁸ The draft legal directions in the January 2020 Consultation said the hourly charge for SFIs in year one of the control period will be £43.28, with total costs for most SFIs being equal to engineering time x hourly charge.

be reported in the published RFS in future and iv) remove information on WLA component FAC as this information was no longer required.³⁴⁹

Stakeholder responses

- 5.57 Responses focused on our proposals relating to the provision of information on FTTP.
- 5.58 BT agreed with our proposals for it to provide us with information on FTTP homes passed and investment in FTTP networks.³⁵⁰ BT also said it wanted to agree a template showing annual FTTP costs (capital expenditure and operating costs), FTTP connections and revenues to track how its investment is progressing. BT said this would help ensure ‘minimal disagreement’ on its FTTP costs, revenues and volumes up to the possible point of future price regulation and a ‘common understanding’ on what it has spent and what remains to be recovered.³⁵¹
- 5.59 Gigaclear said that information on FTTP homes passed, split by those funded commercially and those funded by government subsidies or other grants should also be split by Area 2 and Area 3 separately.³⁵²
- 5.60 KCOM said “Ofcom is proposing to require Openreach to publish information regarding the number of homes passed with FTTP by exchange area, and the level of investment that has supported its rollout. KCOM agrees with this.”³⁵³

Our reasoning and decisions

- 5.61 We have decided to impose the following requirements on BT in relation to WLA markets.

FTTP homes passed

- 5.62 Consistent with our proposal, BT must provide us with information on FTTP homes passed in Area 2 and Area 3, split by those funded commercially and those funded by government subsidies or other grants and also split by exchange area. This information will be provided for Area 2 and Area 3 separately, as suggested by Gigaclear. This will help us monitor that information on FTTP homes passed published in the RFS is reliable and allow us to understand how BT’s rollout evolves over time and by area.
- 5.63 BT may need to make assumptions to report this information for Area 2 and 3 and identify homes passed which have been funded commercially and those funded by other grants so we are also requiring BT to provide us with details of these assumptions where applicable.
- 5.64 KCOM indicated agreement to more being published on FTTP rollout than we had consulted on publishing. As explained in section 3, the published RFS will include information on the number of non-subsidised homes passed by FTTP for Area 3. We do not

³⁴⁹ These proposals were set out in Table 6.3 of the February 2020 Consultation.

³⁵⁰ BT response to July 2020 Consultation, paragraph 5.1.

³⁵¹ BT second response to February 2020 Consultation, paragraph 4.4.

³⁵² Gigaclear response to July 2020 Consultation, page 4.

³⁵³ KCOM response to July 2020 consultation, paragraph 2.8.

consider it would be proportionate to require BT to publish information by exchange area as its commitment relates to the whole of Area 3, not by exchange area.

FTTP revenues and investment

- 5.65 No stakeholders disagreed with our proposals, though BT suggested it also provide us with FTTP connection volume information, which we agree with. We have decided to require BT to provide us with a schedule setting out how much it has invested in FTTP networks in WLA Area 2 and Area 3 on an annual and cumulative basis. The schedule should include capital costs (by asset type such as duct and fibre) and operating costs as well as information on FTTP revenues and FTTP connections. This information will help us understand the level of FTTP investment and take up that is taking place, compare this across geographic WLA markets and assess the effectiveness of the remedies imposed. To enable a comparison with the information on homes passed discussed above, the information on FTTP investment should also identify any grant funding received in relation to FTTP networks.
- 5.66 We recognise BT may need to make assumptions to split investment costs between Area 2 and 3 so we are also requiring BT to provide us with details of these assumptions where applicable.
- 5.67 We agree with BT that this information will help us track the revenues BT has received from its FTTP investment and how much it has spent. In Volume 4 Section 2 we said that we anticipated that the RAB framework could extend into future review periods. We expect that this information could inform our views relating to price regulation in the future.
- 5.68 KCOM indicated agreement to more being published on BT's FTTP investment than we had consulted on publishing. We do not consider it would be proportionate to require BT to publish information on its FTTP investment at this level of granularity. However, as set out in section 3, we are requiring BT to publish information on FTTP service returns and we consider this will give stakeholders an insight into how BT is performing against expectations.

