KCOM Group PLC
Annual report and accounts 2016/17

Connected to our customers

Connected to our customers

By listening to and learning from our customers, we design and deliver the right services to help them create greater value from the way they interact, collaborate and connect with what matters to them.

Strategic report

Directors' report

Financial statements

See also

Online report
ar17.kcomplc.com

Highlights

Revenue
£ million

£331.3m

-5.1%

EBITDA[1,2]
£ million

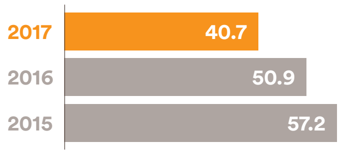
£67.6m

-9.7%

Operating profit[1]
£ million

£40.7m

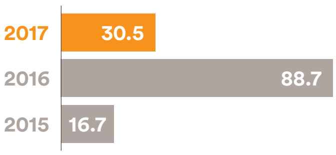
-20.0%



Profit before tax
£ million

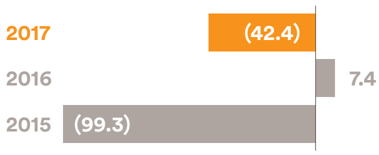
£30.5m

-65.6%



Net (debt)/funds[2]
£ million

£(42.4)m



Proposed full year dividend
(pence per share)

6.00p

+1.5%

1. Before exceptional items.
2. Refer to glossary on page 114.

Operational highlights

- Progress in key focus areas
  - Growth in Enterprise revenue
  - Growth in consumer revenue in Hull and East Yorkshire
  - Fibre network deployment in Hull and East Yorkshire ahead of schedule
- Continued focus on optimising cost base
- Strengthened management team
- Strong cash management

See also

Performance review
page 17

Key performance indicators
page 22

Glossary
page 114

Our business at a glance

We make life easier and better for every customer

We help customers create greater value from the way they interact, collaborate and connect with what matters to them.

We have refined our reporting segments to align with the way the business is run and how financial performance is measured.
See Note 4 on pages 91 to 94.

See also

Our business model
page 10

Market opportunities and trends
page 12

Our strategy
page 20

Enterprise

We help large organisations make the most of technology to serve their customers better and address other business challenges.

Our customers include:

- Bupa
- HMRC
- NFU Mutual
- O2
- Rail Delivery Group
- Shoosmiths

What differentiates us in the Enterprise market

The broadest range of legacy experience combined with cutting edge expertise

Our capability in complex IP-based solutions and cloud implementations is enhanced by partnerships with key vendor partners and niche technology providers.

Agile and nimble by design, we can quickly make a difference to our customers' businesses

We advocate flexible and scalable approaches and technologies to deliver swiftly on the promises of public cloud and digital transformation and help prepare our customers for an unpredictable future.

National Network Services

We provide connectivity-based services to national organisations.

Our customers include:

- Domino's
- Furniture Village
- One Stop
- RNLI
- Wren Kitchens

Our activities in this increasingly commoditising market seek to maximise the value of our historic investment in national network platforms.

Hull and East Yorkshire

Customers can choose from our range of voice and broadband services to suit their needs.

145,000
households and businesses

What differentiates us in the Hull and East Yorkshire market

Our investment in a full fibre network is delivering an unrivalled online experience

Our investment is creating a unique, future-proof platform for the delivery of innovative over-the-top services, with more than half of our customers already able to benefit from ultrafast download speeds that are the exception across the rest of the UK.

As part of the community we serve, we understand our customers' needs

Our unique heritage in Hull and East Yorkshire has made us part of the fabric of the local community. We have a unique ability to engage closely with our customers and use our deep understanding of their needs to deliver services they value.

Chairman's statement

Clear focus on the future

- Strategy focused on delivering shareholder value
  - Long-term cash generation from our Hull and East Yorkshire segment
  - Sustainable growth in our Enterprise segment

Dear Shareholder

Our objective is to deliver long-term, sustainable value for our shareholders. Our strategy is designed to offer shareholders a combination of income generation and value accretion.

Strategic focus

Hull and East Yorkshire is core to the strategic direction of KCOM, and receives the majority of the Group's investment. We are fully committed to completing the fibre deployment across our market to deliver premium services both to homes and businesses. This should deliver long-term sustainable cash generation, to continue to support our dividend policy.

