

## **KCOM Regulatory Financial Reporting**

Statement on new regulatory financial reporting  
directions covering all regulated fixed telecoms  
markets

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**Statement:**

**Publication Date** 6 February 2019

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# 1. Overview

Each year KCOM prepares a set of Regulatory Financial Statements (“RFS”) which include published statements as well as information that is submitted to Ofcom privately. Ofcom has conducted a review of KCOM’s RFS obligations across all markets in which it is regulated.

In this document, we set out the results of our review. Specifically, we set out a new set of directions relating to KCOM’s regulatory financial reporting obligations in the following fixed telecoms markets:

- wholesale local access market;
- business connectivity markets;
- narrowband markets; and
- wholesale broadband access market.

## What we have decided – in brief

**We have decided to revoke the existing SMP directions and impose fresh directions across all markets in which KCOM is regulated.** The new directions will take effect on the date of this statement and will therefore apply for the purposes of KCOM’s 2018/19 RFS and subsequent RFS.

**Network components: we have specified a new list of network components to be used by KCOM to prepare the RFS.** It is important that there is a single list of components used to attribute costs to markets and services in each regulated market, and that that list is up-to-date and relevant.

**Transparency: we have made a new direction with no substantive changes to the requirement.**

**Preparation, audit, delivery and publication of the RFS: we have decided to amend some of the RFS schedules and to require KCOM to provide (and in some cases publish) additional information and, in some cases, less information.** This is to ensure that the information that we (and stakeholders) obtain is relevant, reliable and proportionate.

**Form and content of the RFS: we have decided that KCOM should update the cost categorisations used within some published schedules of its RFS and report an actual Return on Capital Employed (“ROCE”) across all relevant markets, rather than fixing its ROCE at 13%.**

**Audit opinion for the RFS: we have removed the requirement for KCOM to obtain a “Fairly Presents In Accordance with” (FPIA) opinion on its RFS from its regulatory auditors.** In future, KCOM will be required to obtain an opinion that the RFS are “Properly Prepared In Accordance with” (PPIA) its Primary Accounting Documents.

**This overview is a simplified high-level summary only. The decisions we have taken, and the proposals we are consulting on, and our reasoning are set out in the full document.**

## Background

1.1 Since 2004, KCOM has been subject to regulatory financial reporting requirements across all of the fixed telecoms markets in which it is regulated, comprising the:

- wholesale local access market;

- business connectivity markets;<sup>1</sup>
  - narrowband markets;<sup>2</sup> and
  - wholesale broadband access markets.
- 1.2 As part of these requirements, each year KCOM prepares RFS. These are prepared according to a defined framework and methodology and include published statements as well as information that is submitted to Ofcom privately.
- 1.3 These requirements were designed to 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. They should also provide reasonable confidence to stakeholders that KCOM has complied with its SMP conditions and add credibility to the reporting regime.<sup>3</sup>
- 1.4 These requirements are imposed on KCOM by way of an SMP condition set in each regulated market and a suite of directions imposed in each market pursuant to that SMP condition. The SMP condition sets out our general regulatory financial reporting requirements, including any accounting separation and cost accounting obligations. The directions then set out our detailed financial reporting requirements.
- 1.5 Broadly, the SMP condition and directions are the same across all regulated markets. However, they are implemented separately for each regulated market and we have introduced some detailed requirements that are specific for individual markets.
- 1.6 In the 2016 Business Connectivity Market Review (**BCMR**) Statement, we found that the financial information provided by KCOM no longer allowed us to conduct the market analysis that we wished to undertake. In the 2017 Narrowband Market Review (**NMR**) Statement, we found that KCOM was publishing information that was no longer relevant to

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<sup>1</sup> This currently includes the markets for the provision of low bandwidth traditional interface symmetric broadband origination at bandwidths up to and including 8Mb/s and the provision of contemporary interface symmetric broadband origination within the Hull area. Ofcom has however recently consulted on its proposed market definition and SMP findings for the business connectivity markets going forwards as part of its 2019 BCMR review. In that consultation, we proposed that KCOM only has SMP in relation to the market for the provision of contemporary interface access services within the Hull area. We expect to issue our final statement on the 2019 BCMR review in May 2019.

<sup>2</sup> This currently includes the markets for wholesale fixed analogue exchange line services, wholesale ISDN2 exchange line services, wholesale ISDN 30 exchange line services and the market for wholesale call origination on a fixed narrowband network in the Hull area.

<sup>3</sup> Ofcom, *The Regulatory Financial Reporting Obligations on BT and Kingston Communications Final Statement and Notification*, 22 July 2014, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0034/55969/finance\\_report.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0034/55969/finance_report.pdf), (July 2004 Statement)

the remedies that had been imposed. We therefore decided to improve the relevance and reliability of the financial information KCOM provides in relation to those markets.<sup>4</sup>

- 1.7 Following the 2016 BCMR Statement, KCOM introduced a new regulatory accounting system. This system should improve the reliability of its regulatory financial reporting across all regulated markets. It also created an opportunity for us to review KCOM's regulatory financial reporting across all regulated markets.
- 1.8 On 7 August 2018, we therefore published the 2018 KCOM Regulatory Financial Reporting (RFR) Consultation. That consultation set out our first broad review of the effectiveness of KCOM's regulatory financial reporting requirements, across all markets in which KCOM is regulated, since their original imposition in 2004.<sup>5</sup> We proposed to withdraw all existing directions setting out KCOM's detailed regulatory financial reporting obligations and replace them with new updated directions for all regulated markets. We received two responses to the consultation, from KCOM and BT.<sup>6</sup>

## Summary of decisions related to all regulated markets

- 1.9 We have decided to revoke the existing SMP directions and impose fresh directions across all markets in which KCOM is currently regulated. The directions that we have decided to make are substantially the same as those on which we consulted in the 2018 KCOM RFR Consultation, although we have decided to revoke and not replace the FPIA Audit Opinion Direction and to make a small number of other changes in response to representations made to our consultation. They will apply to KCOM in respect of its 2018/19 RFS and subsequent years.
- 1.10 Overall, in addition to making sure consistent regulatory financial reporting requirements apply across all regulated markets, the amount of information that KCOM will be required to publish will (taking account of this decision and our decision in the 2017 NMR Statement) have been reduced by over 30%. This information will also be more useful to us and stakeholders when considered against our current and future regulatory requirements.
- 1.11 In line with our consultation proposals, some of the new directions do not represent a change to the substance of the detailed financial reporting requirements already imposed on KCOM. This is the case, for example, in respect of the new Transparency Direction and new PPIA Audit Opinion Direction as the wording in these new directions is the same as in the directions being revoked. However, some of the new directions do contain more significant changes. Specifically, the new (i) Network Components Direction, (ii)

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<sup>4</sup> See 2016 BCMR Statement, paragraph 14.120, and 2017 NMR Statement paragraphs 20.211 – 20.215. A summary of the findings from the 2016 BCMR Statement and 2017 NMR Statements is available in Section 3 of the 2018 KCOM RFR Consultation.

<sup>5</sup> Ofcom, *KCOM Regulatory Financial Reporting: Consultation on proposed regulatory financial reporting direction for KCOM*, 7 August 2018, [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0017/117413/consultation-kcom-regulatory-financial-reporting.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0017/117413/consultation-kcom-regulatory-financial-reporting.pdf)

<sup>6</sup> All responses to the 2018 KCOM RFR Consultation can be found at <https://www.ofcom.org.uk/consultations-and-statements/category-2/regulatory-financial-reporting-directions-kcom>

Preparation, Audit, Delivery and Publication of the RFS Direction, and (iii) Form and Content Direction are substantially different to those which are being revoked.

1.12 We summarise our final position, at a high-level, in respect of each Direction below:

### **Network components**

1.13 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, and that that list should be up-to-date and relevant. We have therefore decided to make a new direction specifying the network components to be used by KCOM to prepare the RFS. The list of network components in that direction is the same as that used by Ofcom in its 2016 BCMR Statement and 2017 NMR Statement, but it will apply to all of the markets in which KCOM is regulated.

### **Transparency**

1.14 We remain of the view that the current transparency requirement is appropriate. We have therefore decided not to make any substantive changes to the requirement. However, 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 and we have therefore decided to revoke the existing direction and make a new direction.

### **Preparation, audit, delivery and publication of the RFS**

1.15 In line with our view in the 2017 NMR, we have decided that some of the schedules that KCOM has been required to produce (and, in some cases, publish) are no longer relevant or reliable, or that it would no longer be proportionate to continue to require KCOM to produce (or publish) these. We have therefore decided to amend some of the schedules and, in some cases, to no longer require KCOM to publish (or in some cases provide) them. We have also decided that, for the WLA market, KCOM should be required to produce (and publish) the same level of information as for other regulated markets. We have decided to implement these decisions by revoking the existing direction and making a new direction, which will apply across all regulated markets.

### **Form and content of the RFS**

1.16 We have decided that KCOM should update the cost categorisations used within some published schedules of its RFS. We have also decided that KCOM should report an actual ROCE across all relevant markets, rather than fixing it at 13%. We have decided to implement these decisions by revoking the existing direction and making a new direction, which will apply across all regulated markets.

### **Audit opinion for the RFS**

1.17 In the 2018 KCOM RFR Consultation, we recognised that two types of opinion are currently used 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 published Description of its Cost Accounting System (“DOCAS”) prepared by KCOM, as well as our regulatory financial reporting obligations surrounding the RFS. However, 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.

- 1.18 In light of KCOM’s response to our consultation, we agree that it is no longer appropriate and proportionate to require KCOM to obtain a FPIA opinion on its RFS from its regulatory auditors. We have therefore decided to not make the FPIA Direction that we had proposed to make in the 2018 KCOM RFR Consultation. We have however decided that, in future, KCOM should be required to obtain an opinion that the RFS are properly prepared in accordance with (PPIA) its Primary Accounting Documents, and we have therefore decided to make the PPIA Direction on which we consulted in 2018.

## 2. Introduction

### The purpose of regulatory financial reporting

- 2.1 As we 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.<sup>7</sup>
- 2.2 Specifically, and as explained in the 2018 KCOM RFR Consultation,<sup>8</sup> 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 fair and reasonable charging obligations) and accounting separation is important for obligations of non-discrimination. Publication of this information aids transparency.
- 2.3 When imposing the current financial reporting requirements on KCOM in July 2004, we said 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”*.<sup>9</sup>
- 2.4 In the 2014 RFR Statement (which was the last review of BT’s regulatory reporting requirements), we also explained that the purpose of regulatory financial reporting is to provide financial information to both Ofcom and to other stakeholders.
- 2.5 We explained that regulatory financial reporting should provide Ofcom with the information we need 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.<sup>10</sup>
- 2.6 We also explained that 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”*.<sup>11</sup> More specifically, we consider that stakeholders have a legitimate interest in seeing the following information in KCOM’s published Regulatory Financial Statements (as with BT’s<sup>12</sup>):
- visibility of information that will be taken into account in regulatory decisions, such as charge controls;

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<sup>7</sup> July 2004 Statement, paragraph 2.21, page 8

<sup>10</sup> 2018 KCOM RFR Consultation, paragraphs 2.1-2.7.