TRCs and SFIs

- 5.69 No stakeholders commented on our proposals and we have decided to impose the requirements as set out in the consultation.
- 5.70 BT must provide us with hourly costs (split by direct and overheads costs) for TRCs provided in each WLA, LL Access and IEC markets. This information will help us compare trends in hourly costs against BT's hourly TRCs and understand differences between rates charged in these markets.
- 5.71 In relation to SFIs in WLA markets, BT must provide information on the costs per module and the hourly costs these are based on.

Existing WLA AFI requirements

- 5.72 Our decisions in relation to grant funding and electricity charges are discussed elsewhere in this volume.
- 5.73 No stakeholders commented on our proposals to remove requirements to provide information on certain WLA services (as this information will be reported in the published RFS in future) and WLA component FACs (as we are no longer requiring component FACs to be published). We have therefore removed the requirement for BT to provide these AFIs.

Leased lines and inter-exchange connectivity markets

Proposals

- 5.74 We made the following proposals in relation to LL Access and IEC markets:
- **Dark fibre:** we proposed that BT must provide us with i) the costs of patch panel equipment at the exchange and customer premises; and ii) labour costs associated with installing patch panels and undertaking initial testing of dark fibre circuits.
 - **Contractor ECCs:** In the November 2020 consultation we proposed to require BT to provide us with information on the revenues and costs of contractor ECCs. This was to help us understand the costs of these services given they are subject to basis of charges obligations. We said BT could estimate these costs outside of its cost accounting system, but where this was the case it would need to explain any assumptions made and compare total costs to ancillary services reported in the RFS.³⁵⁴ We made a similar proposal in relation to PIA ancillaries, discussed above.
 - **TRCs:** we proposed to require BT to provide us with hourly costs (split by direct and overheads costs) for TRCs provided in each WLA, LL Access and IEC markets.
 - **Existing leased lines requirements:** we proposed to remove the three existing AFIs as the information would either be available in the published RFS or in CostPerform.³⁵⁵

Stakeholder responses

- 5.75 Stakeholder responses focused on our proposals for dark fibre and contractor ECCs.

Dark fibre

- 5.76 BT said we should remove the requirement to provide cost information on dark fibre patch panels and initial testing.³⁵⁶ BT said equipment and labour costs associated with patch panels are captured on single jobs and booked to fibre assets while initial testing is also booked as part of a single job associated with connection (making it hard to isolate the costs of these dark fibre services).³⁵⁷

³⁵⁴ November 2020 consultation, paragraphs 7.14 to 7.18.

³⁵⁵ The three existing AFIs were set out in Table 6.4 of the February 2020 Consultation.

³⁵⁶ BT response to February 2020 Consultation, paragraph 7.21

³⁵⁷ BT response to February 2020 Consultation, paragraphs 4.39 and 4.41.

- 5.77 For the purposes of reporting cost information for these services in the RFS, BT proposed to use an apportionment approach using some inputs from Ofcom’s model (e.g. hours per patch panel install, equipment cost, utilisation per patch panel) and some inputs from Openreach (e.g. labour rate).³⁵⁸
- 5.78 Vodafone said information on patch panel and initial testing costs should be published to allow stakeholder review.³⁵⁹

Contractor ECCs

- 5.79 Stakeholder responses on contractor ECCs (and our corresponding proposal for PIA ancillaries) are set out in the PI section above.

Our reasoning and decisions

- 5.80 We have decided to impose the following requirements on BT in LL Access and IEC markets. These requirements are included in the form and content direction in Volume 7.

