Arqiva Group Limited

Regulatory Accounting Principles and Methodologies
2022/23

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1 Regulatory Accounting Principles

1.1 Background

Arqiva Group Limited ("AGL") and its subsidiaries (the Group) together is required, (under the terms of the Undertakings agreed with the Competition Commission in respect of the acquisition of the National Grid Wireless ("NGW") Group by Arqiva Financing No1, the "Undertaking") to prepare annual Regulatory Accounts ("RA").

These RA report the Network Access ("NA") and Managed Transmission Services ("MTS") activities, as defined by the Undertakings, of the combined Arqiva and NGW businesses.

This document sets out the Regulatory Accounting Principles and Methodologies ("RAPM") on which the RA are based; it sets out detailed methods applied in attributing revenues, costs, assets and liabilities to the NA and MTS activities of the Group.

The RAPM are maintained in accordance with Section 15.5 of the Undertakings given to the Competition Commission. The Competition Commission closed on 1 April 2014; its functions have transferred to the Competition and Markets Authority.

It is intended that this document is read in conjunction with the RA and the AGL Annual Report and Consolidated Financial Statements. This document will be updated annually in the event of any changes to either the RAPM or detailed attribution methods. Key changes are summarised in section 1.4.

1.2 Basis of preparation and form of Audit Opinion

The Undertakings require that the RA be prepared and externally audited on a Fairly Presents ("FP") basis. This takes account of key regulatory reporting principles such as Cost Causality (see section 1.3 below).

The RA for the year ended 30 June 2023 (FY23) have been prepared and audited on a FP basis in accordance with the terms of the Undertakings.

1.3 Regulatory Accounting Principles

The RA are based on the following Regulatory Accounting Principles; this document is prepared to provide a suitably informed reader with a description of the accounting and attribution methods used in the production of the RA.

- **Accounting Principle**: the RA will be derived from the Consolidated Financial Statements of AGL prepared in accordance with International Financial Reporting Standards ("IFRS") as defined by the Group accounting policies set out in the consolidated financial statements, unless any specific deviation is required as a result of conforming to this document.

- **Cost Causality**: Revenues (including transfer charges), cost components, assets and liabilities are attributed to NA, MTS and Non-Regulated Business on a basis which reflects the activities causing the revenues to be earned, costs to be incurred, assets acquired or liabilities incurred. Where such a direct relationship does not exist, revenues, costs, assets and liabilities are attributed on a fair, reasonable and non-discriminatory basis.

- **Data Source Accuracy & Completeness**, empirical data, both financial and non-financial, used as part of the accounting and attribution methodology is subject to financial controls and governance. The objective of the finance teams involved in the regulatory financial reporting of the AGL group, is to maintain financial information to an adequate degree of accuracy, such that the information included in the RA is free from material errors, misstatements or double-counting.

- **Consistency**: the RA are prepared on a consistent basis from one year to the next to allow for meaningful year on year comparisons. Should changes be made to the Regulatory Accounting Principles or the Attribution Methods that lead to a material effect on the information reported in the RA, the corresponding prior year figures will be restated if possible.

- **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 are justified and supported by available relevant empirical data. Cost allocations are intended to be impartial, and not intended to benefit any particular product/service or business unit or to benefit either Arqiva or any other operator.

1.4 Key Changes in the Year

There have been no significant changes to the structure of the business during the FY23 financial year. During the year a selection of existing teams from across Commercial and Technology were brought together under a new 'Simplification' function. This decision was made in order to drive better prioritisation, resource allocation and execution and cut complexity across the whole business, by having a central view of all programmes of work. The majority of headcount and third-party costs were moved into the new function in their existing cost centres on a lift and shift basis, meaning costs have been allocated consistently year on year. New cost centres have been created for management and support however most of the headcount costs moved from existing cost centres undertaking the same roles, these costs have been given a total revenue allocation which is reflective of the activity they are undertaking. This change has not had a material impact on the RA.. We have also continued refining the RA process as in previous years.

Refinements to allocation methodologies include the following:

Revenue – continued refinement to increase direct allocation of revenue (NA and MTS) for unbundled contracts.

Cost allocations – refined allocations driven by cost type to improve cost causality allocation and streamline the calculation process.

1.4.1 700 MHz Clearance

The 700MHz Clearance programme is no longer a key driver to the allocations within the regulated accounts. Following the final clearance event in August 2020 activity on the project has continued to decrease in FY23. Whilst the spectrum has been cleared there are still operational activities that need to be completed (e.g. dismantling the Emley Moor temporary mast). Certain allocation methods have been refined to ensure direct allocation of the 700 MHz Clearance programme is completed before allocation is made across the rest of Terrestrial Broadcast. This is in order to better reflect a different nature or volume of cost causality. The revenue from the programme is unregulated. Equipment which will remain part of the regulated business is classified based on its regulatory status of NA/MTS/Other. Equipment which is only used during the period of clearance activities to 2023 and will not form part of the regulatory business going forward, is classed as Other.