Our Enterprise business is focused on market areas, where we have seen good growth and where we have market leading skills.

We are targeting development in this area to provide momentum in shareholder value. A key part of our growth this year comes from additional business from existing customers who recognise the value we can add to their business. This helps to give us confidence that our strategy is the right one. The Board expects, over the coming 24 months to see further substantial progress, in support of this strategy.

Graham Holden
Non-Executive Chairman

While we continue the investment in our fibre deployment and the further development of our Enterprise business, I am pleased to confirm that the Board is recommending, subject to shareholder approval, a final dividend of 4.00 pence per share, in accordance with our existing commitment to deliver a minimum full year dividend of 6.00 pence per share for both this year and the year ending 31 March 2018. This reflects both our confidence in the strategy being executed by the management team and longer term prospects.

Board appointment

In October, Jane Aikman joined the Board as Chief Financial Officer. Jane previously held a number of Executive level positions, including her most recent role as Chief Financial Officer and Chief Operating Officer for Phoenix IT Group Plc until its acquisition by and merger with Daisy Group.

Jane has quickly established herself as a valued member of the Board and her fresh perspectives are already bringing additional strength and focus to the business. Jane will stand for election by shareholders at the Annual General Meeting in July.

Board effectiveness

We continually consider the effectiveness of the Board and have a formal evaluation annually, which in 2016 was carried out by our Company Secretary. The conclusion from the evaluation was that we are operating effectively but there were some minor areas for improvement. We continue to monitor against our set of Board objectives which are detailed further in the Corporate governance section. In 2017, we will conduct an externally facilitated evaluation.

“We remain in an environment of change and transition both internally and for our customers and markets. Each presents new challenges and exciting opportunities.”

We seek always to ensure that we have appropriate succession plans in place both for the Board and for the senior management team of the business as well as recognising talent right across the organisation. This has been a regular topic of discussion during the year and is covered in the Nomination Committee report on page 44.

Good governance and responsible business

Good governance is essential to the business and we seek to adopt best practice where it is beneficial.

In line with best practice, we have recently completed a consultation with major shareholders around some proposed changes to our Remuneration policy. I am pleased to say that they received widespread support and the policy will be presented to shareholders for approval at the AGM.

As a major business headquartered in Hull, we are delighted to be a Principal Partner for Hull’s 2017 City of Culture celebration. This 12 month programme is designed to bring a wide variety of cultural and artistic events to the city and provide a range of opportunities for the local community to experience the positive impact that this will bring. As well as supporting the events themselves, the business is supporting a number of our employees who are volunteering as City of Culture ambassadors.

We hope that the legacy left by the City of Culture programme will support the continued regeneration of the region for many years to come.

We remain in an environment of change and transition both internally and for our customers and markets. Each presents new challenges and exciting opportunities and we value and appreciate the energy and enthusiasm that our colleagues across the business show in making life easier and better for our customers.

I would like to thank them all for their continuing contribution. This, coupled with the clear focus that we have on the future, gives the Board every confidence that we can achieve our ambitions as a business.

Graham Holden
Non-Executive Chairman
9 June 2017

CEO's statement

Continued transition

Progress towards the creation of

- A regional fibre based services provider through continued deployment of fibre and development of over-the-top services
- A provider of complex IP-based solutions in the Enterprise market, driven in the near term by expanding presence in contact centre and cloud services

Dear Shareholder

We are reporting another period of strategic and operational progress and remain focused on continuing to reposition the business as a provider of fibre-enabled services and IP-based solutions. Our fibre deployment in Hull and East Yorkshire remains on schedule to reach 150,000 premises by December 2017 and we continue to see high levels of customer take-up. In Enterprise, we have strengthened our sales, delivery management and technical capability to respond quickly to customer demand and create a scalable operating model as that demand grows.

Our business is focused on three distinct market segments.

Hull and East Yorkshire: a stable, income-generating segment focused on our regional market. Our plan here is to grow through continued broadband penetration and the introduction of additional services that exploit our continued investment in the market leading fibre network.

Enterprise: our engine for future growth. Our focus is to grow scale and capability in the provision of complex IP-related communications and IT solutions to the Enterprise market.

National Network Services: our national, connectivity-based segment, where we seek to maximise the value from our legacy investment in national network infrastructure with a tight focus on the mid-market's need for connectivity-based services.