Dark fibre

- 5.81 As explained in section 4, when setting dark fibre prices we estimated the costs for patch panels, initial testing, RWT and cessation. The purpose of the proposed requirement was to enable us to monitor the effectiveness of our control by reference to how the costs of patch panels and initial testing develop during the control period. We recognise that BT may need to estimate some of these costs as they form part of larger planning jobs and asset classes, e.g. by reference to an apportionment methodology.
- 5.82 Consistent with our approach in section 4, we have amended the AFI to require BT to provide us with information on how it has estimated the costs of patch panels and initial testing in the RFS. We consider it is proportionate to include RWT and cessation costs in this requirement as our approach to estimating costs and charges for these services was similar to initial testing, as explained in Annex 17. This information will include the cost of patch panel equipment, depreciation of patch panels and relevant labour rates (cost of labour; time taken to install patch panels at exchanges and customer premises; and time taken to test and cease dark fibre circuits, including any differences between single and dual fibre). To estimate the costs of patch panels and initial testing in the RFS, BT notes that it intends to take some inputs from our pricing model and other inputs from Openreach. We would expect BT to update these inputs where its internal data suggests this is appropriate.

Contractor ECCs

- 5.83 We have decided to require BT to provide us with cost information on contractor ECCs to help us understand the costs associated with these services and assess BT’s compliance with the basis of charges obligation.

³⁵⁸ BT response to February 2020 Consultation, paragraphs 4.40 and 4.42.

³⁵⁹ Vodafone response to February 2020 Consultation, paragraph 6.3.

- 5.84 For the reasons given in the PIA ancillaries section above, we have decided to amend the direction to require BT to provide the price and unit cost information set out in the template included in Openreach's response, along with an explanation of how the data has been prepared. This must include the source of data for each cost item; any assumptions, judgements, calculations or estimates made, and an explanation of how overhead uplifts have been estimated from RFS data.

TRCs

- 5.85 No stakeholders commented on our proposals and we have decided to impose the requirements as set out in the consultation. BT must provide us with hourly costs (split by direct and overheads costs) for TRCs provided in each WLA, LL Access and IEC markets. This information will help us compare trends in hourly costs against BT's hourly TRCs and understand differences between rates charged in these markets.

Existing leased lines requirements

- 5.86 No stakeholders commented on our proposals and we have removed the three existing AFIs in relation to leased lines in line with our consultation proposals.

Optical services

- 5.87 In section 3 we said that BT must publish information on rental, connection and main link optical services in the RFS. We note Openreach's comments in response to the November 2020 Consultation that while it tracks revenues for optical circuits, it cannot easily do so by module component.³⁶⁰ To ensure we understand how BT has prepared the revenue information published in the RFS and how this relates to the structure of the price list, we have decided to require BT to provide a breakdown of the volumes and revenues of optical services published in the RFS by reference to the following categories: Optical Spectrum Access (OSA), Optical Spectrum Extended Access (OSEA), Optical Spectrum Access Filter Connect (OSA Filter Connect), Optical Spectrum Extended Access Filter Connect (OSEA Filter Connect and other optical services. Where this is not possible, BT must explain why.

Shared ancillaries

- 5.88 We proposed to require BT to provide us with its calculation of electricity charges, including the mark-up on its purchase of electricity. We said this would help us assess BT's compliance with the proposed basis of charges obligation.
- 5.89 No stakeholders commented on our proposal. We have decided to require BT to provide information on its calculation of electricity charges in line with our proposal. This is implemented in Annex B of the form and content direction in Volume 7.

³⁶⁰ Openreach response to November 2020 Consultation, Annex A, paragraphs 5 to 8.