<sup>9</sup> July 2004 Statement, paragraph 2.26, page 9.

<sup>10</sup> 2014 RFR Statement, paragraph 2.28.

<sup>11</sup> 2014 RFR Statement, paragraph 2.41.

<sup>12</sup> 2014 RFR Statement, paragraph 2.63.



- a reasonable understanding of (KCOM's) financial performance from a regulatory perspective; and
- reasonable confidence regarding compliance with non-discrimination and other regulatory obligations.

2.7 We explained in the 2014 RFR Statement that *“effective Regulatory Financial Reporting should have the following attributes:*

- **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.”*<sup>13</sup>

2.8 As set out in the 2014 RFR Statement, we considered that the information we require SMP providers to publish in their RFS (cost, volume and revenue information) should continue to be published at the level of the remedy<sup>14</sup> and strike a balance between information that stakeholders need to contribute to the regulatory regime and confidentiality concerns around the commercial nature of the financial information. In the case of the detailed regulatory financial reporting requirements which apply to KCOM, we are also mindful of its smaller scale relative to BT. We note, in particular, 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.<sup>15</sup>

## KCOM's regulatory financial reporting framework

2.9 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

2.10 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;

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<sup>13</sup> 2014 RFR Statement, paragraph 2.42, page 14.

<sup>14</sup> 2014 RFR Statement, paragraph 4.76, page 76.

<sup>15</sup> 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.”*

- 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
  - i) the demonstration of non-discrimination.
- 2.11 We decided, in our 2016 BCMR Statement and 2017 Narrowband Statement, to re-apply these SMP conditions (to the extent still extant) to KCOM in respect of the business connectivity and narrowband markets identified in those statements.
- 2.12 However, in the 2018 Hull WLA and WBA Statement and as proposed in the 2018 BCMR Consultation, (to the extent still extant) we have decided to revoke (or in the case of the 2018 BCMR are proposing to revoke) these SMP conditions in relation to each of these markets and impose new regulatory financial reporting obligations through a new set of SMP Conditions. As we explained in those documents, 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.

## Directions

- 2.13 In the July 2004 Statement, we also imposed six directions which implemented our 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.
- a) **Direction 1: Network components.** This direction specifies all the network cost components used by KCOM to prepare the RFS. Network components are used by KCOM to attribute costs to services in regulated markets.  
  
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. The direction is intended to ensure that we obtain information to monitor compliance with regulatory obligations (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.
  - b) **Direction 2: Transparency.** The purpose of this direction is 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.

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 separation.<sup>16</sup> 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 what financial information KCOM is required to provide for each regulated market in the published RFS and in private to Ofcom, and the required audit opinion (consistent with Directions 5 and 6). Some elements of this information relate to all markets, while others relate only to specific markets.

This direction plays an important role in ensuring that the RFS provide relevant information to stakeholders. It ensures that that regulatory financial reporting gives confidence to stakeholders. The direction also ensures that information is provided to us (either in the published RFS or in private) that is needed to monitor KCOM's compliance with any regulatory remedies.

- 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 Ofcom.

- 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

- 2.14 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.
- 2.15 Any requirements imposed by Ofcom on SMP providers following such a periodic review are required by the Communications Act 2003 to be objectively justifiable, not unduly

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<sup>16</sup> KCOM Description of Cost Accounting System (DOCAS): Representing the Primary and Secondary Accounting Statements Together with Wholesale and Retail Catalogues, 25<sup>th</sup> July 2017 <https://www.kcomplc.com/media/1658/description-of-cost-accounting-system-2017-pdf.pdf>.

discriminatory, proportionate to what they are intended to achieve, and transparent in relation to what they are intended to be achieved.

- 2.16 We set out the relevant regulatory framework in the 2018 Hull WLA and WBA Statement and the 2018 BCMR Consultation. Reference should be made to those documents for further detail.<sup>17</sup>

## Impact assessment and equality impact assessment

### Impact assessment

- 2.17 Section 7 of the Act requires Ofcom to carry out impact assessments where its proposals would be likely to have a significant impact on businesses or the general public, or when there is a major change in Ofcom's activities. 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, and this is reflected in section 7 of the Act. However, as a matter of policy Ofcom is committed to carrying out impact assessments in relation to the great majority of our policy decisions.
- 2.18 We set out our impact assessment in relation to those proposals on which we are now reaching a final decision in the 2018 KCOM RFR Consultation.<sup>18</sup> In this document, we consider relevant responses and set out our conclusions on the impact of those changes.

### Equality impact assessment (EIA)

- 2.19 Annex 2 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 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.
- 2.20 We have considered whether or not our decisions will have a particular impact on race, age, disability, gender, pregnancy and maternity, religion or sex equality. We do not envisage that our decisions in this statement will have a detrimental impact on any particular group of people.

## Scope of this document

- 2.21 The focus of this statement is on regulatory financial reporting across all of KCOM's regulated markets (specifically, the wholesale local access, business connectivity,

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<sup>17</sup> Ofcom 2018. WLA and WBA Market Reviews - Competition in the Hull Area, paragraphs 2.33 – 2.46, pages 11- 14.

<sup>18</sup> 2018 KCOM RFR Consultation, Annex 6.

narrowband and wholesale broadband access markets) from 2018/19. Our focus is on the directions which set out KCOM's detailed regulatory financial reporting requirements, rather than the associated SMP conditions.

- 2.22 In this document, we do not consider the regulatory financial reporting obligations which apply to BT. We have however recently considered these as part of a separate consultation, which was published on 4 December 2018.<sup>19</sup>

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<sup>19</sup> See <https://www.ofcom.org.uk/consultations-and-statements/category-1/bt-regulatory-financial-reporting>. The deadline for responses to that consultation was 18 January 2019.

## 3. Improving KCOM's current regulatory financial reporting

- 3.1 In this section, for each of KCOM's regulatory financial reporting directions, we summarise our proposal in the 2018 KCOM RFR Consultation, discuss stakeholder comments and set out our final decision.
- 3.2 By way of a summary, we have decided to revoke all of the existing regulatory financial reporting directions which apply to KCOM and, save for Direction 5 (Form of the FPIA opinion for financial statements), to impose fresh directions across all markets in which it is regulated. The new SMP directions will take effect on the date of this statement and will therefore apply for the 2018/19 RFS and subsequent years.
- 3.3 In line with our consultation proposals, some of the new directions do not represent a change to the substance of the detailed financial reporting requirements already imposed on KCOM. This is the case, for example, in respect of the new Transparency Direction and new PPIA Audit Opinion Direction as the wording in these new directions is the same as in the directions being revoked.
- 3.4 However, some of the new directions do contain more significant changes on a KCOM-wide or market-specific basis. The more substantive changes that we have decided to make are as follows:
- **New Network Component Direction.** In line with our consultation proposals, we have decided to impose, through a new direction, the list of network components imposed in the 2016 BCMR Statement and 2017 NMR Statement across all regulated markets (i.e. to extend this list to the WLA and WBA markets). This reduces the number of network components from over 70 to 11.
  - **New Preparation, Audit, Delivery and Publication of KCOM's RFS Direction.** In line with our consultation proposals, we have decided that:
    - KCOM should no longer publish certain KCOM-wide and market level schedules;
    - KCOM should not have to provide us with some schedules (i.e. Network Services Reconciliation and incremental cost information);
    - KCOM should be required to provide us confidentially with some new schedules (i.e. a wholesale residual current cost profit and loss and wholesale residual activities statement of mean capital employed (**MCE**); and
    - any market-level requirements in the direction should also be extended to the WLA market.
  - **New Form and Content Direction.** We have decided that KCOM should disclose additional cost and asset categories for the KCOM-wide and Market Profit and Loss Account and MCE schedules. We have also decided that KCOM should calculate an

actual ROCE for the purposes of its Profit and Loss schedules, rather than fixing this at 13%.

- **Form of the FPIA opinion for financial statements.** In light of KCOM's response to our consultation, we have decided to entirely revoke Direction 5 which sets out the form of the FPIA opinion for financial statements (and to not replace it).

3.5 The directions are set out in Annex 1 (see Schedules 1 to 5 respectively).

## Network components

### Our proposals

3.6 In the 2018 KCOM RFR Consultation, we noted that the list of network components imposed in some markets (namely the WBA and WLA markets) was no longer relevant as it had not been updated for a number of years and did not represent the actual cost elements of KCOM's regulated services in those markets. Whilst the network component list contained a large number of redundant components, we were concerned that the number of active components in use was too narrow which meant that costs attributed to these active components were likely to be overstated. We considered that the network component list was 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, particularly in the WLA and WBA markets.<sup>20</sup>

3.7 We proposed to withdraw the existing direction and impose a new direction specifying the network components to be used by KCOM to prepare the RFS. We considered that the list of network components imposed in the 2016 BCMR and 2017 NMR statements would be appropriate for all regulated markets. This list comprises 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.

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<sup>20</sup> 2018 Hull WLA and WBA Statement, Table 1.1.

## Stakeholder comments

- 3.8 KCOM agreed that *“it is appropriate to revise the network components applicable to the WBA market and to require us to report against the same common set for WLA for the accounting period 2018/19. Furthermore, given the desire to provide regulatory clarity in respect of the reporting of the network components across other regulated markets, we further agree that is appropriate to introduce a new network component direction”*.<sup>21</sup>
- 3.9 BT did not comment on this proposal.

## Our decision

- 3.10 For the reasons set out in our consultation, and having considered KCOM’s response, we have decided that it is appropriate and proportionate to use the network components list set out in paragraph 3.7 above across all regulated markets for the 2018/19 RFS. In order to give effect to this decision, we have decided to revoke Direction 1 and replace it with a new Network Component Direction. The new direction is set out in Annex 1 (see Schedule 1 to the Notification).

## Transparency

### Our proposals

- 3.11 In the 2018 KCOM RFR Consultation, we explained our provisional view that the current transparency requirement provides a sufficiently transparent description of KCOM’s regulatory cost accounting system (including attribution and valuation methodologies), allowing a suitably informed reader to gain a clear understanding of the information presented in KCOM’s RFS. Therefore, we did not propose any substantive change to the requirements. However, to ensure the consistent application of the transparency direction, we proposed to withdraw the existing direction and impose a new one across all markets in which KCOM is regulated.

### Stakeholder comments

- 3.12 KCOM agreed with our proposal. Specifically, it confirmed that the existing requirement remains, in its view, appropriate and relevant and that, given Ofcom’s desire to provide regulatory clarity in respect of the transparency obligations, it is appropriate to introduce a new Transparency Direction.<sup>22</sup> BT did not comment on this proposal.

### Our decisions

- 3.13 For the reasons set out in our consultation, and taking account of KCOM’s response to that consultation, we have decided that it is appropriate and proportionate to revoke Direction

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<sup>21</sup> KCOM response to the 2018 KCOM RFR Consultation, paragraph 2.5.

<sup>22</sup> KCOM response to the 2018 KCOM RFR Consultation, paragraph 2.6.