Bill Halbert
Chief Executive

Progress

At the beginning of the financial year, we aligned all of our business activities under a single brand. This is enabling us to simplify the way we work and to adapt the size and skills of our teams in support of our core markets. We strengthened our management team at Group level and across our Enterprise segment to help to align the business behind our core market strategy and to drive performance.

As we indicated at the half year, we have tightened our focus on the two segments (Hull and East Yorkshire and Enterprise) that provide sustainable opportunities for the business in terms of delivering dividend support and future growth in overall shareholder value.

The disposal of certain national network assets last year was a fundamental part of this repositioning. The proceeds received from this sale are being re-invested in the deployment of fibre in Hull and East Yorkshire and continuing the transformation of the business.

During the second half of the year we analysed our shared costs in order to allocate them more appropriately to our market segments. This improved insight is helping us to optimise our cost base going forward.

Hull and East Yorkshire

In our Hull and East Yorkshire segment, our focus is on exploiting the value from the continuing investment in our network, particularly our ultra-fast fibre capability, through the introduction of quad-play services to consumers and additional network-based services to businesses. We have a total of approximately 145,000 consumer and business customers in this segment.

Demand for our fibre broadband across both business and consumer markets has remained high during the year with average take-up rates in excess of 30 per cent, where our fibre is available and we remain on target to make those services available to more than two thirds of premises by December 2017.

Building on this fibre capability, towards the end of the calendar year, we plan to introduce an innovative approach to a TV proposition, which importantly will provide also the platform for further in-home 'over the top' content services and applications.

The anticipated decline in revenue generated from our contact centre and media services has continued and we expect this contribution to further reduce over the next year.

Enterprise

Our best growth opportunity is within our Enterprise segment providing IT and integration services to UK-based enterprises. We have a primary focus on the development and support of IP-based solutions and services and have particular skills and experience in taking complex multi-location on-premise call centres to the cloud. This growing market for Contact Centres as a Service and professional cloud deployment for enterprises should mean that our Enterprise segment continues to develop as an asset light business with strong margins.

> **"Focused on creating a simplified business, operating on a reduced cost base and generating sustainable returns for shareholders."**

This segment represents the biggest opportunity for growth and we remain optimistic about future progress and our ability to exploit the opportunities available. Current customers include Bupa, HMRC, Rail Delivery Group and Shoosmiths and each has grown from its initial contract size. New business has been signed with clients across a range of sectors, including Hastings Direct (Insurance), C Hoare & Co (Financial Services) and Dugout (Entertainment).

The growth in our IP solutions activity is encouraging and the potential for this continues to develop, exploiting our unique combination of capabilities across cloud, internet, IT and communications. While we have seen early signs of revenue growth in this segment, margins were held back in the year, as we recognised the impact of incurred and anticipated cost overruns on the development stages of two fixed price, complex software implementations for a single customer. We continue to maintain a strong relationship with the customer, which we expect to continue to grow successfully.

Following those early successes and the valuable experience we have gained in their implementation, we have invested in strengthening our sales leadership and delivery capabilities, including flexible resourcing systems and resource pooling. We expect these actions to result in a stronger pipeline of opportunities and margin expansion in the coming year.

National Network Services

Our National Network Services segment focuses on delivering connectivity-based services to national organisations in both the direct and indirect market.

This segment seeks to maximise the value of our historical investment in national network platforms and, while we expect overall revenues to decline in this segment as a number of legacy contracts come to an end, there are some areas of this market in which we can compete without the need for substantial investment. Primarily this is in the provision of multi-site wide area networks and other associated services. Existing customers for such services include RNLI, One Stop, Furniture Village and Domino's.

We continue to seek ways to limit the effect of the decline and explore other solutions as appropriate.

Outlook

Evidenced by the progress made over the past year, the Board is confident in the transition of KCOM into a regional fibre-based services provider and a provider of complex IP solutions to the Enterprise market. We remain focused on creating a simplified business, with a cost base better aligned to the growth opportunities in our core markets, that the Board believes will generate long-term sustainable returns and growth for shareholders. Whilst we expect to make further progress in both Hull and East Yorkshire and Enterprise, as we transition away from commoditised services, we expect there to be a further decline in revenues and margins associated with our legacy activities.