6. Legal tests

- 6.1 In Sections 1-5 we set out our decisions to impose regulatory financial reporting obligations on BT, in each of the physical infrastructure, wholesale local access, leased lines access and inter-exchange connectivity markets.
- 6.2 In order to give regulatory effect to our decisions we have decided to set a regulatory financial reporting SMP condition in relation to each of those markets: condition 11 set out in Volume 7.
- 6.3 Under the Regulatory Financial Reporting SMP condition, Ofcom may from time to time make such directions as they consider appropriate in relation to BT's reporting obligations.
- 6.4 We have given six directions under section 49 of the Act and the Regulatory Financial Reporting SMP condition, in relation to each of the proposed SMP markets. The directions are set out in full in Volume 7.³⁶¹ The directions are:
- a) Regulatory Accounting Principles Direction
 - b) Preparation, Delivery, Publication, Form and Content Direction
 - c) Consistency with Regulatory Decisions and Regulatory Asset Value Direction
 - d) Audit of the RFS Direction
 - e) Reconciliation Report Direction
 - f) Network Components Direction
- 6.5 Since we have decided to remove the requirement which formerly existed on BT to provide an Adjusted Financial Performance Schedule, we have not given a direction in this regard.

SMP Condition

- 6.6 We remain of the view that there are significant advantages to BT and stakeholders in applying one set of accounting rules across all markets. We consider it would be onerous and disproportionate for BT to be required to implement different approaches in different markets due to the amount of shared costs.
- 6.7 We consider that accounting separation and, where appropriate, some cost accounting rules provide us with the information necessary to help us make informed regulatory decisions, for example cost information to support price controls on an ongoing basis. The obligations also provide the information necessary to assess the impact and effectiveness of our decisions, for example, trends in the usage and returns associated with regulated services. They also enable us to monitor and, if necessary, enforce no undue discrimination and some price control regulations.

³⁶¹ We have slightly reordered these by comparison with the current directions, to make them easier to read in a logical order.

- 6.8 Publication of some information helps inform stakeholders so they can have confidence that BT is complying with its obligations and that regulation is effective and appropriate to achieve its purpose. It enables them to identify and bring issues to our attention and effectively contribute to the regulatory regime. This promotes confidence in the market, which in turn creates the conditions for effective competition.

Accounting separation

- 6.9 Paragraph 1 of the 2005 EC Recommendation states that:
- “The purpose of imposing an obligation regarding accounting separation is to provide a higher level of detail of information than that derived from the statutory financial statements of the notified operator, to reflect as closely as possible the performance of parts of the notified operator’s business as if they had operated as separate businesses, and in the case of vertically integrated undertakings, to prevent discrimination in favour of their own activities and to prevent unfair cross-subsidy”
- 6.10 Our accounting separation obligation requires BT to account separately where appropriate for internal and external sales which allows us and stakeholders to monitor the activities of BT to ensure that, where relevant, it does not discriminate unduly in favour of its own downstream business and to monitor BT’s activities in respect of the non-discrimination and EOI obligations. This, combined with the cost accounting obligation (see below), helps us to ensure that costs are not inappropriately loaded onto one set of regulated services to the benefit of BT, where BT uses primarily another set of regulated services.
- 6.11 Under sections 87(7) and 87(8) of the Act the dominant provider may be required to maintain a separation for accounting purposes between different matters relating to network access or the availability of relevant facilities. We believe this obligation is required to monitor the overall impact and effectiveness of the remedies proposed, and especially to monitor BT’s activities with regard to its non-discrimination and EOI obligations.
- 6.12 Section 87(6)(b) of the Act provides for a dominant provider to publish information for the purpose of securing transparency in relation to matters connected with network access to or with the availability of relevant facilities. Article 9(1) of the Access Directive specifies that such information can include accounting information. The obligation is also necessary to support transparency. It provides a greater detail of information on the relevant markets than could be derived from BT’s statutory financial statements and gives visibility, and thus reassurance, to stakeholders that BT has complied with its SMP conditions.
- 6.13 The specific accounting separation requirements we are imposing on BT in these markets are set out in Condition 11 in Volume 7.

Cost accounting

- 6.14 Recital 2 of the 2005 EC Recommendation states that the purpose of imposing the accounting separation and cost accounting obligations is “to make transactions between

operators more transparent and/or to determine the actual costs of services provided”. Paragraph 2 of Point 1 of the 2005 Recommendation states that:

“The purpose of imposing an obligation to implement a cost accounting system is to ensure that fair, objective and transparent criteria are followed by notified operators in allocating their costs to services in situations where they are subject to obligations for price controls or cost-oriented prices.”