2 and to replace it with the proposed Transparency Direction in respect of all markets in which KCOM is regulated. This direction will come into effect on the date of this statement and will therefore apply for the purposes of the 2018/19 and subsequent RFS. As we are not making any substantive change to this requirement, this will not have any practical implications for KCOM. The direction is set out in Annex 1 (see Schedule 2 to the Notification).

## Preparation, audit, delivery and publication of KCOM's RFS

### Our proposals

3.14 In the 2018 KCOM RFR Consultation, we explained our view that the existing Direction is no longer appropriate. We explained, in particular, that KCOM publishes several schedules that either appear to serve no regulatory purpose or for which publication is disproportionate in relation to the remedy that it is seeking to support. We also explained that, on the other hand, for the WLA market (in which Ofcom has determined KCOM has SMP), KCOM has not been required to publish any information. We explained how we proposed to implement the results of our provisional assessment into 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.

### Proposed public information

3.15 Tables 3.1 and 3.2 below list the schedules that we proposed KCOM should be required to publish in the future. Table 3.1 focuses on KCOM-wide information and Table 3.2 focuses on market-specific information.

**Table 3.1: KCOM-wide schedules proposed to be provided to Ofcom and published**

Schedule currently provided (2017/18 RFS)	Justification for retention and publication
Consolidation Cost Profit and Loss (page 8) Consolidation MCE (page 9)	Sets out the overall return KCOM is making from regulated markets. This demonstrates to Ofcom and stakeholders the effectiveness of regulation across KCOM.
Reconciliation Profit and Loss (pages 45, 46) Reconciliation MCE (page 47)	Reconciles 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 52)	Provides confidence to Ofcom and stakeholders that KCOM is attributing costs correctly across network

components in accordance with its cost accounting and accounting separation obligations.

**Table 3.2: Market-level schedules proposed to be provided to Ofcom and published**

Schedule currently provided	Market currently provided (2017/18 RFS)				Justification
	Narrowband	WBA	Business Connectivity	WLA	
<b>Market Profit and Loss Summaries</b>	Analogue Exchange lines (Page 13) ISDN2 (Page 17) ISDN30 (Page 21) Call Origination (Page 25)	Page 29	TISBO below 8 M/bits (Page 33) CISBO (Page 37)	Not currently provided	Information on market-level financial performance allows 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).
<b>Market MCE</b>	Analogue Exchange lines (Page 14) ISDN2 (Page 18) ISDN30 (Page 22) Call Origination (Page 26)	Page 30	TISBO below 8 M/bits (Page 34) CISBO (Page 38)	Not currently provided	We see this as facilitating stakeholder confidence that such costs have been attributed consistently.

### Information proposed to be provided on a confidential basis to Ofcom

3.16 In the 2018 KCOM RFR Consultation, we explained that prior to the 2017 NMR Statement, we did not require KCOM to provide us with information on a confidential basis. We proposed however that KCOM should no longer be required to publish certain schedules and, instead, that it should be required to provide them to Ofcom on a confidential basis. These are summarised in Tables 3.3 and 3.4 below. Table 3.3 focuses on KCOM-wide information and Table 3.4 focuses on market-specific information.

**Table 3.3: KCOM-wide schedules proposed to be provided to Ofcom in confidence**

Schedule currently provided (2017/18 RFS)	Justification for non-publication and continued provision in private
Retail Residual Profit and Loss (page 48)	

**Retail Residual MCE (page 49)**

We consider that the information in these schedules would help demonstrate to Ofcom that KCOM is using an appropriate regulatory cost accounting system to attribute costs to markets, including residual markets. However, stakeholders are already provided with information on how costs are attributed by KCOM to regulated and residual markets in the Reconciliation Statements (pages 45-47) and the KCOM Network Activity Statement (page 52). Our provisional view was that, whilst we need the information to ensure the correct attribution of costs between regulated and unregulated markets, it is not necessary to provide this detailed information on non-regulated services to stakeholders.

**Inter Market Turnover (page 50)**

The retail residual element shows revenue from each regulated market and is required by us to monitor accounting separation obligations in relation to sales made to retail residual. We provisionally concluded however that it is not appropriate to provide to stakeholders as it relates to non-regulated services.

- 3.17 We also proposed that KCOM provide to us, on a confidential basis, a Wholesale Residual Current Cost Profit and Loss and Wholesale Residual Activities Statement of MCE. We explained that we did not receive information on sales made to (and potentially from) the wholesale residual market from (and potentially to) each market in which KCOM is regulated. We provisionally concluded that this information was however necessary in order to monitor KCOM's compliance with its accounting separation obligations in relation to sales made to (and potentially from) the wholesale residual market.

Table 3.4: Market-level schedules proposed to be provided in confidence

Schedule currently provided	Market currently provided (2017/18 RFS)				Justification for non – publication and continued provision on a confidential basis
	Narrowband	WBA	Business Connectivity	WLA	
<b>Market Network Activity Statement</b>	Analogue Exchange lines (Page 15) ISDN2 (Page 19) ISDN30 (Page 23) Call Origination (Page 27)	Page 31	TISBO below 8 M/bits (Page 35)  CISBO (Page 39)	Not currently provided	We considered that this information would help demonstrate to us that KCOM is using an appropriate regulatory cost accounting system to attribute costs to markets, including residual markets. However, stakeholders are already provided with information on how costs are attributed to regulated and residual markets in the Reconciliation Statements (pages 45-47) and the KCOM Network Activity Statement (page 52).  We provisionally concluded that it is not appropriate to require detailed information to be published on a regulated market basis where a cost-based charge control is not being imposed.

### Schedules proposed to no longer be provided

3.18 In the 2018 KCOM RFR Consultation, we proposed that KCOM should no longer be required to provide the Network Services Reconciliation (Page 51 in the 2017/18 RFS), but that the information relating to unit costs be included within the “Network Activity Statement” (page 52 in the 2017/18 RFS). We also proposed that KCOM should no longer be required to provide Internal and External sales per market (pages 43 and 44 in the 2017/18 RFS).

### Proposed other changes

3.19 In the 2018 KCOM RFR Consultation, we noted that Direction 3 includes a requirement for KCOM to publish incremental cost information and a Network Services Reconciliation for

each market<sup>23</sup> but that KCOM has never published this information to our knowledge. We provisionally concluded that it would be disproportionate to require this information going forward because we do not need it in connection with KCOM's fair and reasonable pricing obligations.<sup>24</sup> Consistent with the 2017 NMR Statement,<sup>25</sup> we proposed to withdraw this requirement.

## Stakeholder comments

- 3.20 KCOM was broadly supportive of Ofcom's proposals. It suggested that it is not necessary for the published RFS to include detailed profit and loss accounts and balance sheets or Network Activity Statements. This is because that detailed information is not, in its view, needed for users of the RFS to understand whether or not it is compliant with its regulatory obligations relating to pricing or for Ofcom to fulfil its statutory duties. However, KCOM also explained that, in its view, while the current level of information that is published may be unnecessary over the longer term, it considers it helpful in the near time.
- 3.21 KCOM suggested that Ofcom should keep under review the information that it is required to report and publish.<sup>26</sup>
- 3.22 It also confirmed its view that it would have sufficient time to make the appropriate adjustments that would follow from Ofcom's proposals.
- 3.23 BT proposed that Ofcom should implement a single reporting framework for KCOM and BT which is based on key principles. These principles would include that (i) the framework should apply consistently across all market reviews and to all UK operators on which SMP obligations are imposed, (ii) information required to be provided should clearly correlate to the pricing and other remedies imposed, and (iii) the information required is proportionate.
- 3.24 Specifically, BT suggested that where we have found KCOM to have SMP and imposed fair and reasonable pricing remedies, the needs of stakeholders would be met by the publication of a performance summary by market only (in a similar level of detail to that in BT's RFS). BT suggested that it is disproportionate to require KCOM, in those circumstances, to produce and publish additional detailed information on KCOM's costs by nature and by network component.
- 3.25 In relation to the publication of information on fair and reasonable pricing, BT said it did not consider that the volume and nature of information that Ofcom continues to require KCOM to produce and publish is proportionate to the needs of stakeholders, given the nature of the pricing remedies (i.e. fair and reasonable) imposed.<sup>27</sup>

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<sup>23</sup> It does publish a consolidated network services reconciliation (see page 59 of the 2016/17 KCOM RFS).

<sup>24</sup> To our knowledge neither KCOM's previous or new regulatory accounting system had the functionality to calculate incremental costs.

<sup>25</sup> 2017 NMR Statement, footnote 917 to paragraph 20.2018, page 444.

<sup>26</sup> KCOM response to the 2018 KCOM RFR Consultation, paragraph 1.8 and 2.8.

<sup>27</sup> BT response to the 2018 KCOM RFR Consultation, paragraph 3.5.

- 3.26 BT also disagreed on the provision of confidential information where it appeared “to be a duplication of what is already disclosed publicly elsewhere”.
- 3.27 Finally, BT had concerns about what it considered to be Ofcom’s inconsistent approach towards BT and KCOM. The examples BT gave were:
- a) Call Termination and Interconnect, where Ofcom has determined that both KCOM and BT have SMP, but KCOM (unlike BT) is not subject to any regulatory reporting requirement.
  - b) Wholesale Broadband Access (WBA) where BT and KCOM’s market sizes (WBA Market A for BT was 0.9% and, for KCOM, it was around 0.7%) are similar as a proportion of the total UK markets although only BT has to provide service level reporting.
  - c) KCOM is not required to produce DLRIC and DSAC information whereas BT is required to provide this information in all markets where it has reporting obligations (including for services where, like KCOM, its prices are only subject to a “fair and reasonable” obligation).

## Our decision

- 3.28 Having carefully considered both KCOM’s and BT’s responses to our consultation, and for the reasons set out below, we have decided that it is both appropriate and proportionate to adopt the proposals set out in our consultation without any modification.
- 3.29 In relation to BT’s proposal for a single reporting framework, we consider that regulatory financial reporting is already subject to a single framework. The regulatory financial reporting obligations to which BT and KCOM are subject have both been imposed in accordance with the same legal framework (specifically, in accordance with the Communications Act 2003 and the 2005 EC Directive<sup>28</sup>) and by reference to the same overarching attributes (namely, that any financial reporting should be relevant, reliable, transparent and proportionate).
- 3.30 Further, in relation to the key principles of a single reporting framework put forward by BT at paragraph 3.2 of its response, we note that:
- a) we have expressly recognised, both in the 2014 RFR Statement and in the 2018 KCOM RFR Consultation, the need to preserve the integrity and consistency of regulatory financial reporting obligations across markets.<sup>29</sup> This is why, in both documents, we

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<sup>28</sup> Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications, recital 4. [http://www.akos-rs.si/files/APEK\\_eng/Legislation/!-26620051011en00640069.pdf](http://www.akos-rs.si/files/APEK_eng/Legislation/!-26620051011en00640069.pdf)

<sup>29</sup> See, for example, paragraph 1.21 of the 2014 RFR Statement and paragraph 1.8 of the 2018 KCOM RFR Consultation.

considered it appropriate to make one set of directions which set out BT and KCOM's detailed financial reporting requirements respectively, to apply across each market in they are regulated;

- b) whilst we do not agree with the specific framework proposed by BT in the table in its response, and we consider that pricing remedies may not be the only factor to take account of when considering the scope of regulatory financial reporting requirements (on which, see paragraph 3.33 below), we broadly agree with BT's suggestion that regulatory financial reporting obligations should be consistent with the remedies imposed;<sup>30</sup> and
- c) we agree with BT that any reporting requirements imposed on UK operators should be proportionate and consistent. We note, in this regard, that Ofcom is required by section 3(3)(a) of the Communications Act 2003 to have regard, when performing its duties, to the principles under which (amongst other things) regulatory activities should be proportionate and consistent.