Consistent with our existing commitment to a minimum full year dividend of 6.00p per share, the Board is recommending a final dividend of 4.00p per share, subject to shareholder approval at the company's Annual General Meeting on 21 July 2017.

Bill Halbert
Chief Executive
9 June 2017

Our business model

Creating value from connections

Our key inputs

The skills, expertise and experience of our people

Our people are one of our key differentiators in delivering value to our customers, particularly in our Enterprise market where the combination of design, development and applications integration skills in the areas of cloud, contact and collaboration sets us apart from competitors.

Our investment in our Hull and East Yorkshire fibre network

Our Fibre To The Premises deployment gives customers in Hull and East Yorkshire a superior online experience and provides a platform for the delivery of other valued-added services.

Our technology platforms

Our technology platforms underpin our ability to provide solutions to customers.

Our strategic partners

We work closely with carefully selected partners including Amazon Web Services, Cisco and Microsoft and use our skills and experience to design, create and support solutions based on their market leading technologies.

See also
Our strategy
page 20

How we generate revenue

Enterprise

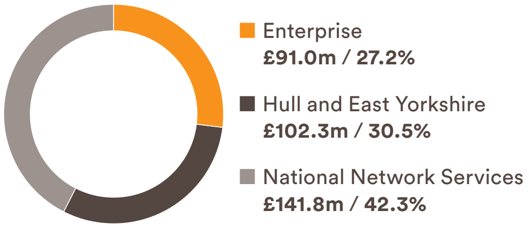
We provide consulting, design, implementation and managed services related to the collaborative systems and cloud markets.

Hull and East Yorkshire

We provide communication and internet-based services to residential and business customers in the region.

National Network Services

We provide network connectivity and related services to businesses nationally.



See also
Market opportunities and trends
page 12

How we create value

For shareholders

6.00p

Proposed full year dividend (pence per share)

We are uniquely positioned to compete in the Enterprise market. Our strategy in this market represents a strong growth opportunity by creating an asset-light, margin-rich revenue stream.

Our operations in Hull and East Yorkshire deliver strong income and cash generation that allow us to make a clear dividend commitment.

Our National Network Services drive value from our historical investment in national network platforms.

For customers

137,000

Premises passed by our Hull and East Yorkshire fibre deployment

We help enterprises improve their business performance and the experience they offer customers.

We help consumers and businesses in Hull and East Yorkshire live and work in a digital world.

The connectivity-based services we provide to national businesses help them operate more efficiently.

See also
Key performance indicators
page 22

For employees

73

Latest employee engagement score (October 16)

We aim to:

- Attract, develop and retain the best talent
- Recognise and reward success
- Value the diverse contributions of our people
- Create an environment where people feel trusted, safe, supported and healthy
- Share values that reflect what matters to our people

We offer personal growth and development opportunities across a wide range of disciplines. Our reward and recognition packages are closely aligned to business and personal performance.

See also
Sustainability
page 30

Secure and efficient

“Millions of our customers are choosing to use our digital services rather than picking up a phone or pen, with more joining them every day. But we know that not everyone can, or wants to, deal with us online, and so we’re continuing to improve our services across all contact channels. Voice ID is the latest example of the cutting-edge technology we are using to make it easier for people to manage their tax and tax credits.”

Ruth Owen
Director General for Customer Services, HMRC

KCOM has developed a new voice biometrics system for HM Revenue & Customs (HMRC). Customers calling HMRC’s contact centre with self-assessment and tax credit queries can now use their voice to self-authenticate their identity.

The new authentication and security verification process has significantly reduced average call handling times and received positive feedback from customer service advisors at HMRC. It is the first time a government organisation has adopted voice biometric technology for large scale public use.