6.15 The imposition of a cost accounting obligation ensures that BT has in place a system of rules that support the attribution of revenues and costs to individual markets and services. It therefore supports the accounting separation obligation, which requires BT to prepare and report financial information relating to individual markets and services, by ensuring that the rules attributing revenues and costs to individual markets and services are fair, objective and transparent. The cost accounting obligation is an important means of ensuring that:

- a) Ofcom and stakeholders can have confidence in the financial information prepared and provided by BT since the attribution processes and rules supporting that financial information are fair, objective and transparent. Where we do not consider that the attribution process and rules are fair and objective, transparency (via publication of the processes and rules followed by BT) allows us to effectively challenge them.
- b) Revenues and costs are attributed to individual markets and services in a consistent manner. Where relevant, this mitigates the risk of over recovery of costs or that costs might be unfairly loaded onto particular services or markets.
- c) BT records all information necessary for the purposes listed above at the time that relevant transactions occur, on an ongoing basis. Absent such a requirement, there is a strong possibility that the necessary information would not be available when it is required, and in the necessary form and manner.

6.16 Section 87(9)(c) authorises conditions imposing such rules as we may make for the purposes of matters connected with the provision of network access to the relevant network, or with the availability of relevant facilities about the use of cost accounting systems. These would include conditions enabling Ofcom to require the dominant provider to explain what assumptions it has used in determining costs and charges, for the purposes of setting price controls, rules and obligations imposed in relation to price controls, cost recovery and cost orientation, cost accounting systems and adjusting of prices in accordance with Directions from Ofcom (section 87(10)). Where such conditions are imposed, section 87(11) imposes a duty on us to also set an SMP condition which imposes an obligation:

- to make arrangements for a description to be made available to the public of the cost accounting system used in pursuance of that condition; and
- to include in that description details of:
 - the main categories under which costs are brought into account for the purposes of that system; and

- the rules applied for the purposes of that system with respect to the allocation of costs.
- 6.17 We consider that the condition would fulfil our duty under section 87(11) in that the cost accounting conditions require the publication of a description of the cost accounting system used and the main categories of cost and the cost allocation rules applied.
- 6.18 We believe the cost accounting obligation is necessary to ensure the processes and rules used by BT to attribute revenues and costs to individual markets and services are fair, objective and transparent. Therefore, we have decided to impose a cost accounting requirement on BT.
- 6.19 The specific cost accounting requirements we are imposing on BT in these markets are set out in Volume 7, Condition 11.
- 6.20 For the reasons set out below, we are satisfied that the accounting separation and cost accounting SMP conditions for BT in respect of the SMP markets would meet the various tests set out in the Act and that they are appropriate to address the competition concerns identified, in line with section 87(1) of the Act.

Section 47 tests

- 6.21 We consider that the accounting separation and cost accounting SMP conditions we are imposing satisfy the tests set out in section 47 of the Act, namely that each obligation is:
 - a) objectively justifiable in relation to the networks, services or facilities to which it relates;
 - b) not such as to discriminate unduly against particular persons or against a particular description of persons;
 - c) proportionate to what the condition or modification is intended to achieve; and
 - d) transparent in relation to what it is intended to achieve.

Objectively justified

- 6.22 We consider that each of the SMP conditions is objectively justifiable. The remedies that we are imposing are designed to address the competition concerns that we have identified in our market analysis. As explained in Section 1 of Volume 3, our market analysis has found that Openreach has the ability and incentive:
 - a) to refuse to supply access and thus restrict competition in the provision of products and services in the relevant downstream markets;
 - b) to favour its downstream retail businesses to the detriment of its competitors in the relevant retail markets, by both price and non-price discrimination;
 - c) not to invest in new networks or do so more slowly than would occur in a competitive market;

- d) to target price reductions or adopt other commercial terms that distort competition in the rollout of new networks; and
- e) to not maintain an adequate level of service quality in the provision and repair of wholesale services or to discriminate in the quality of provision.