3.31 To the extent that there are any differences in the regulatory financial reporting requirements imposed on BT and those imposed on KCOM, we consider that we do nevertheless adopt a consistent approach and that those differences are justified because of (amongst other things):

- a) the smaller scale of KCOM;
- b) the different regulatory obligations to which KCOM and BT are subject; and
- c) the fact that Ofcom has sought to take account of the different accounting systems and practices adopted by KCOM and BT to date, so as not to impose a disproportionate regulatory burden on either of these operators.

3.32 For these reasons, we also disagree that we have been inconsistent in the examples that BT has provided at paragraph 4.2 of its response to our consultation. Specifically:

- a) **Call Termination (WCT) and Interconnect:** We recognise that the financial reporting obligations imposed on BT and KCOM in respect of these services differ. However, our decision to require BT to publish more extensive financial information than KCOM reflected, in part, our decision to impose additional SMP conditions on BT when compared to KCOM. In particular, we decided that only BT should be subject to an obligation to not unduly discriminate as well as to accounting separation and cost

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<sup>30</sup> However, as highlighted in the 2014 RFR Statement, in certain circumstances, we may decide that a regulated entity needs to publish regulatory financial data that goes beyond the level of the remedy to give stakeholders reasonable confidence that it has complied with its SMP conditions and allow them to contribute to the regulatory regime. See, in particular, footnote 60 of the 2014 RFR Statement.

accounting obligations.<sup>31</sup> Ofcom's reasons for imposing these additional SMP conditions on BT are set out in full in the 2017 NMR Statement.<sup>32</sup>

- b) **WBA market review:** We recognise that the financial reporting obligations imposed on BT and KCOM in respect of these services also differ. However, as with the WCT and Interconnect services discussed above, this reflects in part our decision to impose additional SMP conditions on BT when compared to KCOM. Specifically, Ofcom concluded in the 2018 WLA Statement that BT should continue to be subject to an obligation to provide network access on an Equivalent of Inputs basis (which is, broadly speaking, a stricter form of non-discrimination remedy than an obligation to not unduly discriminate).<sup>33</sup> KCOM is not subject to an EOI obligation.<sup>34</sup> We explained in the 2018 WBA Statement that the purpose of WBA service level reporting by BT is to provide stakeholders with reassurance that BT is complying with its EOI obligations in the WLA market.<sup>35</sup> Ofcom's detailed reasoning was set out in the 2018 WLA and WBA Statements.
- c) **DLRIC and DSAC information:** It is the case, as BT suggests, that KCOM is not required to produce DLRIC and DSAC information for reporting to Ofcom, but that BT is currently required to do so. However, in the 2018 BT RFR Consultation, we proposed that BT no longer be required to provide us with this level of financial information.<sup>36</sup>

3.33 We have also considered the specific framework put forward by BT in the table in its response to our consultation. We note that the case for such a framework, specifically tied to the pricing remedy imposed, has been put forward by both BT and Openreach in previous market reviews,<sup>37</sup> and Ofcom has explained as part of those market reviews why it disagrees with BT's suggestion. As we articulated in the 2017 NMR Statement,<sup>38</sup> we do not consider that pricing remedies are the only factor to take account of when considering the requirements for public reporting. While pricing remedies are a relevant factor when considering the services or level of cost information to report, more generally it is important to ensure that sufficient information is published to achieve the objectives of

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<sup>31</sup> 2017 NMR Statement, see section 13 for WCT services (and, in particular, from paragraph 13.67 for a discussion of the additional remedies on BT only), and section 18 for Interconnect services.

<sup>32</sup> We note that, in respect of WCT, additional remedies on BT only were considered necessary to address our competition concerns because of BT's scale in the provision of WCT (due to its network reach and number of connected customers at the wholesale level). See 2017 NMR Statement, paragraph 17.109. Similarly, in respect of Interconnection, we recognised that an additional consideration to BT's SMP in WCO and WCT markets is the network effect deriving from its large customer base served by a very distributed set of terminating nodes; KCOM, on the other hand, has a much smaller network of subscribers (as compared to BT and some other telecoms providers) and has far fewer terminating nodes than BT. See 2017 NMR Statement, paragraph 17.112.

<sup>33</sup> 2018 WLA Statement, from paragraph 6.97.

<sup>34</sup> 2017 WLA and WBA Statement (Hull), paragraph 4.106.

<sup>35</sup> 2018 WBA Statement, from paragraph 7.77 page 149.

<sup>36</sup> 2018 BT RFR Consultation, paragraphs 3.49 – 3.53, pages 23 to 24.

<sup>37</sup> We note that we had not previously understood BT's proposed framework to be something that should apply to anyone other than itself.

<sup>38</sup> 2017 NMR Statement, paragraph 20.37, pages 407 -8. See also footnote 60 of Ofcom's consultation, published on 4 December 2018, on "*Proposed regulatory reporting directions covering all regulated fixed telecoms markets*". In that document, we explained that in certain circumstances, we may decide that a regulated entity needs to publish regulatory financial data that goes beyond the level of the remedy to give stakeholders reasonable confidence that it has complied with its SMP conditions and allow them to contribute to the regulatory regime.



public reporting, i.e. to enable stakeholders to have reasonable confidence that BT has complied with its SMP conditions, allow them to contribute to the regulatory regime and add credibility to the regulatory accounting system. We therefore continue to consider that appropriate reporting requirements should be determined as part of each market review, so we can assess what a sufficient level of detail would be in respect of each market in light of our competition concerns, taking account of stakeholder representations and other factors relevant to the particular market. For the reasons set out in those previous documents, we continue to disagree with the specific framework put forward by BT.

- 3.34 Consistent with this, we also disagree with BT's suggestion that, because KCOM is not subject to any price caps or cost orientation obligations, it is disproportionate to require it to produce and publish some information on its costs by nature and by network component. Ofcom has determined that KCOM has significant market power in each of the regulated markets to which the new directions would apply and that KCOM should be subject to a requirement that its charges be fair and reasonable in those markets. Against that background, and for the reasons set out in our consultation and in this statement (see 3.15 above), including our view that pricing remedies are not the only factor to take account of when considering the requirements for public reporting, we remain of the view that it is appropriate and proportionate for KCOM to provide the financial information proposed in our consultation and set out above. We note, in this regard, that whilst BT's response criticised our proposals at a high-level, it did not challenge them at a more granular level.
- 3.35 Further, on BT's suggestion that KCOM should only be required to publish a performance summary by market (in a similar level of detail to that in BT's RFS), we are mindful of the fact that KCOM does not currently prepare one of these. We consider that it would not be appropriate, in those circumstances, to require KCOM to prepare and publish such a performance summary by market.
- 3.36 We also note that the amount of information that KCOM will be required to publish will (taking account of both this decision and our decision in the 2017 NMR Statement) have been reduced by over 30%. This information will also be more useful to us and stakeholders, when considered against our current and future regulatory requirements.
- 3.37 We recognise, as KCOM has suggested, that Ofcom should keep under review whether the information required for publication is in practice used by stakeholders. However, we are satisfied that the market review process provides us with the opportunity to do this and, specifically, to take account of comments from KCOM and other stakeholders on the appropriateness and proportionality of specific financial reporting requirements. We note, in this regard, that we made significant changes to KCOM's detailed reporting requirements as part of the 2016 BCMR review and 2017 Narrowband review, and that those reviews also led us to consider the scope of KCOM's reporting requirements more generally in the 2018 KCOM RFR Consultation and this statement.

- 3.38 We also disagree with BT's suggestion that provision of the schedule "*Kingston Inter Market Turnover (Reconciliation)*"<sup>39</sup> - which sets out turnover in the current year between each market including 'Residual Activities', 'Residual Wholesale' and 'Residual Retail' - is a duplication of what's already disclosed publicly. As set out in Table 3.3 above, KCOM does not provide intra market sales between each market and the residual wholesale and residual retail market in any other schedule.
- 3.39 In light of the above, and the fact that KCOM was broadly supportive of our specific proposals on Direction 3, we have decided to implement the Preparation, Audit, Delivery and Publication of KCOM's RFS Direction as proposed in the 2018 KCOM RFR Consultation across all regulated markets for the 2018/19 RFS.<sup>40</sup> The direction is set out in Annex 1 (see Schedule 3 to the Notification).

## Form and content of the RFS

### Our proposals

- 3.40 In the 2018 KCOM RFR Consultation, we explained that for certain schedules, the format of the information included within the schedules provided by KCOM was no longer appropriate. Specifically, we proposed some changes to the format of the public schedules to replace incorrect and/or out-of-date cost headings with correct and/or up-to-date cost headings. We provisionally concluded that these changes were necessary in order for us to be able to make informed regulatory decisions, monitor compliance and provide reasonable confidence to stakeholders on KCOM's compliance with those obligations.
- 3.41 In the 2018 KCOM RFR Consultation, we proposed changes to:
- turnover categories (Table 3.5(a)) and operating cost categories used in KCOM-wide and market-level Profit and Loss Schedules (Table 3.5(b)), both of which we proposed should continue to be published by KCOM (on which, see above);
  - asset categories used in the Statement of Current Cost MCE (Table 3.6), which (as discussed above) we proposed should continue to be published by KCOM; and
  - other schedules (Table 3.7).

### Current cost Profit and Loss Schedules

- 3.42 We proposed to replace the categorisation of Turnover and CCA operating costs in the KCOM-wide and market-level summary Current Cost Profit and Loss Account schedules<sup>41</sup> as set out in tables 3.5(a) and 3.5(b).

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<sup>39</sup> See page 57 of the 2016/17 KCOM RFS.

<sup>40</sup> We note, however, that this would not appear to have any practical implications for KCOM.

<sup>41</sup> We also proposed this format for Retail Residual Profit and Loss (page 55 of 2017/18 RFS) and proposed Wholesale Residual Profit and Loss schedules to be provided in confidence.

Table 3.5(a): Turnover Categories

Current Categories – Turnover	Proposed Categories – Turnover
Internal Sales	Internal Sales (see paras 3.44 and 3.55 d below)
External Sales	External Sales

Table 3.5(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

3.43 We explained that KCOM would be best placed to decide how to construct the proposed cost categories. However, we noted that the proposed Transparency Direction required KCOM to set out details on how it does this transparently in the DOCAS and that we would continue to engage with KCOM on the implementation of the proposed cost categories.