Enterprise

Enabling digital transformation through contact and cloud services

Market opportunities and trends

Enterprises are undergoing a digital disruption

- The requirement to find technology solutions to business challenges is being driven by increasing customer expectations, growth in the number of communication channels and the need to adapt to rapid change
- As a result, key priorities in digital transformation within enterprises include:
  - Increased focus on monitoring and improving customer experience
  - IT infrastructure consolidation and virtualisation

Contact and cloud services are key digital transformation strategies

- One of the key digital transformation strategies to improve customer experience is the enhancement of communications with customers. This has resulted in contact centres becoming a key step in the customer journey, and a route to a transformed customer experience
- Contact Centre as a Service (CCaaS) offers enterprises access to a model that can provide multi-channel customer engagement in a more flexible and scalable way than traditional on-premise options
- A further key digital transformation strategy is the transition to flexible IT models and cloud infrastructures that can adapt to changing technologies and be scaled to meet changing demand and customer requirements

Growth drivers for CCaaS and cloud

- The market for CCaaS and cloud is estimated at £1 billion today and growing rapidly
- 75 per cent of contact centre seats are still on-premise, and the opportunity to transition to CCaaS delivers opportunities not just to enhance customer experience flexibility and responsiveness but also to reduce costs
- As enterprises have become reassured of the security of public cloud solutions, growth in the market for cloud consultancy professional services is being driven by the increasing complexity of projects and the lack of specialist skills in-house

Responding to market opportunities

Leveraging our CCaaS expertise

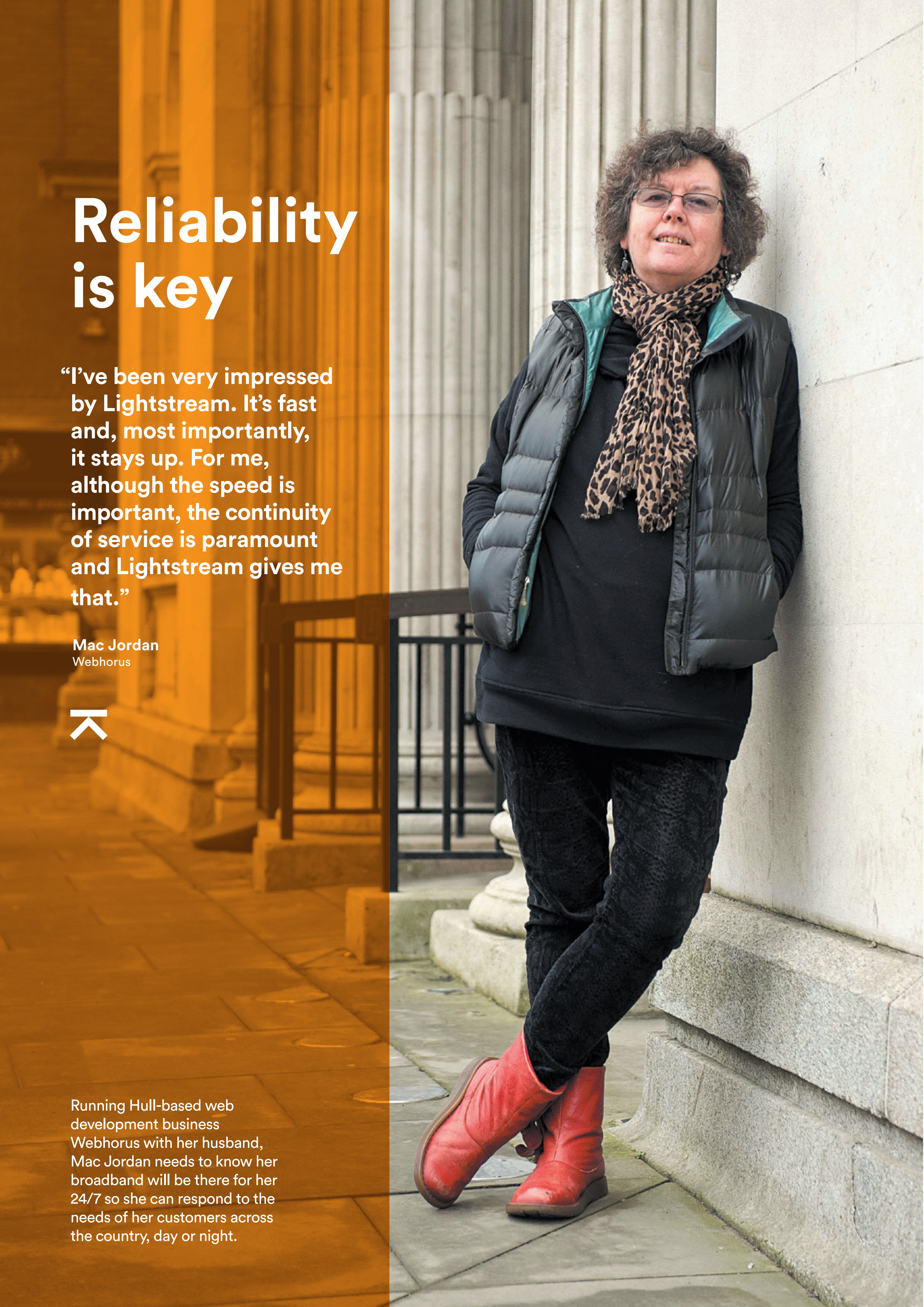
- We are seeking to leverage our proven track record in migrating the largest UK contact centre to the cloud and delivering subsequent improvements to both customer experience and efficiency
- Our capability in this market is enhanced by our preferred partner status with Cisco and our Workplaces proposition, which is capable of customisation through technology from multiple vendors
- Our target market for our CCaaS proposition, where we can deliver the greatest value, is larger enterprises that require complex integrations