6.23 Therefore, in the absence of a requirement to provide network access, supported by associated obligations, Openreach could refuse or impede access, or it could provide access on less favourable terms and conditions compared to those obtained by its own downstream businesses. The accounting separation and cost accounting obligations we are imposing form part of a package of remedies to address these competition concerns. In particular:

- a) The accounting separation requirement allows us and stakeholders to monitor the activities of BT to ensure that, where relevant, it does not discriminate unduly in favour of its own downstream business and to monitor BT's activities in respect of the non-discrimination and EOI obligations. This, combined with the cost accounting obligation, helps us to ensure that costs are not inappropriately loaded onto one set of regulated services to the benefit of BT, where BT uses primarily another set of regulated services.
- b) The cost accounting obligation is necessary to ensure the appropriate maintenance and provision of accounts in order to monitor BT's activities with regard to the pricing remedies we are implementing and monitor their effectiveness at addressing the competition concerns. It is also necessary to secure that information continues to be created and captured so as to secure, and to give stakeholders confidence, that pricing can continue to be appropriately regulated in future, creating the conditions for the price controls we are now imposing to impose to be effective. It also relates to the need to ensure competition develops fairly, to the benefit of consumers, by providing transparency of BT's compliance with rules set to address the risk of exploitative or anti-competitive pricing.

Not such as to discriminate unduly

6.24 We consider that each of the conditions does not discriminate unduly against BT. BT is the only telecoms provider to hold SMP in the markets that we have identified and the conditions seek to address that market position.

Proportionate

6.25 We consider that each of the conditions is proportionate to what that condition is intended to achieve. In each case, we are imposing an obligation on BT that: is effective to achieve our aim; is no more onerous than is required to achieve that aim; and does not produce adverse effects which are disproportionate to our aim. We explain why we consider the SMP conditions are proportionate in the context of the markets we are reviewing in sections 1 to 5 above.

Transparent

- 6.26 We consider that each of the conditions is transparent in relation to what is intended to be achieved. The text of the conditions is published in Volume 7 and the operation of those conditions is aided by our explanations in this document. This document sets out our analysis of responses to the consultation and the basis for the final decision.

Section 87 tests

- 6.27 We have taken into account the factors set out in section 87(4) of the Act.
- 6.28 As required by section 87(11), because we are imposing a condition setting rules on BT about the use of cost accounting systems, the condition also requires BT to make arrangements for a description to be made available to the public of the cost accounting system used in pursuance of that condition; and to include in that description details of (i) the main categories under which costs are brought into account for the purposes of that system; and the rules applied for the purposes of that system with respect to the allocation of costs.

Section 88 tests

- 6.29 In setting cost accounting conditions, we must also ensure that the network access pricing conditions set out in section 88 are also satisfied.
- 6.30 We consider that imposing a cost accounting obligation would be consistent with section 88 for the reasons set out in Volume 4. We also consider that imposing a cost accounting obligation is necessary for price controls to be effective.

Section 46

- 6.31 In Volumes 3 and 4 we explained that we are imposing SMP services conditions to apply to deregulated BT exchanges for a transitional period of 12 months. We consider this is consistent with section 46(8A) of the Act which provides that we can continue to treat a person (here BT) previously determined as having SMP in a given market, who we determine no longer has SMP in that market, as continuing to have SMP in that market for so long as we consider necessary to ensure a sustainable transition for those benefitting from the obligations imposed as a result of the previous SMP determination. For the remedies to have their intended effect, it is appropriate for the associated regulatory reporting obligations to be extended too.
- 6.32 For the reasons set out in Volumes 3 and 4 we consider that the 12 month period is necessary for a sustainable transition for telecoms providers from Openreach's active leased lines to alternative services. We consider 12 months is no longer than is necessary to achieve this aim.

