Navigating through the complexities of the fixed asset management function

Survey into the management of fixed assets by global telecommunications operators
Navigating through the complexities of the fixed asset management function

Telecoms companies worldwide are under enormous pressure to deliver new, data-rich products to customers while meeting shareholder demands for profitability.

The global financial turmoil has driven down the confidence of investors, businesses and consumers alike. Although the telecoms market has proven fairly resilient to recessionary impacts, it has not been immune. In an environment where financing opportunities are limited and household income restrained, maximizing returns on capex programs has never been more important.

With fixed assets comprising the bulk of a telecoms company’s capital base, operators must capitalize on them to drive competitive advantage. Yet the near-universal global compliance with IFRS is creating a standardized approach to fixed assets management, leaving little room for differentiation.

To find out how organizations are responding to these challenges, in 2013 EY conducted its fifth online global study into the impact of global reporting and regulatory frameworks on a telecoms company’s ability to manage its assets. The findings were combined with secondary research and EY’s own insights and analysis.

The following report discusses the accounting practices, capitalization policies and strategies and risk management approaches being taken across the industry – and the implications for operators.

This report would not have been possible without the time and input of executives from the participating companies around the world. We thank all our respondents and hope that they, and our other readers, find the report’s insights helpful in developing fixed assets management strategies to support their corporate goals.
Methodology and how to use this report

About the survey
This report summarizes the findings of EY’s biennial online survey about how telecoms companies are responding to the current challenges of fixed assets management. The survey was available for companies to participate between June and October 2013.

Of the 16 responding telecoms companies, 50% are returning participants from the 2011 survey, representing a mix of global and smaller players. Over 80% prepare their financial statements in accordance with International Financial Reporting Standards (IFRS).
Objective

Telecommunications is a very capital-intensive industry, with the fixed assets of network infrastructure forming a large part of a telecoms company’s balance sheet whether it is a fixed line, mobile or fiber network, backbone or last mile. Given the constant evolution and emergence of new technologies, managing fixed assets has become extremely complex also from an accounting perspective. Moreover, the global move to IFRS is leaving less room for differentiation.

To determine how the industry is responding to these issues, telecoms companies were asked detailed questions about their network rollout plans and physical assets management, as well as the impact of regulatory requirements, specifically:

- The importance of fixed assets accounting
- Their current fixed assets practices, policies, procedures and systems
- The impact, if any, that transition to IFRS has had on their fixed assets accounting
- Their current treatment of specific asset categories
02

Participating companies

The companies represented have more than US$230 billion in combined annual revenues and US$180 billion in combined total fixed assets.

EY thanks the 16 participating telecoms companies and telecoms company executives whose contributions made this report possible.
Information was current at the time of the study. Material is presented in aggregate form, because participants were promised anonymity. Only participating companies are entitled to the full survey results. To register your interest in participating in the next survey, please contact your local EY representative. Alternatively, submit your inquiry to EY’s Global Telecommunications Center at GlobalTelecommunicationsCenter@uk.ey.com

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<th>AT&amp;T</th>
<th>European Integrated Operator x 2*</th>
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<td>Algar Telecom</td>
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<td>BT</td>
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<td>Econet Wireless Zimbabwe Limited</td>
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*Consent to disclose name of participant was not available at the time of publishing this report.
Overview

As the complexities surrounding telecoms operators’ fixed asset management function evolve, a deep understanding of this function is becoming ever more important for operators to succeed in differentiating themselves from the competition.

Today, navigating successfully through the associated operational and internal control challenges is essential to meet customer needs through an efficient network and consistent quality of service.

In line with the 2011 survey, we witnessed a strong willingness at operator level to dedicate significant attention to their fixed assets management function, with all surveyed companies having a dedicated team serving this purpose. Fixed assets management is not only important for balance sheet purposes but also to measure performance with key performance indicators (KPIs) such as EBIT, which include depreciation and amortization of assets. Fixed assets management is also of primary importance for accurate information on investment activities as part of cash flow analysis. The “capex over revenue” ratio remains a major metric for investors and analysts.
Nonetheless, we still found a lack of new business metrics based on forward-looking data to provide enough granularity to improve the customer experience and present more accurate financial statements. This is an area that operators should be working to address.

Furthermore, for the fixed assets management function to be able to respond efficiently to investor expectations and the tough competitive environment, the function needs to integrate a broad set of skills, beyond just accounting. We are seeing operators include a better blend of tasks and responsibilities in the fixed asset management function. This trend will need to be sustained, given the increasing complexity of the overall business value chain.

Study highlights

The study revealed the following challenges for telecommunications executives.

1 | Revisiting the fixed assets management function

Although every respondent has a dedicated team to manage fixed assets, resourcing levels, responsibilities and reporting lines differ quite substantially across the sector. The findings suggest that many operators need to: review resourcing efficiency or adequacy, assess whether skill sets should be broadened to include technical data management or capex management, and consider adding new reporting linkages to operational parts of the business.

