
KCOM Regulatory Financial Reporting

Consultation on proposed regulatory financial reporting directions for KCOM

CONSULTATION:

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About this document

In this document we consult on a new set of directions relating to KCOM's Regulatory Financial Reporting obligations. These cover all markets in which KCOM is regulated.

We invite responses to this consultation by 18 September 2018.

We will take all responses to this consultation into account before reaching our final conclusions which we plan to publish in a statement later this year.

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1. Executive Summary

The purpose of this consultation

- 1.1 While we have reviewed to some degree KCOM's regulatory financial reporting as part of each market review, we have not undertaken a broader strategic review of KCOM's regulatory financial reporting requirements since their original imposition in 2004¹. As we have recently undertaken reviews of the Wholesale Local Access (WLA) and Wholesale Broadband Access (WBA) markets for KCOM and following KCOM's introduction of a new regulatory cost accounting system, we have taken the opportunity to carry out a wider assessment of KCOM's regulatory financial reporting.
- 1.2 In the 2014 Regulatory Financial Reporting Statement (2014 RFR Statement)² on BT's regulatory financial reporting, we explained that regulatory financial reporting should provide us with the information that we need to make informed regulatory decisions, monitor compliance with regulatory obligations, ensure that obligations address underlying competition issues and investigate potential breaches of obligations. It should also provide reasonable confidence to stakeholders that the regulated company has complied with its SMP conditions while adding credibility to the regulatory financial reporting regime. We consider that these objectives also apply to KCOM's regulatory financial reporting.
- 1.3 In the 2018 Hull WLA and WBA Statement, we set out our intention to consult on detailed directions in relation to regulatory financial reporting conditions. We have now completed our review of the effectiveness of those regulatory financial reporting directions, not just on their application to the WLA and WBA markets but across all markets in which KCOM is regulated.
- 1.4 Following on from that review, this document sets out our proposals (including new draft directions) for regulatory financial reporting across all relevant regulated markets, including the WLA and WBA markets.

Proposals

- 1.5 In the 2018 Hull WLA and WBA Statement³ we decided to revoke the SMP conditions referred to in the 2004 Statement (as amended) in relation to each of the WLA and WBA markets and to impose regulatory financial reporting obligations through SMP Condition 8. We proposed no substantive changes to the requirement of the Financial Reporting SMP conditions, only textual updates aimed at consistency with the other SMP conditions.

¹ Ofcom, 2004. *The Regulatory Financial Reporting Obligations on BT and Kingston Communications Final Statement and Notification (2004 Statement)*, https://www.ofcom.org.uk/data/assets/pdf_file/0034/55969/finance_report.pdf.

² Ofcom, 2014. *Regulatory Financial Reporting Statement*, <https://www.ofcom.org.uk/consultations-and-statements/category-2/KCOM-transparency>.

³ Ofcom 2018. *WLA and WBA Market Reviews - Competition in the Hull Area*, <https://www.ofcom.org.uk/consultations-and-statements/category-1/wholesale-local-broadband-access-market-reviews-hull>.

- 1.6 In contrast, our proposals below in relation to the regulatory financial reporting directions alter the current detailed regulatory financial reporting requirements. While we propose a similar textual update to ensure the new directions are consistent with the new SMP conditions, we also propose changes to some of the directions in relation to the information that is published in KCOM's regulatory financial statements ('RFS'). We also propose to impose these directions across all relevant regulated markets.
- 1.7 Our proposals have been developed following an assessment of the information provided by KCOM Regulatory Financial Reporting against our current and future regulatory requirements.
- 1.8 Overall, in addition to making sure consistent regulatory financial reporting requirements apply across all regulated markets, the amount of information we propose that KCOM publish (including decisions made in the 2017 Narrowband Market Review Statement (2017 NMR Statement))⁴ will be reduced by over 30%. We consider that the information we propose that KCOM publish will however be more useful to us and stakeholders. Below, we summarise our regulatory financial reporting proposals for new directions by reference to the current directions, which will be revoked in due course.

Network Components

- 1.9 As explained in Section 2, KCOM uses network components as building blocks to describe the cost elements within services disclosed in its RFS.
- 1.10 As explained in Section 4, the list of network components used in the WLA and WBA markets is out of date and does not show the cost elements within those services transparently. We reviewed this list in the 2016 Business Connectivity Market Review Statement (2016 BCMR Statement)⁵ and imposed 11 new network cost components on KCOM that were designed to be applicable across all relevant regulated markets. In the 2017 NMR Statement we also imposed the same 11 new network cost components on KCOM.
- 1.11 We consider that to preserve the integrity and consistency of KCOM's regulatory financial reporting it is important that there is a single list of components used to attribute costs to markets and services in each regulated market.
- 1.12 In Section 4 we propose to:
- implement the same list of network components that apply to KCOM in the BCMR and Narrowband markets to all other markets in which KCOM is regulated; and
 - revoke Direction 1 that currently applies to all markets in which KCOM is regulated and replace it with a new Network Component Direction.

⁴ Ofcom, 2017. *Narrowband Market Review Statement*, https://www.ofcom.org.uk/data/assets/pdf_file/0020/108353/final-statement-narrowband-market-review.pdf.

⁵ Ofcom, 2016. *Business Connectivity Market Review Statement*, <https://www.ofcom.org.uk/consultations-and-statements/category-1/business-connectivity-market-review-2016>.

- 1.13 We propose that KCOM start using the new network components for the 2018/19 RFS. KCOM have however confirmed they are implementing all the proposed changes across all markets in time for the publication of the 2017/18 RFS.

Transparency

- 1.14 As explained in Section 2, KCOM is currently required to publish documentation that allows a suitably informed reader to gain a clear understanding of the how the information presented in the RFS is prepared. KCOM has historically produced a single Description of Cost Accounting System (DOCAS) which applies to all markets.
- 1.15 As explained in Section 4, we believe that the current transparency requirement remains appropriate. We therefore do not propose any substantive changes to the requirement, other than to ensure it is consistent with the new SMP conditions. To preserve the integrity and consistency of the RFS we consider that all markets in which KCOM is regulated should be subject to the same Transparency Direction.
- 1.16 In Section 4, we propose to revoke Direction 2 that currently applies to all markets in which KCOM is regulated and replace it with a new Transparency Direction.
- 1.17 We propose the new direction applies for the 2018/19 RFS although the proposal does not have any practical implications for KCOM because the current requirements remain unchanged.

Preparation, audit, delivery and publication of the RFS

- 1.18 As explained in Section 2, this requirement sets out the schedules KCOM must provide on a KCOM-wide basis, for each regulated market and the audit opinion that it is required to obtain for each schedule (consistent with the form and content and audit opinion directions).
- 1.19 As explained in Section 4, some of the information KCOM publishes is no longer relevant. KCOM publishes several schedules that either appear to serve no regulatory purpose or publication is disproportionate in relation to the remedy that it is seeking to support. On the other hand, for the WLA market, KCOM currently publishes no information. To preserve the integrity and consistency of the RFS, we consider that all markets in which KCOM is regulated should be subject to the same reporting requirements because some elements of the published RFS relate to all regulated markets.
- 1.20 In Section 4 we propose:
- To remove the requirement to provide the following schedules that relate to all markets:
 - Internal and External sales per market (pages 50 and 51 of the 2016/17 RFS⁶); and
 - Network Services Reconciliation (page 59 of the 2016/17 RFS).

⁶ KCOM Group plc, Regulatory Financial Statements for the year ended 31 March 2017
<https://www.kcomplc.com/media/1657/regulatory-financial-statements-2017.pdf>

- To remove the requirement to publish the following schedules that relate to all markets. We propose these schedules are instead provided to Ofcom on a confidential basis:
 - Retail Residual Activities Reconciliation – Current Cost Profit and Loss Account (page 55 of the 2016/17 RFS));
 - Retail Residual Activities Reconciliation Statement of Current Cost MCE (page 56 of the 2016/17 RFS)); and
 - Inter market Turnover (Reconciliation) (page 57 of the 2016/17 RFS)).
- To remove the requirement to publish the following schedules in relation to the Narrowband, WBA and BCMR markets. This information will instead be provided to Ofcom on a confidential basis for these markets and the WLA:
 - Network Activity Statement (Pages 13, 17, 21, 25, 30, 34, 38, 42 and 46)⁷.
- To require KCOM to publish the following schedules in respect of the WLA market:
 - Current Cost Profit and Loss Account; and
 - Statement of Current Cost MCE.
- To revoke the current Direction 3 and replace it with a new Preparation, audit, delivery and publication of the RFS Direction.

1.21 As explained in Section 4, we propose that KCOM implement these changes in 2018/19. As explained in Section 3, the introduction of KCOM's new regulatory cost accounting system has caused significant cost movements between services and markets thus reducing comparability of 2017/18 RFS with 2016/17. To provide as much transparency as possible, we believe the current level of information published, while unnecessary in the longer term, is justified in this transitional year.

1.22 We propose that KCOM start publishing the overall reduced level of information in the 2018/19 RFS. We have discussed this with KCOM who have confirmed they can implement all the required changes by this date.

Form and content of the RFS

1.23 As explained further in Section 2, this requirement sets out the format of each financial schedule imposed on KCOM through the preparation, audit, delivery and publication of the RFS direction discussed above.

1.24 In Section 4, we explain that the format of the information provided is neither relevant or reliable for our regulatory purposes because of the out-of-date cost categorisations that KCOM uses within some of the schedules it publishes. KCOM also report a derived 13%

⁷ In respect of the BCMR Markets, the 2016 BCMR Statement decided that the regulated markets were Wholesale market for low bandwidth traditional interface symmetric broadband origination in the Hull Area, at bandwidths up to and including 8Mbit/s and Wholesale market for contemporary interface symmetric broadband origination in the Hull Area

Return on capital Employed (ROCE) across all relevant markets rather than calculate an actual ROCE.

1.25 In Section 4 we propose:

- to specify additional operating and fixed asset cost categories for KCOM to report within its RFS;
- to require KCOM to calculate an actual ROCE across all markets rather than derive the 13% return;
- revoking the current Direction 4 that applies to all markets in which KCOM is regulated and replace it with a new Form and Content Direction.

1.26 As explained in Section 4, we propose that KCOM implement these changes in 2018/19. In relation to new cost categories, the introduction of KCOM's new regulatory cost accounting system has caused significant cost movements between services and markets and will reduce the comparability of 2017/18 RFS with 2016/17 RFS; introducing new cost categories would compound this problem of comparability.

1.27 As explained in Section 3, for KCOM to calculate the actual ROCE they will need to record internal sales, which will require systems changes in advance of the 2018/19 RFS.

The form of the audit opinion for financial statements

1.28 As explained in Section 2, these directions set out the standard of audit review.

1.29 As explained in Section 4, we believe that the current form of opinions requirement remains appropriate. We therefore do not propose any substantive changes to the requirement, other than to ensure it is consistent with the new SMP conditions.

1.30 In Section 4 we propose to revoke the current Directions 4 and 5 that apply to all markets in which KCOM is regulated and replace them with new audit opinion directions.

1.31 We propose the new directions apply for the 2018/19 RFS (but note that the proposal does not have any practical implications for KCOM because the current requirements remain unchanged).

Consultation and next steps

1.32 We invite comments on the proposals in this document. The consultation runs for 5 weeks and the deadline for responses is 18 September 2018. Annex 1 provides further details of how to respond. We aim to publish our overall conclusions this autumn.

2. Introduction

The purpose of regulatory financial reporting

- 2.1 As explained in the July 2004 Statement, regulatory financial information is fundamental to the economic regulation of the electronic communications sector and in particular to many of the decisions of Ofcom.⁸
- 2.2 There is a close link between the Regulatory Financial Reporting requirements (covering cost accounting, accounting separation and publication of accounting information) and other regulatory requirements. Cost accounting has a particular role in supporting price regulation (including network charge controls and cost orientation obligations) and accounting separation is important for obligations of non-discrimination. Publication of this information aids transparency.
- 2.3 This is also addressed in the EC Recommendation adopted in 2005 which addressed the implementation of a cost accounting and/or accounting separation system⁹, which states:

“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 charge controls or cost-oriented prices.

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.”¹⁰

“The cost accounting and accounting separation systems of the notified operators need to be capable of reporting regulatory financial information to demonstrate full compliance with regulatory obligations.”¹¹

⁸ July 2004 Statement, paragraph 2.21, page 8.

⁹ Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications”, OJ L 266, 11.10.2005, p 64. An explanatory memorandum to the EC Recommendation was published alongside.

¹⁰ “Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications”, OJ L 266, 11.10.2005, p 64, at paragraph 1

¹¹ “Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications”, OJ L 266, 11.10.2005, p 64, at paragraph 2

“The cost accounting and accounting separation systems of the notified operators need to be capable of reporting regulatory financial information to demonstrate full compliance with regulatory obligations.”¹²

- 2.4 When imposing the current financial reporting requirements on KCOM in July 2004, we also added that *“It is necessary for Ofcom to be able to establish a financial reporting regime that meets its requirements for regulatory financial information that can be used to make economic regulatory decisions and to monitor compliance with other obligations (including the obligations of dominant providers to be able to demonstrate compliance with, for example, cost orientation)”*.¹³ The need for this information is still relevant today.
- 2.5 In the 2014 RFR Statement (which was the last review of BT’s regulatory reporting requirements), consistent with the EU Recommendation, we also explained that the purposes of regulatory financial reporting is to provide financial information to both Ofcom and to other stakeholders.
- 2.6 The purpose of regulatory financial reporting as regards Ofcom is to enable it to have information to:
- make informed regulatory decisions;
 - monitor compliance with SMP conditions;
 - ensure that those SMP conditions continue to address the underlying competition issues; and
 - investigate potential breaches of SMP conditions and anti-competitive practices.¹⁴
- 2.7 And the purpose of regulatory financial reporting as regards stakeholders is that the published information *“should provide reasonable confidence to stakeholders that the SMP provider has complied with its SMP conditions and add credibility to the Regulatory Financial Reporting Regime”*.¹⁵

The legal tests for regulatory financial reporting

- 2.8 As set out in the Communications Act 2003 (the “Act”), the requirements imposed on SMP providers should be objectively justifiable; not unduly discriminatory; proportionate to what is intended to be achieved; and transparent in relation to what is intended to be achieved.¹⁶
- 2.9 In the 2014 RFR Statement we explained our view that in order for regulatory financial reporting to continue to meet the purposes of the EC Recommendation and be objectively justifiable under the Act, SMP conditions and directions need to ensure that the basis of preparation of the RFS and the scope and format of reporting provide information that has the attributes of effective reporting, including:

¹² “Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications”, OJ L 266, 11.10.2005, p 64, at paragraph 2.

¹³ July 2004 Statement, paragraph 2.26, page 9.

¹⁴ 2014 RFR Statement, paragraph 2.28, page 12.

¹⁵ 2014 RFR Statement, paragraph 2.41, page 14.

¹⁶ Communications Act 2003, sections 45 and 49.

- **Relevance.** The information needs to answer the right questions, in the right way and at the right time.
- **Reliability.** The underlying data must be reliable, suitable rules for treatment of those data must be chosen and those rules need to be followed.
- **Transparency.** The basis of preparation should be understood by the users of the reports and the presentation of the data should be clear.
- **Proportionality.** The reporting requirements should be proportionate to the benefits.¹⁷

2.10 To be proportionate, the requirements must go no further than necessary. As set out in the 2014 RFR Statement, we consider that the information we require SMP providers to publish in their RFS should reflect the level of the remedy, and strike a balance between information that stakeholders need to contribute to the regulatory regime, confidentiality concerns around the commercial nature of the financial information and, in the case of KCOM, its smaller scale relative to BT. On this last point, we note that given KCOM's size relative to BT and its potential impact on the UK telecoms market, the regulatory financial reporting requirements on KCOM in the past have been less extensive than those applied to BT.¹⁸

KCOM's regulatory financial reporting framework

2.11 As noted above, the specific form of KCOM's accounting separation and cost accounting requirements have been imposed on KCOM through a set of SMP conditions and directions as part of the ongoing market review process. These conditions were first imposed in 2004.

SMP Conditions

2.12 In the July 2004 Statement, we imposed SMP Conditions OB1 to OB33 on KCOM. These SMP conditions related to

- a) the preparation, audit, delivery, publication of the RFS;
- b) the audit of the RFS;
- c) the Primary and Secondary Accounting Documents;
- d) the up-dating of systems, Accounting Documents and form and content;
- e) deficiencies in the Regulatory Financial Statements (RRS) and the Accounting Documents;
- f) the maintenance of sufficient accounting records;
- g) the preparation and maintenance of a Wholesale Catalogue;
- h) further accounting separation requirements and

¹⁷ 2014 RFR Statement, paragraph 2.42, page 14.

¹⁸ This was recognised in our July 2004 Statement. In paragraph 3.25 we said "Given Kingston's size relative to BT and its potential impact on the UK telecoms market, Ofcom considers that there is some scope to reduce the level of detail that Kingston is required to prepare, have audited and publish on a regular basis. However, Ofcom notes that it expects Kingston to have processes in place that will enable it to produce this information if required."

i) the demonstration of non-discrimination

2.13 In the 2018 Hull WLA and WBA Statement, we (to the extent still extant) decided to revoke these SMP conditions in relation to each of the WLA and WBA markets and to impose regulatory financial reporting obligations through SMP Condition 8. As we explained, this does not represent a change to the substance of the accounting separation and cost accounting conditions as set out in the July 2004 Statement.

SMP Directions

2.14 In the July 2004 Statement we also imposed six directions which implemented the detailed regulatory financial reporting requirements. These requirements have been imposed on KCOM since 2004 through the same set of directions as part of the ongoing market review process, although these have been amended from time to time to reflect the changes to the associated markets over time.

2.15 These six directions specify regulatory financial reporting requirements in relation to the following:

a) Direction 1: Network components. This direction specifies all the network cost components used by KCOM to prepare the RFS. To preserve the integrity and consistency of KCOM's regulatory financial reporting it is important that there is a single list of components used to attribute costs across markets and services. Network components are used to prepare the RFS.

We direct a list of network components for KCOM to use that describe, in a transparent way, the significant cost elements of a telecommunications network consumed by regulated services, as determined by KCOM's regulatory cost accounting system. They meet our requirement to monitor compliance with proposed remedies, for example on non-discrimination, as checking the attribution rules on network components allows us to see how costs are attributed to internal as well as external services. It is important that there is a single list of network components used to attribute costs to services in regulated markets.

b) Direction 2: Transparency. One of the purposes of imposing a cost accounting obligation is to ensure that fair, objective and transparent criteria are used to prepare regulatory financial statements. The purpose of this direction is therefore to ensure that any information, material or explanatory document prepared by KCOM in respect of the RFS is sufficiently transparent, such that a suitably informed reader can gain a clear understanding of the information presented. To preserve the integrity and consistency of the RFS we consider that all regulated markets should be subject to the same transparency direction.

The transparency requirement requires KCOM to publish documentation that provides a description of KCOM's regulatory cost accounting system, that is, the accounting system that is used to meet KCOM's obligations on cost accounting and accounting

separation¹⁹. As well as providing transparency to stakeholders on KCOM's regulatory accounting system the document also serves as a reference point for KCOM's auditors for their PPIA opinions (see below).

- c) Direction 3: Preparation, audit, delivery and publication of the RFS. This direction sets out which financial schedules KCOM is required to provide for each regulated market and the audit opinion that it is required to obtain for each schedule (consistent with Directions 5 and 6). This direction plays an important role in ensuring that the RFS provide relevant information to stakeholders. Some elements of the published RFS relate to all markets, while others relate only to specific markets. To preserve the integrity and consistency of the RFS, we consider that all markets should be subject to appropriate reporting requirements.
- d) Direction 4: Form and content of the RFS. This direction sets out the format of each financial schedule from Direction 3. As with Direction 3, this direction plays an important role in ensuring that the RFS provide relevant information to stakeholders and, to preserve the integrity and consistency of the RFS, we consider that all markets should be subject to appropriate reporting requirements.

This requirement is closely related to the preparation and publication requirements of Direction 3. The form and content direction sets out the format (i.e. the descriptions) of the information contained within the schedules that KCOM is required to produce under Direction 3.