Section 49 tests

- 6.33 Section 49(2) of the Act requires that Ofcom must be satisfied that any direction satisfies the test in that section, which requires directions to be:
- a) objectively justifiable in relation to the networks, services or facilities to which it relates;
 - b) not such as to discriminate unduly against particular persons or against a particular description of persons;
 - c) proportionate to what the condition or modification is intended to achieve; and
 - d) transparent in relation to what it is intended to achieve.
- 6.34 We set out our reasoning below separately in relation to each direction.

Regulatory Accounting Principles Direction

- 6.35 The RAP are a set of guiding principles with which BT's Regulatory Financial Reporting must comply. 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.
- 6.36 We have given the Regulatory Accounting Principles Direction in relation to BT in each of the SMP markets as set out in Volume 7. This direction reflects the changes discussed in Section 4.
- 6.37 We consider that the Regulatory Accounting Principles Direction would meet the tests set out in section 49(2) of the Act in that it is:
- a) objectively justifiable because by specifying the Regulatory Accounting Principles we will establish the attributes for BT's regulatory financial reporting;
 - b) not unduly discriminatory in that BT is the only telecoms provider on which we have imposed specific pricing and financial reporting remedies, as the only telecoms provider which we have found holds SMP in the markets concerned;
 - c) proportionate because our direction requires no more than what 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; and
 - d) transparent because the intention of our direction is to ensure we take a role in the basis of preparation of the RFS to ensure an absence of bias and consistency with regulatory decisions.

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

- 6.38 This direction provides details of the financial information to be included in the published RFS and to be provided to Ofcom privately. It therefore plays an important role in ensuring the RFS provide relevant information to stakeholders and Ofcom. Some elements of the published RFS relate to all of BT while others are specific to particular markets. To preserve the integrity and consistency of the RFS, we consider that all SMP markets should be subject to appropriate reporting requirements.
- 6.39 We have given the Preparation, Delivery, Publication, Form and Content of the RFS Direction in relation to BT in each of the SMP markets as set out in Volume 7. This direction reflects our decisions set out in sections 3 and 5 above. All other requirements of this direction remain unchanged from those included in the July 2019 RFR Statement.
- 6.40 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. This direction will ensure visibility of financial information for each SMP market;
 - b) not unduly discriminatory in that BT is the only telecoms provider on which we have imposed specific pricing and financial reporting remedies, as the only telecoms provider which we have found holds SMP in the markets concerned. 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 proposals in this market review and will ensure that Ofcom and stakeholders are provided with a sufficient level of information; 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.

Consistency with Regulatory Decisions and Regulatory Asset Value Direction

- 6.41 This direction specifies how BT should prepare the RFS to be consistent with our regulatory decisions. This ensures that the RFS are prepared on a basis that allows us to assess the impact and effectiveness of our remedies and provides assurance to stakeholders that information is being created and retained such that appropriate regulation can continue to be maintained in future.
- 6.42 We have given the Consistency with Regulatory Decisions and Regulatory Asset Value Direction in relation to BT in each of the proposed SMP markets as set out in Volume 7.

- 6.43 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 the SMP markets in order that the RFS fulfils its purpose in enabling the monitoring of our SMP conditions, securing the effectiveness of our price controls and stakeholder confidence in the market. For example, in the physical infrastructure market we need to specify the accounting treatment of the physical infrastructure costs so that the RFS is consistent with our regulatory decision to set maximum charges on PIA; in the Leased Lines Access – Area 3 and IEC – BT only markets we need to specify the accounting treatment of dark fibre costs so that the RFS is consistent with our regulatory decision to set prices for dark fibre at cost; in other markets where we have set some form of price regulation it is necessary to specify the accounting treatment of various costs to ensure consistency with our regulatory proposals 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 current cost basis;
 - b) not unduly discriminatory, in that BT is the only telecoms provider on which we have imposed specific pricing and financial reporting remedies, as the only telecoms provider which we have found holds SMP in the markets concerned;
 - 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 direction is to ensure that BT's RFS are consistent with our decisions in relation to the price controls imposed in the SMP markets, and the wider pricing obligations in other markets.