1.4.2 COVID-19 Radio discounts

During the 2020 and 2021 financial years a support package was formulated giving structured industry discounts to radio customers to assist with the impact of COVID-19, the revenue recognition accounting policy recognises these discounts across the lives of the relevant contracts. These discounts have been allocated to "Other" in the preparation of the RA as they are considered to be exceptional discounts and have not changed the normal operations of the regulated business.

1.4.3 Bilsdale

On 10 August 2021 the Bilsdale transmitter was irreparably damaged by fire, causing disruption to transmission services. Significant exceptional costs have been incurred to restore service; these costs have been allocated based on the windloading of the Bilsdale site. Non-incremental costs, such as internal labour, have been expensed or capitalised as normal, incremental costs have been treated as exceptional. Interim insurance payments of £20m (FY22: £5m) have been recognised in the RA in FY23 to the extent that it relates to costs allocated. In August 2023, the final stage payment of £16.0m was received from the insurers and has been disclosed as an event after the reporting period in the AGL accounts, at 30 June 2023 this represented a contingent asset and has therefore not been recognised in the FY23 RA. Service credits recognised in the AGL accounts have been allocated to "Other" in the preparation of the RA as they are considered to be exceptional and have not changed the normal operations of the regulated business.

2 Attribution and Allocation Methodologies

2.1 Introduction

The reporting requirements set out in the Undertakings differ from the way in which AGL is organised for management and statutory reporting purposes. As such, the RA are derived from the general ledger used to prepare the consolidated financial statements of AGL with the reporting requirements of the Undertakings overlaid.

The consolidated financial statements are prepared on a historical cost basis, except for financial instruments which are measured at fair value at the end of each financial period. Fixed assets are held at cost, modified for the fair value of those assets acquired through business combinations.