- 3.44 In respect of the “Return on Mean Capital Employed and Turnover” line in these schedules, we proposed that it be calculated as the actual Return / Mean Capital Employed (MCE) rather than being fixed at 13%. We noted that, in order to, calculate this, KCOM will need to record actual internal revenue and volumes, rather than derive these figures to achieve the 13% return. We said 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, we explained that KCOM should explain why this is the case and set out how they have calculated internal volumes in the DOCAS.
- 3.45 In respect of the “Return on Turnover” line in these schedules, we proposed that KCOM no longer discloses these figures as they are not a useful measure of KCOM’s profitability for an asset driven business. In respect of “Return on Capital Employed” to help transparency, we proposed that KCOM disclose the aggregate MCE in these schedules that is used in the calculation.
- 3.46 In respect of the column headings in the schedules, we proposed that KCOM should continue to disclose both the current and prior year in absolute terms rounded to the nearest £’000. We proposed that KCOM should continue to disclose the percentage change year on year. We proposed that KCOM should additionally disclose the absolute change year on year rounded to the nearest £’000. This would replace the percentage per line item/total in the current and prior year which would provide users of the RFS with more relevant information on turnover and cost movements year on year.

### Statement of Current Cost MCE

- 3.47 We proposed to replace the categories used to disclose fixed assets in the KCOM-wide and market-level summary Statement of Current Cost MCE schedules<sup>42</sup> as set out in Table 3.6.

**Table 3.6: 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

- 3.48 We did not propose that KCOM make any changes to the current asset categories, creditor categories or any of the other headings or sub headings.

<sup>42</sup> We also proposed this format for Retail Residual MCE (page 56 of 2017/18 RFS) and proposed Wholesale Residual MCE schedules to be provided in confidence.

- 3.49 We explained that KCOM is best placed to decide how to construct the proposed asset categories. However, we noted that the proposed Transparency direction would require KCOM to set out details on how it does this transparently in the DOCAS and that we will continue to engage with KCOM on the implementation of the proposed cost categories.
- 3.50 In respect of the column headings in the Statement of Current Cost MCE schedules, we proposed that KCOM should disclose both the current and prior year in absolute terms rounded to the nearest £'000. We proposed that KCOM should continue to disclose the percentage change year on year. We also proposed 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.

### Other schedules

- 3.51 We summarise our proposals for changes to other schedules in KCOM's RFS in Table 3.7 below.

**Table 3.7: Proposed changes to other schedules**

Schedule name (2017/18 RFS)	Summary of proposed change
<b>Reconciliation Profit and Loss (pages 45 and 46).</b>	Underneath the bottom row titled "Profit for the year attributable to owners of the parent" we proposed that KCOM include the relevant page reference <sup>43</sup> to the KCOM plc Annual Report to provide stakeholders with a more transparent reconciliation between the RFS and KCOM Annual Report.
<b>Reconciliation MCE (page 47)</b>	<p>We proposed that the asset categorisation in this schedule be no longer required.</p> <p>The schedule should reconcile the closing capital employed figure in the RFS to the Consolidated Balance Sheet in KCOM plc Annual Report<sup>44</sup> with a page reference to the KCOM plc Annual report.</p> <p>The schedule should set out the MCE for each regulated market, retail residual and wholesale residual. This aggregate total of these should equate to the MCE total for KCOM. It should then be converted into a closing CCA capital employed.</p> <p>The schedule should 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.</p>

<sup>43</sup> Currently page 82 of the 2016/17 KCOM plc Annual Report <https://www.kcomplc.com/media/1625/annual-report-2016-17.pdf>.

<sup>44</sup> 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>.

The information should be 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 52) – to be provided in private**

We proposed that the format of this schedule should stay the same but with the addition of two columns containing information that is currently provided in the Network Services Reconciliation (which we were proposing need no longer be published). The first column would set out the unit 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. We explained that KCOM should set out the methodology on how it calculates the new column information in the DOCAS.

**Inter Market Turnover (page 50) – to be provided in private**

We proposed that the format of this information should stay 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.

## Stakeholder comments

3.52 In its initial response to our consultation, KCOM agreed with our proposed new form and content direction.<sup>45</sup> BT did not comment.

## Subsequent discussions with KCOM

3.53 However, following the end of the consultation period, KCOM wrote to Ofcom explaining that as part of their scoping exercise to update the RFS (based on the consultation proposals) they had *“identified some areas where we consider that Ofcom’s proposals could be improved on for practical or transparency reasons and so considered it helpful to highlight these and offer our observations in advance of you finalising your statement”*. We set out KCOM’s observations in Table 3.8 below.

**Table 3.8: KCOM proposed RFS improvements**

Schedule name (2017/18 RFS page references)	Summary of KCOM proposed improvement
<b>Retail Residual Profit and Loss (page 48) and MCE (page 49).</b>	As explained in footnotes 41 and 42 above, we proposed in the 2018 KCOM RFR Consultation that the format for the Retail Residual P&L and MCE would have the same reported cost and asset categories as required for reported regulated and wholesale residual. KCOM noted that, given

<sup>45</sup> KCOM response to the 2018 KCOM RFR Consultation, paragraph 2.9.

	<p>the very different business activities of the retail business compared to the wholesale business, most of the proposed reporting categories (duct, copper etc) would have zero values. KCOM suggested that we adopt a different reporting format for the retail statements which includes more relevant cost categories.</p>
<p><b>Proposed Categories – CCA Operating costs (pages 8, 13, 17, 21, 25, 29, 33, 37)</b></p>	<p>KCOM explained that, due to the structure of their general ledger, it will not be possible to separately report costs for the proposed operating categories as set out in Table 3.5b above for each of:</p> <ul style="list-style-type: none"> <li>• End User Installation;</li> <li>• Field Maintenance; and</li> <li>• Network Provision.</li> </ul> <p>KCOM proposed they report against a new reporting category of ‘Engineering Support’ in the Current Account Profit and Loss Schedules, which would capture the costs of the engineering team as recorded in their general ledger.</p>
<p><b>Proposed Categories – Fixed Assets (pages 9, 14, 18, 22, 26, 30, 34, 38, 47)</b></p>	<p>KCOM suggested that the fixed asset reporting, as set out in Table 3.5b above, should align to the proposed operating cost reporting as set out in Table 3.6 above. They therefore proposed that we remove the requirement for separate disclosure for each of:</p> <ul style="list-style-type: none"> <li>• Transmission Equipment;</li> <li>• Exchange Equipment; and</li> <li>• Other asset categories,</li> </ul> <p>and replace them with cost categories for:</p> <ul style="list-style-type: none"> <li>• Equipment; and</li> <li>• Other asset categories.</li> </ul>

3.54 KCOM also asked for clarification on turnover reporting and comparatives;

- a) **Turnover Reporting.** As set out in the 2018 KCOM RFR Consultation, we proposed that for all Current Account Profit and Loss Schedules, KCOM should disclose turnover identifying Gross, Discounts and net turnover. However, KCOM proposed to report wholesale revenues in reported markets on a gross basis, based on reference offer prices. We understand this to be because KCOM does not currently offer any volume-related discounts. For residual markets, KCOM proposed reporting turnover on a net basis inclusive of any discounts.
- b) **Reporting of Mean Capital Employed balances.** KCOM noted that balance sheet values for each reported category are currently reported in the RFS using year end values (with total MCE for the market also shown), but that the proposed format in our

consultation suggested that balance sheet values should be reported as MCE for each individual reported category. KCOM queried whether this was correct.

- c) **Comparatives.** KCOM asked for confirmation as to whether the 2018 comparative numbers in the 2019 RFS need to be restated using the new format in the 2019 RFS.

## Our decisions

3.55 Having considered KCOM's responses to our consultation, we have decided to implement the Form and Content Direction as proposed in the 2018 KCOM RFR Consultation across all regulated markets for the 2018/19 RFS, subject to some minor amendments. The purpose of these amendments is to take account of the improvements proposed by KCOM. Specifically, we have decided to accept the suggested amendments made by KCOM which are summarised in Table 3.8 above.

- a) **Retail Residual Activities.** Reflecting KCOM's representations and taking account of the cost categories that it currently uses for Retail Residual Activities in the RFS,<sup>46</sup> we have decided that the reported cost headings for the RFS should be:

- i) Retail Residual Current Cost P&L
- Charges from Wholesale markets
  - Marketing
  - Sales
  - Customer Services
  - Bad debt
  - Depreciation – Land and Buildings
  - Depreciation - Other
  - Other
  - Holding (Gain)/Loss
  - Supplementary Depreciation
  - CCA Adjustments (Inc. holding (gain/ loss) and Supplementary depreciation
  - Other adjustments
- ii) Retail Residual MCE
- Land and Buildings
  - Other
  - Stocks
  - Cash

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<sup>46</sup> See pages 48 and 49 of the 2017/18 KCOM RFS.



External Debtors

Internal Debtors

External Creditors

Internal Creditors

- b) **CCA Operating Cost categories.** We agree that the structure of the RFS P&L schedules should be as closely aligned as possible to KCOM's general ledger. We have therefore decided that the operating categories (except for retail residual activities – see above) should be:
- i) Engineering Support
  - ii) Finance and Billing
  - iii) General Management
  - iv) Bad Debts
  - v) Back office support
  - vi) Depreciation – Duct
  - vii) Depreciation – Copper
  - viii) Depreciation – Fibre
  - ix) Depreciation – Transmission
  - x) Depreciation – Exchange
  - xi) Deprecation - Other
  - xii) Other Costs
  - xiii) CCA Adjustments (inc. Holding (gain)/loss and Supplementary depreciation
  - xiv) Other adjustments
- c) **Fixed Asset categories.** We agree that the structure of the RFS balance sheet should be consistent with the RFS P&L. We have decided that the asset categories (except for retail residual activities – see above) should be:
- i) Land and Buildings
  - ii) Duct
  - iii) Fibre
  - iv) Copper
  - v) Transmission
  - vi) Exchange
  - vii) Other

- d) **Turnover reporting.** Regarding wholesale revenues, we understand from KCOM that it will calculate its internal sales by reference to its reference offer prices, and that it does not apply any volume-related discounts. For this reason, we agree with KCOM that internal revenues from its regulated markets should be calculated on a gross basis using reference offer prices, and that discounts are not currently relevant. However, to the extent that KCOM decides, in the future, to apply any discounts to its reference offer price for internal sales, then we would expect it to report the revenues from those sales on both a gross and discounted basis. Consistent with this, with respect to external sales in wholesale reported markets, if discounts are given, then these must be disclosed to show the gross and discounted revenues. We agree with KCOM that for retail residual markets, turnover should be reported showing gross revenue and discounted revenue.
- e) **Reporting of Mean Capital Employed balances.** We agree with KCOM that the balance sheet values should be reported on a closing balance basis for each reported category statement of current cost mean capital employed with total MCE reported on the current cost profit and loss account in order for stakeholders to understand on what basis the return on mean capital is calculated.
- f) **Comparatives.** The SMP conditions which set out KCOM's general regulatory financial reporting obligations provide that each RFS shall include prior year comparatives which shall be prepared on a basis consistent with current year figures.<sup>47</sup> The restated comparatives will help stakeholders and ourselves to understand year on year movements in the RFS, and we note that the comparative would be meaningless if not restated. For these reasons, KCOM must restate the 2018 comparative figures in the 2019 RFS on the same basis as the 2019 figures.