Audit of the RFS Direction

- 6.44 Audit of the RFS gives users confidence that the information provides a fair reflection of financial performance, is free from error and has been prepared following the accounting methodology statements published by BT and relevant directions issued by Ofcom. To preserve the integrity and consistency of the RFS we consider that all markets should be subject to the same Audit Direction.
- 6.45 We have given the Audit of the RFS Direction in relation to BT in each of the SMP markets as set out in Volume 7. The Audit Direction is similar to that imposed in the March 2019 BT RFR Statement and July 2019 RFR Statement. It requires BT to secure PPIA (“properly prepared in accordance with”) opinions on the RFS.
- 6.46 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 in that BT is the only telecoms provider on which we impose specific pricing and financial reporting remedies, as the only telecoms provider which we found holds SMP in the markets concerned;
- 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 is to ensure that an appropriate level of assurance is provided on the RFS.

Reconciliation Report Direction

- 6.47 The Reconciliation Report Direction requires BT to publish the impact of all material changes and errors each year with an accompanying assurance report from its regulatory auditors.
- 6.48 Changes to attribution methods or the correction of errors can affect all markets reported in the RFS. As a result, to preserve the integrity and consistency of the RFS, we consider that all markets should be subject to the same direction to produce a reconciliation report. Therefore, we have given the Reconciliation Report Direction in relation to BT in each of the SMP markets as set out in Volume 7.
- 6.49 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 error corrections and methodology changes made in RFS, both for us and 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 in that BT is the only telecoms provider on which we impose specific pricing and financial reporting remedies, as the only telecoms provider which we found holds SMP in the markets concerned;
 - c) proportionate because our direction is no more than is required to provide visibility in relation to error corrections and methodology changes for us and other stakeholders; and
 - d) transparent because our direction seeks to provide visibility in relation to error corrections and methodology changes for us and other stakeholders and to provide BT with clarity about the requirements specifying the content of the reconciliation report and the accompanying audit opinion.

Network Components Direction

- 6.50 To preserve the integrity and consistency of BT's Regulatory Financial Reporting it is important that there is a single list of components used to attribute costs to services in regulated markets. As discussed in Section 4, we have amended the SMP condition to

provide BT with more flexibility to change the components used to prepare the RFS, subject to appropriate controls. The SMP condition requires BT to do the following:

- To publish an annual list of cost components used to prepare the RFS (Cost Component List).
- The Cost Component List must include a list of components used to prepare the RFS, a description of each component, and diagrams showing which part of the network, or which activity, each component represents.
- Changes to the Cost Component List must be put through the annual Change Control Notification process.
- The list of components to be included in the Cost Component List on 1 April 2021 must consist of those directed by Ofcom.

6.51 This direction specifies the cost components to be used by BT to prepare the RFS as at 1 April 2021, i.e. the components that must appear in the Cost Component List as at this date. This list includes the new fibre components discussed in section 4. Changes to this component list can be made by BT through the CCN process.

6.52 We have given the Network Components Direction in relation to BT in each of the SMP markets as set out in Volume 7.

6.53 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 ensure there is a single list of components used to attribute costs to the SMP markets;
- b) not unduly discriminatory in that BT is the only telecoms provider on which we impose specific pricing and financial reporting remedies, as the only telecoms provider which we found holds SMP in the markets concerned;
- c) proportionate because our direction is no more than is required to specify an appropriate initial list of network components; and
- d) transparent because it is clear that our direction seeks to specify relevant network components in the light of our charge controls and to ensure that these network components are fit for purpose.

Ofcom's duties

6.54 As set out in Volume 1, we consider the package of SMP conditions both individually and together meet our duties in sections 3 and 4 of the Act