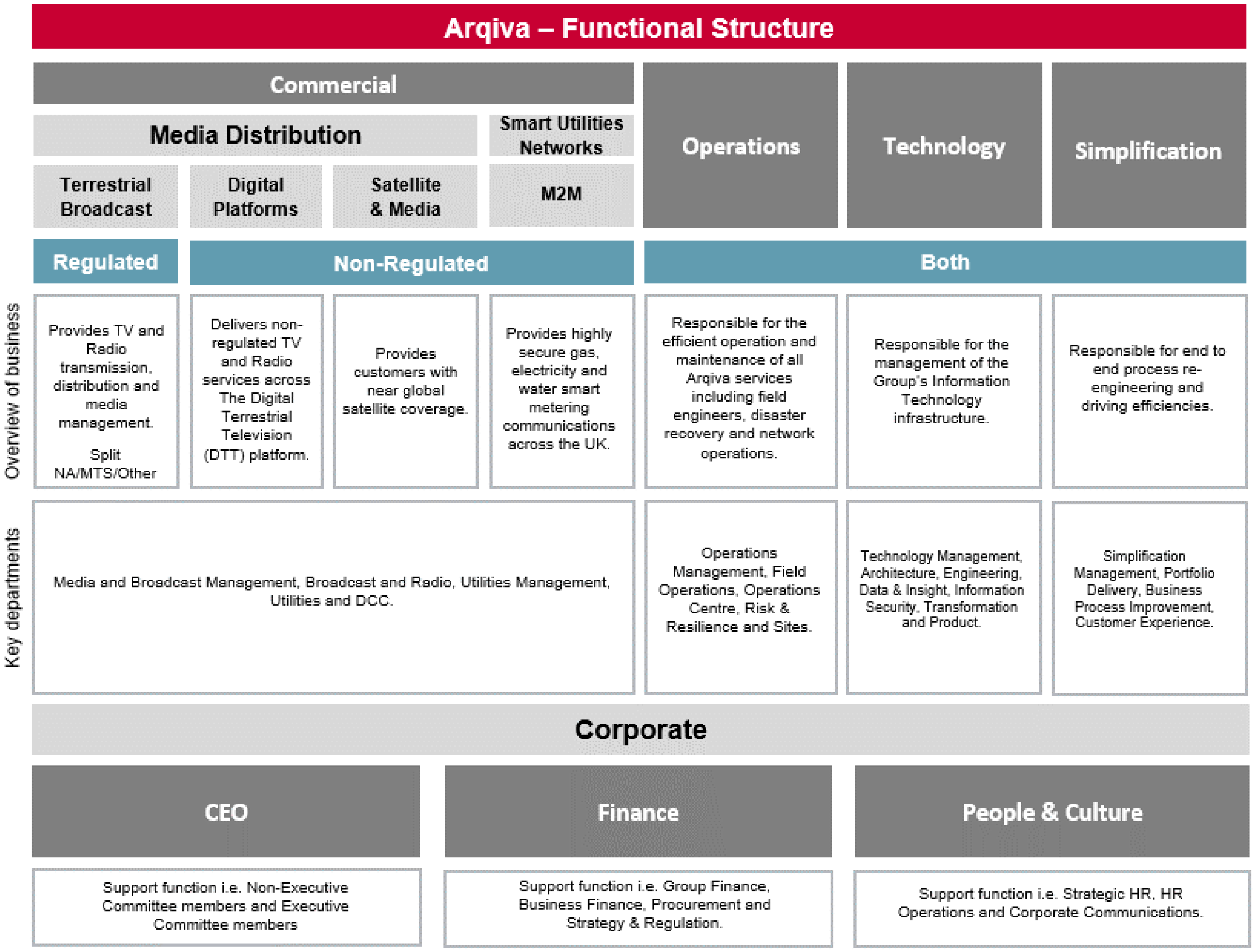
2.2 Organisation Structure

The Group owns and operates a portfolio of communications infrastructure and provides television and radio transmission services, media services and radio communications in the United Kingdom ("UK") and overseas.

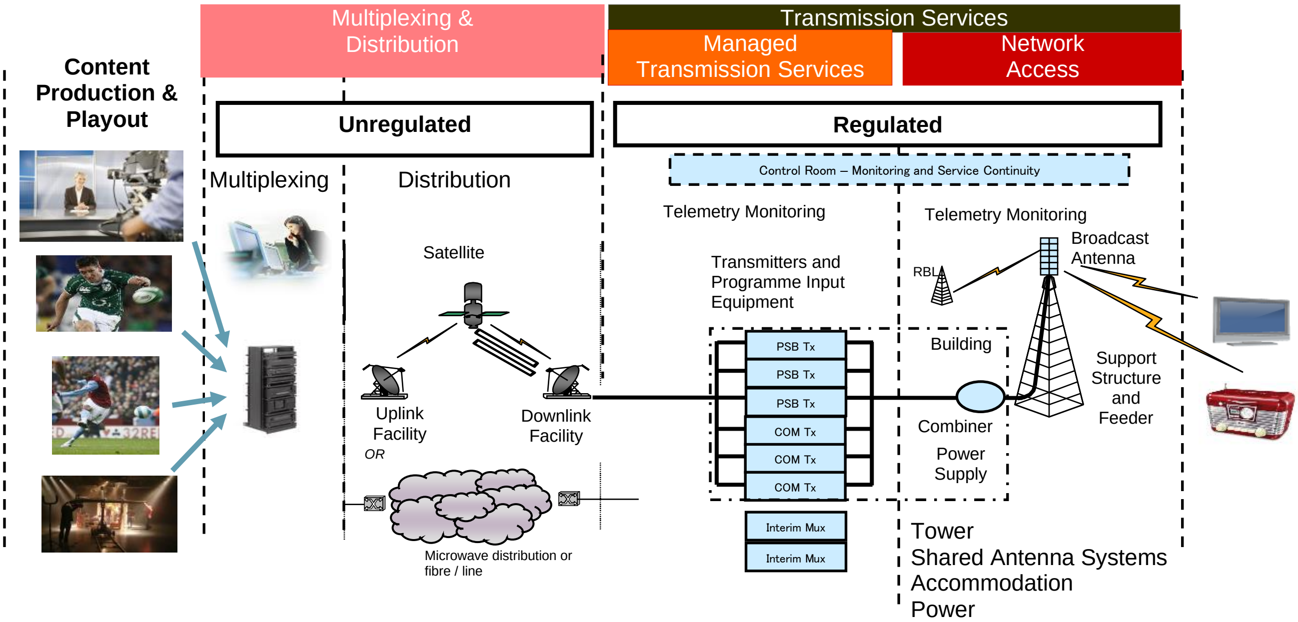
There are two customer segments within the group: Media Distribution and Smart Utilities Networks

The regulated part of the business is within Media Distribution, with an element of the Corporate functions requiring apportionment. To ensure allocations based on revenue measures are not distorted, results relating to Satellite and Media, Digital Platforms and M2M have been removed where appropriate. Non-regulated 700 MHz Clearance revenues are also removed from revenue allocation methodologies where appropriate, in line with previous years.

NA and MTS services represent sub-categories of the Regulated Business within Media Distribution. "Other" represents the remaining Non-Regulated business included in the RA for the purposes of reconciliation to the consolidated financial statements. The table below shows the business functions, their key cost centres and how these are represented within the Regulated Business:



Within Media Distribution, Terrestrial Broadcast contains the regulated NA and MTS business and Other non-regulated activities. Satellite & Media and Digital Platforms, also known as Commercial Video Channels, and M2M are classified as Other non-regulated. The Operations, Technology, Simplification and Corporate Functions provide support services across the entire commercial business and as such require attribution to the Regulated Business activities (NA and MTS) and Non-Regulated activities.