- e) Direction 5 (form of the 'FPIA' opinion for financial statements) and Direction 6 (form of the 'PPIA' opinion for financial statements). These directions set out the standard of audit review for each financial schedule set out in Direction 3. FPIA means 'fairly presents in accordance with' and PPIA means 'properly prepared in accordance with'.

Regulatory Framework

- 2.16 The regulatory framework for market reviews is set out in UK legislation that implements five EU Directives. These Directives impose obligations on relevant regulatory authorities, such as Ofcom, one of which is to carry out periodic reviews of certain electronic communications markets.
- 2.17 We have set out the relevant regulatory framework in the 2018 Hull WLA and WBA Statement and reference should be made to those documents for further detail.²⁰

¹⁹ KCOM description of Cost Accounting System (DOCAS): Representing the Primary and Secondary Accounting Statements Together with Wholesale and Retail Catalogues, 25th July 2017 <https://www.kcomplc.com/media/1658/description-of-cost-accounting-system-2017-pdf.pdf>.

²⁰ Ofcom 2018. WLA and WBA Market Reviews - Competition in the Hull Area, paragraphs 2.33 – 2.46, pages 11- 14

Impact assessment and equality impact assessment

Impact assessment

- 2.18 The analysis presented in this document constitutes an impact assessment as defined in section 7 of the Act.
- 2.19 Impact assessments provide a valuable way of assessing the options for regulation and showing why the chosen option was preferred. They form part of best practice policy-making. This is reflected in section 7 of the Act, which means that, generally, we have to carry out impact assessments in cases where our conclusions would be likely to have a significant effect on businesses or the general public, or where there is a major change in Ofcom's activities. However, as a matter of policy Ofcom is committed to carrying out impact assessments in relation to the great majority of our policy decisions.

Equality impact assessment (EIA)

- 2.20 Annex 7 sets out our EIA for this market review. Ofcom is required by statute to assess the potential impact of all our functions, policies, projects and practices on race, disability and gender equality. EIAs also assist us in making sure that we are meeting our principal duty of furthering the interests of citizens and consumers regardless of their background or identity.
- 2.21 It is not apparent to us that the outcome of our review is likely to have any particular impact on race, disability and gender equality. More generally, we do not envisage the impact of any outcome to be to the detriment of any group of society. Nor do we consider it necessary to carry out separate EIAs in relation to race or gender equality or equality schemes under the Northern Ireland and Disability Equality Schemes.

Scope of this document

- 2.22 The focus of this consultation is on regulatory financial reporting across all KCOM's regulated markets including the WLA, WBA, BCMR and Narrowband markets.

Structure of this document

- 2.23 In Section 3 we explain the background to our review of KCOM's regulatory financial reporting, including findings from the 2016 BCMR Statement which was the catalyst for the review and the introduction of KCOM's new regulatory cost accounting system which provided the opportunity for improvement.
- 2.24 In Section 4 we explain what KCOM's current regulatory financial reporting provides and assess whether it remains relevant and proportionate to meet the regulatory requirements set out above. We then set out our proposals to impose financial reporting requirements on KCOM for all relevant regulated markets following the assessment we carried out.

3. Background to improving KCOM's Regulatory Financial Reporting

- 3.1 In this section we explain the background to our review of KCOM's regulatory financial reporting, including findings from the 2016 BCMR Statement which was the catalyst for this review and the introduction of KCOM's new regulatory cost accounting system which provided the opportunity for improvement.
- 3.2 The 2016 BCMR Statement and the 2017 NMR Statement both identified issues with KCOM's regulatory financial reporting. In the 2016 BCMR Statement we found that the information provided did not allow us to conduct the market analysis that we wished to undertake. In the 2017 NMR Statement we found that KCOM was publishing information that was not relevant to the remedies that had been imposed.
- 3.3 These issues led to Ofcom taking decisions (as set out in the 2016 BCMR Statement and the 2017 NMR Statement) that will improve the relevance and reliability of the regulatory financial information KCOM will provide in the 2017/2018 RFS in relation to those markets.
- 3.4 KCOM's new regulatory cost accounting system will improve the reliability of its regulatory financial reporting across all regulated markets. In addition, through engagement with KCOM as the system was introduced, Ofcom was able to review KCOM's regulatory financial reporting across all regulated markets and formulate proposals to improve the relevance of the information that is provided to Ofcom and to stakeholders.

Issues with KCOM's current regulatory financial reporting arising out of the 2016 BCMR Statement and 2017 NMR Statement

- 3.5 In 2016 BCMR Statement we found that KCOM had a very high market share (>70%) in the provision of retail leased lines. KCOM's retail prices were high when compared to its 2013 prices and BT's prices. At the wholesale level there appeared little prospect of competition²¹.
- 3.6 Despite evidence of high prices, we were unable to carry out either an analysis of the profits KCOM was making within the BCMR markets or how the costs of its leased lines services compared to the prices that were being charged to retail customers. KCOM's RFS could not provide the information we needed to perform either task.
- 3.7 The principal reasons that we could not perform these tasks were:
- a) KCOM's RFS did not include information about the actual profitability of KCOM's regulated activities. While BT's RFS calculate actual ROCE based on reported revenues and costs, KCOM fixes its ROCE at 13% and calculates internal sales as the balancing figure to achieve this.

²¹ 2016 BCMR Statement, Volume 1, Section 6.

- b) We did not believe that the attributions of costs into regulated markets and services were reliable, as KCOM's regulatory cost accounting system was out of date, meaning that more costs were likely to be attributed to legacy services.
 - c) The information that was provided was not relevant for our analysis. The cost categories KCOM published and network components used for BCMR services were out of date. KCOM was essentially using Narrowband network components to report costs relating to Ethernet and Fibre services.
- 3.8 In relation to the 2017 NMR Statement, while we did not require KCOM's RFS for any financial analysis, we found that the published RFS contained a lot of information that was either duplicated within the RFS or no longer relevant to the remedy being imposed.

KCOM's new regulatory costs accounting system

- 3.9 As part of the 2016 BCMR Statement we imposed requirements to improve our visibility of KCOM's costs and returns in the markets for the BCMR in the Hull Area. We imposed a more appropriate list of network components in respect of which KCOM is required to attribute costs within in its regulated financial reporting to obtain more relevant and reliable information on BCMR services. We discuss the improvements made to network components in Section 4.
- 3.10 Following our decision to impose new network components on KCOM and following informal discussions with us on how these would affect the recording of costs across all regulated markets, KCOM decided to introduce a new regulatory cost accounting system, based on 'CostPerform' – a system popular with SMP operators in smaller EU countries. As well as facilitating the introduction of the new network components, the introduction of the new regulatory cost system required KCOM to investigate how costs are attributed.
- 3.11 We were in dialogue with KCOM during the introduction of the new regulatory cost accounting system. KCOM kept us informed during the exercise of introducing the CostPerform platform that it was uncovering errors in how they had been attributing costs within the previous regulatory cost accounting system. These errors were caused by the use of out-of-date attributions; whether hardcoded data, external Excel models that themselves were not kept up to date, or data from superseded general ledger codes.
- 3.12 KCOM also informed us that in introducing the new regulatory cost accounting system, its approach was to minimise errors caused by out-of-date information. This involved a simplification exercise, including minimising the use of non-financial data for attributions and external model feeds. Where the attribution process itself was complicated, KCOM sought to use a simpler method.

Impact of changes

- 3.13 KCOM's RFS that was published recently shows significant movements in costs between markets in respect of this year's restated 2016/17 comparative RFS and last year's presented 2016/17 RFS, due the correction of the attribution and classification errors.

No requirement for systems reconciliation report

- 3.14 In the 2014 RFR Statement, in relation to BT introducing a new regulatory cost accounting system, we decided that “BT must produce and provide to us a report that:
- sets out all differences between the outputs of the new regulatory cost accounting system and the old regulatory cost accounting system;
 - for any number reported in the Regulatory Financial Statements that is rounded to £millions, explain any differences in the systems reconciliation report that are greater than 1% or £1m, whichever is the highest; and
 - for any other number reported in the Regulatory Financial Statements (e.g. unit volumes or unit cost figures) explain any differences in the systems reconciliation report that are greater than 1%.”²²
- 3.15 This was imposed following comments made in response to the 2013 Regulatory Financial Reporting Consultation.²³ Stakeholders expressed concern over the introduction of BT’s new regulatory costs accounting system, including cost increases resulting purely from the introduction of a replacement regulatory cost accounting system.²⁴ We therefore imposed a systems reconciliation report requirement.
- 3.16 Given that we do not use KCOM’s RFS as a basis for setting charge controls and the lower level of interest in KCOM’s RFS from stakeholders, we do not consider that requiring a systems reconciliation report would be proportionate.
- 3.17 As with BT, throughout the process of introducing its new regulatory cost accounting system we have had an ongoing dialogue with KCOM and were kept informed about the changes being made. We have discussed movement in costs between markets with KCOM and are satisfied with the explanations provided.

²² 2014 RFR Statement, paragraph 6.68.

²³ Ofcom, 2013. *Regulatory Financial Reporting: A review*, https://www.ofcom.org.uk/data/assets/pdf_file/0018/41067/btrfs.pdf.

²⁴ 2014 RFR Statement, paragraphs 6.39 to 6.47.

4. Improving KCOM's current regulatory financial reporting

- 4.1 As set out in Section 2, regulatory financial reporting should provide us with the information that we need to make informed regulatory decisions, monitor compliance with regulatory obligations, ensure that obligations address underlying competition issues and investigate potential breaches of obligations. It should also provide reasonable confidence to stakeholders that the regulated entity has complied with its SMP conditions while adding credibility to the regulatory financial reporting regime.
- 4.2 While we have undertaken several reviews of BT's regulatory financial reporting requirements since 2004 to ensure that they remain relevant and proportionate (the last in 2014), KCOM's regulatory financial reporting obligations have remained largely unchanged since 2004. This is partly a consequence of the level of scrutiny given to KCOM's costs reflecting the size of regulated markets in the Hull Area.
- 4.3 As explained in Section 3, issues arising from the 2016 BCMR Statement and the 2017 NMR Statement highlighted problems with KCOM's regulatory financial reporting, and the discussions with KCOM (as it introduced its new regulatory cost system) provided a practical opportunity of conducting a review, which we do below.
- 4.4 In this section, for each requirement covered by the current regulatory financial reporting directions, we explain what KCOM's current regulatory financial reporting provides and then assess whether the current reporting requirements are appropriate, including whether they achieve the relevant policy aims. Where we consider that the current requirements are not appropriate, we propose revised regulatory financial reporting requirements and explain why these changes are required.²⁵

Summary

- 4.5 We propose to revoke the existing SMP directions and impose fresh directions across all markets in which KCOM is regulated. While some of the new directions do not represent a change to the substance of the accounting separation and cost accounting obligations, others do propose changes on a KCOM and market basis. The new SMP directions will apply for the 2018/19 RFS and subsequent years. In summary the proposals are as follows:
- **New Network Component Direction.** We propose that the list of network components imposed in the 2016 BCMR Statement and 2017 NMR Statement is extended to the WLA and WBA markets. For administrative reasons, we propose to revoke the existing BCMR and Narrowband directions and to impose a single network component list across all markets in which KCOM is regulated. In doing so, we propose to remove redundant network components from the list included in the new direction.

²⁵ We discuss how our proposals meet the tests set out in Sections 47(2) and 49(2) of the Act where we discuss our proposals in detail.

- New Transparency Direction. While the current Transparency requirements in substance remain appropriate, to provide regulatory clarity, a new direction is proposed for all markets in which KCOM is regulated.
- New Preparation, audit, delivery and publication of KCOM's RFS direction. We propose that KCOM no longer publish certain KCOM-wide schedules; and consistent with the 2017 NMR Statement, that the network components schedules for the WBA and BCMR markets are no longer publicly available. We propose to remove the requirement for KCOM to provide certain schedules where the information is duplicated within the RFS. We also propose that KCOM publish a Profit and Loss Account and MCE statement in relation to the WLA Market. To provide regulatory clarity a new direction is proposed for all markets in which KCOM is regulated.
- New Form and Content Direction. In relation to the form and content of KCOM's RFS, we propose that for KCOM-wide and Market Profit and Loss Account schedules, additional cost categories be disclosed. We also propose that KCOM calculate an actual ROCE rather than derive the 13% return. For KCOM-wide and Market MCE schedules we propose that new asset categories be disclosed. To provide regulatory clarity, a new direction is proposed for all markets in which KCOM is regulated.
- New Audit Directions. While the current audit requirements remain appropriate, to provide regulatory clarity, a new direction is proposed for all markets.

4.6 The proposed directions are set out in Annex 5 (see Schedules 1 to 6 to the Notification respectively).

Recent regulatory financial reporting developments in regulated markets in the Hull Area

WLA market

4.7 In the 2018 Hull WLA and WBA Statement, we determined that KCOM has SMP in relation to WLA Market in the Hull Area and imposed certain SMP conditions on KCOM, including cost accounting and accounting separation obligations.

4.8 In the 2018 Hull WLA and WBA Statement, we explained that we intended to consult further on KCOM's regulatory financial reporting directions following a review of KCOM's regulatory financial reporting which we have set out in this consultation.

WBA market

4.9 In the 2018 Hull WLA and WBA Statement, we determined that KCOM has SMP in relation to WBA Market in the Hull Area and imposed certain SMP conditions on KCOM, including cost accounting and accounting separation obligations.

4.10 In the 2018 Hull WLA and WBA Statement, we explained that we intended to consult further on KCOM's regulatory financial reporting directions following a review of KCOM's regulatory financial reporting which we have set out in this consultation.

BCMR Markets

4.11 In the 2016 BCMR Statement we imposed cost accounting and accounting separation obligations on KCOM in respect Traditional Interface Leased lines below 8 Mbits/s and on Contemporary Interface leased Lines for all bandwidths.²⁶ In Section 14 of the 2016 BCMR Statement we amended the list of network components that KCOM must attribute costs to within its financial reports (for each of the wholesale leased lines markets). In all other respects we decided to re-impose the same accounting obligations as in the 2013 BCMR Statement.²⁷ These changes took effect for the 2017/18 RFS.

Narrowband Markets

4.12 In the 2017 NMR Statement²⁸ we imposed cost accounting and accounting separation obligations on KCOM in the WFAEL, ISDN30, ISDN2 and WCO markets. In Section 20 of the 2017 NMR Statement we:

- amended the list of network components so they are consistent with the 2016 BCMR Statement;
- removed the requirement for KCOM to publish cost component information for the WFAEL, ISDN30, ISDN2 and WCO markets and instead provide this to us privately; and
- removed other schedules in KCOM's RFS that were no longer needed or duplicated information from elsewhere in the RFS.

4.13 We amended the financial reporting directions on KCOM in these markets to give effect to these changes, as well as making some minor modifications to ensure the directions accurately reflect our decisions. This change took effect for the 2017/18 RFS²⁹.

Current network components (Direction 1)

Current situation and assessment

4.14 As explained in Section 2, network components are used to prepare the RFS. Network components facilitate the meeting of our requirement to monitor compliance with proposed remedies. For example, for non-discrimination, checking the attribution rules on network components allows us to see how costs are attributed to internal as well as external services.

²⁶ 2016 BCMR Statement, Table 1.6, page 13.

²⁷ 2016 BCMR, Volume 1, Paragraphs 14.115 – 14.116.

²⁸ Sections 8, 11, 13 and 18.

²⁹ 2017 NMR Statement, page 441, paragraph 20.195.

- 4.15 At the time of the 2016 BCMR Statement, KCOM had a list of 70 network components. In the 2016 BCMR Statement we explained our view that this list of network components was no longer appropriate. We said: *“we note that the list of network components imposed in the BCMR 2013 does not reflect the main cost elements of leased lines services. Accordingly, we consider it is appropriate to amend the list of network components as we proposed in the May 2015 BCMR Consultation to provide us with better visibility of KCOM’s wholesale leased line costs. This expanded list of components will better enable us to monitor KCOM’s activities and ensure that it complies with the non-discrimination obligations and the obligation to ensure that its charges are fair and reasonable”*.³⁰
- 4.16 We amended the list by adding the 11 new network components. The new components were generic in nature such that they would apply to the other regulated markets, as well as the BCMR. As explained in Section 3, KCOM decided it would need to make major changes to its regulatory cost accounting system in order to report against the proposed network components.³¹ We required that KCOM implement the new network components for the 2017/18 RFS.
- 4.17 In the 2017 NMR Statement we amended the list of network components to make them consistent with the 2016 BCMR Statement. This preserved the integrity and consistency of KCOM’s RFS and ensured what was published in Narrowband markets remained relevant and proportionate. Consistent with the 2016 BCMR Statement, we decided that KCOM must implement this change for its 2017/18 RFS.³²
- 4.18 In respect of the WLA and WBA markets, the 11 new network components do not currently apply. Instead, as we found in the BCMR, costs are attributed to inappropriate network components. In addition, a number of the current list of network components appear to be no longer relevant as they are not attributed any costs.
- 4.19 KCOM’s regulatory financial reporting therefore is not as relevant as it should be because the 2016/17 network components list does not represent the actual cost elements of KCOM’s regulated services. KCOM’s regulated financial reporting is not as reliable as it should be as costs attributed to the narrow set of components KCOM uses are likely to be overstated. The consequence of this is that the current network components are not effective in allowing us to monitor KCOM’s activities and ensure that it complies with the no undue discrimination and fair and reasonable charging obligations imposed in the WLA and WBA markets.³³

Proposed new network component direction

- 4.20 To ensure we can monitor KCOM’s activities and that it complies with the no undue discrimination and fair and reasonable charging obligations imposed in all markets in which KCOM is regulated through the use of relevant network components, we propose a new direction specifying network components to be used by KCOM to prepare the RFS. As

³⁰ 2017 NMR Statement, paragraph 2.210.

³¹ 2017 NMR Statement, paragraph 1.118.

³² 2017 NMR Statement, paragraph 2.16.

³³ 2018 Hull WLA and WBA Statement, Table 1.1.

explained above, we consider that the list of Network Components imposed in the 2016 BCMR and 2017 NMR Statements to be appropriate to all regulated markets.

- 4.21 In relation to the WLA market, as KCOM does not currently report on the WLA market (the services are currently included within residual markets), KCOM does not report costs on a network component basis in this market.
- 4.22 We expect the list of Network Components imposed in the 2016 BCMR and 2017 NMR Statements to broadly reflect the costs associated with the main building blocks required to provide WLA services. We therefore propose to impose in the WLA market the list of Network Components imposed in the 2016 BCMR and 2017 NMR Statements. These components are set out in paragraph 4.29.
- 4.23 In relation to the WBA market, KCOM's 2016/17 RFS reports four components in relation to the WBA market (page 30):
- Exchange concentrator;
 - Exchange-exchange Transmission link;
 - PPP for narrowband call services; and
 - Local Loop infrastructure.
- 4.24 We do not consider that these components reflect the main cost elements of WBA services. At a high level, while the Exchange-exchange infrastructure costs are captured in the Exchange-exchange Transmission link component, we would expect the list of Network Components imposed in the 2016 BCMR and 2017 NMR Statements broadly to reflect the costs associated with the other main building blocks required to provide WBA services, for example, the electronic equipment (other than the concentrator, such as the DSLAM) used to provide the service. We therefore propose to impose in the WBA market the list of Network Components imposed in the 2016 BCMR Statement and 2017 NMR Statements. These components are set out in paragraph 4.29.
- 4.25 Once included in KCOM's regulatory cost accounting system, we would expect the Electronics component would capture costs of DSLAMS and testing equipment.
- 4.26 We propose that KCOM should start using the new network components for the 2018/19 RFS. KCOM have confirmed they are implementing all the required changes in time for the publication of the 2017/18 RFS.
- 4.27 In relation to the BCMR markets we are proposing a new direction to replace the amended direction imposed in the 2016 BCMR Statement in order to provide regulatory clarity.³⁴ In substance the proposed direction is identical to the existing amended direction. While we propose that KCOM must start using the new network components for the 2018/19 RFS, this has no practical implication for them given they will be using the same components in the 2017/18 RFS for the BCMR Markets.

³⁴ That is, that it is clear to KCOM and other stakeholders exactly what regulatory financial reporting requirements are imposed on KCOM and that those requirements, where applicable, are consistently applied across all markets in which KCOM is regulated.

