



KCOM's response to Ofcom's consultation on its proposed regulatory financial reporting requirements in the Hull Area

1. Summary

- 1.1 KCOM Group PLC ('KCOM') welcomes the opportunity to respond to Ofcom's consultation on the proposed regulatory financial reporting directions for KCOM (the "Consultation").¹
- 1.2 We have a clear interest in the Consultation as it relates directly to KCOM's business operations in the Hull Area. Specifically, the regulatory financial reporting of KCOM's operations in economic markets where KCOM has been found to hold Significant Market Power (SMP).
- 1.3 We consider that where Ofcom finds an undertaking holds SMP and considers it appropriate to impose a remedy relating to pricing, the regulatory financial reporting requirements should be aligned with monitoring compliance with the pricing remedy. In addition, we recognise that the financial reporting regime should be sufficient to enable Ofcom to discharge its regulatory duties, and to give credibility to the financial reporting regime and to provide stakeholders with reasonable confidence that the regulated undertaking in question has complied with its SMP conditions.
- 1.4 We further agree that in KCOM's case, where the reporting regime is out-of-date it is appropriate for Ofcom to have reviewed whether the regime is still needed and if so, what information should be provided directly to Ofcom and what information should be published in the Regulatory Financial Statements (RFS).
- 1.5 KCOM has recently introduced a new regulatory cost accounting system² and so we agree that this is an opportune time for Ofcom to consider what further changes might be appropriate to KCOM's financial reporting regime.
- 1.6 As Ofcom recognises, in developing a fit-for-purpose regime, we should not be required to supply detailed reports that Ofcom do not need for internal assessments, nor does it assist the credibility of the regime to require us to produce unnecessary information in the RFS. It is therefore appropriate that Ofcom takes this opportunity to:
 - (i) review the link between the underlying pricing remedies imposed in each of the regulated markets and the financial reporting requirements appropriate to those remedies; and

¹ Ofcom (2018), *KCOM Regulatory Financial Reporting: Consultation on proposed regulatory financial reporting directions for KCOM*, Consultation, 7 August 2018, available at: <https://www.ofcom.org.uk/consultations-and-statements/category-2/regulatory-financial-reporting-directions-kcom>

² The new system utilises specialist activity based costing software (CostPerform) used by a range of communications providers in the UK, Europe and internationally.

- remove the burden of producing and publishing accounting documentation that serves no clear regulatory purpose.
- (ii) consider whether to add additional regulatory requirements in the form of a requirement to publish certain schedules. Specifically:
- Current Cost Profit and Loss Account; and
 - Statement of Current Cost MCE
- 1.7 In principle, for those economic markets where we hold SMP and are required to charge 'fair and reasonable' prices, we consider 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 needed for users of the RFS to understand whether or not we are compliant with our SMP Conditions relating to pricing or for Ofcom to fulfil its statutory duties. However, we recognise that with the introduction of new cost accounting system this has introduced significant cost movements for this financial year it is helpful to provide as much transparency as possible. So, while the current level of information that is published may be unnecessary over the longer term we consider it helpful in the near term
- 1.8 Furthermore, while Ofcom's proposal to reduce the amount of information that is published by 30% for the accounting year 2018/19 is to be welcomed, we ask Ofcom to keep under review whether the information it is requiring us to publish on an ongoing basis is in practice used by stakeholders. If in the future Ofcom finds that it is not, Ofcom should consider further reducing the level of information that we are required to publish in our RFS, while continuing to provide Ofcom with the requisite level of detail it considers appropriate we supply directly to it in order to allow it to meet its regulatory duties.
- 1.9 We note the implementation regulatory accounting period for which these changes are required to be implemented is 2018/19 and, as Ofcom comments, we consider this sufficient time to make the appropriate adjustments to our regulatory costing model.
- 1.10 Ofcom has proposed to continue to require us to obtain a 'fairly prepared in accordance' ('FPIA') audit opinion on our regulatory accounts. In light of changes to International Standard on Auditing (UK) (ISA (UK) 800 (Revised)), we consider the appropriate and proportionate requirement to be a 'properly prepared in accordance with' ('PPIA') audit opinion, which will provide Ofcom with the necessary level of assurance that our RFS can be used effectively and with confidence by it and stakeholders in determining whether we are meeting our regulatory requirements in the Hull Area. In this context we note that BT is required to obtain a PPIA opinion on its RFS and KCOM does not consider that a more onerous auditing obligation would be proportionate for KCOM.
- 1.11 Set out below are the more detailed points on specific proposals that Ofcom has detailed in the Consultation. We hope that Ofcom finds these helpful.