The RA analyse the activities within the Commercial, Operations, Technology, Simplification and Corporate Functions into two core categories: Network Access (‘NA’) and Managed Transmission Services (‘MTS’) with all remaining activities ‘Other’ being included in the RA only in order to support reconciliation to the consolidated financial statements.

NA and MTS can be defined as:

- Network Access - a package of services including combining output from transmitters and broadcasting the combined signal from antennas located on suitable masts or other structures. The provision of NA will include access to the following:
    1. Masts and Towers
    2. Antenna Systems including feeders and combining units
    3. Buildings and/or cabins
    4. Power systems including back-up power in a form of fixed generators
    5. Existing Re-Broadcast Links (receive antennas) at Relay Stations
    6. Remote monitoring of all the Stations

- Managed Transmission Service - a package of services including some or all of network design, procurement and installation of transmitters, network monitoring, quality assurance of the signal and maintenance of the transmission equipment but excluding: the provision of programmes and other content for each channel, the transfer of the channels content to a multiplexing centre and blending them into a single digital signal. As such, MTS includes a mixture of service provision and return on assets.

2.3 Allocation Bases

2.3.1 Overview

The Group maintains its core accounting records in a manner which allows for revenues, costs, assets and liabilities to be separated into the various functions noted above.

Once costs have been analysed by function, these can then be attributed either directly or indirectly to NA, MTS or Other.

Where costs, assets and liabilities are captured at a total company level and fall into the Operations, Technology , Simplification and Corporate functions, these require further analysis and management judgement to apportion into the regulated activities presented in the RA.

Where data is recorded in the general ledger by site location code (for example fixed assets and rent costs) the windloading methodology (see section 2.3.9.1) is used to allocate these site-specific shared costs/assets between Regulated and Non-Regulated activities.

2.3.2 Revenue

Revenue is shown net of VAT (excluding exceptional COVID-19 radio discounts and service credits noted in 1.4.2 and 1.4.3) and is extracted directly from the accounting records and customer billing system. Revenue is coded at source to the product the income is attributable to.

Commercial revenue is further analysed and allocated to NA, MTS or Other using its product classification based on contract values, unless the contracts are bundled – these methodologies are described below in further detail.

For bundled contracts which do not have a specific price for each service provided, allocation is required as follows:

- BBC bundled television contract revenues are split in accordance with the reporting contract cost model agreed with the BBC. The remaining bundled television contracts are split using the respective proportions of NA, MTS and Other charges identified for High Power Digital Terrestrial Television (HPDTT) contracts.

- BBC bundled radio contract revenues are split in accordance with the Schedule 13 radio allocations, part of the NRA (National Radio Agreement) with the BBC.

- Commercial radio unbundled revenues are allocated directly to MTS, NA or Other. Bundled revenues are split based upon an analysis of radio contracts renewed or amended on new terms (derived from cumulative radio reference offers across an indicative period), to estimate the portion of regulated revenue and how this is split between NA and MTS. Pass-through elements such as Rent & Rates and Electricity are allocated between NA and Other.

2.3.3 Costs – Cost of Sales and Operating Costs

All costs are recorded in cost centres with clearly defined activity. Costs allocated to the Operations, Technology , Simplification and Corporate functions are by:

- Certain costs are incurred directly by the Commercial function and are captured in Commercial cost centres.
- Other costs are allocated to the Regulated Business using methodologies identified in 2.3.3.1 and 2.3.3.3, 2.3.3.4, 2.3.3.5 and 2.3.3.6 below.

Shared Regulated Business Costs

Where shared Regulated Business costs are not directly attributable to NA or MTS activities these have been allocated based on a number of methodologies, based on the cost driver:

- The RAB (Regulated Asset Base) valuation - The % split is 86% NA and 14% MTS for TV and 95% NA and 5% MTS for Radio based upon a management estimate informed by data available from the valuation of the RAB carried out in 2012. The valuation has been updated annually by management reflecting additions and RPI to support Reference Offer Pricing for TV and Radio.

- Revenue percentages calculated as part of the revenue workings outlined above, attributable to TV NA, TV MTS, Radio NA and Radio MTS.
- OTL (Oracle Time & Labour) percentages calculated as part of the labour workings outlined in 2.3.9.2, again, attributable to TV NA, TV MTS, Radio NA and Radio MTS.