- 4.28 In relation to the Narrowband markets, we are proposing a new direction to replace the amended direction imposed in the 2017 NMR Statement, in order to provide regulatory clarity. In substance the proposed direction is identical to the existing amended direction. While we propose that KCOM must start using the new network components for the 2018/19 RFS, this has no practical implication for them given they will be using the same components in the 2017/18 RFS for the Narrowband Markets.
- 4.29 Following on from the above, we propose to revoke the existing Direction 1 across all markets in which KCOM is regulated and propose a new direction which will contain the following network components:
- Electronics;
 - Field provision;
 - Field maintenance;
 - Local Loop infrastructure
 - Exchange concentrator;
 - Exchange-exchange Transmission link;
 - Back-office Provision;
 - Back-office Maintenance;
 - Sales and Product Management;
 - PPP for narrowband call services;
 - Net Current Assets; and
 - Other.
- 4.30 Our proposed direction which specifies the list of network components is objectively justified as it ensures that the presentation and usability of the RFS is improved and gives confidence to stakeholders about the absence of bias in the preparation of the RFS. We consider that our proposed direction is proportionate because it specifies no more network components than necessary to ensure we can monitor KCOM's activities and that it complies with the no undue discrimination and fair and reasonable charging obligations imposed in all regulated markets in which KCOM is regulated.
- 4.31 The proposed direction is set out in Annex 5 (see Schedule 1 to the Notification).

Transparency direction (Direction 2)

Current situation and assessment

- 4.32 The transparency direction requires KCOM to publish documentation that describes KCOM's regulatory cost accounting system, that is, the accounting system that is used to meet KCOM's obligations on cost accounting and accounting separation. The documentation (DOCAS) sets out the KCOM organisational structure, the objectives of the accounting separation framework and how KCOM's system meets that objective through a 'tier framework and cascade approach'; it sets out in more detail how the tier framework and cascade approach works; it explains its attribution methods for revenues and costs; it explains its methodology for valuing assets on a current cost basis (CCA); and provides detail on the methodology used to estimate traffic minutes and routing factors for

different types of calls. As well as providing transparency to stakeholders on KCOM's regulatory cost accounting system, the document also serves as a reference point for KCOM's auditors for their PPIA opinions (see below). The current documentation (for 2016/17) is published on KCOM's website.³⁵

- 4.33 We consider that the current transparency requirement requires a sufficiently transparent description of KCOM's regulatory cost accounting system (including attribution and valuation methodologies) such that a suitably informed reader can gain a clear understanding of the information presented in KCOM's RFS. On this basis, we consider that the current transparency requirement remains appropriate.
- 4.34 We note that the introduction of KCOM's new regulatory cost accounting system has required KCOM to reconsider how the current transparency requirement can be fulfilled. As a consequence the 2018 DOCAS has been updated to reflect the new regulatory cost accounting system.

Proposed new transparency direction

- 4.35 Given our view that the current transparency requirement remains appropriate, we do not propose any substantive change to Direction 2.
- 4.36 We propose to revoke Direction 2 across all markets in which KCOM is regulated and impose a new transparency direction. The purpose of this proposal is to promote the consistent application of the transparency direction across all the markets in which KCOM is regulated. For the avoidance of doubt, this does not represent a substantive change as the wording in the new direction is the same as in the old direction being revoked. This change is aimed at clarifying KCOM's obligations across all markets in which it is regulated. We propose that it would apply for the 2018/19 RFS and in subsequent years.³⁶
- 4.37 The proposed direction is set out in Annex 5, Schedule 2.
- 4.38 The transparency direction is objectively justified because KCOM's DOCAS needs to continue to provide a sufficiently transparent description of KCOM's regulatory cost accounting system (including attribution and valuation methodologies) such that a suitably informed reader can gain a clear understanding of the information presented in KCOM's RFS in respect of all markets in which KCOM is regulated. The proposed direction will ensure that the presentation of the basis of preparation is transparent for users of KCOM's RFS. Our proposed direction does not require more information than necessary to ensure that presentation of the basis of preparation is transparent for users of the RFS.

³⁵ KCOM description of Cost Accounting System (DOCAS): Representing the Primary and Secondary Accounting Statements Together with Wholesale and Retail Catalogues, 25th July 2017 <https://www.kcomplc.com/media/1658/description-of-cost-accounting-system-2017-pdf.pdf>.

³⁶ We note, however, that this would not appear to have any practical implications for KCOM.

Preparation, audit, delivery and publication of KCOM's RFS (Direction 3) and the form and content direction (Direction 4)

Current requirements and assessment

- 4.39 Direction 3 sets out the financial information KCOM is required to provide for the RFS. Some elements of the published RFS relate to KCOM as a whole, while others are market specific. The direction sets out:
- a) the titles of the schedules KCOM is required to provide and publish both in general and for each regulated market; and
 - b) that KCOM is required to prepare, secure and publish an audit opinion in relation to the KCOM-wide schedules and the regulated markets.
- 4.40 Direction 4 sets out the detail of what information KCOM regulatory financial reporting should include. It is closely related to the preparation and publication requirements of Direction 3. The form and content direction sets out the format (i.e. the description) of the information contained within the schedules that KCOM is required to produce under Direction 3.
- 4.41 The requirements relating to the titles of the schedules KCOM provides and publishes must be consistent with the form and content direction, which sets out the detail to be included within the schedules. We therefore undertake our assessment of these requirements (the schedules KCOM produces and the information that is contained in them) together.
- 4.42 This direction also sets out that KCOM is required to prepare, secure and publish an audit opinion in relation to the KCOM-wide schedules and the regulated markets. The requirements relating to the publishing of the audit opinion must be consistent with the audit opinion directions (Directions 5 and 6).
- 4.43 In respect of Narrowband, we previously assessed the titles of schedules to be provided and published in the 2017 NMR Statement. The 2017 NMR Statement found that in respect of both the KCOM-wide schedules and Narrowband schedules, several were no longer relevant:
- at the KCOM level, we removed the requirement for KCOM to publish the supplementary summary profit and loss and balance sheets where the information was already included in the individual profit and loss and balance sheet schedules for each individual market³⁷;

³⁷ 2017 NMR Statement, page 444, paragraph 20.208.

- for the relevant markets, we decided to remove the requirement for KCOM to publish cost component information where we have decided not to impose cost-based charge controls or cost orientation obligations on KCOM.³⁸ Instead, this information was to be provided for each of these markets to Ofcom on a confidential basis.

4.44 We have reconsidered this assessment below. Having done so, for the reasons we set out we are of the view that the position we took in Narrowband remains appropriate for those markets. Therefore, in respect of Narrowband, we are proposing to maintain the current requirements.

4.45 Below we set out the current form and content of KCOM's RFS, first by reference to KCOM-wide information, and then information provided on a market basis.³⁹ KCOM wide information refers to the consolidated schedules, schedules that cover more than one market and schedules that cover both regulated and unregulated markets. Market basis schedules are the schedules that cover an individual market. We then assess whether the information we require is justified and proportionate. We then set out our proposals for new directions to apply to all markets in which KCOM is regulated.

Current KCOM-wide information - Assessment

4.46 Below we set out each schedule being currently provided under Direction 3 for KCOM-wide information (with the page numbers in the 2016/17 RFS referenced) and the content within that schedule under Direction 4. We consider whether those requirements are justified and proportionate.

- a) Kingston Wholesale Markets Consolidation Statement – Consolidated Total – For all Wholesale Markets where cost accounting and/or accounting separation obligations apply - Current Cost Profit and Loss Account “Consolidated Profit and Loss” (page 7).
 - i) This schedule contains current and prior year information for internal and external sales, operating costs (split between maintenance, provision and installation, out payments, depreciation and 'other') holding gains, CCA depreciation, the absolute return and the percentage return on MCE and turnover. This schedule is required because it provides information as to the effectiveness of our regulation on KCOM's financial performance.
 - ii) The operating cost categories have not been updated since 2005. We consider that the current cost categories are no longer relevant as they are too aggregated and are not transparent. Further, the attribution of costs to these categories does not look reliable. For example, the Maintenance cost category covers 63% of the total operating cost while the Provisions and Installation cost category covers 0%. The Return on Capital employed (ROCE) % is 13% on MCE and has been since 2005. This

³⁸ We also decided to remove the requirement for KCOM to publish two schedules showing internal and external sales by market in relation to narrowband markets. In addition to information on time of day prices that was no longer relevant, the revenue information in the schedules was duplicated in other schedules in the RFS.

³⁹ Except for the narrowband market. In the 2016/17 RFS identical information was provided for each market in which KCOM is regulated except for (i) the Narrowband market, where two additional schedules were provided, and (ii) the WLA market, where no schedules were provided.

is because the internal revenue figure is fixed to achieve 13% rather than KCOM recording the actual volumes and revenues of services sold internally. The returns and internal revenue are therefore neither reliable or transparent. Therefore, we do not consider that the schedule in its current form is relevant as it does not give a true reflection of the returns KCOM is making.

- iii) While we consider that this schedule should continue to be published, we are proposing that it should be put into a new format that seeks to replace incorrect and/or out of date cost headings with correct and/or up to date cost headings. Our proposal is set out in table 4.1 below.
- b) Kingston Wholesale Markets Consolidation Statement – Consolidated Total – For all Wholesale Markets where cost accounting and/or accounting separation obligations apply - Statement of Current Cost Mean Capital Employed “Consolidated MCE” (page 8).
- i) This schedule contains current and prior year information on fixed assets, split between Land and buildings, duct, transmission equipment, exchange equipment and ‘other’. Current assets disclosed are stocks, debtors (internal and external), while current liabilities consist of internal creditors. This schedule is required as it provides us and stakeholders with information as to the effectiveness of regulation on KCOM’s financial performance.
 - ii) The asset categories in the MCE schedules have not been updated since 2004. We consider that these asset categories are no longer relevant. The amalgamation of copper and fibre assets within the duct category means that the figure for duct is not reliable or transparent as this aggregation fails to disclose these large and important asset classes.
 - iii) While we consider that this schedule should continue to be published, we are proposing that it should be put into a new format that seeks to replace incorrect and/or out of date cost headings with correct and/or up to date cost headings. Our proposal is set out in table 4.1 below.
- c) Kingston Reconciliation Statement - Consolidated Profit and Loss Account “Reconciliation Statement profit and loss” (pages 52 and 53).
- i) These schedules reconcile the current and prior year turnover, operating costs and HCA return to ‘Profits for the year attributable to owners of the parent’ by disclosing adjustments required for the reconciliation. The schedule is required as it demonstrates that KCOM’s RFS reconciles to the KCOM plc annual report.⁴⁰ This reconciliation provides us and stakeholders with information that gives confidence that the RFS is based on a record of KCOM’s actual costs.
 - ii) We consider that this schedule should continue to be published with no changes to the current format.

⁴⁰ KCOM 2016/17 RFS, page 80.

- d) Kingston Reconciliation Statement – Consolidated Mean Capital Employed “Reconciliation MCE” (page 54)
- i) This schedule sets out the combined impact of consolidating the schedule referred to at b) (Consolidated MCE) above with the schedule f) (Residual MCE) for the current and prior year referred to below. The schedule is required as it demonstrates that KCOM’s RFS reconciles to the KCOM plc annual report.⁴¹ This reconciliation provides us and stakeholders with information that gives confidence that the RFS is based on a record of KCOM’s actual costs.
 - ii) The asset categories have the same issue as with schedule b), that is, the asset categories are out of date. In its current form the schedule is therefore, misleading as it is not in fact a reconciliation but the combination of two schedules. Unlike the schedule referred to at c) above, it does not provide any comfort to stakeholders as it does not show how KCOM’s RFS MCE reconciles to the balance sheet in KCOM plc’s annual report.
 - iii) While we consider that this schedule should continue to be published, we are proposing that it should be put into a new format that seeks to replace incorrect and/or out of date cost headings with correct and/or up to date cost headings. Our proposal is set out in table 4.1 below.
- e) Kingston Retail Residual Activities Reconciliation – Current Cost Profit and Loss Account “Retail Residual Profit and Loss” (page 55).
- i) This schedule contains information for both the current and prior year profit and loss in the retail residual market in much greater detail than in the schedule referred to at a) above. This schedule is required to provide us with information that KCOM is complying with its accounting separation obligation to attribute costs between regulated and residual markets.
 - ii) The schedule is not a reconciliation but is the profit and loss account for retail residual activities. Unlike schedule a), the ROCE is a real one as there is no internal revenue for retail activities. Given that this schedule provides more information on retail residual activities than is provided on regulated activities, we do not consider that it is proportionate for the schedule to continue to be published. We do however, continue to be require information on residual activities, in order to see how KCOM attributes costs across regulated and unregulated markets. In order to do this we require information on wholesale residual activities as well as retail residual activities.
 - iii) We consider that this schedule should no longer be published. However, we do consider that it is appropriate for this information to be provided to us in confidence in a new format. This will provide us with information to demonstrate that KCOM is attributing costs between regulated and unregulated markets appropriately. Our proposal is set out in table 4.3 below.

⁴¹ KCOM 2016/17 RFS, page 80.

- f) Kingston Retail Residual Activities Reconciliation – Statement of Current Cost MCE “Retail Residual MCE” (page 56).
- i) This schedule contains information for both the current and prior year retail residual MCE for retail residual activities in the form of the schedule referred to a b) above. This schedule is required to provide us with information that KCOM is complying with its accounting separation obligation to attribute costs between regulated and residual markets.
 - ii) The schedule is not a reconciliation but is the MCE for retail residual activities. Its format has the same issues as schedule b), that is, the asset categories are out of date. Given that this schedule provides more information on retail residual activities than is provided on regulated activities, we do not consider that it is proportionate for the schedule to continue to be published. To be of more relevance to us we require information on wholesale residual activities reduces as well as retail residual activities.
 - iii) We consider that this schedule should no longer be published. However, we do consider that it is appropriate for this information to be provided to us in confidence in a new format. This will provide us with information to demonstrate that KCOM is attributing costs between regulated and unregulated markets appropriately. Our proposal is set out in table 4.3 below.
- g) Kingston Inter Market Turnover (Reconciliation) “Inter Market Turnover” (page 57).
- i) This schedule sets out the turnover in the current year between each market including ‘Residual Activities’, ‘Residual Wholesale’ and ‘Residual Retail’. The information on this schedule is a useful control schedule for us to check KCOM’s compliance with its cost accounting and accounting separation obligations, as it sets out in once place where intra market sales originate.
 - ii) Most of the information in this schedule is already duplicated as it is disclosed in the market profit and loss summaries (see para 4.48a) or the Residual Profit and Loss (the schedule referred to at e) above), with the exception of ‘Residual Activities’, so while useful for us, we do not consider that it is proportionate to publish this information given the level of duplicated information and the only information not duplicated (“Residual Activities”) is not appropriate for stakeholders.
 - iii) We consider that this schedule should no longer be published. However, we do consider that it is appropriate for this information to be provided to us in confidence in a new format. This will provide us with information to demonstrate that KCOM is attributing intra market revenue between regulated and unregulated markets appropriately. Our proposal is set out in table 4.3 below.
- h) Kingston Statement of Costs on a Current Cost basis - Network Activity Statement “Consolidated Network Activity Statement” – (page 58).

- i) This schedule sets out KCOM's current year aggregate operating and capital costs on a network components basis. This partly reconciles to the schedules referred to at a) and c) above. We need this schedule to provide information to us and give stakeholders confidence that KCOM is attributing costs correctly to its network components. This ensures that we can monitor KCOM's compliance with its costs accounting and accounting separation obligations.
 - ii) The information presented highlights the lack of transparent, relevant and reliable information on the attribution of costs to network components being provided currently. It shows for example that across KCOM 88% of capital costs and 60% (excluding WLA) of operating costs are attributed to one network component – Local loop Infrastructure. However, this is due to the list of network components being out of date rather than issues with the form and content of the schedule itself. We explain above our proposals on network components.
 - iii) We consider that this schedule should continue to be published as it is currently.
- i) Kingston Network Services Reconciliation "Network Services Reconciliation" – (page 59).
- i) This schedule sets out for the current year, for each market, the total FAC for each network component attributed into that market. It also calculates a component unit cost based on a 'service volume' (rather than component volume) measure. This schedule is required to provide us and stakeholders with confidence that KCOM is attributing costs correctly across network components. It should also provide us with a control total to verify market level information. This ensures that we can monitor KCOM's compliance with its costs accounting and accounting separation obligations.
 - ii) As with the schedule at h) above, this information highlights the lack of transparency, relevance and reliability being provided currently on the attribution of costs to the current list of network components. The 'service volume' unit cost is not the relevant measure. As the purpose of the schedule is to check the attribution of costs to network components, network component is the relevant 'unit cost' and not service volume. As this schedule duplicates relevant information for stakeholders included at the market level information (see 4.48c below) we do not think is proportionate to continue to provide to stakeholders.
 - iii) We consider that this schedule should no longer be published. However, we do consider that it is appropriate for this information to be provided to us in confidence in a new format. This will provide us with information to demonstrate that KCOM is attributing costs between regulated and unregulated markets appropriately. Our proposal is set out in para. 4.58 below.

4.47 Following this assessment, we set out our specific proposals for these KCOM-wide schedules (preparation, audit, delivery and publication and then form and content) at paragraphs 4.60 to 4.86 below.

Current Market-level information - Assessment

4.48 Below we set out each schedule currently being provided under Direction 3 for the regulated markets (exc. WLA) (with the page number in the 2016/17 RFS) and the content within that schedule under Direction 4 for the regulated markets. As noted above, the information provided is the same across all markets in which KCOM is regulated except for the Narrowband⁴² and the WLA Markets⁴³. We consider whether the requirements are justified and proportionate.

- a) Kingston Wholesale market – Current Cost Profit “Market profit and loss summaries” (Narrowband – pages 12, 16, 20 and 24, WBA - page 28 and BCMR – page 32, 35, 40 and 44).
 - i) This schedule sets out information on WBA market in the same format as Consolidated Profit and Loss (see 4.46 a). As with the Consolidated Profit and Loss , this schedule is required because it provides information as to the effectiveness of our regulation on KCOM’s financial performance.
 - ii) The information provided on the WBA market has the same issues as the Consolidated profit and Loss (see 4.46 a).
 - iii) We consider that this schedule should continue to be published, but in a new format that seeks to replace incorrect and/or out of date cost headings with correct and/or up to date cost headings. Our proposal is set out in table 4.2 below.
- b) Kingston Wholesale market - Statement of Current Cost MCE “Market MCE” (Narrowband – pages 13, 17, 21 and 25, WBA - page 29 and BCMR – page 33, 36, 41 and 45).
 - i) This schedule sets out information on WBA market in the same format as the Consolidated MCE (see 4.46 b). As with the Consolidated MCE , this schedule is required as it provides us and stakeholders with information as to the effectiveness of regulation on KCOM’s financial performance.
 - ii) The information provided on the market MCE’s WBA market has the same issues as Consolidated MCE (see 4.46 b)
 - iii) We consider that this schedule should continue to be published, but in a new format that seeks to replace incorrect and/or out of date cost headings with correct and/or up to date cost headings. Our proposal is set out in table 4.2 below.
- c) Kingston Statement of Costs on a Current Cost basis - Network Activity Statement “Market Network Activity Statement” (Narrowband – pages 14, 18, 22 and 26, WBA - page 30 and BCMR – page 34, 37, 42 and 46).

⁴² In the 2017 NMR Statement (page 44) we decided KCOM would no longer provide two additional Narrowband schedules 2017 NMR Statement, page 444, paragraph 20.220. These schedules are specific to Narrowband markets, no equivalent information is provided in relation to other markets.

⁴³ No WLA information is currently provided or published.

- i) This schedule sets out information on WBA market in the same format as the Consolidated Network Activity Statement (see 4.46 h), with the exception of the average costs per line which is duplicated in the Network Services Reconciliation (see 4.46 i).
- ii) The information provided has the same issues as the Consolidated Network Activity Statement and network Services Reconciliation (see 4.46 h and 4.46 i). Consistent with our approach on Narrowband, where we have not imposed cost-based remedies on KCOM in the form of cost-based charge controls or cost orientation obligations, we do not consider that it is proportionate to require KCOM to publish information on a cost component basis for individual markets. The 'service volume' unit cost measure used in regulated markets is not the relevant measure, it should be component costs. Component costs information will allow us to see that they are correctly attributed to the relevant regulated markets.
- iii) Consistent with the 2017 NMR Statement, we consider that this information should be provided to Ofcom on a confidential basis.