3.56 The direction is set out in Annex 1 (see Schedule 4 to the Notification).

## Audit opinion for the RFS

### Our proposals

3.57 In the 2018 KCOM RFR Consultation, we explained our provisional view that the current audit arrangements in relation to KCOM are justifiable and do not require any substantive change. However, we proposed to withdraw the current audit directions (namely, Directions 5 and 6) across all markets in which KCOM is regulated and to impose new audit opinion directions. The purpose of this proposal was to promote the consistent application of the audit opinion directions across all the markets in which KCOM is regulated. This would not have represented a substantive change as the wording in the proposed directions was the same as in the directions being revoked.

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<sup>47</sup> See, for example, SMP Condition 8.9 – Regulatory Financial Reporting, Ofcom 2018, WLA and WBA Market Reviews - Competition in the Hull Area, page 147. See also SMP Condition OB 9 in respect of the business connectivity and narrowband markets.

- 3.58 The proposals allowed for two types of opinion to be used for the regulatory audit: “Fairly Presents in Accordance with” (FPIA) and “Properly Prepared in Accordance with” (PPIA) opinion. Both types of opinion would consider KCOM’s compliance, when preparing its regulatory financial reports, with the published DOCAS prepared by KCOM, as well as our regulatory financial reporting obligations surrounding the RFS. However, the scope of the two types of opinion is different; 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.

## Stakeholder comments

- 3.59 KCOM considered that, in light of changes to International Standard on Auditing (UK) (ISA (UK) 800 (Revised)<sup>48</sup> (the **ISA 800**), it would no longer be appropriate and proportionate for Ofcom to continue to require KCOM to obtain an FPIA opinion from its auditors. In its view, it should only be subject to a common PPIA audit opinion direction.
- 3.60 In particular, KCOM noted that its auditors undertake their audit on its RFS in accordance with the ISA 800. It stated that these standards identify financial reporting provisions established by a regulator to meet the requirements of a regulator as a ‘special purpose framework’, and that a suitable opinion framework for such financial statements would be a PPIA opinion in accordance with the identified special purpose framework.<sup>49</sup>
- 3.61 KCOM’s view is that its RFS are produced using the rules in the DOCAS, which is a special purpose framework. According to KCOM, the DOCAS special purpose framework is not a fair presentation framework. This view was supported by its regulatory auditors.<sup>50</sup> It suggested that a PPIA opinion would provide Ofcom with the necessary level of assurance that its RFS can be used effectively and with confidence by it and stakeholders in determining whether KCOM is meeting its regulatory obligations.<sup>51</sup>

## Ofcom Decision

- 3.62 Having considered KCOM’s response, we agree that it is no longer appropriate to require KCOM to obtain a FPIA opinion on its RFS. We agree that a PPIA opinion will be sufficient. We have therefore decided to implement the proposed PPIA Audit Direction and not the FPIA Audit Direction. The PPIA Direction will apply to all regulated markets for the 2018/19 RFS.<sup>52</sup> The direction is set out in Annex 1 (see Schedule 5 to the Notification).

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<sup>48</sup> Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks (“ISA (UK) 800”) issued by the Financial Reporting Council, effective for audits of financial statements for periods commencing on or after 1 January 2017.

<sup>49</sup> KCOM response to the 2018 KCOM RFR Consultation, paragraph 2.10.

<sup>50</sup> Letter from KCOM to Ofcom, dated 12 October 2018.

<sup>51</sup> KCOM response to the 2018 KCOM RFR Consultation, paragraph 1.10.

<sup>52</sup> We note, however, that this would not appear to have any practical implications for KCOM.

## Legal tests

- 3.63 We have considered whether, for each new direction discussed above, we are satisfied that the relevant legal tests set out in the Act would be satisfied. For the reasons set out below, we are satisfied of this.
- 3.64 In each case we consider that the 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 decisions are aligned with Ofcom's regulatory decisions and give confidence to stakeholders about the absence of bias in the preparation of the RFS. They also ensure that the presentation and usability of the RFS is improved and that the obligations that are imposed on KCOM are proportionate.
  - the decision therefore seeks to ensure that the RFS remain relevant, thereby increasing transparency. Ultimately, this promotes competition.
- 3.65 In imposing 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<sup>53</sup>.

## Network components

- 3.66 We have decided to withdraw the current list of network components and replace them with the network components listed at paragraph 3.7 above. To do this, we have decided to make the new direction set out at Annex 1, Schedule 1).
- 3.67 We consider that this new direction meets the tests set out in section 49(2) of the Act in that it is:
- Objectively justifiable, because it is necessary for us to give a direction specifying network components for KCOM so that it can attribute costs 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 (separately) to update BT's list of components.
  - Proportionate, because the new direction does no more than is required to specify network components.
  - Transparent, because we have set out clearly the network components that KCOM is required to report against.

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<sup>53</sup> Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications, recital 4. [http://www.akos-rs.si/files/APEK\\_eng/Legislation/I-26620051011en00640069.pdf](http://www.akos-rs.si/files/APEK_eng/Legislation/I-26620051011en00640069.pdf).

## Transparency

- 3.68 We have decided to withdraw the current Direction and to replace it with a new Transparency Direction (*see Annex 1, Schedule 2*).
- 3.69 We consider that the 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 (i.e. to ensure that presentation of the basis of preparation is clear for users) is clear.

## Preparation, audit, delivery and publication of the RFS

- 3.70 We have decided to withdraw the current direction and to replace it with a new Preparation, Audit, Delivery and Publication of the RFS Direction (*see Annex 1, Schedule 3*).
- 3.71 We consider that the direction meets the tests set out in section 49(2) of the Act in that it is:
- Objectively justifiable, because it 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 from KCOM to provide them with reasonable confidence about its 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, to the extent that there are any differences between the information required to be provided and published by BT and KCOM, we consider that these are justified.
  - Proportionate, because the requirements will be no more than is required to ensure the effectiveness of the decisions in this statement and that Ofcom and stakeholders are provided with a sufficient level of information. The requirements do not extend beyond those necessary to achieve this.
  - 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 an appropriate and proportionate level of information.

## Form and content of the RFS

- 3.72 We have decided to withdraw the current direction and to replace it with a new Form and Content of the RFS Direction. We have decided to require KCOM to publish and provide different information within its schedules (*see Annex 1, Schedule 4*).
- 3.73 We consider that the new direction meets the tests set out in section 49(2) of the Act in that it is:
- 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 from KCOM to provide them with reasonable confidence about its 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, to the extent that there are any differences between the information required to be provided and published by BT and KCOM, we consider that these are justified.
  - Proportionate, because the requirements will be no more than is necessary to ensure the effectiveness of the decisions in this statement and that Ofcom and stakeholders are provided with a sufficient level of information. The requirements do not extend beyond those necessary to achieve this.
  - 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 an appropriate and proportionate level of information.

## Audit opinion for the RFS

- 3.74 We have decided to withdraw the current directions (i.e. both the FPIA and PPIA Audit Directions) and to adopt a new PPIA Audit Opinion Direction (*see Annex 1, Schedule 5*).
- 3.75 We consider that the new PPIA Audit Opinion direction meets the tests set out in section 49(2) of the Act in that it is:
- 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 (i.e. to ensure that an appropriate level of assurance is provided on the RFS) is clear.

# A1. Directions

## Directions relating to regulatory financial reporting requirements for WLA, WBA, BCMR and Narrowband markets

### Section 1 – Network Component direction

#### Notification of determination, under section 49 of the Communications Act 2003 and SMP Services Condition OB2 and SMP Services Condition 8.2, to revoke Direction 1 and impose a new direction specifying network components

##### Background

A1.1 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.

A1.2 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.

A1.3 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.

A1.4 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.

A1.5 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 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.

A1.6 On 7 August 2018, OFCOM published a consultation document entitled “KCOM Regulatory Financial Reporting: Consultation on proposed regulatory financial reporting directions for KCOM” (the “**2018 KCOM RFR 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.

A1.7 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.

A1.8 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.



A1.9 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.

A1.10 In the 2018 KCOM RFR Consultation, Ofcom proposed to revoke Direction 1 and propose a new Network Components Direction in relation to each of the markets set out in paragraph A1.6 above.

A1.11 Ofcom invited responses to the 2018 KCOM RFR Consultation by 11 September 2018. On 11 September 2018, Ofcom extended the deadline for responses to 18 September 2018.

A1.12 A copy of the 2018 KCOM RFR Consultation was sent to the Secretary of State in accordance with section 49C(1) of the Act.

A1.13 Ofcom received two responses in relation to the proposals set out in the 2018 KCOM RFR Consultation and it has considered every such representation. The Secretary of State has not notified Ofcom of any international obligation of the United Kingdom for the purposes of section 49A(6)(b) of the Act.

A1.14 The 2018 KCOM RFR Consultation did not contain proposals of EU significance for the purposes of the Act.

## **Determination to revoke Direction 1 and make a new Network Component Direction**

A1.15 In accordance with section 49 of the Act, Ofcom has determined to revoke Direction 1 and make a new direction pursuant to SMP Condition OB2 and SMP Condition 8 specifying Network Components in relation to each of the markets set out in paragraph A1.6 above.

A1.16 The direction is set out in the Schedule to this Notification.

A1.17 The effect of and reasons for giving the direction are set out in the statement accompanying this Notification.

## **Ofcom's duties and legal tests**

A1.18 For the reasons set out in the statement accompanying this Notification, Ofcom considers that the new direction referred to in paragraph A1.15 complies with the requirements of section 49(2) of the Act.

A1.19 In making the direction referred to in paragraph A1.15, 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.

## **Interpretation**

A1.20 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.

A1.21 This direction will take effect on 6 February 2019.

A1.22 A copy of this Direction has been sent to the Secretary of State and the European Commission in accordance with sections 49C(1) and 49C(2) of the Act respectively.

**Signed**

A handwritten signature in black ink, appearing to read 'Dawn [unclear]', written in a cursive style.

Director of Financial Economics, Ofcom

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

6 February 2019

## Schedule 1 – Network Component Direction

**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, Conditions OB1 to OB33 and SMP Services Conditions 8.1 to 8.29.**

1. In accordance with section 49 of the Act, Ofcom hereby makes a Direction specifying network components, in relation to the markets listed in paragraph A1.6 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 of the Act, Ofcom hereby gives a Direction revoking Direction 1 in relation to the markets listed in paragraph A1.6 above.

## Section 2 – Transparency direction

### Notification of determination, under section 49 of the Communications Act 2003 and SMP Services Condition OB2 and SMP Services Condition 8.2, to revoke Direction 2 and impose a new direction specifying the transparency requirements for the purposes of preparing and maintaining the accounting records, accounting documents, and regulatory financial statements

#### Background

A1.23 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.

A1.24 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.

A1.25 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.

A1.26 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.

A1.27 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 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.

A1.28 On 7 August 2018, OFCOM published a consultation document entitled "KCOM Regulatory Financial Reporting: Consultation on proposed regulatory financial reporting directions for KCOM." (the "**2018 KCOM RFR 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.

A1.29 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.

A1.30 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.