2.3.3.1 Cost of Sales ("COS")

The allocation methodology used for each of the classification categories are as follows:

- **Rent and rates** are charged on a site by site basis and are therefore allocated directly to sites on an as incurred basis. Where Broadcast sites share common infrastructure with other services (as part of our M2M business), the Windloading methodology (described in the Non-Financial Data section below) is used to allocate the Regulated/Non-Regulated elements across both customer segments. Satellite & Media and M2M only sites are allocated directly to Other, as no regulated infrastructure is present on these sites.

- **Power** is allocated directly from supplier invoices to sites as incurred. The majority of Media Distribution electricity is consumed by MTS equipment. These costs are a pass-through to the customer (no margin being earned by AGL) and categorised as Other.

- **Circuits -** the majority of circuits and telephony costs within Commercial are procured directly for a specific Customer contract. It is possible for Broadcasters to procure their requirements directly from a supplier, therefore the costs associated with this service are Non-Regulated and classified as 'Other'.

- **Intercompany charges –** these costs are Non-Regulated and therefore classified as 'Other'.

- **Labour COS -** Labour COS represent an allocation of time booked against "billable projects" using OTL (described in the Non-Financial data section 2.3.9.2).

- **Maintenance costs –** these are allocated by revenue. Maintenance costs relate to third party invoices for Regulated Business infrastructure and equipment.

- **Other COS -** the majority of Other COS within Commercial relate to Satellite and Microwave Links which are Non-Regulated therefore the costs are classified as 'Other'.

2.3.3.2 Commercial Operating Costs

The RA model allocates Commercial costs based on the cost centres and the nature of the activity within the cost centre. Commercial Opex costs include a separate allocation for Billable labour recharge, Capitalised Overheads, Expense Labour Recharge and Recharges as an improvement to using the available standing data. Determination of the OTL allocation percentages includes capital charged labour (along with billable and expenses) in the over / under recovery stage of the calculation.

Employee and Agency related costs such as salaries are allocated using OTL derived percentages. These percentages are driven by the value of labour time recorded against projects which have been classified into NA, MTS, Support and Non-Regulated (see section 2.3.9.2 on Non-Financial Data for further information).

Commercial operating costs are allocated into 7 Cost Centres, which are:

- Media and Broadcast Management
  Operating costs (excluding labour) within this cost centre relate to the generation of revenue for all Broadcast products therefore using revenue allocation excluding M2M is reflective of the total cost within this cost centre.

- Utilities Management – non-regulated and all costs are allocated to Other.

- Commercial Radio
  Operating costs (excluding labour) within this cost centre relate wholly to the support of sales and revenue streams for Commercial Radio customers, therefore using a radio revenue allocation is reflective of the total cost within this cost centre.

- Sales – France – non-regulated and all costs are allocated to Other.

- Sales – Broadcast – non-regulated and all costs are allocated to Other.

- Accounts Management Water – non-regulated and all costs are allocated to Other.

- Commercial Management DCC – non-regulated and all costs are allocated to Other.

Labour related costs are allocated on the basis of Commercial salary costs (employee only, agency only or weighted average) using OTL derived percentages.

Exceptions

- Bank charges and foreign exchange transactions predominantly relate to non-regulated foreign transactions and are classed as Other.

2.3.3.3 Operations Operating Costs

Operations operating costs are allocated into 24 Cost Centres, which are:

- Operations Management
  Operating costs (excluding labour) within this cost centre relate to management of the entire Operations function, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- S.H.E
  This is the Groups Safety, Health & Environment function, Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Field Operations
  Operating costs (excluding labour) within this cost centre relate to field operations for the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.
- Service Operations Management
  Operating costs (excluding labour) within this cost centre relate to management of the operations centres which support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Operations Centre – Emley Moor
  Operating costs (excluding labour) within this cost centre relate to the operations centre at Emley Moor which manages Broadcast and Utilities activity, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Operations Centre – Crawley Court
  Operating costs (excluding labour) within this cost centre relate to the operations centre at Crawley Court which manages Broadcast and Utilities activity, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Operations Centre - Paris
  Operating costs (excluding labour) within this cost centre relate to the operations centre in Paris which only manages Satellite activity, therefore it is non-regulated and all costs are allocated to Other.

- Service Operations NMC – Emley Moor – non-regulated and all costs are allocated to Other.

- Digital Operations – non-regulated and all costs are allocated to Other.

- Sites Management Team
Operating costs (excluding labour) within this cost centre relate to the management of the Groups portfolio of sites, therefore using an average windloading allocation is reflective of the total cost within this cost centre.

- CAD Services
Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Structures
Operating costs (excluding labour) within this cost centre are incurred predominantly by the HPTV and Radio structures, therefore using a revenue allocation excluding Commercial Video Channels and M2M is reflective of the total cost within this cost centre.

- Estates & Facilities
Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Security
Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Service Management
Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Assurance Management
Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Operations Customer Reporting
Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Service Desk - IT
Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Service Desk – Utilities – non-regulated and all costs are allocated to Other.