Proposed new Preparation, audit, delivery and publication of the RFS direction

- 4.49 In this section we explain how we propose to implement the results of our assessment above in relation to the direction on the preparation, audit, delivery and publication of KCOM's RFS by identifying:
- the information proposed to be made public (KCOM-wide and market level);
 - the information proposed to be provided on a confidential basis to Ofcom (KCOM-wide and market level);
 - the schedules proposed to no longer be provided; and
 - other proposed changes.
- 4.50 We propose that KCOM implement these changes in 2018/19. As explained in Section 3, the introduction of KCOM's new regulatory cost accounting system has caused significant cost movements between services and markets and will thus reduce the comparability of 2017/18 RFS with 2016/17. To provide as much transparency as possible, we consider the current level of information published is justified in the 2017/18 transitional year
- 4.51 We set out in Annex 5, Schedule 3 the proposed new direction. Annex A and B to Schedule 3 sets out the schedules that are to be provided and the audit opinions on them.
- 4.52 Our proposed direction is intended to ensure that regulatory financial reporting gives confidence to stakeholders and allows them to contribute to the regulatory regime. This direction provides details of the financial information to be included in the published RFS and therefore plays an important role in ensuring the RFS provide relevant information to stakeholders. The proposed direction is also intended to ensure that the information that is needed for our monitoring of compliance with remedies is provided to us, whether in the published RFS or on a confidential basis. We consider that our proposed direction is

proportionate since we are only requiring the provision of the minimum amount information necessary for these purposes.

Proposed public information – KCOM wide and market level

4.53 As set out above, we propose that KCOM publish the schedules listed in table 4.1 in relation to KCOM-wide information.

Table 4.1 KCOM wide schedules to be provided and published.

Schedule Currently provided – 2016/17 RFS (page ref)	Justification for retention and publication
Consolidation Cost Profit and Loss. (page 7).	These schedules set out the return KCOM is making from regulated markets. This demonstrates to stakeholders the effectiveness of regulation across KCOM.
Consolidation MCE (page 8).	
Reconciliation Profit and Loss. (pages 52 and 53). Reconciliation MCE (page 54)	These schedules reconcile KCOM’s RFS to its published statutory accounts. This provides us and stakeholders with confidence that the information in the RFS is a record of KCOM’s actual costs.
Consolidated Network Activity Statement (page 58)	This schedule provides confidence to stakeholders that KCOM is attributing costs correctly across network components in accordance with its cost accounting and accounting separation obligations.

4.54 As set out above, we propose that KCOM publish the schedules listed in table 4.2 in relation to market-specific information.

Table 4.2 Market level schedules to be provided and published.

Schedule Currently provided	Market – Currently provided –2017/18 RFS page ref				Justification
	Narrowband	WBA	BCMR ⁴⁴	WLA	
Market Profit and Loss Summaries	Analogue	Page	Below 8	Not	Propose to retain in BCMR, WBA, Narrowband and extend to WLA. The lack of provision of WLA information (which is in currently in Residual) reduces the transparency of the RFS Trends in market-level financial performance allow us to monitor developments in the market and are informative in the context of considering the impact and effectiveness of remedies. Market-level cost information also provides transparency regarding how KCOM has attributed costs between regulated markets (and between regulated and unregulated markets). We see this as facilitating stakeholder confidence that such costs have been attributed consistently.
	Exchange lines (Page 12)	28	M/bits (Page 32)	currently provided	
	ISDN2 (Page 16)		Between 8 M/bits and 45 M/bits (Page 35)		
	ISDN30 (Page 20)		Between 45 M/bits and 155 M/bits (Page 40)		
Market MCE	Call Origination (Page 24)		AISBO (Page 44)		
	Analogue	Page	Below 8	Not	
	Exchange lines (Page 13)	29	M/bits (Page 33)	currently provided	
	ISDN2 (Page 17)		Between 8 M/bits and 45 M/bits (Page 36)		
Market MCE	ISDN30 (Page 21)		Between 45 M/bits and 155 M/bits (Page 41)		
	Call Origination (Page 25)		AISBO (Page 45)		

⁴⁴ In respect of the BCMR Markets, the 2016 BCMR Statement decided that the regulated markets were Wholesale market for low bandwidth traditional interface symmetric broadband origination in the Hull Area, at bandwidths up to and including 8Mbit/s and Wholesale market for contemporary interface symmetric broadband origination in the Hull Area

addition to the changes above, KCOM provides to us on a confidential basis a Wholesale Residual Current Cost Profit and Loss and Wholesale Residual Activities Statement of MCE.

4.57 As set out in our assessment above, for the schedules listed in table 4.4 below, we propose to remove the requirement for KCOM to publish market-level information and instead propose to receive the information on a confidential basis.

Table 4.4 Market level schedules to be provided in confidence.

Schedule Currently provided	Market – Currently provided – 2016/17 RFS page ref				Justification for non – publication and continued provision on a confidential basis
	Narrowband	WBA	BCMR ⁴⁵	WLA	
Market Network Activity Statement	Analogue Exchange lines (Page 13) ISDN2 (Page 17) ISDN30 (Page 21) Call Origination (Page 25)	Page 30	Below 8 M/bits (Page 34) Between 8 M/bits and 45 M/bits (Page 38) Between 45 M/bits and 155 M/bits (Page 42) AISBO (Page 46)	Not currently provided	While this information will help demonstrate to us that KCOM is using an appropriate regulatory cost accounting system to attribute costs to markets, including residual markets, stakeholders are already provided information on how costs are attributed to regulated markets and residual in the Reconciliation Statements (pages 52, 53 and 54) and the KCOM Network Activity Statement (page 58). We do not consider it appropriate to provide detailed information on a regulated market basis where a cost-based charge control is not being imposed.

⁴⁵ In respect of the BCMR Markets, the 2016 BCMR Statement decided that the regulated markets were Wholesale market for low bandwidth traditional interface symmetric broadband origination in the Hull Area, at bandwidths up to and including 8Mbit/s and Wholesale market for contemporary interface symmetric broadband origination in the Hull Area

Schedules proposed to no longer be provided – KCOM-wide

- 4.58 We propose that KCOM no longer provide the Network Services Reconciliation (Page 59 in the 2016/17 RFS). We propose that the information relating to unit costs be included within the “Network Activity Statement” (page 58 in the 2016/17 RFS).

Other changes

- 4.59 When reviewing Direction 3, we noted that it included requirements for KCOM to publish incremental cost information and a Network Services Reconciliation for each market.⁴⁶ KCOM has never published this information to our knowledge. We consider that it would be disproportionate to require that the information be provided going forward because we would not require this information in connection with KCOM’s fair and reasonable pricing obligations⁴⁷. In the 2017 NMR Statement we amended Direction 3 to remove these requirements⁴⁸. We therefore do not propose to include these requirements in the proposed preparation, audit, delivery and publication of the RFS direction.

Proposed new form and content direction – KCOM wide and market level

- 4.60 As explained in Section 2, the current Direction 3 specifies the format of the information within the schedules that KCOM must provide. We explain above, for certain schedules, the format of the information included within the schedules KCOM provides may no longer be appropriate to promote informed regulatory decisions, monitor compliance and provide reasonable confidence to stakeholders on those obligations.
- 4.61 In this section, for each schedule that we propose in Tables 4.1 to 4.4 above is published and/or prepared, we set out the proposed format of the information to be contained in each schedule. Where the format of the proposed market level schedule is the same as the proposed KCOM-wide schedule, we set out the proposals for both at the same time. The precise format of the schedules which we propose below is specified in Annex 2, Schedule 4.

Public reporting

- 4.62 The proposed changes to formats of the public schedules seek to replace incorrect and/or out of date cost headings with correct and/or up to date cost headings. We need correct and up to date cost headings and information to accurately reflect KCOM’s actual costs in order to make informed regulatory decisions, monitor compliance and provide reasonable confidence to stakeholders on KCOM’s compliance with those obligations. We set out under subheadings taken from the proposed KCOM-wide and market schedules that are to be published (referenced to the 2016/17 RFS), the current format of the information provided and the revised format we are proposing.

⁴⁶ It does publish a consolidated network services reconciliation (see page 59 of the 2016/17 KCOM RFS).

⁴⁷ To our knowledge neither KCOM’s previous or new regulatory accounting system had the functionality to calculate incremental costs.

⁴⁸ 2017 NMR Statement, footnote 917 to paragraph 20.2018, page 444.

Profit and loss (Consolidated Page 7, BCMR Pages 32, 35, 40 and 44, WBA page 28, Narrowband Pages 12, 16, 20 and 24 and WLA - n/a)

4.63 We propose to replace the categorisation of Turnover and CCA operating costs in the Current Cost Profit and Loss Account schedules as set out in tables 4.5.

Table 4.5 (a) Turnover Categories

Current Categories – Turnover	Proposed Categories – Turnover
Internal Sales	Internal Sales (see para 4.66 below)
External Sales	External Sales

Table 4.5 (b) Operating Cost Categories

Current Categories – CCA Operating costs	Proposed Categories – CCA Operating costs
Maintenance	Field Maintenance
	Other maintenance
Provision & Installation	Network Provision
	End User Installation
Out-payments	Finance and Billing
	General Management
	Accommodation
	Bad Debts
	Back office support
Depreciation	Depreciation – Duct
	Depreciation – Copper
	Depreciation – Fibre
	Depreciation – Electronics
	Depreciation - Other
Other	Other Costs
Holding gain	Holding (Gain)/Loss
Supplementary Depreciation	Supplementary Depreciation
	CCA Adjustments
	Other adjustments

- 4.64 KCOM is best placed to decide how to construct the proposed cost categories and it will be required to set out details on how it does this transparently in the DOCAS. We will continue to engage with KCOM on the implementation of the proposed cost categories.
- 4.65 In respect of the “Return on Mean Capital Employed and Turnover” line in these schedules, we propose that it is calculated as the actual Return / Mean Capital Employed (MCE) rather fixed at 13%.
- 4.66 In order to calculate the actual return on MCE, KCOM will need to record actual internal revenue and volumes, rather than derive these figures to achieve the 13% return. We would expect internal sales to be recorded on the same basis (or as closely as practically possible) as external sales. In instances where KCOM is unable to calculate internal volumes on the same basis as external volumes, KCOM should explain why this is the case and set out how they have calculated internal volumes in the DOCAS.
- 4.67 The actual return on MCE is a key indicator in assessing the effectiveness of our regulatory policies on KCOM as a whole and on the markets that we regulate.
- 4.68 In respect of the “Return on turnover” line in these schedules, we propose that KCOM no longer discloses this figure as this is not a useful measure of KCOM’s profitability for an asset driven business. In respect of “Return on Capital Employed” to help transparency, we propose that KCOM disclose the aggregate MCE in these schedules that is used in the calculation.
- 4.69 In respect of the column headings in the schedules, we propose that KCOM should continue to disclose both the current and prior year in absolute terms rounded to the nearest £’000. We propose that KCOM should continue to disclose the percentage change year on year. We propose that KCOM should additionally disclose the absolute change year on year rounded to the nearest £’000. This will replace the percentage per line item/total in the current and prior year which we think will provide users of the RFS with more relevant information on turnover and cost movements year on year.

Statement of MCE (Consolidated Page 8, BCMR Pages 33, 36, 41 and 45, WBA page 29, Narrowband Pages 13, 17, 21 and 25 and WLA - n/a)

- 4.70 We propose to replace the categories used to disclose fixed assets in the Statement of Current Cost mean capital employed as per table 4.6.

Table 4.6 Fixed Asset Categories

Current Categories – Fixed Assets	Proposed Categories – Fixed Assets
Land and Buildings	Land and Buildings
Duct	Duct Fibre Copper
Exchange Equipment	Exchange Equipment
Transmission Equipment	Transmission Equipment
Other	Other

- 4.71 We do not propose that KCOM make any changes to the current asset categories, creditor categories or any of the other headings or sub headings.
- 4.72 KCOM is best placed to decide how to construct the proposed asset categories. It must set out details on how these are constructed transparently in the DOCAS. We will continue to engage with KCOM on the implementation of the proposed cost categories.
- 4.73 In respect of the column headings in the mean capital employed statements, we propose that KCOM should disclose both the current and prior year in absolute terms rounded to the nearest £'000. We propose that KCOM should continue to disclose the percentage change year on year. We propose that KCOM should additionally disclose the absolute change year on year rounded to the nearest thousand. This will provide users of the RFS with more relevant information on asset movements year on year.

Reconciliation Profit and Loss (pages 52 and 53).

- 4.74 We propose a minor change to the format of these schedules. Underneath the bottom row titled "Profit for the year attributable to owners of the parent" we propose that KCOM include the relevant page reference⁴⁹ to the KCOM plc Annual report. This will provide stakeholders with a more transparent reconciliation between the RFS and KCOM Annual Report.

Reconciliation MCE (page 54)

- 4.75 The asset categorisation in this schedule will no longer be required. Instead the schedule should reconcile the closing capital employed figure in the RFS to the Consolidated Balance Sheet in KCOM plc Annual Report⁵⁰ with a page reference to the KCOM plc Annual report.
- 4.76 We propose the schedule should set out the MCE for each regulated market, retail residual and wholesale residual. This aggregate total of these will equate to the MCE total for KCOM. It should then be converted into a closing CCA capital employed.
- 4.77 We propose the schedule should then list the CCA impact of the various CCA and other adjustments (mainly those disclosed in the Reconciliation Statement Consolidated Profit and Loss Account) which when added or subtracted to/from the closing CCA capital employed will reconcile to the closing shareholders' funds in the KCOM plc Annual Report.
- 4.78 We propose the information is provided for both the current and prior financial period. This information will provide stakeholders with a transparent reconciliation between the RFS and the KCOM plc Annual Report.

Consolidated Network activity statement (page 58)

- 4.79 We propose that the format of this schedule stays the same but with the addition of two columns containing information that is currently provided in the Network Services Reconciliation which is to be no longer published. The first column would set out the unit

⁴⁹ Currently page 82 of the 2016/17 KCOM plc Annual Report <https://www.kcomplc.com/media/1625/annual-report-2016-17.pdf>.

⁵⁰ We envisage this would be reconciled to page 81 of the 2016/17 KCOM plc Annual Report <https://www.kcomplc.com/media/1625/annual-report-2016-17.pdf>.

of measure for each network components, the second column would set out the volume of components. This unit measure must be based on network components and not service volumes that is currently produced. KCOM should set out the methodology on how it calculates the new column information in the DOCAS.

Information provided on a confidential basis

4.80 We set out below the format of reports that we propose KCOM to provide to us in confidence. Where this information is currently publicly reported we cross reference it to the 2016/17 KCOM RFS.

Market Network Activity Statement (BCMR Pages 34, 37, 42 and 47, WBA page 30, Narrowband Pages 14, 18, 22 and 26 and WLA - n/a).

4.81 We propose the format of this information should be the same as that provided on a KCOM-wide basis as set out above in para 4.63)

Retail Residual Profit and Loss (page 55)

4.82 We propose that the format of this information should be the same as provided on a consolidated and market basis as set out above in paras 4.63 to 4.69.

Retail Residual MCE (page 56)

4.83 We propose that the format of this information should be the same as provided on a consolidated and market basis as set out above in paras 4.70 to 4.73.

Wholesale Residual Profit and Loss (n/a)

4.84 We propose that the format of this information should be the same as provided on a consolidated and market basis as set out above in paras 4.63 to 4.69.

Wholesale Residual MCE (n/a)

4.85 We propose that the format of this information should be the same as provided on a consolidated and market basis as set out above in paras 4.70 to 4.73.

Inter Market Turnover (KCOM wide page 57)

4.86 We propose that the format of this information stays the same as currently except that the schedule (including disclosures for residual retail, residual wholesale and residual activities) must be reconciled to the published revenue in KCOM plc's annual report.

Current FPIA (Direction 5) and PPIA (Direction 6) audit opinions

Current situation and assessment

4.87 Under Directions 5 and 6, two types of opinion are used currently for the regulatory audit: Fairly Presents in Accordance With (FPIA) and Properly Prepared in Accordance With (PPIA). Both types of opinion consider the 'rules'. The 'rules' in this case refer to the DOCAS prepared by KCOM, as well as the regulation surrounding the RFS.

- 4.88 The PPIA opinion represents a view on whether the rules have been followed, whereas the FPIA opinion provides some additional assurance on whether those rules are reasonable. An FPIA opinion therefore involves a greater degree of judgment (and more work) by the auditor.
- 4.89 The provision of FPIA and PPIA audit opinions on the RFS and schedules within it have given us confidence that the information provides a fair reflection of KCOM's financial performance, is free from material error and has been prepared following the DOCAS published by KCOM and relevant directions issued by us. Therefore, we consider that the current audit arrangements in relation to KCOM are justifiable, such that they do not require any substantive change. We consider our proposed directions are proportionate because the audit requirements are no more than is necessary to ensure that an appropriate level of assurance is provided on the RFS.

Proposed new PPIA and FPIA audit opinion directions

- 4.90 Given our view that the current audit opinion requirements remain appropriate, we do not propose any substantive change to Directions 5 and 6. To preserve the integrity and consistency of the RFS we consider that all markets should be subject to the same audit directions.
- 4.91 We propose to revoke Directions 5 and 6 across all markets in which KCOM is regulated and impose new audit opinion directions. The purpose of this proposal is to promote the consistent application of the audit opinion directions across all the markets in which KCOM is regulated. For the avoidance of doubt, this does not represent a substantive change as the wording in the new directions is the same as in the directions being revoked. This change is aimed at clarifying KCOM's obligations across all markets in which it is regulated. We propose that it would apply for the 2018/19 RFS.⁵¹

Legal tests

- 4.92 In each case we consider that the proposed new directions would fulfil our general duties under section 3 of the Act and meet the Community requirements set out in section 4 of the Act by promoting competition because:
- our proposals are aligned with Ofcom's regulatory decisions and give confidence to stakeholders about the absence of bias in the preparation of the Regulatory Financial Statements. They also ensure that the presentation and usability of the Regulatory Financial Statements is improved and that the obligations that are imposed on KCOM are proportionate.
 - The proposal therefore seeks to ensure that the RFS remain relevant, thereby increasing transparency. Ultimately, this promotes competition.

⁵¹ We note, however, that this would not appear to have any practical implications for KCOM.

- 4.93 In proposing each of these directions, we have taken due account of all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive, in particular the 2005 EC Recommendation.

Network Components

- 4.94 We propose a new network component list which will revoke the current list of network components in Direction 1 and replace them with the network components listed at paragraph 4.29 above. (*See Annex 2, Schedule 1.*)
- 4.95 We consider that the proposed direction specifying KCOM's list of network components meet the tests set out in section 49(2) of the Act in that they are:
- Objectively justifiable because it is necessary for us to give a direction specifying network components for KCOM to attribute costs to consistently across all markets.
 - Not unduly discriminatory because it reflects KCOM's market position in the Hull Area. BT is the only other SMP provider which has regulatory accounting obligations and we have also decided to update BT's list of components.
 - Proportionate because our proposal is no more than is required to specify network components.
 - Transparent because we set out clearly the network components that KCOM is required to report against.

Transparency

- 4.96 We propose to revoke the current Direction 2 and to replace it with a new Transparency direction. (*See Annex 2, Schedule 2.*)
- 4.97 We consider that the proposed direction meets the tests set out in section 49(2) of the Act in that it is:
- Objectively justifiable because KCOM's DOCAS needs to continue to provide a sufficiently transparent description of KCOM's regulatory accounting system (including attribution and valuation methodologies) such that a suitably informed reader can gain a clear understanding of the information presented in KCOM's RFS across all regulated markets.
 - Not unduly discriminatory because the proposed direction reflects KCOM's market position in the Hull Area.
 - Proportionate because the proposed direction requires no more than necessary to ensure that presentation of the basis of preparation is clear for users.
 - Transparent because the intention of our proposed direction is to ensure that presentation of the basis of preparation is clear for users.