Data points

- Every participant has a dedicated team for fixed asset management.
- For 88% of fixed asset management functions, accounting remains the primary task.
- However, control (75%) and reporting (69%) are also now important responsibilities, almost double their 2011 levels.
- While most fixed assets team report to either Finance or Operations, this year 19% of departments now report to both Finance and Operations.
- In 2013, 38% had capex management and 31% technical data management responsibilities, up from 15% and 12%, respectively, in 2011.
- The number of functions performing all tasks fell to 13%, down from 16% in 2011.
- Function size does not align with total fixed asset values or breadth of responsibilities.
- Just 19% of respondents have more than 200 people working in the function, compared with 39% in 2011.
- Teams of 100-200 people jumped from 4% to 19%.
- One in five uses fewer than 10 people to manage their fixed assets, comparable with 2011 findings.

Implications

- Telecoms companies are expanding the responsibilities of their fixed asset functions beyond accounting, to include a focus on control and reporting.
- However, many operators have yet to integrate all the technical aspects required for efficient fixed assets management.
- Operators require a broader team, with a mix of accounting, finance, IT and network engineers, to perform the diversity of tasks required to manage their fixed assets.
- Those starting to diversify are either adding capex management or technical data management responsibilities to the function – but not both.
- Reporting to both Finance and Operations would be more effective, driving synergies and ensuring decision-making clarity and consistency.
- Some fixed asset functions are extremely thinly resourced, creating a worrying potential for ineffective asset management.
- Others are continuing the risky model of having fragmented responsibilities across multiple silos.
2 | Differentiating strategies in capitalization policies

Although capitalization policies are becoming more and more standardized, as expected with increased conversion toward IFRS, they still incorporate aspects requiring judgment from the operator, such as asset boundaries and their treatment of functional changes to management information systems and spare parts. Policies also have to include metrics transformation led by fast-changing technological and external forces, such as web services and ongoing device innovation.

<table>
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<tr>
<th>Data points</th>
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<td>• 65% of respondents capitalize the costs for access to the network at the customer premise.</td>
<td>• The increasing number of participants capitalizing costs at the first cross-connect point highlights the fact that the boundaries for capitalizing costs for access to the network are shifting.</td>
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<td>• 23% of respondents capitalize the costs for access at the first cross-connect point, up from 4% of respondents in 2011.</td>
<td>• Although the conversion to IFRS is leading to standardized accounting policies, several areas remain where judgment applies, for example useful life, granularity of asset identification or impairment.</td>
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<td>• 62% of respondents use timesheets to identify employee time spent on capital projects, similar to 2011.</td>
<td>• Participants are increasingly relying on other means to amortize customer acquisition costs than average customer relationship, which dropped from 57% to 28%. This implies that operators have to consider new concepts of connectivity, service adoption and usage, as well as new customer definitions and patterns of behavior.</td>
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<td>• 2013 saw 100% of participants capitalizing capacity enhancements or upgrades – up from 87% in 2011.</td>
<td>• The previous trend to amortize the cost over the average customer relationship based on churn rates dropped from 57% to 28%.</td>
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<td>• The number of participants capitalizing customer acquisition costs fell from 22% to 13%.</td>
<td>• Operators are just as likely to amortize based on the period of customer contract.</td>
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3 | Managing impairment more effectively

In 2013, with the industry standardizing under IFRS, the study found annual reviews of impairment as standard practice, with some operators testing even more regularly. Approaches to impairment tests are diverging, with increasing numbers of operators focusing more on product and geography. When it comes to calculating fixed asset service lives, telecoms companies are continuing to rely on past experience to determine service asset lives, rather than considering forward-looking indicators. Operators now need to focus on industry practices and pay more attention to guidance from vendors, who generally are best placed to estimate an appropriate useful life for newer assets.

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<td>• 69% have rolled out FTTN or FTTP, or plan to, down from 76% in 2011.</td>
<td>• In coming years, we expect FTTN will continue to develop at a slower pace, with a growing focus on developing 4G LTE networks.</td>
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<td>• 81% review their asset service lives at least annually, down from 87% in 2011.</td>
<td>• At least an annual review of asset service lives is now an industry standard as required by IFRS.</td>
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<td>• The number of respondents viewing their network as separate cash-generating units (CGUs) fell from 56% to 33%.</td>
<td>• Divergent practices are emerging when evaluating networks for impairment purposes.</td>
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<td>• 20% of respondents are making their network impairment assessment on the basis of product/service obsolescence, and another 20% is making their assessment based on the geography of their equipment.</td>
<td>• When calculating fixed asset service lives, telecoms companies are continuing to rely on past experience to determine service asset lives, rather than considering forward-looking indicators.</td>
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<td>• Respondents stated that the rollout of FTTN or FTTP did not have any impact on the service life of their traditional network assets.</td>
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• 33% of respondents recorded an impairment charge over the past 12 months compared with 30% in 2011 and 19% in 2009.
• Respondents ranked company policy and past experience as most important in determining asset service life. Vendor estimates and practices were seen as largely irrelevant.
• Just one operator recorded an impairment charge on its UMTS/3G license and/or assets due to less-than-anticipated growth in 3G services.
• Changing strategies and technology choices have affected radio access and transmission/core network assets the most.