- Service Design & Transition
Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Inventory and Demand
Operating costs (excluding labour) within this cost centre relate to the management of Broadcast inventory, therefore using a revenue allocation excluding M2M is reflective of the total cost within this cost centre.

- Warehouse & Logistics
Operating costs (excluding labour) within this cost centre relate to the management of Broadcast inventory, therefore using a revenue allocation excluding M2M is reflective of the total cost within this cost centre.

- Technical Repair
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Scheduling & Access
  Operating costs (excluding labour) within this cost centre relate to the scheduling and site access for field engineers, therefore using an allocation derived from the OTL data for Field Operations is reflective of the total cost within this cost centre.

Labour related costs are allocated on the basis of Operations salary costs (employee only, agency only or weighted average) using OTL derived percentages.

Exceptions

- Bank charges and foreign exchange transactions predominantly relate to non-regulated foreign transactions and are classed as Other.

2.3.3.4 Technology & Transformation Operating Costs

Technology & Transformation (T&T) operating costs are allocated into 31 Cost Centres, which are:

- Technology Senior Management Team
  Operating costs (excluding labour) within this cost centre relate to management of the entire T&T function, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Architecture Commercial
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Spectrum Planning
  Operating costs (excluding labour) within this cost centre relate wholly to the support of sales and revenue streams for "Terrestrial Broadcast" products, therefore a revenue allocation method excluding Commercial Video Channels and M2M revenue is reflective of the total costs within this cost centre.

- Engineering Management
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Radio Transmission
  Operating costs (excluding labour) within this cost centre relate wholly to the support of sales and revenue streams for Radio customers, therefore using a radio revenue allocation is reflective of the total cost within this cost centre.

- OSS, AI & ML
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- DTT Transmission
  Operating costs (excluding labour) within this cost centre relate to sales and revenue streams for Broadcast customers, therefore using a revenue allocation excluding M2M is reflective of the total cost within this cost centre.

- Video & Audio Processing Ops – non-regulated and all costs are allocated to Other.

- Video & Audio Processing Design – non-regulated and all costs are allocated to Other.

- RF
  Operating costs (excluding labour) within this cost centre relate wholly to the support of sales and revenue streams for “Terrestrial Broadcast” products, therefore a revenue allocation method excluding Commercial Video Channels and M2M revenue is reflective of the total costs within this cost centre.

- Broadcast & Satellite Management
  Operating costs (excluding labour) within this cost centre relate to sales and revenue streams for Broadcast customers, therefore using a revenue allocation excluding M2M is reflective of the total cost within this cost centre.

- Power & Environment
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Software Development & Support
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- DUK MDS – non-regulated and all costs are allocated to Other.

- Digital Enterprise Platforms
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Platform Build, Test & Release
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Engineering Other (700 MHz Clearance) – non-regulated and all costs are allocated to Other.

- Utilities – non-regulated and all costs are allocated to Other.

- Security Operations
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Network Operations
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Circuit Delivery – non-regulated and all costs are allocated to Other.

- Network Management
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Data Centre & Security Design
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Network Design
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- IT Data & Information Management
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Information Security
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Transformation
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Transformation Other
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- IT Transformation
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Broadcast Product
  Operating costs (excluding labour) within this cost centre relate to the generation of revenue for all Broadcast products therefore using revenue allocation excluding M2M is reflective of the total cost within this cost centre.

- Utilities Product - non-regulated and all costs are allocated to Other.

Labour related costs are allocated on the basis of Technology & Transformation salary costs (employee only, agency only or weighted average) using OTL derived percentages.

Exceptions

- Bank charges and foreign exchange transactions predominantly relate to non-regulated foreign transactions and are classed as Other.

2.3.3.5 Simplification Operating Costs

Simplification operating costs are allocated into 11 Cost Centres, which are:

- CSO Management
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- CSO Support
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- CSO OCM
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Portfolio Delivery Management
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- 700 Clearance Programme Delivery – non-regulated and all costs are allocated to Other.

- Project Management
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Project Support
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Business Process Improvement
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Customer Experience
  Operating costs (excluding labour) within this cost centre support the whole Arqiva business, therefore using a total revenue allocation is reflective of the total cost within this cost centre.

- Pre Sale Broadcast
  Operating costs (excluding labour) within this cost centre relate to the generation of revenue for all Broadcast products therefore using a revenue allocation excluding M2M is reflective of the total cost within this cost centre.

- Pre Sale Utilities - non-regulated and all costs are allocated to Other.

Labour related costs are allocated on the basis of Simplification salary costs (employee only, agency only or weighted average) using OTL derived percentages.

Exceptions

- Bank charges and foreign exchange transactions predominantly relate to non-regulated foreign transactions and are classed as Other.