Preparation, Audit, Delivery and Publication of the RFS

- 4.98 We propose to revoke Direction 3 and to replace it with a new Preparation, Audit, Delivery and Publication of the RFS direction. (*See Annex 2, Schedule 3*)

4.99 We also consider that proposed directions meet the tests set out in section 49(2) of the Act in that they are:

- Objectively justifiable because the Direction will seek to ensure that through the information to be provided, both in public and on a confidential basis, that stakeholders have sufficient information about the products and services they purchase to provide them with reasonable confidence about KCOM's compliance with its SMP conditions, and that we have sufficient information necessary to carry out our functions.
- Not unduly discriminatory because it reflects KCOM's market position in the Hull Area. BT is the only other SMP provider which has regulatory accounting obligations and we have explained the reasons for requiring relevant information from KCOM both publicly and on a confidential basis.
- Proportionate because the requirements will be no more than is required to ensure the effectiveness of the proposals in this consultation and ensures that Ofcom and stakeholders are provided with a sufficient level of information and does not extend beyond these.
- Transparent because it is clear that 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.

Form and Content of the RFS

4.100 We propose to revoke Direction 4 and to replace it with a new form and content direction. We propose to require KCOM to publish and provide different information within its schedules. (*See Annex 2, Schedule 4.*)

4.101 We also consider that the proposed direction meets the tests set out in section 49(2) of the Act in that they are:

- Objectively justifiable because the requirements will seek to ensure that through the information to be provided, both in public and on a confidential basis, stakeholders have sufficient information about the products and services they purchase to provide them with reasonable confidence about KCOM's compliance with its SMP conditions and that we have sufficient information necessary to carry out our functions.
- Not unduly discriminatory because it reflects KCOM's market position in the Hull Area. BT is the only other SMP provider which has regulatory accounting obligations, and we have explained the reasons for requiring relevant information from KCOM both publicly and on a confidential basis.
- Proportionate because the requirements will be no more than is necessary to ensure the effectiveness of the proposals in this consultation and ensures that Ofcom and stakeholders are provided with a sufficient level of information and does not extend beyond these.
- Transparent because it is clear that the intention of the modifications is to make sure that the RFS remain fit for purpose and that Ofcom and stakeholders are provided with a sufficient level of information.

Audit Opinions

- 4.102 We propose to revoke Directions 5 and 6 and to replace them with new audit opinion directions. (See Annexes 5 and 6)
- 4.103 We consider that the proposed directions meet the tests set out in section 49(2) of the Act in that they are:
- Objectively justifiable because it is important for both stakeholders and Ofcom that an appropriate level of assurance is provided on the RFS.
 - Not unduly discriminatory because it reflects KCOM's market position in the Hull Area.
 - Proportionate because the audit requirements are no more than is necessary to ensure that an appropriate level of assurance is provided on the RFS.
 - Transparent because the intention of our changes is to ensure that an appropriate level of assurance is provided on the RFS.

Next steps

- 4.104 Subject to any issues raised in responses to this Consultation, we would expect to make a final decision on the proposals set out in this document in the autumn. As noted, our proposal is that the new reporting requirements should be in place for April 2019. This means that these changes would be reflected in the 2018/19 RFS to be published in July 2019.

Consultation question

Question: Do you agree with our proposals for KCOM's Regulatory Financial Reporting?
If not, what alternative(s) would you propose and why?

A1. Responding to this consultation

How to respond

- A1.1 Ofcom would like to receive views and comments on the issues raised in this document, by 5pm on 15th January 2018.
- A1.2 You can download a response form from <https://www.ofcom.org.uk/consultations-and-statements/category-2/regulatory-financial-reporting2>. You can return this by email or post to the address provided in the response form.
- A1.3 If your response is a large file, or has supporting charts, tables or other data, please email it to gary.carey@ofcom.org.uk, as an attachment in Microsoft Word format, together with the cover sheet (<https://www.ofcom.org.uk/consultations-and-statements/consultation-response-coversheet>). This email address is for this consultation only and will not be valid after 15 January 2018.
- A1.4 Responses may alternatively be posted to the address below, marked with the title of the consultation:
- Gary Carey
Ofcom
Riverside House
2A Southwark Bridge Road
London SE1 9HA
- A1.5 We welcome responses in formats other than print, for example an audio recording or a British Sign Language video. To respond in BSL:
- Send us a recording of you signing your response. This should be no longer than 5 minutes. Suitable file formats are DVDs, wmv or QuickTime files. Or
 - Upload a video of you signing your response directly to YouTube (or another hosting site) and send us the link.
- A1.6 We will publish a transcript of any audio or video responses we receive (unless your response is confidential)
- A1.7 We do not need a paper copy of your response as well as an electronic version. We will acknowledge receipt if your response is submitted via the online web form, but not otherwise.
- A1.8 You do not have to answer all the questions in the consultation if you do not have a view; a short response on just one point is fine. We also welcome joint responses.
- A1.9 It would be helpful if your response could include direct answers to the questions asked in the consultation document. The questions are listed at Annex 4. It would also help if you could explain why you hold your views, and what you think the effect of Ofcom's proposals would be.

A1.10 If you want to discuss the issues and questions raised in this consultation, please contact Gary Carey on 020 7783 4393, or by email to gary.carey@ofcom.org.uk.

Confidentiality

- A1.11 Consultations are more effective if we publish the responses before the consultation period closes. In particular, this can help people and organisations with limited resources or familiarity with the issues to respond in a more informed way. So, in the interests of transparency and good regulatory practice, and because we believe it is important that everyone who is interested in an issue can see other respondents' views, we usually publish all responses on our website, www.ofcom.org.uk, as soon as we receive them.
- A1.12 If you think your response should be kept confidential, please specify which part(s) this applies to and explain why. Please send any confidential sections as a separate annex. If you want your name, address, other contact details or job title to remain confidential, please provide them only in the cover sheet, so that we don't have to edit your response.
- A1.13 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and try to respect it. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A1.14 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's intellectual property rights are explained further at <https://www.ofcom.org.uk/about-ofcom/website/terms-of-use>.

Next steps

- A1.15 Following this consultation period, Ofcom plans to publish a statement in early 2018.
- A1.16 If you wish, you can register to receive mail updates alerting you to new Ofcom publications; for more details please see <https://www.ofcom.org.uk/about-ofcom/latest/email-updates>

Ofcom's consultation processes

- A1.17 Ofcom aims to make responding to a consultation as easy as possible. For more information, please see our consultation principles in Annex x.
- A1.18 If you have any comments or suggestions on how we manage our consultations, please email us at consult@ofcom.org.uk. We particularly welcome ideas on how Ofcom could more effectively seek the views of groups or individuals, such as small businesses and residential consumers, who are less likely to give their opinions through a formal consultation.
- A1.19 If you would like to discuss these issues, or Ofcom's consultation processes more generally, please contact Steve Gettings, Ofcom's consultation champion:

Steve Gettings
Ofcom
Riverside House
2a Southwark Bridge Road
London SE1 9HA
Email: corporationsecretary@ofcom.org.uk

A2. Ofcom's consultation principles

Ofcom has seven principles that it follows for every public written consultation:

Before the consultation

- A2.1 Wherever possible, we will hold informal talks with people and organisations before announcing a big consultation, to find out whether we are thinking along the right lines. If we do not have enough time to do this, we will hold an open meeting to explain our proposals, shortly after announcing the consultation.

During the consultation

- A2.2 We will be clear about whom we are consulting, why, on what questions and for how long.
- A2.3 We will make the consultation document as short and simple as possible, with a summary of no more than two pages. We will try to make it as easy as possible for people to give us a written response. If the consultation is complicated, we may provide a short Plain English / Cymraeg Clir guide, to help smaller organisations or individuals who would not otherwise be able to spare the time to share their views.
- A2.4 We will consult for up to ten weeks, depending on the potential impact of our proposals.
- A2.5 A person within Ofcom will be in charge of making sure we follow our own guidelines and aim to reach the largest possible number of people and organisations who may be interested in the outcome of our decisions. Ofcom's Consultation Champion is the main person to contact if you have views on the way we run our consultations.
- A2.6 If we are not able to follow any of these seven principles, we will explain why.

After the consultation

- A2.7 We think it is important that everyone who is interested in an issue can see other people's views, so we usually publish all the responses on our website as soon as we receive them. After the consultation we will make our decisions and publish a statement explaining what we are going to do, and why, showing how respondents' views helped to shape these decisions.

A3. Consultation coversheet

BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

Please tick below what part of your response you consider is confidential, giving your reasons why

Nothing

Name/contact details/job title

Whole response

Organisation

Part of the response

If there is no separate annex, which parts? _____

If you want part of your response, your name or your organisation not to be published, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response that Ofcom can publish. However, in supplying this response, I understand that Ofcom may need to publish all responses, including those which are marked as confidential, in order to meet legal obligations. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name

Signed (if hard copy)

A4. Consultation question

Question: Do you agree with our proposals for KCOM's Regulatory Financial Reporting?
If not, what alternative(s) would you propose and why?

A5. Draft Legal Instrument

Proposals for directions relating to regulatory financial reporting requirements for WLA, WBA, BCMR and Narrowband markets

Section 1 – Proposed Network Component direction

Notification of proposal under sections 49 and 49A of the Communications Act 2003, and SMP Services Condition OB2 and SMP Services Condition 8.2 to revoke Direction 1 and impose a direction specifying network components

Background

A5.1 On 22 July 2004, Ofcom published a statement entitled “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” (“**July 2004 Statement**”). At Annex 3 of that statement, Ofcom imposed SMP conditions with respect to regulatory accounting (Conditions OB1 to OB33) on KCOM in markets in which KCOM had been found to have significant market power in previously concluded market reviews.

A5.2 At Annex 5 of the July 2004 Statement, Ofcom published various directions for KCOM given under the SMP conditions. These included directions (“**2004 Regulatory Financial Reporting Directions**”) specifying network components (“**Direction 1**”), Transparency (“**Direction 2**”), Preparation, audit, delivery and publication of regulatory financial statements (“**Direction 3**”), Form and content of Regulatory Financial Statement (“**Direction 4**”), Form of the ‘FPIA’ opinion for financial statements (“**Direction 5**”) and Form of the ‘PPIA’ opinion for financial statements (“**Direction 6**”) for the purposes of, among others, SMP Conditions OB1 to OB33. The 2004 Regulatory Reporting Direction have been subsequently amended on various occasions.

A5.3 On 28 April 2016 OFCOM published a statement “Business Connectivity Market Review: Review of competition in the provision of leased lines” (“**2016 BCMR Statement**”) The 2016 BCMR Statement found that KCOM continues to have significant market power in each of the markets covered by the review in the Hull Area. OFCOM decided to set on KCOM SMP conditions under section 45 of the Communications Act 2003 (the Act) designed to encourage greater competition in leased lines in the Hull Area. These included SMP conditions OB1 to OB33 in respect to regulatory financial reporting. OFCOM also amended, where necessary the 2004 Regulatory Financial Reporting Directions. As set out at section 4 of Annex 35 of the 2016 BCMR Statement, OFCOM modified Direction 1.

A5.4 On 30 November 2017 OFCOM published a statement “Narrowband Market Review: Statement” (“**2017 NMR Statement**”). The 2017 NMR Statement found that KCOM continues to have significant market power in each of the markets covered by the review in the Hull Area. OFCOM decided to set on KCOM SMP conditions under section 45 of the Act designed to encourage greater competition for Narrowband services in the Hull Area. These included SMP conditions OB1 to OB33 in respect to regulatory financial reporting. OFCOM also amended, where necessary the

2004 Regulatory Financial Reporting Directions. As set out at section 2 of Annex 9 of the 2017 NMR Statement, OFCOM modified Direction 1.

A5.5 On 31 July 2018 OFCOM published a statement entitled “Wholesale Local Access and Wholesale Broadband Access Market Reviews: Review of competition in the Hull Area” (the “**2018 WLA and WBA Statement**”). The 2018 WLA and WBA Statement presents OFCOM’s conclusion that KCOM continues to have significant market power in each of the markets for wholesale local access and wholesale broadband access in the Hull Area. OFCOM decided to set on KCOM SMP conditions under section 45 of the Communications Act 2003 (the Act) designed to encourage greater competition in the provision of fixed telecoms services for consumers in the Hull Area. At Annex 6 of that Statement, Ofcom revoked Conditions OB1 to OB33 from the July 2004 Statement insofar as they applied to the WLA and WBA markets and in their place imposed SMP Condition 8 with respect to regulatory accounting on KCOM in the WLA and WBA markets. This did not represent a change to the substance of the accounting separation and cost accounting conditions as set out in the July 2004 Statement but was a ‘structural’ change to the way in which the financial reporting obligations are imposed, aimed at clarifying KCOM’s obligations.

A5.6 Today, Ofcom is consulting, in a consultation document entitled “KCOM Regulatory Financial Reporting: Consultation on proposed regulatory financial reporting directions for KCOM” (“**2018 KCOM Reporting Consultation**”), on proposals to replace the 2004 Regulatory Financial Reporting Directions with new regulatory financial reporting directions in relation to the following markets:

- a) the supply of wholesale local access at a fixed location in the Hull Area;
- b) the supply of wholesale broadband access in the Hull Area;
- c) wholesale market for low bandwidth traditional interface symmetric broadband origination in the Hull Area, at bandwidths up to and including 8Mbit/s;
- d) wholesale market for contemporary interface symmetric broadband origination in the Hull Area;
- e) wholesale fixed analogue exchange line services in the Hull Area;
- f) wholesale ISDN30 exchange line services in the Hull Area;
- g) wholesale ISDN2 exchange line services in the Hull Area; and
- h) wholesale call origination on a fixed narrowband network in the Hull Area.

A5.7 In SMP Condition OB2 and SMP Condition 8, network components are defined as the network components specified in a direction given by Ofcom from time to time for the purposes of these conditions.

A5.8 Under Condition OB2 set out at Annex 2 of the July 2004 Statement which Ofcom decided to apply to KCOM in the 2016 BCMR Statement and the 2017 NMR Statement, Ofcom may from time to time make such directions as they consider appropriate in relation to KCOM’s obligations under these conditions.

A5.9 Under SMP Condition 8 which Ofcom has decided to apply to KCOM in the 2018 WLA and WBA Statement, Ofcom may from time to time make such directions as they consider appropriate in relation to KCOM’s obligations under these conditions.

A5.10 This Notification sets out proposals to revoke Direction 1 and impose a Network Component direction in relation to each of the markets set out in paragraph A5.6 above.

Proposal to give a direction

A5.11 Ofcom is proposing, in accordance with section 49 of the Act, to give a direction pursuant to SMP Condition OB2 and SMP Condition 8 specifying Network Components in relation to each of the markets set out in paragraph A5.6 above.

A5.12 The proposed direction is set out in the Schedule to this Notification.

A5.13 The effect of and reasons for giving the proposed direction are set out in the 2018 KCOM Reporting Consultation accompanying this Notification.

Ofcom's duties and legal tests

A5.14 For the reasons set out in the 2018 KCOM Reporting Consultation, Ofcom considers that the proposals referred to in paragraph A5.11 complies with the requirements of section 49(2) of the Act.

A5.15 In making the proposals referred to in paragraph A5.11, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.

Making representations

A5.16 Representations may be made to Ofcom about the proposals set out in this Consultation by no later than 18th September 2018.

A5.17 In accordance with section 49C(1)(a) of the Act, a copy of the Notification, together with the Schedules, will be sent to the Secretary of State.

Interpretation

A5.18 Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 3 of the July 2004 Statement and Annex 6 of the 2018 WLA and WBA Statement and otherwise any word or expression shall have the same meaning as it has in the Act.

A5.19 The Interpretation Act 1978 (c. 30) shall apply as if this notification were an Act of Parliament.

Signed

Director of Financial Economics, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

7 August 2018

Schedule 1 – Proposed Network Component Direction

Proposed Direction made under section 49 of the Communications Act 2003 and SMP Services Condition OB2 and SMP Services Condition 8.2 specifying network components for the purposes of, among others, SMP Services Conditions 8.1 to 8.29 and Conditions OB1 to OB33.

1. In accordance with section 49(1) of the Act, Ofcom hereby gives a Direction specifying network components, in relation to the markets listed in paragraph A5.6 above, as follows:
 - Electronics;
 - Field provision;
 - Field maintenance;
 - Local Loop infrastructure
 - Exchange concentrator;
 - Exchange-exchange Transmission link;
 - Back-office Provision;
 - Back-office Maintenance;
 - Sales and Product Management;
 - PPP for narrowband call services;
 - Net Current Assets; and
 - Other.
2. In accordance with section 49(1) of the Act, Ofcom hereby gives a Direction revoking Direction 1 in relation to the markets listed in paragraph A5.6 above.

Section 2 – Proposed Transparency direction

Notification of proposal under sections 49 and 49A of the Communications Act 2003 and SMP Services Condition OB2 and SMP Services Condition 8.2 to revoke Direction 2 and impose a direction specifying the transparency requirements for the purposes of preparing and maintaining the accounting records, Accounting Documents, and Regulatory financial statements

Background

A5.20 On 22 July 2004, Ofcom published a statement entitled “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” (“**July 2004 Statement**”). At Annex 3 of that statement, Ofcom imposed SMP conditions with respect to regulatory accounting (Conditions OB1 to OB33) on KCOM in markets in which KCOM had been found to have significant market power in previously concluded market reviews.

A5.21 At Annex 5 of the July 2004 Statement, Ofcom published various directions for KCOM given under the SMP conditions. These included directions (“**2004 Regulatory Financial Reporting Directions**”) specifying network components (“**Direction 1**”), Transparency (“**Direction 2**”), Preparation, audit, delivery and publication of regulatory financial statements (“**Direction 3**”), Form and content of Regulatory Financial Statement (“**Direction 4**”), Form of the ‘FPIA’ opinion for financial statements (“**Direction 5**”) and Form of the ‘PPIA’ opinion for financial statements (“**Direction 6**”) for the purposes of, among others, SMP Conditions OB1 to OB33. The 2004 Regulatory Reporting Direction have been subsequently amended on various occasions.

A5.22 On 28 April 2016 OFCOM published a statement “Business Connectivity Market Review: Review of competition in the provision of leased lines” (“**2016 BCMR Statement**”) The 2016 BCMR Statement found that KCOM continues to have significant market power in each of the markets covered by the review in the Hull Area. OFCOM decided to set on KCOM SMP conditions under section 45 of the Communications Act 2003 (the Act) designed to encourage greater competition in leased lines in the Hull Area. These included SMP conditions OB1 to OB33 in respect to regulatory financial reporting. OFCOM also amended, where necessary the 2004 Regulatory Financial Reporting Directions.

A5.23 On 30 November 2017 OFCOM published a statement “Narrowband Market Review: Statement” (“**2017 NMR Statement**”). The 2017 NMR Statement found that KCOM continues to have significant market power in each of the markets covered by the review in the Hull Area. OFCOM decided to set on KCOM SMP conditions under section 45 of the Act designed to encourage greater competition for Narrowband services in the Hull Area. These included SMP conditions OB1 to OB33 in respect to regulatory financial reporting. OFCOM also amended, where necessary the 2004 Regulatory Financial Reporting Directions.

A5.24 On 31 July 2018 OFCOM published a statement entitled “Wholesale Local Access and Wholesale Broadband Access Market Reviews: Review of competition in the Hull Area” (the “**2018 WLA and WBA Statement**”). The 2018 WLA and WBA Statement presents OFCOM’s conclusion that

KCOM continues to have significant market power in each of the markets for wholesale local access and wholesale broadband access in the Hull Area. OFCOM decided to set on KCOM SMP conditions under section 45 of the Communications Act 2003 (the Act) designed to encourage greater competition in the provision of fixed telecoms services for consumers in the Hull Area. At Annex 6 of that Statement, Ofcom revoked Conditions OB1 to OB33 from the July 2004 Statement insofar as they applied to the WLA and WBA markets and in their place imposed SMP Condition 8 with respect to regulatory accounting on KCOM in the WLA and WBA markets. This did not represent a change to the substance of the accounting separation and cost accounting conditions as set out in the July 2004 Statement but was a 'structural' change to the way in which the financial reporting obligations are imposed, aimed at clarifying KCOM's obligations.