A1.31 In the 2018 KCOM RFR Consultation, Ofcom proposed to revoke Direction 2 and to make a new Transparency Direction in relation to each of the markets set out in paragraph A1.28 above.

A1.32 Ofcom invited responses to the 2018 KCOM RFR Consultation by 11 September 2018. On 11 September 2018, Ofcom extended the deadline for responses to 18 September 2018.

A1.33 A copy of the 2018 KCOM RFR Consultation, was sent to the Secretary of State in accordance with section 49C(1) of the Act.

A1.34 Ofcom received two responses in relation to the proposals set out in the 2018 KCOM RFR Consultation and it has considered every such representation. The Secretary of State has not notified Ofcom of any international obligation of the United Kingdom for the purposes of section 49A(6)(b) of the Act.

A1.35 The 2018 KCOM RFR Consultation did not contain proposals of EU significance for the purposes of the Act.

### **Determination to revoke Direction 2 and make a new Transparency Direction**

A1.36 In accordance with section 49 of the Act, Ofcom has determined to revoke Direction 2 and make a new direction pursuant to SMP Condition OB2 and SMP Condition 8 imposing transparency requirements in relation to each of the markets set out in paragraph A1.28 above.

A1.37 The direction is set out in the Schedule to this Notification.

A1.38 The effect of and reasons for giving the direction are set out in the statement accompanying this Notification.

### **Ofcom's duties and legal tests**

A1.39 For the reasons set out in the statement accompanying this Notification, Ofcom considers that the new direction referred to in paragraph A1.36 above complies with the requirements of section 49(2) of the Act.

A1.40 In making the direction referred to in paragraph A1.36, 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.

### **Interpretation**

A1.41 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.

A1.42 This direction will take effect on 6 February 2019.

A1.43 A copy of this Direction has been sent to the Secretary of State and the European Commission in accordance with sections 49C(1) and 49C(2) of the Act respectively.

**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**

6 February 2019

## Schedule 2 - Transparency Direction

**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 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 A1.28 above.
2. In accordance with section 49 of the Act, Ofcom hereby gives a Direction revoking Direction 2 in relation to the markets listed in paragraph A1.28 above.



## Section 3 - Direction for the preparation, audit, delivery and publication of the Regulatory Financial Statements

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

A1.44 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.

A1.45 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.

A1.46 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.

A1.47 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.

A1.48 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 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.

A1.49 On 7 August 2018, OFCOM published a consultation document entitled "KCOM Regulatory Financial Reporting: Consultation on proposed regulatory financial reporting directions for KCOM" (the "**2018 KCOM RFR 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.

A1.50 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.

A1.51 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.

A1.52 In the 2018 KCOM RFR Consultation, Ofcom proposed to revoke Direction 3 and make a new direction specifying the preparation, audit, delivery and publication requirements in relation to the regulatory financial statements in each of the markets set out in paragraph A1.49 above.

A1.53 Ofcom invited responses to the 2018 KCOM RFR Consultation by 11 September 2018. On 11 September 2018, Ofcom extended the deadline for responses to 18 September 2018.

A1.54 A copy of the 2018 KCOM RFR Consultation was sent to the Secretary of State in accordance with section 49C(1) of the Act.

A1.55 Ofcom received two responses in relation to the proposals set out in the 2018 KCOM RFR Consultation and it has considered every such representation. The Secretary of State has not notified Ofcom of any international obligation of the United Kingdom for the purposes of section 49A(6)(b) of the Act.

A1.56 The 2018 KCOM RFR Consultation did not contain proposals of EU significance for the purposes of the Act.

### **Determination to revoke Direction 3 and make a new preparation, audit, delivery and publication of the Regulatory Financial Statements Direction**

A1.57 In accordance with section 49 of the Act, Ofcom has determined to revoke Direction 3 and make a new direction pursuant to SMP Condition OB2 and SMP Condition 8 imposing requirements in relation to the preparation, audit, delivery and publication of the Regulatory Financial Statements in relation to each of the markets set out in paragraph A1.49 above.

A1.58 The direction is set out in the Schedule to this Notification.

A1.59 The effect of and reasons for giving the direction are set out in the statement accompanying this Notification.

### **Ofcom's duties and legal tests**

A1.60 For the reasons set out in the statement accompanying this Notification, Ofcom considers that the direction referred to in paragraph A1.57 above complies with the requirements of section 49(2) of the Act.

A1.61 In making the direction referred to in paragraph A1.57, 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.

### **Interpretation**

A1.62 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.

A1.63 This direction will take effect on 6 February 2019.

A1.64 A copy of this Direction has been sent to the Secretary of State and the European Commission in accordance with sections 49C(1) and 49C(2) of the Act respectively.

**Signed**

A handwritten signature in black ink, appearing to be 'D. Smith', written over a horizontal line.

Director of Financial Economics, Ofcom

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

6 February 2019

## **Schedule 3– Direction for the preparation, audit, delivery and publication of the Regulatory Financial Statements**

**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, delivery and publication of Regulatory Financial Statements**

1. In accordance with section 49 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 the Annex to this direction for the markets listed above in paragraph A1.49.
2. In accordance with section 49 of the Act, Ofcom hereby gives a Direction revoking Direction 3 in relation to the markets listed in paragraph A1.49 above.

## Annex to the preparation, audit, delivery and publication of the 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; and
- references to annexes are to the Form and Content Direction dated 6 February 2019

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];

KCOM Regulatory Financial Reporting

- SDR – statement of responsibility, as set out in annex 2 [NB – no audit opinion is required for the SDR];
- 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.

Review of Narrowband Markets														
	CPPS	RTW	RTR	RTSA	SoAC FA (market)	Financial statements							Audit	
						SoAC FA (consolidated)	NCR FA	SOS	IMT	SoACIC	RFR	SDR	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	
Wholesale ISDN30 exchange line services	X	X	X	X	O	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	
Wholesale call origination on a fixed narrowband network	X	X	X	X	O	X	X	X	X	X	X	X	X	

  

Review of Business Connectivity Markets														
	CPPS	RTW	RTR	RTSA	SoAC FA (market)	Financial statements							Audit	
						SoAC FA (consolidated)	NCR FA	SOS	IMT	SoACIC	RFR	SDR	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	
Wholesale market for contemporary interface symmetric broadband origination	X	X	X	X	O	X	X	X	X	X	X	X	X	

  

Review of Wholesale Broadband Origination Market														
	CPPS	RTW	RTR	RTSA	SoAC FA (market)	Financial statements							Audit	
						SoAC FA (consolidated)	NCR FA	SOS	IMT	SoACIC	RFR	SDR	PPIA	
Wholesale market and illustrative services														
Wholesale broadband access provided at a fixed location	X	X	X	X	O	X	X	X	X	X	X	X	X	

  

Review of Wholesale Local Access Markets														
	CPPS	RTW	RTR	RTSA	SoAC FA (market)	Financial statements							Audit	
						SoAC FA (consolidated)	NCR FA	SOS	IMT	SoACIC	RFR	SDR	PPIA	
Wholesale market and illustrative services														
Wholesale supply of Copper loop-based, cable-based and fibre-based wholesale local access at a fixed location	X	X	X	X	O	X	X	X	X	X	X	X	X	

## Section 4 - Direction for the form and content of Regulatory Financial Statements

### Notification of determination, under section 49 of the Communications Act 2003 and SMP Services Condition OB2 and SMP Services Condition 8.2, to revoke Direction 4 and impose a new direction specifying the form and content of the Regulatory Financial Statements

A1.65 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.

A1.66 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.

A1.67 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.

A1.68 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.

A1.69 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 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.

A1.70 On 7 August 2018, OFCOM published a consultation document entitled "KCOM Regulatory Financial Reporting: Consultation on proposed regulatory financial reporting directions for KCOM" (the "**2018 KCOM RFR 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.

A1.71 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.

A1.72 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.

A1.73 In the 2018 KCOM RFR Consultation, Ofcom proposed to revoke Direction 4 and make a new direction specifying requirements in relation to the form and content of the Regulatory Financial Statements in relation to each of the markets set out in paragraph A1.70 above.

A1.74 Ofcom invited responses to the 2018 KCOM RFR Consultation by 11 September 2018. On 11 September 2018, Ofcom extended the deadline for responses to 18 September 2018.

A1.75 A copy of the 2018 KCOM RFR Consultation was sent to the Secretary of State in accordance with section 49C(1) of the Act.

A1.76 Ofcom received two responses in relation to the proposals set out in the 2018 KCOM RFR Consultation and it has considered every such representation. The Secretary of State has not notified Ofcom of any international obligation of the United Kingdom for the purposes of section 49A(6)(b) of the Act

A1.77 The 2018 KCOM RFR Consultation did not contain proposals of EU significance for the purposes of the Act.

### **Determination to revoke Direction 4 and make a new direction specifying requirements in relation to the form and content of the Regulatory Financial Statements**

A1.78 In accordance with section 49 of the Act, Ofcom has determined to revoke Direction 4 and make a new direction pursuant to SMP Condition OB2 and SMP Condition 8 specifying requirements in relation to the form and content of the Regulatory Financial Statements in relation to each of the markets set out in paragraph A1.70 above.

A1.79 The direction is set out in the Schedule to this Notification.

A1.80 The effect of and reasons for giving the direction are set out in the statement accompanying this Notification.

### **Ofcom's duties and legal tests**

A1.81 For the reasons set out in the statement accompanying this Notification, Ofcom considers that the new direction referred to in paragraph A1.78 complies with the requirements of section 49(2) of the Act

A1.82 In making the direction referred to in paragraph A1.78, 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.

### **Interpretation**

A1.83 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.

A1.84 This direction will take effect on 6 February 2019.

A1.85 A copy of this Direction has been sent to the Secretary of State and the European Commission in accordance with sections 49C(1) and 49C(2) of the Act respectively.