2.3.3.6 Corporate Division Operating Costs

The Corporate functions undertake a number of activities which support the whole business, namely Finance, Procurement, Legal and People & Organisation. Accordingly, these corporate costs are allocated across the Commercial business. These are known as Corporate Cost allocations.

The RA model allocates total corporate costs on a total revenue basis.

Specific allocation methods are used for the following corporate cost categories:

- Corporate Adjustments

The nature of costs captured within Corporate Adjustments are usually specific to the business area to which they relate. Any such items are analysed on a line by line basis.

- Bank charges and foreign exchange transactions predominantly relate to non-regulated foreign transactions and are classed as Other.

2.3.3.7 Depreciation

NA, MTS and Non-Regulated depreciation is identified based upon the Regulatory assets classification determined as part of the fixed assets methodology – see 2.3.5.

Accrued depreciation on regulated broadcast assets that have been completed but not yet added to the Regulated Fixed Asset Register (“RFAR”) are allocated using the Regulatory Asset Base (“RAB”) (see section 2.3.5).

Depreciation on right-of-use assets is allocated directly to sites based on the nature of activity occurring on the site. Where Broadcast sites share common infrastructure with other services (as part of our M2M business), the Windloading methodology (described in the Non-Financial Data section below) is used to allocate the

Regulated/Non-Regulated elements across both divisions. Satellite & Media and M2M only sites are allocated directly to Other, as no regulated infrastructure is present on these sites.

2.3.3.8 Exceptional Costs

The exceptional costs for the Group are extracted from the accounting system on a business stream and cost centre basis. Costs are analysed and allocated based on the nature of the cost incurred.

Categories of exceptional cost include but are not limited to:

- Restructuring, redundancy and organisational transformation - these costs are allocated using the Corporate Cost allocation based on revenue.

2.3.4 Capital Employed

Capital employed comprises:

- Total assets, excluding goodwill, intangibles arising from acquisitions and retirement benefits; less
- Total liabilities, excluding dividends payable, borrowings and retirement obligations.

Deferred tax is included within Debtors and has been treated as Other, whilst current tax liability is within Other Creditors and has also been classified as Other.

2.3.5 Regulated Fixed Asset Register ("RFAR")

The RFAR is produced using the Fixed Asset Register ("FAR") within AGL.

Assets are attributed to NA and MTS by firstly considering the site location to identify whether assets are located on broadcast sites. Assets which do not have any broadcast use or are at sites which do not broadcast regulated services are classified as Non-Regulated. Each asset type is subsequently sub-divided into a specific asset category (e.g. Masts, Buildings, Power, Antennas, Land and Transmitters) and finally these asset categories are then apportioned using the following steps:

1. Direct Allocation – where possible, assets are allocated directly to NA, MTS or Other based upon asset category as described above.

2. Network Access asset categories not allocated directly during step 1 are shared NA assets with other business divisions, such as M2M. These assets (e.g. Buildings, Masts, Land) are further categorised into Regulated/Non-Regulated using Windloading allocations, described in more detail in the Non-Financial Data Section below.

3. An element of the Head Office assets are allocated to NA, MTS or Other based upon the total Corporate Division allocation methodology into Media Networks NA, MTS and Other (see section 2.3.3.6).

Capitalised overhead costs are allocated between NA, MTS and Other based on the average split of total assets (excl. capitalised labour).

Telemetry systems relating specifically to the DSO project have been allocated 62%/38% (NA/MTS) based on expert operational assessments from the DSO Operations Team.

Telemetry systems relating specifically to Radio have been allocated 60%/40% (NA/MTS) based on expert operational assessments from the Engineering and Implementation team.

Right-of-use assets are allocated directly to sites based on the nature of activity occurring on the site. Where Broadcast sites share common infrastructure with other services (as part of our M2M business), the Windloading methodology (described in the Non-Financial Data section below) is used to allocate the Regulated/Non-

Regulated elements across both divisions. Satellite & Media only sites are allocated directly to Other, as no regulated infrastructure is present on these sites.

2.3.6 Work In Progress ("WIP")

In order to attribute Capital WIP balances to NA, MTS or Other, the Regulatory Project classification has been used. Projects are classified by Project Managers at the project initiation stage, as described in section 2.3.9.2. Where a Regulated project is identified as split between NA and MTS, this is allocated using the Regulated Asset Base ("RAB") valuation as described above.

For large projects such as the Digital Switch Over (DSO) programme, the capital WIP balances supporting the new HPDTT NA assets have been identified and are allocated in full to NA. Windloading is not applied as these costs are incurred wholly and exclusively for the purpose of HPDTT. DSO Capitalised interest has been allocated using the appropriate RAB valuation.

Projects relating specifically to the 700 and 800 MHz Clearance project not directly attributable to NA or MTS are allocated using the proportion of actual spend of 700 and 800MHz Clearance of assets, as per the RFAR (see section 2.3.5).