A5.25 Today, Ofcom is consulting, in a consultation document entitled "KCOM Regulatory Financial Reporting: Consultation on proposed regulatory financial reporting directions for KCOM." ("**2018 KCOM Reporting Consultation**"), on proposals to replace the 2004 Regulatory Financial Reporting Directions with new regulatory financial reporting directions in relation to the following markets:

- a) the supply of wholesale local access at a fixed location in the Hull Area;
- b) the supply of wholesale broadband access provided in the Hull Area;
- c) wholesale market for low bandwidth traditional interface symmetric broadband origination in the Hull Area, at bandwidths up to and including 8Mbit/s;
- d) wholesale market for contemporary interface symmetric broadband origination in the Hull Area;
- e) wholesale fixed analogue exchange line services in the Hull Area;
- f) wholesale ISDN30 exchange line services in the Hull Area;
- g) wholesale ISDN2 exchange line services in the Hull Area; and
- h) wholesale call origination on a fixed narrowband network in the Hull Area.

A5.26 Under Condition OB2 set out at Annex 2 of the July 2004 Statement which Ofcom has decided to apply to KCOM in the 2016 BCMR and 2017 MNR Statements, Ofcom may from time to time make such directions as they consider appropriate in relation to KCOM's obligations under these conditions.

A5.27 Under SMP Condition 8 which Ofcom has decided to apply to KCOM in the 2018 WLA and WBA Statement, Ofcom may from time to time make such directions as they consider appropriate in relation to KCOM's obligations under these conditions.

A5.28 This Notification sets out proposals to revoke Direction 2 and to impose a Transparency direction in relation to each of the markets set out in the supply of paragraph A5.25 above.

Proposal to give a direction

A5.29 Ofcom is proposing, in accordance with section 49 of the Act, to give a direction pursuant to SMP Condition OB2 and SMP Condition 8 imposing a Transparency direction in relation to each of the markets set out in paragraph A5.25 above.

A5.30 The proposed direction is set out in the Schedule to this Notification.

A5.31 The effect of and reasons for giving the proposed direction are set out in the 2018 KCOM Reporting Consultation accompanying this Notification.

Ofcom's duties and legal tests

A5.32 For the reasons set out in the 2018 KCOM Reporting Consultation, Ofcom considers that the proposals referred to in paragraph A5.29 complies with the requirements of section 49(2) of the Act.

A5.33 In making the proposals referred to in paragraph A5.29, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.

Making representations

A5.34 Representations may be made to Ofcom about the proposals set out in this Consultation by no later than 18 September 2018.

A5.35 In accordance with section 49C(1)(a) of the Act, a copy of the Notification, together with the Schedules, will be sent to the Secretary of State.

Interpretation

A5.36 Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 3 of the July 2004 Statement and Annex 6 of the 2018 WLA and WBA Statement and otherwise any word or expression shall have the same meaning as it has in the Act.

A5.37 The Interpretation Act 1978 (c. 30) shall apply as if this notification were an Act of Parliament.

Signed

Director of Financial Economics, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

7 August 2018

Schedule 2 - Proposed Transparency Direction

Proposed Direction made under section 49 of the Communications Act 2003 and SMP Services Condition OB2 SMP Services Condition 8.2, specifying the transparency requirements for the purposes of preparing and maintaining the accounting records, Accounting Documents, and Regulatory financial statements for the purposes of among others, SMP Services Conditions OB1 to OB33 and SMP Services Conditions 8.1 to 8.29

1. In accordance with section 49(1) of the Act, Ofcom hereby directs KCOM to ensure that any data, information, description, material or explanatory document prepared under SMP Services Conditions OA1 to OB33 and SMP Services Conditions 8.1 to 8.29 in respect of accounting and other methods used in the preparation of the accounting records and Regulatory Financial Statements shall be sufficiently transparent and prepared such that a suitably informed reader can gain a clear understanding of such data, information, description, material or explanatory document, and, if necessary, the overall structure of KCOM's financial and information systems from which regulatory accounting data is derived and in particular the sequence of the processing and 'cascade' effect of the intermediate cost centres; gain a detailed understanding of all the material, methodologies and drivers (e.g. Systems, Processes and procedures) applied in the preparation of regulatory accounting data; and make their own judgement as to the reasonableness of these methodologies and driver data and any changes to them, in relation to the markets listed in paragraph A5.25 above.
2. In accordance with section 49(1) of the Act, Ofcom hereby gives a Direction revoking Direction 2 in relation to the markets listed in paragraph A5.25 above.

Section 3 - Proposed direction for the preparation, audit, delivery and publication Regulatory Financial Statements

Notification of proposal under sections 49 and 49A of the Communications Act 2003, and SMP Services Condition OB2 and SMP Services Condition 8.2 to revoke Direction 3 and impose a direction specifying the requirements in relation to preparation, audit, delivery and publication of the Regulatory Financial Statements

A5.38 On 22 July 2004, Ofcom published a statement entitled “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” (“**July 2004 Statement**”). At Annex 3 of that statement, Ofcom imposed SMP conditions with respect to regulatory accounting (Conditions OB1 to OB33) on KCOM in markets in which KCOM had been found to have significant market power in previously concluded market reviews.

A5.39 At Annex 5 of the July 2004 Statement, Ofcom published various directions for KCOM given under the SMP conditions. These included directions (“**2004 Regulatory Financial Reporting Directions**”) specifying network components (“**Direction 1**”), Transparency (“**Direction 2**”), Preparation, audit, delivery and publication of regulatory financial statements (“**Direction 3**”), Form and content of Regulatory Financial Statement (“**Direction 4**”), Form of the ‘FPIA’ opinion for financial statements (“**Direction 5**”) and Form of the ‘PPIA’ opinion for financial statements (“**Direction 6**”) for the purposes of, among others, SMP Conditions OB1 to OB33. The 2004 Regulatory Reporting Direction have been subsequently amended on various occasions.

A5.40 On 28 April 2016 OFCOM published a statement “Business Connectivity Market Review: Review of competition in the provision of leased lines” (“**2016 BCMR Statement**”) The 2016 BCMR Statement found that KCOM continues to have significant market power in each of the markets covered by the review in the Hull Area. OFCOM decided to set on KCOM SMP conditions under section 45 of the Communications Act 2003 (the Act) designed to encourage greater competition in leased lines in the Hull Area. These included SMP conditions OB1 to OB33 in respect to regulatory financial reporting. OFCOM also amended, where necessary the 2004 Regulatory Financial Reporting Directions.

A5.41 On 30 November 2017 OFCOM published a statement “Narrowband Market Review: Statement” (“**2017 NMR Statement**”). The 2017 NMR Statement found that KCOM continues to have significant market power in each of the markets covered by the review in the Hull Area. OFCOM decided to set on KCOM SMP conditions under section 45 of the Act designed to encourage greater competition for Narrowband services in the Hull Area. These included SMP conditions OB1 to OB33 in respect to regulatory financial reporting. OFCOM also amended, where necessary the 2004 Regulatory Financial Reporting Directions. As set out at section 2 of Annex 9 of the 2017 NMR Statement, OFCOM modified Direction 3.

A5.42 On 31 July 2018 OFCOM published a statement entitled “Wholesale Local Access and Wholesale Broadband Access Market Reviews: Review of competition in the Hull Area” (the “**2018 WLA and WBA Statement**”). The 2018 WLA and WBA Statement presents OFCOM’s conclusion that

KCOM continues to have significant market power in each of the markets for wholesale local access and wholesale broadband access in the Hull Area. OFCOM decided to set on KCOM SMP conditions under section 45 of the Communications Act 2003 (the Act) designed to encourage greater competition in the provision of fixed telecoms services for consumers in the Hull Area. At Annex 6 of that Statement, Ofcom revoked Conditions OB1 to OB33 from the July 2004 Statement insofar as they applied to the WLA and WBA markets and in their place imposed SMP Condition 8 with respect to regulatory accounting on KCOM in the WLA and WBA markets. This did not represent a change to the substance of the accounting separation and cost accounting conditions as set out in the July 2004 Statement but was a 'structural' change to the way in which the financial reporting obligations are imposed, aimed at clarifying KCOM's obligations.

A5.43 Today, Ofcom is consulting, in a consultation document entitled "KCOM Regulatory Financial Reporting: Consultation on proposed regulatory financial reporting directions for KCOM." ("**2018 KCOM Reporting Consultation**"), on proposals to replace the 2004 Regulatory Financial Reporting Directions with new regulatory financial reporting directions in relation to the following markets:

- a) the supply of wholesale local access at a fixed location in the Hull Area;
- b) the supply of wholesale broadband access provided in the Hull Area;
- c) wholesale market for low bandwidth traditional interface symmetric broadband origination in the Hull Area, at bandwidths up to and including 8Mbit/s;
- d) wholesale market for contemporary interface symmetric broadband origination in the Hull Area;
- e) wholesale fixed analogue exchange line services in the Hull Area;
- f) wholesale ISDN30 exchange line services in the Hull Area;
- g) wholesale ISDN2 exchange line services in the Hull Area; and
- h) wholesale call origination on a fixed narrowband network in the Hull Area.

A5.44 Under SMP Services Condition OB2 set out at Annex 2 of the July 2004 Statement which Ofcom has decided to apply to KCOM in the 2016 BCMR and 2017 NMR Statements, Ofcom may from time to time make such directions as they consider appropriate in relation to KCOM's obligations under these conditions.

A5.45 Under SMP Services Condition 8 which Ofcom has decided to apply to KCOM in the 2018 WLA and WBA Statement, Ofcom may from time to time make such directions as they consider appropriate in relation to KCOM's obligations under these conditions.

A5.46 This Notification sets out proposals to revoke Direction 3 and impose a direction in relation to the preparation, audit, delivery and publication of the Regulatory Financial Statements in each of the markets in paragraph A5.43 above.

Proposal to give a direction

A5.47 Ofcom is proposing, in accordance with section 49 of the Act, to give a direction pursuant to SMP Condition OB2 and SMP Condition 8 imposing a direction in relation to the preparation, audit,

delivery and publication of the Regulatory Financial Statements in each of the markets set out in paragraph A5.2543 above.

A5.48 The proposed direction is set out in the Schedule to this Notification.

A5.49 The effect of and reasons for giving the proposed direction are set out in the 2018 KCOM Reporting Consultation accompanying this Notification.

Ofcom's duties and legal tests

A5.50 For the reasons set out in the 2018 KCOM Reporting Consultation, Ofcom considers that the proposals referred to in paragraph A5.47 complies with the requirements of section 49(2) of the Act.

A5.51 In making the proposals referred to in paragraph A5.47, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.

Making representations

A5.52 Representations may be made to Ofcom about the proposals set out in this Consultation by no later than 18 September 2018.

A5.53 In accordance with section 49C(1)(a) of the Act, a copy of the Notification, together with the Schedules, will be sent to the Secretary of State.

Interpretation

A5.54 Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 3 of the July 2004 Statement and Annex 6 to the 2018 WLA and WBA Statement and otherwise any word or expression shall have the same meaning as it has in the Act.

A5.55 The Interpretation Act 1978 (c. 30) shall apply as if this notification were an Act of Parliament.

Signed

Director of Financial Economics, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

7 August 2018

Schedule 3– Proposed direction for the preparation, audit, delivery and publication of the Regulatory Financial Statements

Proposed direction made under section 49 of the Communications Act 2003, and SMP Services Condition OB2 and SMP Services Condition 8.2 specifying requirements for the preparation, audit and delivery of Regulatory Financial Statements

1. In accordance with section 49(1) of the Act, Ofcom hereby specifies that KCOM shall prepare, secure an audit opinion in respect of, deliver to Ofcom and publish the Regulatory Financial Statements in accordance with Annex A and B of to this direction for the markets listed above in paragraph A5.37.
2. In accordance with section 49(1) of the Act, Ofcom hereby gives a Direction revoking Direction 3 in relation to the markets listed in paragraph A5.43 above.

Annex A to the preparation, audit and delivery of Regulatory Financial Statements direction –

For the purposes of this annex the following abbreviations are used, the scope of these statements are set out in the matrix of obligations that follows; references to annexes are to the Proposed form and content direction dated 7 August 2018 [see page 75 of this consultation]

In the table below, “X” means that the financial statement set out at the head of the column is required for the market on that row to be published, “O” means it is provided on a confidential basis.

- CCPS = ‘current cost primary statements’, current cost profit and loss statement (CC P&L) and statement of current cost mean capital employed (CC MCE), as set out in Annexes 4 & 5 in relation to consolidation of markets subject to cost accounting and as set out in Annexes 8 & 9 in relation to individual wholesale markets;
- NCR FA = attribution of activity costs on a current fully allocated cost basis for the market (as set out in Annex 6 in relation to consolidation of markets subject to cost accounting and as set out in Annex 10 [NB to be provided on a confidential basis] in relation to individual wholesale markets).
- RTW = ‘wholesale residual’, CC P&L and CC MCE to - consolidation across group of markets covered by wholesale residual markets (as set out in Annexes 14 & 15) [NB to be provided on a confidential basis];
- RTR = ‘retail residual’, CC P&L and CC MCE - consolidation across group of markets covered by retail markets (as set out in Annexes 16 & 17); [NB to be provided on a confidential basis];
- RTSA = ‘reconciliation to statutory accounts’, reconciliation of consolidated CC P&L and CC MCE for wholesale markets subject to cost accounting to the profit and loss account and balance sheet of the operator shown in their statutory financial statements (as set out in annexes 12 & 13 [NB to be published], supported by annexes 14, 15, 16 & 17 [NB to be provided on a confidential basis]);
- SoAC FA (market) = Market network activity statement costs on a current fully allocated cost basis for the market (as set out in Annex 10) [NB to be provided on a confidential basis];
- SoAC FA (consolidated) = Consolidated network activity statement costs on a current fully allocated cost basis (as set out in Annex 6 [NB to be published])
- SOS – notes to the financial statements (as set out in annex 11) in relation to sufficiency of separation, in particular assurance that activities to which accounting separation applies have been sufficiently separated from each other and from activities to which separation does not apply;
- IMT – Inter-market turnover, reconciliation of the source and destination of inter market turnover, to verify that transfer charges are self-cancelling overall (as set out in annex 18); [NB to be provided on a confidential basis];
- RFR – regulatory financial review, as set out in annex 7 [NB – no audit opinion is required for the RFR];

- SDR – statement of responsibility, as set out in annex 2 [NB – no audit opinion is required for the SDR];
- FPIA – Audit Opinion required for statements, for inclusion in audit report as set out in annex 3;
- PPIA – Audit opinion required for statements, for inclusion in audit report as set out in annex 3;
- Notes – notes to the financial statements, as set out in annex 10.

Annex B to the preparation, audit and delivery of Regulatory Financial Statements direction

Review of Narrowband Markets

	CPPS	RTW	RTR	RTSA	Financial statements								Audit		
					SoAC FA (market)	SoAC FA (consolidated)	NCR FA	SOS	IMT	SoACIC	RFR	SDR	FPIA	PPIA	
Wholesale market and illustrative services															
Wholesale fixed analogue exchange line services	X	X	X	X	O	X	X	X	X	X	X	X	X	X	
Wholesale ISDN30 exchange line services	X	X	X	X	O	X	X	X	X	X	X	X	X	X	
Wholesale ISDN2 exchange line services	X	X	X	X	O	X	X	X	X	X	X	X	X	X	
Wholesale call origination on a fixed narrowband network	X	X	X	X	O	X	X	X	X	X	X	X	X	X	

Review of Business Connectivity Markets

	CPPS	RTW	RTR	RTSA	Financial statements								Audit		
					SoAC FA (market)	SoAC FA (consolidated)	NCR FA	SOS	IMT	SoACIC	RFR	SDR	FPIA	PPIA	
Wholesale market and illustrative services															
Wholesale market for traditional interface symmetric broadband origination (up to and including 8Mbit/s)	X	X	X	X	O	X	X	X	X	X	X	X	X	X	
Wholesale market for contemporary interface symmetric broadband origination	X	X	X	X	O	X	X	X	X	X	X	X	X	X	

Review of Wholesale Broadband Access Market

	CPPS	RTW	RTR	RTSA	Financial statements								Audit		
					SoAC FA (market)	SoAC FA (consolidated)	NCR FA	SOS	IMT	SoACIC	RFR	SDR	FPIA	PPIA	
Wholesale market and illustrative services															
The supply of wholesale local broadband access	X	X	X	X	O	X	X	X	X	X	X	X	X	X	

Review of Wholesale Local Access at a Fixed Location Market

	CPPS	RTW	RTR	RTSA	Financial statements								Audit		
					SoAC FA (market)	SoAC FA (consolidated)	NCR FA	SOS	IMT	SoACIC	RFR	SDR	FPIA	PPIA	
Wholesale market and illustrative services															
The supply of wholesale local access at a fixed location	X	X	X	X	O	X	X	X	X	X	X	X	X	X	

Section 4 - Proposed direction for the form and content of Regulatory Financial Statements

Notification of proposal under sections 49 and 49A of the Communications Act 2003, and SMP Services Condition OB2 and SMP Services Condition 8.2 to revoke Direction 4 and specify the form and content of the Regulatory Financial Statements

A5.56 On 22 July 2004, Ofcom published a statement entitled “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” (“**July 2004 Statement**”). At Annex 3 of that statement, Ofcom imposed SMP conditions with respect to regulatory accounting (Conditions OB1 to OB33) on KCOM in markets in which KCOM had been found to have significant market power in previously concluded market reviews.

A5.57 At Annex 5 of the July 2004 Statement, Ofcom published various directions for KCOM given under the SMP conditions. These included directions (“**2004 Regulatory Financial Reporting Directions**”) specifying network components (“**Direction 1**”), Transparency (“**Direction 2**”), Preparation, audit, delivery and publication of regulatory financial statements (“**Direction 3**”), Form and content of Regulatory Financial Statement (“**Direction 4**”), Form of the ‘FPIA’ opinion for financial statements (“**Direction 5**”) and Form of the ‘PPIA’ opinion for financial statements (“**Direction 6**”) for the purposes of, among others, SMP Conditions OB1 to OB33. The 2004 Regulatory Reporting Direction have been subsequently amended on various occasions.

A5.58 On 28 April 2016 OFCOM published a statement “Business Connectivity Market Review: Review of competition in the provision of leased lines” (“**2016 BCMR Statement**”) The 2016 BCMR Statement found that KCOM continues to have significant market power in each of the markets covered by the review in the Hull Area. OFCOM decided to set on KCOM SMP conditions under section 45 of the Communications Act 2003 (the Act) designed to encourage greater competition in leased lines in the Hull Area. These included SMP conditions OB1 to OB33 in respect to regulatory financial reporting. OFCOM also amended, where necessary the 2004 Regulatory Financial Reporting Directions.

A5.59 On 30 November 2017 OFCOM published a statement “Narrowband Market Review: Statement” (“**2017 NMR Statement**”). The 2017 NMR Statement found that KCOM continues to have significant market power in each of the markets covered by the review in the Hull Area. OFCOM decided to set on KCOM SMP conditions under section 45 of the Act designed to encourage greater competition for Narrowband services in the Hull Area. These included SMP conditions OB1 to OB33 in respect to regulatory financial reporting. OFCOM also amended, where necessary the 2004 Regulatory Financial Reporting Directions. As set out at section 2 of Annex 9 of the 2017 NMR Statement, OFCOM modified Direction 4.

A5.60 On 31 July 2018 OFCOM published a statement entitled “Wholesale Local Access and Wholesale Broadband Access Market Reviews: Review of competition in the Hull Area” (the “**2018 WLA and WBA Statement**”). The 2018 WLA and WBA Statement presents OFCOM’s conclusion that KCOM continues to have significant market power in each of the markets for wholesale local access

and wholesale broadband access in the Hull Area. Ofcom decided to set on KCOM SMP conditions under section 45 of the Communications Act 2003 (the Act) designed to encourage greater competition in the provision of fixed telecoms services for consumers in the Hull Area. At Annex 6 of that Statement, Ofcom revoked Conditions OB1 to OB33 from the July 2004 Statement insofar as they applied to the WLA and WBA markets and in their place imposed SMP Condition 8 with respect to regulatory accounting on KCOM in the WLA and WBA markets. This did not represent a change to the substance of the accounting separation and cost accounting conditions as set out in the July 2004 Statement but was a 'structural' change to the way in which the financial reporting obligations are imposed, aimed at clarifying KCOM's obligations.