2. KCOM's response on Ofcom's specific proposals

Introduction

The purpose of regulatory financial reporting

- 2.1 As Ofcom sets out in section 2 of the Consultation, there is a close link between the regulatory financial reporting requirements and other regulatory requirements. Given this link and the role played by the financial reporting requirements we recognise the need for relevant information to be provided to Ofcom and for an appropriate level of information to be published.
- 2.2 As we note in paragraphs 1.7 and 1.8 above, we would ask Ofcom to revisit the links it refers to in section 2 of the Consultation in the future and consider the case for further revisions to the reporting regime.

Publication of KCOM's RFS

- 2.3 [X]

Systems reconciliation report

- 2.4 We agree that given our RFS is not used as a basis for setting charge controls and the low level of interest in our RFS from industry stakeholders that it is not proportionate to require us to produce a systems reconciliation report.

Changes to KCOM's current regulatory reporting

Proposed new network component direction

- 2.5 We agree 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.

Transparency direction

- 2.6 We agree that the current transparency requirement ensures that we produce a sufficiently transparent description through the relevant accounting documentation (DOCAS) of our regulatory cost accounting system to provide interested stakeholders with a clear understanding of our RFS. As such the obligation and the means by which we discharge it remains appropriate and relevant. Again, given the desire to provide regulatory clarity in respect of the transparency obligations we consider it appropriate to introduce a new transparency direction.

KCOM-wide and market-level information

- 2.7 We agree with Ofcom's proposals that we should no longer be required to provide certain specified schedules to the RFS relating to all regulated markets; and to no longer publish certain other schedules across all markets, as well as others specific to identified markets that we are required to provide to Ofcom on a confidential basis.
- 2.8 As we set out in paragraph 1.6 and 1.7 above, we consider it appropriate for Ofcom to keep under review the information that we are required report and publish.

Proposed new form and content direction

- 2.9 We agree with the proposed form and content direction.

Preparation, audit, delivery and publication of the RFS

- 2.10 Ofcom has proposed to continue to require us to obtain an FPIA opinion on the RFS. However, as we note in paragraph 1.10 above, with the change in UK audit standard we no longer consider it appropriate or proportionate for Ofcom to continue to require an FPIA opinion on our RFS. The PPIA audit standard provides Ofcom with the necessary level of assurance that our RFS can be used effectively and with confidence by Ofcom and stakeholders in determining whether we are meeting our regulatory requirements in the Hull Area.³ Specifically:

- Our auditors undertake their audit on the RFS in accordance with the International Standards on Auditing (UK) 800 (Revised October 2016) – 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.
- ISA (UK) 800 identifies financial reporting provisions established by a regulator to meet the requirements of a regulator as a special purpose framework. The standard explains that there may be circumstances where a special purpose framework is based on a framework established by an authorised or recognised standards setting organisation or by law or regulation, but does not comply with all the requirements of a fair presentation framework (ISA (UK) 800 paragraph A2).
- In the circumstances described in paragraph A2 of ISA (UK) 800, the special purpose framework may not be a fair presentation framework

³ To the extent that Ofcom considers an additional level of comfort is needed as a consequence of an exceptional change to the regulatory costing system (e.g. the introduction of newly designed regulatory reporting model) then there are alternative mechanisms available to Ofcom which it can use to effectively satisfy itself that the changes that have been made are appropriate.

even if the financial reporting framework on which it is based is a fair presentation framework. This is because the special purpose framework may not comply with all the requirements of the financial reporting framework established by the authorised or recognised standards setting organisation or by law or regulation that are necessary to achieve fair presentation of the financial statements (ISA (UK) 800 paragraph A3). As such the standard sets out that a suitable opinion framework for such financial statements would be 'properly prepared' basis in accordance with the identified special purpose framework.

- An example of a special purpose framework would be a specific cost accounting framework, such as a Description of Cost Accounting System ('DOCAS').
- An auditor's report consistent with those contained as illustration's appended to the standard and sets out the basis in an emphasis of matter paragraph, as required by the standard.

Proposed new PPIA and FPIA audit opinion direction

2.11 For the reasons set out in paragraph 2.10 above, we do not agree with the proposed new PPIA and FPIA audit opinion direction. Rather, we consider we should be subject to a common PPIA audit opinion direction.