**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**

6 February 2019

## **Schedule 4 – Direction for the form and content of the Regulatory Financial Statements**

1. In accordance with section 49 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 (as applicable), 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 of the Act, Ofcom hereby gives a Direction revoking Direction 4 in relation to the markets listed in paragraph A1.70 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
<b>Turnover</b> (identifying Gross, Discounts and Net turnover for external sales if applicable)					
Internal Sales [Note]					
External Sales					
<b>Total Turnover</b>					
<b>Operating costs</b>					
Operating costs					
- Engineering Support					
- Finance & Billing					
- General Management					
- Bad Debts					
- Back Office Support					
- Other Costs (total of items below 5% of operating cost)					
Sub total operating expenditure					
Depreciation					
- Duct					
- Copper					
- Fibre					
- Transmission					
- Exchange					
- Other					
CCA adjustments:					
Holding (gain)/loss					
Supplementary depreciation					
Other adjustments					
<b>Total operating costs</b>					

**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
<b>Fixed assets</b>					
Tangible fixed assets					
- Land & Buildings					
- Duct					
- Fibre					
- Copper					
- Transmission					
- Exchange					
- Other					
Investments					
<b>Total fixed assets</b>					
<b>Current assets</b>					
Stocks					
Debtors					
- internal					
- external					
<b>Total current assets</b>					
<b>Creditors: amounts falling due within one year</b>					
Other creditors					
- internal					
- external					
<b>Total creditors: amounts falling due within one year</b>					
<b>Net current assets</b>					
Total assets less current liabilities					
Provisions for liabilities and charges					
<b>Closing capital employed</b>					

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
<b>Fully Allocated Cost Components</b>											

Electronics;  
Field provision;  
Field maintenance;  
Local Loop infrastructure  
Exchange concentrator;  
Exchange-exchange Transmission link;  
Back-office Provision;  
Back-office Maintenance;  
Sales and Product Management;  
PPW 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	£k CY	Restated (cross refer to notes) £k PY	£'k Change Year on	% Change Year on Year
<b>Turnover</b> (identifying Gross, Discounts and Net turnover for external sales if applicable)				
Internal Sales [Note]				
External Sales				
<b>Total Turnover</b>				
<b>Operating costs</b>				
Operating costs				
- Engineering Support				
- Finance & Billing				
- General Management				
- Bad Debts				
- Back Office Support				
- Other Costs (total of items below 5% of operating cost)				
Sub total operating expenditure				
Depreciation				
- Duct				
- Copper				
- Fibre				
- Transmission				
- Exchange				
- Other				
CCA adjustments:				
Holding (gain)/loss				
Supplementary depreciation				
Other adjustments				
<b>Total operating costs</b>				
<b>Return</b>				
<b>MCE</b>				
<b>RETURN ON MEAN CAPITAL EMPLOYED</b>				
for the year ended 31 March 20xx	CY	PY		%
	%	%		
<b>Return on mean capital employed</b>				

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

## Annex 9

**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
<b>Fixed assets</b>					
Tangible fixed assets					
- Land & Buildings					
- Duct					
- Fibre					
- Copper					
- Transmission					
- Exchange					
- Other					
<b>Total fixed assets</b>					
<b>Current assets</b>					
Stocks					
Debtors					
- internal					
- external					
Cash					
<b>Total current assets</b>					
<b>Creditors: amounts falling due within one year</b>					
Other creditors					
- internal					
- external					
<b>Total creditors: amounts falling due within one year</b>					
<b>Net current assets</b>					
Total assets less current liabilities					
Provisions for liabilities and charges					
<b>Closing capital employed</b>					

## 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						
<b>Total</b>						
<b>Adjustments (as necessary)</b>						
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						
<b>As per the KCOM Annual Report (pxxx)</b>						

Annex 13

<b>KCOM Reconciliation statement</b>	<b>CY</b>	<b>PY</b>
		<b>Restated</b> (cross refer to explanatory notes)
<b>Consolidated mean capital employed</b>		
For the year ended 31 March 200XX	<b>£k</b>	<b>£k</b>
Shareholders' funds as in the Annual Report (pxxx)		
CCA adjustments		
<b>Adjustments</b>		
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		
<b>Closing CCA capital employed at 31 March</b>	_____	_____
<b>Opening CCA capital employed at 1 April</b>		
Adjustment to opening capital employed		
Revised opening CCA capital employed at 1 April	_____	_____
Average CCA capital employed		
Daily averaging adjustment		
Deferred costs		
<b>Total CCA mean capital employed</b>	_____	_____
<b><u>Mean capital employed of SMP Markets</u></b>		
Wholesale Market A (where cost accounting and accounting separation obligations apply)		
Wholesale Market B etc (where cost accounting and accounting separation obligations apply)		
<b>Sub total markets</b>	_____	_____
<b><u>Residual activities</u></b>		
- Wholesale residual activity		
- Retail residual activity		
<b>Total CCA mean capital employed</b>	_____	_____

## KCOM Regulatory Financial Reporting

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
<b>Turnover</b> (identifying Gross, Discounts and Net turnover for external sales if applicable)					
Internal Sales [Note]					
External Sales					
<b>Total Turnover</b>					
<b>Operating costs</b>					
Charges from Other KCOM Markets					
Operating costs (to show all cost categories that exceed 5% of operating cost including)					
- Engineering Support					
- 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					
- Transmission					
- Exchange					
- Other					
CCA adjustments:					
Holding (gain)/loss					
Supplementary depreciation					
Other adjustments					
<b>Total operating costs</b>					
<b>Return</b>					

## 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
<b>Fixed assets</b>				
Tangible fixed assets				
- Land & Buildings				
- Duct				
- Fibre				
- Copper				
- Transmission				
- Exchange				
- Other				
<hr/>				
<b>Total fixed assets</b>				
<b>Current assets</b>				
Stocks				
Debtors				
- internal				
- external				
Cash				
<hr/>				
Total current assets				
<hr/>				
<b>Creditors: amounts falling due within one year</b>				
Other creditors				
- internal				
- external				
<hr/>				
Total creditors: amounts falling due within one year				
<hr/>				
Net current assets				
<hr/>				
Total assets less current liabilities				
Provisions for liabilities and charges				
<hr/>				
<b>Closing capital employed</b>				
<hr/>				



## 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
<b>Turnover</b> (identifying Gross, Discounts and Net turnover)					
Internal Sales [Note]					
External Sales					
<b>Total Turnover</b>					
<b>Operating costs</b>					
Charges from Other KCOM Markets					
Operating costs (to show all cost categories that exceed 5% of operating cost including)					
- Marketing					
- Sales					
- Customer Services					
- Bad Debts					
- Other Costs (total of items below 5% of operating cost)					
Sub total operating expenditure					
Depreciation					
- Land and Buildings					
- Other					
CCA adjustments:					
Holding (gain)/loss					
Supplementary depreciation					
Other adjustments					
<b>Total operating costs</b>					
<b>Return</b>					
<b>MCE</b>					
<b>RETURN ON MEAN CAPITAL EMPLOYED</b>					
for the year ended 31 March 20xx		CY	PY		
		%	%		%
<b>Return on mean capital employed</b>					

[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
<b>Fixed assets</b> (to show all asset categories that exceed 5% of operating cost including)					
Tangible fixed assets					
- Land & Buildings					
- Other (total of items below 5% of fixed assets)					
<hr/>					
<b>Total fixed assets</b>					
<b>Current assets</b>					
Stocks					
Debtors					
- internal					
- external					
Cash					
<hr/>					
Total current assets					
<hr/>					
<b>Creditors: amounts falling due within one year</b>					
Other creditors					
- internal					
- external					
<hr/>					
Total creditors: amounts falling due within one year					
<hr/>					
Net current assets					
<hr/>					
Total assets less current liabilities					
Provisions for liabilities and charges					
<hr/>					
<b>Closing capital employed</b>					
<hr/>					

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
<b>Turnover originating in:</b>											
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											
<b>Total 20xx</b>											

## Section 5 – Direction for the form of the ‘PPIA’ opinion for Regulatory Financial Statements

### Notification of determination, under section 49 of the Communications Act 2003 and SMP Services Condition OB2 and SMP Services Condition 8.2, to revoke Directions 5 and 6 and impose a new direction specifying requirements for the ‘PPIA’ audit of Regulatory Financial Statements.

A1.86 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.

A1.87 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.

A1.88 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.

A1.89 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.

A1.90 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 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.

A1.91 On 7 August 2018, OFCOM published a consultation document entitled "KCOM Regulatory Financial Reporting: Consultation on proposed regulatory financial reporting directions for KCOM" (the "**2018 KCOM RFR 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.

A1.92 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.

A1.93 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.

A1.94 In the 2018 KCOM RFR Consultation, Ofcom proposed revoke Directions 5 and 6 and propose a new direction specifying the form of the audit opinion for the Regulatory Financial Statements in relation to each of the markets set out in paragraph A1.91 above.

A1.95 Ofcom invited responses to the 2018 KCOM RFR Consultation by 11 September 2018. On 11 September 2018, Ofcom extended the deadline for responses to 18 September 2018.

A1.96 A copy of the 2018 KCOM RFR Consultation was sent to the Secretary of State in accordance with section 49C(1) of the Act.

A1.97 Ofcom received two responses in relation to the proposals set out in the 2018 KCOM RFR Consultation and it has considered every such representation. The Secretary of State has not notified

Ofcom of any international obligation of the United Kingdom for the purposes of section 49A(6)(b) of the Act

A1.98 The 2018 KCOM RFR Consultation did not contain proposals of EU significance for the purposes of the Act.

### **Determination to revoke Directions 5 and 6 and make a new direction specifying the requirements as to the form of the PPIA opinion for the Regulatory Financial Statements**

A1.99 In accordance with section 49 of the Act, Ofcom has determined to revoke Directions 5 and 6 and make a new direction pursuant to SMP Condition OB2 and SMP Condition 8 specifying the requirements as to the form of the PPIA opinion for the Regulatory Financial Statements in relation to each of the markets set out in paragraph A1.91 above.

A1.100 The direction is set out in the Schedule to this Notification.

A1.101 The effect of and reasons for giving the direction are set out in the statement accompanying this Notification.

### **Ofcom's duties and legal tests**

A1.102 For the reasons set out in the statement accompanying this Notification, Ofcom considers that the new direction referred to in paragraph A1.99 above complies with the requirements of section 49(2) of the Act.

A1.103 In giving the direction referred to in paragraph A1.99, 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.

### **Interpretation**

A1.104 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.

A1.105 This direction will take effect on 6 February 2019.

A1.106 A copy of this Direction has been sent to the Secretary of State and the European Commission in accordance with sections 49C(1) and 49C(2) of the Act respectively.

**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**

6 February 2019

## Schedule 5 - PPIA audit Direction

**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 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 their 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 their opinion under (b) above, anything has come to their attention that would lead them 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 they consider to be required in respect of any such matter; and
    - ii) having reviewed the Accounting Documents, nothing has come to their attention that would lead them to conclude that the Accounting Documents are unreasonable.
2. In accordance with section 49 of the Act, Ofcom hereby makes a Direction revoking Directions 5 and 6 in relation to the markets listed in paragraph A1.91 above.



## A2. Equality Impact Assessment

### Introduction

- A2.1 Ofcom<sup>54</sup> is required by statute to assess the potential impact of all its functions, policies, projects and practices on equality.<sup>55</sup> 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.
- A2.2 It is not apparent to us that the financial reporting requirements that we have decided to impose on KCOM in this document will have a differential impact on any equality group.
- A2.3 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 Ireland<sup>56</sup> or disabled consumers compared to consumers in general.

### Equality impact assessment

- A2.4 We have considered whether the regulatory financial reporting requirements set out in this document would have an adverse impact on promoting equality. In particular, we have considered whether the requirements 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.
- A2.5 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) to provide stakeholders with relevant regulatory financial information on a proportionate basis.
- A2.6 To understand how our reporting requirements 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 regulation is aimed at promoting competition across the range of services that rely on BCMR, Narrowband, WLA and WBA services within the Hull Area.

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<sup>54</sup> We explain why we undertake an Equality Impact Assessment (EIA) and how we have done it in Section 2 of this consultation.

<sup>55</sup> 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.

<sup>56</sup> 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.

- A2.7 We consider that the regulatory financial reporting requirements that we have decided to impose on KCOM in this document will not have a detrimental impact on any defined equality group.
- A2.8 Rather, we consider that those requirements 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.