Data points
• 100% have specific risk management processes for acquisitions and 94% for disposal.
• Profitability and utilization are the main KPIs for fixed asset effectiveness and efficiency.
• 88% use ERP systems for tracking and monitoring assets and their service lives.
• 50% still rely on physical verification, with the other 50% using a mix of automation and physical verification.
• No respondents have full automation, compared with 32% in 2011.
• 56% verify their fixed assets register at least once a year, while 13% had not verified the register in the past five years.
• In 2013, unit-level record-keeping increased from 47% to 57%, while frame-level fell from 37% to 29%.
• 74% perform verification internally, with only 10% opting to outsource - a fall from 17% in 2011. A few outsource just a few elements of the process.

Implications
• Although some operators are paying attention to industry practices, this needs to become more widespread.
• All operators need to focus more on guidance from vendors, who generally are best placed to estimate an appropriate useful life for newer assets.
• As the current shift toward 4G LTE continues, more operators may record 3G impairments.
• In coming years, as telecoms companies capitalize on growth opportunities in IP and data, operators will also have to constantly monitor asset categories that help to deliver rich content.
• Operators need to find the right balance between determining realistic assets service lives and performing accurate impairment tests.

4 | Getting the risk balance right
Managing risk in fixed assets continues to be a high priority, with IFRS compliance galvanizing considerable investment in risk management processes around all the critical fixed assets sub processes, such as acquisition and disposal. At the same time, operators are standardizing around partial automation, integrated ERP and internal resourcing. That said, most are still trying to find the balance between cost and adequate control. The study found: considerable variations in verification frequency; different ideas about how much physical verification is necessary; and diverse interpretations of the level of detail required to comply with the IFRS component approach.

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Implications
• Given the fierce competition and an increasingly sophisticated and demanding customer base, operators may need to consider a wider range of KPIs, covering additional financial and technical aspects of network performance.
• Integrated ERP systems are close to being standard across the industry, improving data quality and process.
• Operators need to find the right balance between automating fixed assets management processes and mitigating risk with physical verification.
• Physical verification will continue to be necessary to back up book values; however, companies need to use it in the most efficient way possible.
• Operators may need to sample only one location out of a group of sites that are the same type and size.
• If operators are obtaining data from multiple databases, they may discover inconsistent or duplicative information. Databases must interface effectively and present an adequate level of detail to meet IFRS requirements.
• Verification is likely to continue to be resourced internally, ensuring knowledge retention.
5 | Growth in network investment

2013 saw a rise in the proportion of capex budgets being dedicated to IT and network related WIP. Interestingly, IT and network projects are spending less time in WIP before the completed project is transferred into fixed assets.

The new shape of network sourcing arrangements (network sharing, managed services, passive infrastructure offloading, etc.) is making lease accounting a particular challenge.

Data points

- In 2013, half (up from 29%) are investing more than 40% of capex in their networks, and only 19% (down from 48%) are under the 20% mark.
- Almost two-thirds of participants now transfer WIP projects into fixed assets within three to six months, up from 41% in 2011.
- 50% of respondents have entered into, or are planning to enter into network sharing and/or network managed services transactions.
- 31% have entered into agreements to offload their passive infrastructure, or are planning to.
- 73% rated ‘lease accounting’ as their top accounting challenge, followed by cost recognition.
- Participants are split 50:50 between managing their shared assets via a holding company or through a joint venture agreement.

Implications

- We expect to see even greater proportional investment in the future, as operators seek competitive advantage by keeping pace with technological evolution and continuing to deliver service quality.
- Increased investment is an important trend, correlated with the fast-moving pace of the telecoms industry and the experience curve effect.
- The industry trend to maximize the return on investment of fixed assets continues and network sharing/network managed services transactions are still seen as means to improve the return on invested capital.
- Given that these transactions require lease considerations, lease accounting will continue to be a challenge.
- The nature and volume of assets shared should drive operators’ decisions when it comes to setting up a legal structure for shared assets management.
- Capex ratio over revenue remains a major KPI that investors and analysts are looking for.
How EY’s Global Telecommunications Center can help your business

Telecommunications operators are facing a rapidly transforming business model. Competition from technology companies is creating challenges around customer ownership. Service innovation, pricing pressures and network capacity are intensifying scrutiny on return on investment. Additionally, regulatory pressures and shareholder expectations require agility and cost efficiency. If you are facing these challenges, we can provide a sector-based perspective to addressing your assurance, advisory, transaction and tax needs. Our Global Telecommunications Center is a virtual hub that brings together people, cultures and leading ideas from across the world. Whatever your need, we can help you improve the performance of your business.