For site NA infrastructure projects, the capital WIP balances have been allocated using windloading factors. This is in line with the allocation of NA infrastructure assets within the RFAR (see section 2.3.5).

2.3.7 Other Assets

These balances are allocated based upon their key driver in the profit and loss account.

Debtors and prepayments – The debtors balance is analysed by Business Function, with accounts that are specifically non-regulated being excluded. Regulated related debtor balances are allocated by revenue, unless a superior method is applicable such as using third party costs (excluding labour) for prepayments. Corporate balances are first allocated by divisional revenue before being allocated as per regulated related balances.

Cash – The total cash balance, removing cash for other purposes such as refinancing and debt servicing, is attributed to NA, MTS and other using the proportion of EBITDA arising from each regulated activity.

2.3.8 Liabilities

These balances are allocated based upon their key driver in the profit and loss account.

Creditors (including over and under 1 year) – The creditors balance is analysed by Business Function, with accounts that are specifically non-regulated being excluded. Regulated related creditor balances are allocated by Third party costs which include agency costs but exclude payroll based labour, unless a superior method is applicable such as revenue for deferred income. Corporate balances are first allocated by divisional revenue before being allocated as per regulated related balances.

Provisions – Accounts are analysed and allocated into NA, MTS and other depending on the account drivers for each provision held. Accounts that are specifically non-regulated are excluded.

2.3.9 Non-Financial Data

Certain attributions to NA, MTS and Other are made using Non-Financial Data. The use of such data and its application is consistent with methodologies applied in HPDTT and Radio Reference Offers previously audited for Ofcom.

The key methodologies used are as follows:

2.3.9.1 Windloading

Windloading is a technical assessment of the 'base moments' in relation to each antenna and associated feeder and apportioned bare structure on a Broadcast site. The base moment of each antenna on a mast is a function of the size and height of the antenna and related feeder (cable). The Windloading base moment for a site that relates to each category of antenna ("Broadcast" or "Other") is expressed as a percentage of the total base moment.

Windloading is a recognised methodology for attributing NA asset values and costs as it relates common services to the underlying cost drivers. It has been used extensively in various documents that have been reviewed and approved by Ofcom and their appointed advisors e.g. Windloading was used as a cost allocation base in the Reference Offers for DSO and Radio Reference Offers.

2.3.9.2 Oracle Time & Labour (OTL)

OTL is a time recording system which includes a dataset for cost allocation based upon time recorded data using employee skills based hourly rates.

Employees record time to projects which are subsequently allocated to relevant cost centres.

Projects are classified into three main categories; Billable (Cost of Sales), Expense (Operating Expenditure) and Capital (classed as Other – Balance Sheet).

The Labour cost allocated to NA, MTS and Other is derived using the following approach:

- Project classifications

  All employees in Arqiva are allocated to a cost centre. Where employees charge their time to a Regulated NA project, this is wholly attributable to NA. The hours recorded against specific Regulatory projects are multiplied by the equivalent skill-based rate per hour, to give an overall labour cost for the time recorded against each project. Determination of the OTL allocation percentages includes capital charged labour (along with billable and expenses) in the over / under recovery stage of the calculation, improving the use of the empirical data available.

Projects have been categorised into NA, MTS Support and Non-Regulated based upon their Regulatory Classification (TV/Radio/Other) assigned by Project Managers at project set up. Projects are reviewed by the finance team on a monthly basis to ensure accuracy. Projects which have no clear distinction between NA and MTS but are clearly Regulatory are divided using the RAB valuation (see section 2.3.3).

Support projects are projects which have been determined to support the whole Arqiva business and are therefore allocated based on total revenue.

Corporate – The primary purpose of the Corporate Functions are to support the AGL revenue generating business areas, an element of the hours charged to Corporate projects need to be recharged back into the Regulated Business. The process is as follows:

- All Corporate projects are classified as Regulated, Support or Non-Regulated by establishing whether the project has an impact on the Regulated Business (e.g. a generic mast inspection project is classed as a regulatory project).
- Regulatory projects are given a secondary classification which identifies which allocation percentage to use to recharge the costs against this project back into the RA (e.g. estates and property projects which relate to owned sites are classified as 'Rates' and the weighted average percentages of Rates costs is used).

A reconciliation is performed from OTL to the General Ledger to ensure that any under/over-recovery and employees that do not time record are considered. Where the under recovery is less than 25% of the cost recorded in the General Ledger it is allocated to the Regulated Business based on a weighted average of the OTL time recording, where it is over 25% it is allocated to the Regulated Business based on the nature of the activity in the relevant cost centre. Where there is an over recovery of the cost recorded in the General Ledger it is allocated to the Regulated Business based on a weighted average of the OTL time recording.