A5.61 Today, Ofcom is consulting, in a consultation document entitled "KCOM Regulatory Financial Reporting: Consultation on proposed regulatory financial reporting directions for KCOM." ("**2018 KCOM Reporting Consultation**"), on proposals to replace the 2004 Regulatory Financial Reporting Directions with new regulatory financial reporting directions in relation to the following markets:

- a) the supply of wholesale local access at a fixed location in the Hull Area;
- b) the supply of wholesale broadband access provided in the Hull Area;
- c) wholesale market for low bandwidth traditional interface symmetric broadband origination in the Hull Area, at bandwidths up to and including 8Mbit/s;
- d) wholesale market for contemporary interface symmetric broadband origination in the Hull Area;
- e) wholesale fixed analogue exchange line services in the Hull Area;
- f) wholesale ISDN30 exchange line services in the Hull Area;
- g) wholesale ISDN2 exchange line services in the Hull Area; and
- h) wholesale call origination on a fixed narrowband network in the Hull Area.

A5.62 Under Condition OB2 set out at Annex 2 of the July 2004 Statement which Ofcom has decided to apply to KCOM in the 2016 BCMR and 2017 NMR Statement, Ofcom may from time to time make such directions as they consider appropriate in relation to KCOM's obligations under these conditions.

A5.63 Under SMP Condition 8 which Ofcom has decided to apply to KCOM in the 2018 WLA and WBA Statement, Ofcom may from time to time make such directions as they consider appropriate in relation to KCOM's obligations under these conditions.

A5.64 This Notification sets out proposals to revoke Direction 4 and impose a direction in relation to the form and content of the Regulatory Financial Statements in each of the markets set out in each of the markets set out in paragraph A5.61 above.

Proposal to give a direction

A5.65 Ofcom is proposing, in accordance with section 49 of the Act, to give a direction pursuant to SMP Condition OB2 and SMP Condition 8 imposing a direction in relation to the form and content of the Regulatory Financial Statements in each of the markets set out in paragraph A5.2561 above.

A5.66 The proposed direction is set out in the Schedule to this Notification.

A5.67 The effect of and reasons for giving the proposed direction are set out in the 2018 KCOM Reporting Consultation accompanying this Notification.

Ofcom's duties and legal tests

A5.68 For the reasons set out in the 2018 KCOM Reporting Consultation, Ofcom considers that the proposals referred to in paragraph A5.65 complies with the requirements of section 49(2) of the Act

A5.69 In making the proposals referred to in paragraph A5.65, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.

Making representations

A5.70 Representations may be made to Ofcom about the proposals set out in this Consultation by no later than 18 September 2018.

A5.71 In accordance with section 49C(1)(a) of the Act, a copy of the Notification, together with the Schedules, will be sent to the Secretary of State.

Interpretation

A5.72 Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 3 of the July 2004 Statement and Annex 6 to the WLA and WBA Statement and otherwise any word or expression shall have the same meaning as it has in the Act.

A5.73 The Interpretation Act 1978 (c. 30) shall apply as if this notification were an Act of Parliament.

Signed

Director of Financial Economics, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

7 August 2018

Schedule 4 – Proposed direction for the form and content of the Regulatory Financial Statements

1. In accordance with section 49(1) of the Act, Ofcom hereby specifies that, except where KCOM is entitled to amend the form and content of the Regulatory Financial Statements in accordance with Conditions OB7 and OB20 and Conditions 8.7 and 8.20, KCOM shall ensure that the Regulatory Financial Statements, required by condition OB5 and condition 8.5 and the direction for the preparation, audit, delivery and publication of the Regulatory Financial Statements, shall be prepared, as appropriate, as to form and content in the manner set out in the Annexes to this Direction.
2. In accordance with section 49(1) of the Act, Ofcom hereby gives a Direction revoking Direction 4 in relation to the markets listed in paragraph A5.64 above.

Annexes to Direction

Index of form and content annexes

Annex 1 – Statement by Ofcom

Annex 2 – Statement of responsibility

Annex 3 – Report of the Regulatory Auditors

Annex 4 – Consolidation Profit and Loss (P&L) Statement

Annex 5 – Consolidation Mean Capital Employed (MCE) Statement

Annex 6 – Consolidated Network Activity statement

Annex 7 – Regulatory financial review

Annex 8 – Market P&L statement

Annex 9 – Market MCE statement

Annex 10 – Market Network Activity Statement [provided on a confidential basis]

Annex 11 – Notes to financial statements

Annex 12 – Reconciliation statement, P&L

Annex 13 – Reconciliation statement, MCE

Annex 14 – Wholesale residual, P&L [provided on a confidential basis]

Annex 15 – Wholesale residual, MCE [provided on a confidential basis]

Annex 16 – Retail residual, P&L [provided on a confidential basis]

Annex 17 – Retail residual, MCE [provided on a confidential basis]

Annex 18 – Inter-market turnover [provided on a confidential basis]

Annex 1

Statement by Ofcom (KCOM)

Ofcom is entitled, to comment on the data in, the notes to, or the presentation of any of the Financial Statements, in relation to each of the markets.

Annex 2

Statement of Responsibility (KCOM)

The Board of Directors of the dominant provider (or if this includes a group of companies, the ultimate holding company) have responsibility for setting out the basis of preparation of the Financial Statements, confirming compliance with its responsibilities under the Conditions, and any other information relevant to carrying out its obligations under those conditions.

Annex 3

Report of the Regulatory Auditors (KCOM)

The report of the independent regulatory auditors, produced in accordance with the SMP Condition and Directions.

The statement by the regulatory auditor shall set out the responsibilities of the Dominant Provider and of the auditor, the basis of audit opinion in accordance with current auditing standards, to whom a duty of care is owed and their opinion in respect of each Financial Statement.

For reasons of simplicity and understandability the auditor may have a single opinion covering Accounting Separation Financial Statements and Cost Accounting Financial Statements, provided that their opinion clearly identifies the nature of the assurance given in relation to each.

Annex 4

KCOM Consolidation Statement

Consolidated Total - For all markets where cost accounting and accounting separation obligations apply

CURRENT COST PROFIT AND LOSS ACCOUNT

for the year ended 31 March 20xx

	Notes	£k CY	Restated (cross refer to notes) £k PY	£k Change Year on year	% Change Year on Year
Turnover (identifying Gross, Discounts and Net turnover)					
Internal Sales [Note]					
External Sales					
Total Turnover					
Operating costs					
Operating costs					
- Field Maintenance					
- Other Maintenance					
- Network Provision					
- End user installation					
- Finance & Billing					
- General Management					
- Bad Debts					
- Back Office Support					
- Other Costs (total of items below 10% of operating cost)					
Sub total operating expenditure					
Depreciation					
- Duct					
- Copper					
- Fibre					
- Electronics					
- Other					
CCA adjustments:					
Holding (gain)/loss					
Supplementary depreciation					
Other adjustments					
Total operating costs					
Return					
MCE					
RETURN ON MEAN CAPITAL EMPLOYED					
for the year ended 31 March 20xx		CY %	PY %		%
Return on mean capital employed					

[Note - All sales to be based on actual volumes x price]

Annex 5

KCOM Consolidation Statement

Consolidated Total - For all markets where cost accounting and accounting separation obligations apply

STATEMENT OF CURRENT COST MEAN CAPITAL EMPLOYED for the year ended 31 March 20xx		Restated (cross refer to notes)			
	Notes	£k CY	£k PY	£'k Change	% Change
Fixed assets					
Tangible fixed assets					
- Land & Buildings					
- Duct					
- Fibre					
- Copper					
- Transmission Equipment					
- Exchange Equipment					
- Other					
Investments					
Total fixed assets					
Current assets					
Stocks					
Debtors					
- internal					
- external					
Total current assets					
Creditors: amounts falling due within one year					
Other creditors					
- internal					
- external					
Total creditors: amounts falling due within one year					
Net current assets					
Total assets less current liabilities					
Provisions for liabilities and charges					
Mean capital employed					

Annex 6

KCOM Consolidated Statement of Costs

Network Activity Statement
for year ended 31st March 20xx

Network Activity Statement - Consolidated current costs (this is a consolidation of all markets where there are cost accounting obligations)

	HCA operating cost	Supplementary Depreciation	Holding gain and other CCA adjustments	Total CCA operating costs	CCA mean capital employed	Applicable rate of return on capital %	Capital costs	Total of operating costs and capital costs relating to current year	Unit of measure (based on network components)	Volume	Average costs per unit on a current cost basis relating to current year
Fully Allocated Cost Components											
Electronics;											
Field provision;											
Field maintenance;											
Local Loop infrastructure											
Exchange concentrator;											
Exchange-exchange Transmission link;											
Back-office Provision;											
Back-office Maintenance;											
Sales and Product Management;											
PPP for narrowband call services;											
Net Current Assets; and											
Other.											
Totals											

Annex 7

Regulatory Financial Review (KCOM)

The dominant provider will be required to prepare a Regulatory Financial Review (RFR) to encompass all markets for which cost accounting and/or accounting separation obligations apply.

The RFR should assist the user's assessment of the regulatory financial statements as produced under condition 8 and provide commentary on compliance with this regulatory condition.

The RFR should focus on those matters which are relevant to the users of the information, be clearly written and readily understandable

It should include discussion of the regulatory financial performance of each individual market, in which the dominant provider has accounting separation or cost accounting obligations, in the period and the main influences on performance, including known trends and the effect of risks facing each market.

The information and analysis contained within the RFR should be complete and free from bias

Disclosure should make clear any issues of comparability that would assist the reader's understanding of the review. It should highlight accounting policies that are key to the understanding of performance, focusing on those which have required the particular exercise of judgement in their application and those accounting policies which have changed in the year

When using financial and non financial measures in the RFR, it is important these are defined and explained, assumptions set out and prior year comparatives are disclosed on the same basis as current year figures

A key aim of the operating review is to enable the user to understand the dynamics of the products and services in each market where the dominant provider has SMP status and specific regulatory accounting obligations, and the main influences on financial performance and how these interrelate.

The review should explain the main factors that underlie each market and in particular those which have either varied in the past or are expected to change in the future. It should set out an analysis of the effect of changes in each market or the environment in which it operates and of developments within each market. For example changes in the market conditions, introduction or announcement of new products and services, new and discontinued activities, other acquisitions and disposals.

The RFR should also analyse the main factors and influences that may have an effect on future performance, whether or not they were significant in the period under review. There should be a discussion on the principal risks facing activities and markets, with a commentary on the approach taken to manage them.

Annex 8

KCOM Market A (there will be a statement for each wholesale market where cost accounting and accounting separation obligations apply)

CURRENT COST PROFIT AND LOSS ACCOUNT
for the year ended 31 March 20xx

	Notes	Restated (cross refer to notes)		£'k Change Year on Year	% Change Year on Year
		£k CY	£k PY		
Turnover (identifying Gross, Discounts and Net turnover)					
Internal Sales [Note]					
External Sales					

Total Turnover

Operating costs

Operating costs

- Field Maintenance
- Other Maintenance
- Network Provision
- End user installation
- Finance & Billing
- General Management
- Bad Debts
- Back Office Support
- Other Costs (total of items below 10% of operating cost)

Sub total operating expenditure

Depreciation

- Duct
- Copper
- Fibre
- Electronics
- Other

CCA adjustments:

- Holding (gain)/loss
- Supplementary depreciation
- Other adjustments

Total operating costs

Return

MCE

RETURN ON MEAN CAPITAL EMPLOYED

for the year ended 31 March 20xx

CY	PY	
%	%	%

Return on mean capital employed

[Note - All sales to be based on actual volumes x price]

Annex 9 (Confidential)

KCOM Market A (there will be a statement for each wholesale market where cost accounting and accounting separation obligations apply)**STATEMENT OF CURRENT COST MEAN CAPITAL EMPLOYED**
for the year ended 31 March 20xxRestated (cross refer
to notes)

	Notes	£k CY	£k PY	£'k Change	% Change
Fixed assets					
Tangible fixed assets					
- Land & Buildings					
- Duct					
- Fibre					
- Copper					
- Transmission Equipment					
- Exchange Equipment					
- Other					
Investments					
Total fixed assets					
Current assets					
Stocks					
Debtors					
- internal					
- external					
Total current assets					
Creditors: amounts falling due within one year					
Other creditors					
- internal					
- external					
Total creditors: amounts falling due within one year					
Net current assets					
Total assets less current liabilities					
Provisions for liabilities and charges					
Mean capital employed					

KCOM Regulatory Financial Reporting

Annex 10 (confidential)

KCOM Market A Statement of Costs (there will be a statement for each wholesale market where cost accounting and accounting separation obligations apply)

Network Activity Statement
for year ended 31st March 20xx

Network Activity Statement - Consolidated current costs

Fully Allocated Cost	HCA operating cost	Supplementary Depreciation	Holding gain and other CCA adjustments	Total CCA operating costs	CCA mean capital employed	Applicable rate of return on capital %	Capital costs	Total of operating costs and capital costs relating to current year	Unit of measure (based on network components)	Volume	Average costs per unit on a current cost basis relating to current year
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Components

Electronics;
Field provision;
Field maintenance;
Local Loop infrastructure
Exchange concentrator;
Exchange-exchange Transmission link;
Back-office Provision;
Back-office Maintenance;
Sales and Product Management;
PPP for narrowband call services;
Net Current Assets; and
Other.

Totals

Annex 11

Notes to the Financial Statements (KCOM)

These will contain notes, modelled on statutory accounting conventions, to assist the user in the interpretation of the individual statements.

The notes will address issues necessary to ensure the fair presentation of the financial statements (where fairly presents is the basis of presentation) and that they are properly prepared (where properly prepared is the basis of presentation) including to the extent necessary the basis of accounting, accounting policies, changes for restatement, non compliance with UK GAAP and any other information that will enable users to properly understand the individual financial statement.

Amongst others the necessary notes would be expected to include:

- a description of the basis on which revenue from sales to other operators arise and other related matters necessary to understand how financial performance has been measured
- a commentary setting out how the principle of non discrimination and the calculation of usage factors have been applied in the preparation and presentation of financial statements in respect of wholesale services

Annex 12

KCOM Reconciliation Statement

Consolidated profit and loss account
For the year ended 31 March 20xx

Market/Area	Turnover £k	Operating Costs £k	HCA Return or Profit before taxation £k	Holding gain/(loss) and other Adjustments £k	Supple- mentary depreciation £k	CCA Return or Profit Before Taxation £k
Wholesale SMP Markets						
<u>Residual activities</u>						
- Wholesale residual activities						
- Retail residual activities						
Total						
Adjustments (as necessary)						
Elimination of Inter Business turnover and costs						
Other operating income						
Goodwill						
Group's share of profits of associates and joint ventures						
Profit on sale of fixed asset investments						
Profit on sale of Group undertakings						
Amounts written off investments						
Profit on sale of property fixed assets before exceptional items						
Profit on sale of property fixed assets						
Net short term interest payable						
Long term interest payable						
As per the KCOM Annual Report (pxxx)						

Annex 13

KCOM Reconciliation statement	CY	PY
		Restated (cross refer to explanatory notes)
Consolidated mean capital employed		
For the year ended 31 March 200XX	£k	£k
Shareholders' funds as in the Annual Report (pxxx) CCA adjustments		
Adjustments		
Corporation taxes payable		
Provision for dividends payable		
Deferred tax /(ACT recoverable)		
Long term borrowing:		
Due in less than one year		
Due in more than one year		
Adjustments to closing capital employed		
Goodwill		
Minority interests		
Closing CCA capital employed at 31 March	_____	_____
Opening CCA capital employed at 1 April		
Adjustment to opening capital employed		
Revised opening CCA capital employed at 1 April	_____	_____
Average CCA capital employed		
Daily averaging adjustment		
Deferred costs		
Total CCA mean capital employed	_____	_____
<u>Mean capital employed of SMP Markets</u>		
Wholesale Market A (where cost accounting and accounting separation obligations apply)		
Wholesale Market B etc (where cost accounting and accounting separation obligations apply)		
Sub total markets	_____	_____
<u>Residual activities</u>		
- Wholesale residual activity		
- Retail residual activity		
Total CCA mean capital employed	_____	_____

Annex 14 (confidential)

KCOM Wholesale Residual Activities

CURRENT COST PROFIT AND LOSS ACCOUNT for the year ended 31 March 20xx		Restated (cross refer to notes)		£'k Change	% Change
Notes	£k CY	£k PY		Year on	Year on Year
Turnover (identifying Gross, Discounts and Net turnover)					
Internal Sales [Note]					
External Sales					
Total Turnover					
Operating costs					
Charges from Other KCOM Markets					
Operating costs (to show all cost categories that exceed 10% of operating cost including)					
- Field Maintenance					
- Other Maintenance					
- Network Provision					
- End user installation					
- Finance & Billing					
- General Management					
- Bad Debts					
- Back Office Support					
- Other Costs (total of items below 10% of operating cost)					
Sub total operating expenditure					
Depreciation					
- Duct					
- Copper					
- Fibre					
- Electronics					
- Other					
CCA adjustments:					
Holding (gain)/loss					
Supplementary depreciation					
Other adjustments					
Total operating costs					
Return					
MCE					
RETURN ON MEAN CAPITAL EMPLOYED					
for the year ended 31 March 20xx		CY	PY		
		%	%		%
Return on mean capital employed					

[Note - All sales to be based on actual volumes x price]

Annex 15 (confidential)

KCOM Wholesale Residual Activities

STATEMENT OF CURRENT COST MEAN CAPITAL EMPLOYED for the year ended 31 March 20xx		Restated (cross refer to notes)		
	Notes	£k CY	£k PY	£'k Change % Change
Fixed assets				
Tangible fixed assets				
- Land & Buildings				
- Duct				
- Fibre				
- Copper				
- Transmission Equipment				
- Exchange Equipment				
- Other				
Investments				
Total fixed assets				
Current assets				
Stocks				
Debtors				
- internal				
- external				
Total current assets				
Creditors: amounts falling due within one year				
Other creditors				
- internal				
- external				
Total creditors: amounts falling due within one year				
Net current assets				
Total assets less current liabilities				
Provisions for liabilities and charges				
Mean capital employed				

Annex 16 (confidential)

KCOM Retail Residual Activities

CURRENT COST PROFIT AND LOSS ACCOUNT for the year ended 31 March 20xx		Restated (cross refer to notes)		£'k Change	% Change
	Notes	£k CY	£k PY	Year on	Year on Year
Turnover (identifying Gross, Discounts and Net turnover)					
Internal Sales [Note]					
External Sales					
Total Turnover					
Operating costs					
Charges from Other KCOM Markets					
Operating costs (to show all cost categories that exceed 10% of operating cost including)					
- Field Maintenance					
- Other Maintenance					
- Network Provision					
- End user installation					
- Finance & Billing					
- General Management					
- Bad Debts					
- Back Office Support					
- Other Costs (total of items below 10% of operating cost)					
Sub total operating expenditure					
Depreciation					
- Duct					
- Copper					
- Fibre					
- Electronics					
- Other					
CCA adjustments:					
Holding (gain)/loss					
Supplementary depreciation					
Other adjustments					
Total operating costs					
Return					
MCE					
RETURN ON MEAN CAPITAL EMPLOYED					
for the year ended 31 March 20xx		CY	PY		%
		%	%		
Return on mean capital employed					

[Note - All sales to be based on actual volumes x price]

Annex 17 (confidential)

KCOM Retail Residual Activities

STATEMENT OF CURRENT COST MEAN CAPITAL EMPLOYED for the year ended 31 March 20xx		Restated (cross refer to notes)			
	Notes	£k CY	£k PY	£'k Change	% Change
Fixed assets					
Tangible fixed assets					
- Land & Buildings					
- Duct					
- Fibre					
- Copper					
- Transmission Equipment					
- Exchange Equipment					
- Other					
Investments					
Total fixed assets					
Current assets					
Stocks					
Debtors					
- internal					
- external					
Total current assets					
Creditors: amounts falling due within one year					
Other creditors					
- internal					
- external					
Total creditors: amounts falling due within one year					
Net current assets					
Total assets less current liabilities					
Provisions for liabilities and charges					
Mean capital employed					

Annex 18 (confidential)

KCOM Inter Market Turnover
for year ended 31st March 20xx

	Wholesale supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the Hull Area	Wholesale Broadband Access provided at a fixed location in the Hull Area	Wholesale market for low bandwidth traditional interface symmetric broadband origination in the Hull Area, at bandwidths up to and including 8Mbit/s	Wholesale market for contemporary interface symmetric broadband origination in the Hull Area	Wholesale analogue fixed exchange line services in the Hull Area	Wholesale ISDN30 exchange line services in the Hull Area	Wholesale Call origination on fixed public narrowband networks in the Hull Area	[any other market for which cost accounting and accounting separation obligations apply]	Residual Wholesale	Residual Retail	Total 20xx
	£k	£k	£k	£k	£k	£k	£k	£k	£k	£k	£k
Turnover originating in:											
Wholesale supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the Hull Area											
provided at a fixed location in the Hull Area											
Wholesale market for low bandwidth traditional interface symmetric broadband origination in the Hull Area, at bandwidths up to and including 8Mbit/s											
Wholesale market for contemporary interface symmetric broadband origination in the Hull Area											
Wholesale analogue fixed exchange line services in the Hull Area											
Wholesale ISDN30 exchange line services in the Hull Area											
Wholesale Call origination on fixed public narrowband networks in the Hull Area											
[any other market for which cost accounting and accounting separation obligations apply]											
Residual Wholesale											
Residual Retail											
Total 20xx											

Section 5 – Proposed direction for the form of the ‘FPIA’ opinion for Regulatory Financial Statements

Notification of proposal under sections 49 and 49A of the Communications Act 2003, and SMP Services Condition OB2 and SMP Services Condition 8.2 to revoke Direction 5 and impose a direction specifying requirements for the ‘FPIA’ audit of Regulatory Financial Statements.

A5.74 On 22 July 2004, Ofcom published a statement entitled “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” (“**July 2004 Statement**”). At Annex 3 of that statement, Ofcom imposed SMP conditions with respect to regulatory accounting (Conditions OB1 to OB33) on KCOM in markets in which KCOM had been found to have significant market power in previously concluded market reviews.

A5.75 At Annex 5 of the July 2004 Statement, Ofcom published various directions for KCOM given under the SMP conditions. These included directions (“**2004 Regulatory Financial Reporting Directions**”) specifying network components (“**Direction 1**”), Transparency (“**Direction 2**”), Preparation, audit, delivery and publication of regulatory financial statements (“**Direction 3**”), Form and content of Regulatory Financial Statement (“**Direction 4**”), Form of the ‘FPIA’ opinion for financial statements (“**Direction 5**”) and Form of the ‘PPIA’ opinion for financial statements (“**Direction 6**”) for the purposes of, among others, SMP Conditions OB1 to OB33. The 2004 Regulatory Reporting Direction have been subsequently amended on various occasions.

A5.76 On 28 April 2016 OFCOM published a statement “Business Connectivity Market Review: Review of competition in the provision of leased lines” (“**2016 BCMR Statement**”) The 2016 BCMR Statement found that KCOM continues to have significant market power in each of the markets covered by the review in the Hull Area. OFCOM decided to set on KCOM SMP conditions under section 45 of the Communications Act 2003 (the Act) designed to encourage greater competition in leased lines in the Hull Area. These included SMP conditions OB1 to OB33 in respect to regulatory financial reporting. OFCOM also amended, where necessary the 2004 Regulatory Financial Reporting Directions.

A5.77 On 30 November 2017 OFCOM published a statement “Narrowband Market Review: Statement” (“**2017 NMR Statement**”). The 2017 NMR Statement found that KCOM continues to have significant market power in each of the markets covered by the review in the Hull Area. OFCOM decided to set on KCOM SMP conditions under section 45 of the Act designed to encourage greater competition for Narrowband services in the Hull Area. These included SMP conditions OB1 to OB33 in respect to regulatory financial reporting. OFCOM also amended, where necessary the 2004 Regulatory Financial Reporting Directions.

A5.78 On 31 July 2018 OFCOM published a statement entitled “Wholesale Local Access and Wholesale Broadband Access Market Reviews: Review of competition in the Hull Area” (the “**2018 WLA and WBA Statement**”). The 2018 WLA and WBA Statement presents OFCOM’s conclusion that KCOM continues to have significant market power in each of the markets for wholesale local access and wholesale broadband access in the Hull Area. OFCOM decided to set on KCOM SMP conditions

under section 45 of the Communications Act 2003 (the Act) designed to encourage greater competition in the provision of fixed telecoms services for consumers in the Hull Area. At Annex 6 of that Statement, Ofcom revoked Conditions OB1 to OB33 from the July 2004 Statement insofar as they applied to the WLA and WBA markets and in their place imposed SMP Condition 8 with respect to regulatory accounting on KCOM in the WLA and WBA markets. This did not represent a change to the substance of the accounting separation and cost accounting conditions as set out in the July 2004 Statement but was a 'structural' change to the way in which the financial reporting obligations are imposed, aimed at clarifying KCOM's obligations.

A5.79 Today, Ofcom is consulting, in a consultation document entitled "KCOM Regulatory Financial Reporting: Consultation on proposed regulatory financial reporting directions for KCOM." ("**2018 KCOM Reporting Consultation**"), on proposals to replace the 2004 Regulatory Financial Reporting Directions with new Regulatory financial reporting Directions in relation to the following markets:

- a) the supply of wholesale local access at a fixed location in the Hull Area;
- b) the supply of wholesale broadband access provided in the Hull Area;
- c) wholesale market for low bandwidth traditional interface symmetric broadband origination in the Hull Area, at bandwidths up to and including 8Mbit/s;
- d) wholesale market for contemporary interface symmetric broadband origination in the Hull Area;
- e) wholesale fixed analogue exchange line services in the Hull Area;
- f) wholesale ISDN30 exchange line services in the Hull Area;
- g) wholesale ISDN2 exchange line services in the Hull Area; and
- h) wholesale call origination on a fixed narrowband network in the Hull Area.

A5.80 Under Condition OB2 set out at Annex 2 of the July 2004 Statement which Ofcom has decided to apply to KCOM in the 2016 BCMR and 2017 NMR Statements, Ofcom may from time to time make such directions as they consider appropriate in relation to KCOM's obligations under these conditions.

A5.81 Under Condition 8.2 set out at Annex 6 of the 2018 WLA and WBA Statement which Ofcom has provisionally decided to apply to KCOM, Ofcom may from time to time make such directions as they consider appropriate in relation to KCOM's obligations under these conditions.

A5.82 This Notification sets out proposals to impose a direction in relation to the form of the 'FPIA' opinion for Regulatory Financial Statements in each of the markets set out in paragraph A5.79 above.

Proposal to give a direction

A5.83 Ofcom is proposing, in accordance with section 49 of the Act, to give a direction pursuant to SMP Condition OB2 and SMP Condition 8 imposing a direction in relation to the form of the 'FPIA' opinion for Regulatory Financial Statements in each of the markets set out in paragraph A5.79 above.

A5.84 The proposed direction is set out in the Schedule to this Notification.

A5.85 The effect of and reasons for giving the proposed direction are set out in the 2018 KCOM Reporting Consultation accompanying this Notification.

Ofcom's duties and legal tests

A5.86 For the reasons set out in the 2018 KCOM Reporting Consultation, Ofcom considers that the proposals referred to in paragraph A5.83 complies with the requirements of section 49(2) of the Act.

A5.87 In making the proposals referred to in paragraph A5.83, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.

Making representations

A5.88 Representations may be made to Ofcom about the proposals set out in this Consultation by no later than 18 September 2018.

A5.89 In accordance with section 49C(1)(a) of the Act, a copy of the Notification, together with the Schedules, will be sent to the Secretary of State.

Interpretation

A5.90 Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 3 of the July 2004 Statement and Annex 6 to the 2018 WLA and WBA Statement and otherwise any word or expression shall have the same meaning as it has in the Act.

A5.91 The Interpretation Act 1978 (c. 30) shall apply as if this notification were an Act of Parliament.

Signed

Director of Financial Economics, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

7 August 2018

Schedule 5 - Proposed FPIA audit Direction

Proposed Direction made under section 49 of the Communications Act 2003, and SMP Services Condition OB2 and SMP Services Condition 8.2, specifying the 'FPIA' audit of Regulatory Financial Statements for the purposes of among others, SMP Services Conditions OB1 to OB33 and SMP Services Conditions 81 to 8.29

1. In accordance with section 49(1) of the Communications Act 2003 (the Act), Ofcom hereby directs KCOM to ensure that where KCOM is required by any direction of OFCOM to secure the expression of an audit opinion to FPIA standards upon any Regulatory Financial Statement, KCOM shall ensure that the Regulatory Auditor shall state whether in his opinion:
 - a. each Regulatory Financial Statement complies with the requirements of Condition OB5 and Condition 8.5;
 - b. each Regulatory Financial Statement fairly presents in accordance with the Accounting Documents:
 - i. in the case of the profit and loss account and profit and loss reconciliation statements, the results in the relevant Market, Disaggregated Activities and/or Accounting Separation Activities (as appropriate) for the Relevant Financial Year and Prior Year Comparatives;
 - ii. in the case of the statement of mean capital employed and mean capital employed reconciliation statements, the mean capital employed in the relevant Market, Disaggregated Activities and/or Accounting Separation Activities (as appropriate) for the Relevant Financial Year and Prior Year Comparatives; and
 - iii. in the case of the other statements of revenues, costs, assets, liabilities and other quantities, the revenues, costs, assets, liabilities and other quantities incurred or employed in the relevant Market, Disaggregated Activities and/or Accounting Separation Activities (as appropriate) for the Relevant Financial Year and Prior Year Comparatives.
2. In accordance with section 49(1) of the Act, Ofcom hereby gives a Direction revoking Direction 5 in relation to the markets listed in paragraph A5.79 above.

Section 6 – Proposed direction for the form of the ‘PPIA’ opinion for Regulatory Financial Statements

Notification of proposal under sections 49 and 49A of the Communications Act 2003, and SMP Services Condition OB2 and SMP Services Condition 8.2 to revoke Direction 6 and impose a direction specifying requirements for the ‘PPIA’ audit of Regulatory Financial Statements.

A5.92 On 22 July 2004, Ofcom published a statement entitled “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” (“**July 2004 Statement**”). At Annex 3 of that statement, Ofcom imposed SMP conditions with respect to regulatory accounting (Conditions OB1 to OB33) on KCOM in markets in which KCOM had been found to have significant market power in previously concluded market reviews.

A5.93 At Annex 5 of the July 2004 Statement, Ofcom published various directions for KCOM given under the SMP conditions. These included directions (“**2004 Regulatory Financial Reporting Directions**”) specifying network components (“**Direction 1**”), Transparency (“**Direction 2**”), Preparation, audit, delivery and publication of regulatory financial statements (“**Direction 3**”), Form and content of Regulatory Financial Statement (“**Direction 4**”), Form of the ‘PPIA’ opinion for financial statements (“**Direction 5**”) and Form of the ‘PPIA’ opinion for financial statements (“**Direction 6**”) for the purposes of, among others, SMP Conditions OB1 to OB33. The 2004 Regulatory Reporting Direction have been subsequently amended on various occasions.

A5.94 On 28 April 2016 OFCOM published a statement “Business Connectivity Market Review: Review of competition in the provision of leased lines” (“**2016 BCMR Statement**”) The 2016 BCMR Statement found that KCOM continues to have significant market power in each of the markets covered by the review in the Hull Area. OFCOM decided to set on KCOM SMP conditions under section 45 of the Communications Act 2003 (the Act) designed to encourage greater competition in leased lines in the Hull Area. These included SMP conditions OB1 to OB33 in respect to regulatory financial reporting. OFCOM also amended, where necessary the 2004 Regulatory Financial Reporting Directions.

A5.95 On 30 November 2017 OFCOM published a statement “Narrowband Market Review: Statement” (“**2017 NMR Statement**”). The 2017 NMR Statement found that KCOM continues to have significant market power in each of the markets covered by the review in the Hull Area. OFCOM decided to set on KCOM SMP conditions under section 45 of the Act designed to encourage greater competition for Narrowband services in the Hull Area. These included SMP conditions OB1 to OB33 in respect to regulatory financial reporting. OFCOM also amended, where necessary the 2004 Regulatory Financial Reporting Directions.

A5.96 On 31 July 2018 OFCOM published a statement entitled “Wholesale Local Access and Wholesale Broadband Access Market Reviews: Review of competition in the Hull Area” (the “**2018 WLA and WBA Statement**”). The 2018 WLA and WBA Statement presents OFCOM’s conclusion that KCOM continues to have significant market power in each of the markets for wholesale local access and wholesale broadband access in the Hull Area. OFCOM decided to set on KCOM SMP conditions

under section 45 of the Communications Act 2003 (the Act) designed to encourage greater competition in the provision of fixed telecoms services for consumers in the Hull Area. At Annex 6 of that Statement, Ofcom revoked Conditions OB1 to OB33 from the July 2004 Statement insofar as they applied to the WLA and WBA markets and in their place imposed SMP Condition 8 with respect to regulatory accounting on KCOM in the WLA and WBA markets. This did not represent a change to the substance of the accounting separation and cost accounting conditions as set out in the July 2004 Statement but was a 'structural' change to the way in which the financial reporting obligations are imposed, aimed at clarifying KCOM's obligations.

A5.97 Today, Ofcom is consulting, in a consultation document entitled "KCOM Regulatory Financial Reporting: Consultation on proposed regulatory financial reporting directions for KCOM." ("**2018 KCOM Reporting Consultation**"), on proposals to replace the 2004 Regulatory Financial Reporting Directions with new regulatory financial reporting directions in relation to the following markets:

- a) the supply of wholesale local access at a fixed location in the Hull Area;
- b) the supply of wholesale broadband access provided in the Hull Area;
- c) wholesale market for low bandwidth traditional interface symmetric broadband origination in the Hull Area, at bandwidths up to and including 8Mbit/s;
- d) wholesale market for contemporary interface symmetric broadband origination in the Hull Area;
- e) wholesale fixed analogue exchange line services in the Hull Area;
- f) wholesale ISDN30 exchange line services in the Hull Area;
- g) wholesale ISDN2 exchange line services in the Hull Area; and
- h) wholesale call origination on a fixed narrowband network in the Hull Area.

A5.98 Under Condition OB2 set out at Annex 2 of the July 2004 Statement which Ofcom has decided to apply to KCOM in the 2016 BCMR and NMR Statements, Ofcom may from time to time make such directions as they consider appropriate in relation to KCOM's obligations under these conditions.

A5.99 Under Condition 8.2 set out at Annex 6 of the 2018 WLA and WBA Statement Ofcom has decided to apply to KCOM, Ofcom may from time to time make such directions as they consider appropriate in relation to KCOM's obligations under these conditions.

A5.100 This Notification sets out proposals to impose a direction in relation to the form of the 'PPIA' opinion for Regulatory Financial Statements in each of the markets set out in paragraph A5.97 above.

Proposal to give a direction

A5.101 Ofcom is proposing, in accordance with section 49 of the Act, to give a direction pursuant to SMP Condition OB2 and SMP Condition 8 imposing a direction in relation to the form of the 'PPIA' opinion for Regulatory Financial Statements in each of the markets set out in paragraph A5.97 above.

A5.102 The proposed direction is set out in the Schedule to this Notification.

A5.103 The effect of and reasons for giving the proposed direction are set out in the 2018 KCOM Reporting Consultation accompanying this Notification.

Ofcom's duties and legal tests

A5.104 For the reasons set out in the 2018 KCOM Reporting Consultation, Ofcom considers that the proposals referred to in paragraph A5.101 complies with the requirements of section 49(2) of the Act.

A5.105 In making the proposals referred to in paragraph A5.101, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.

Making representations

A5.106 Representations may be made to Ofcom about the proposals set out in this Consultation by no later than 18 September 2018.

A5.107 In accordance with section 49C(1)(a) of the Act, a copy of the Notification, together with the Schedules, will be sent to the Secretary of State.

Interpretation

A5.108 Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 3 of the July 2004 Statement and Annex 6 of the 2018 WLA and WBA Statement and otherwise any word or expression shall have the same meaning as it has in the Act.

A5.109 The Interpretation Act 1978 (c. 30) shall apply as if this notification were an Act of Parliament.

Signed

Director of Financial Economics, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

7 August 2018

Schedule 6 - Proposed PPIA audit Direction

Proposed Direction made under section 49 of the Communications Act 2003, and SMP Services Condition OB2 and SMP Services Condition 8.2, specifying the 'PPIA' audit of Regulatory Financial Statements for the purposes of among others, SMP Service Conditions OB1 to OB33 and SMP Services Conditions 8.1 to 8.29

1. In accordance with section 49(1) of the Communications Act 2003 (the Act), Ofcom hereby directs KCOM to ensure that where KCOM is required by any direction of OFCOM to secure the expression of an audit opinion to PPIA standards upon any Regulatory Financial Statement, KCOM shall ensure that the Regulatory Auditor shall state whether in his opinion:
 - a) each Regulatory Financial Statement complies with the requirements of Condition OB5 and Condition 8.5;
 - b) each Regulatory Financial Statement has been properly prepared in accordance with the Accounting Documents, including the Prior Year Comparatives;
 - i) having reviewed the Accounting Documents in forming his opinion under (b) above, anything has come to his attention that would lead him to conclude that the Accounting Documents have not been properly applied in the preparation of the relevant Regulatory Financial Statement, disclosing where practicable any adjustments he considers to be required in respect of any such matter; and
 - ii) having reviewed the Accounting Documents, nothing has come to his attention that would lead him to conclude that the Accounting Documents are unreasonable.
2. In accordance with section 49(1) of the Act, Ofcom hereby gives a Direction revoking Direction 6 in relation to the markets listed in paragraph A5.97 above.

A6. Equality Impact Assessment

Introduction

- A6.1 Ofcom⁵² is required by statute to assess the potential impact of all its functions, policies, projects and practices on equality.⁵³ An equality impact assessment (EIA) also assists us in making sure that we are meeting our principal duty of furthering the interests of citizens and consumers regardless of their background or identity.
- A6.2 Unless we state otherwise in this document, it is not apparent to us that our proposed remedies will have a differential impact on any equality group.
- A6.3 Further, we have not considered it necessary to carry out separate EIAs in relation to race or sex equality or equality schemes under the Northern Ireland and Disability Equality Schemes. This is because we anticipate that our regulatory intervention will not have a differential impact on people of different sexes or ethnicities, consumers with protected characteristics in Northern Ireland⁵⁴ or disabled consumers compared to consumers in general.
- A6.4 The analysis presented in this document represents an impact assessment, as defined in section 7 of the Communications Act 2003 (the Act).
- A6.5 You should send any comments on this impact assessment to us by the closing date for this consultation. We will consider all comments before deciding whether to implement our proposals.

Equality impact assessment

- A6.6 We have considered whether the proposed remedies would have an adverse impact on promoting equality. In particular, we have considered whether the remedies would have a different or adverse effect on consumers and citizens with respect to the following equality groups: age, disability, sex, gender reassignment, pregnancy and maternity, race, religion or belief and sexual orientation in the Hull Area.
- A6.7 The intention behind our approach to regulating financial reporting in the BCMR, Narrowband, WLA and WBA markets in the Hull Area is to promote competition to the ultimate benefit of end consumers by, for example, requiring any telecoms provider with Significant Market Power (SMP) provide stakeholders with relevant regulatory financial information on a proportionate basis.

⁵² We explain why we undertake an Equality Impact Assessment (EIA) and how we have done it in Section 2 of this consultation.

⁵³ Ofcom has a general duty under the 2010 Equality Act to advance equality of opportunity in relation to age, disability, sex, gender reassignment, pregnancy and maternity, race, religion or belief and sexual orientation.

⁵⁴ In addition to the characteristics outlined in the 2010 Equality Act, in Northern Ireland consumers who have dependents or hold a particular political opinion are also protected.

- A6.8 To understand how our proposals may affect equality groups, we have considered how different groups in society engage with communications services. While our research identifies differences in take-up and use of fixed line services by different groups within society, our proposed regulation is aimed at promoting competition across the range of services that rely on BCMR, Narrowband, WLA and WBA services within the Hull Area.
- A6.9 We consider that our proposals will not have a detrimental impact on any defined equality group.
- A6.10 Rather, we consider that our proposals will further the aim of advancing equality of opportunity between different groups in society by furthering the interests of all consumers that use retail services reliant on BCMR, Narrowband, WLA and WBA services in the Hull Area.