Distinctive cloud capabilities provide competitive advantage

- Our strengths in the cloud professional services market include a team of architects with significant experience on cloud assignments, partnerships with two of the three key vendor partners and a premier reference client that required high-end consulting, architecting and development work
- We are differentiating our service in this market by targeting complex projects requiring public cloud-specific architecting and development skills associated with infrastructure migrations (Infrastructure as a Service (IaaS)) and application architecture/development (Platform as a Service (PaaS)) as opposed to competing in the mainstream Software as a Service (SaaS) market

Medium and long term focus on expanding the markets served

- While our current focus is on the CCaaS and cloud professional services markets, our capabilities will allow us to expand the range of markets we serve in the medium term to include the security and identity access management markets
- In the longer term our focus will expand to include Internet of Things (IoT), Big Data and Machine Learning solutions



Reliability is key

"I've been very impressed by Lightstream. It's fast and, most importantly, it stays up. For me, although the speed is important, the continuity of service is paramount and Lightstream gives me that."

Mac Jordan
Webhorus

Running Hull-based web development business Webhorus with her husband, Mac Jordan needs to know her broadband will be there for her 24/7 so she can respond to the needs of her customers across the country, day or night.

Hull and East Yorkshire

Supporting customers to live and work in a connected world

Market opportunities and trends

Internet usage among consumers and businesses continues to grow

- The average consumer broadband customer in Hull and East Yorkshire downloaded 52 per cent more data in 2016/17 than in 2015/16
- The volume of data downloaded by Hull and East Yorkshire business customers increased by 81 per cent in 2016/17 compared to the previous year
- Consumers using our Lightstream fibre broadband service download 65 per cent more data than those using non-fibre connections

Smart TV adoption and TV/video streaming are on the rise

- The largest increase in take-up of internet-connected devices in the UK during 2016 was of smart TVs, with ownership increasing to 27 per cent from 21 per cent in 2015[1]
- TV/video streaming by consumer customers in Hull and East Yorkshire increased by 44 per cent in 2016/17 compared to the previous year

Demand for faster broadband services remains strong

- High take-up rates of our Lightstream broadband service have been maintained throughout our fibre deployment as both consumers and businesses use more internet-based services through more internet-connected devices

Fixed-line voice calls are declining

- In line with UK-wide trends, the substitution of fixed-line voice calls for text-based forms of communication and smartphone use has resulted in declining fixed-line call volumes across both consumers and businesses in the region

1. The Communications Market Report, Ofcom, 2016.

Responding to market opportunities

Fibre deployment

- The accelerated deployment of fibre broadband across our Hull and East Yorkshire network since March 2016 means we are on track to make our Lightstream service available to 150,000 premises in the region by December 2017. Our focus is on improving the return on our investment by developing new services that help customers make the most of their connectivity

New propositions development

- Following an intensive customer research project we are refreshing our range of broadband and communication services to allow consumers to choose a package that more closely meets their needs, whether they want faster speeds, a bigger data download allowance or no inclusive calls. We will introduce the full range of new propositions, together with an improved buying experience, later this year
- We are developing a TV proposition based on an innovative, Android-based home technology hub that will create a platform for the introduction of other over-the-top content and applications
- For the regional business market we are developing a new internet-based voice service (SIP trunking) and refreshing our hosted phone system, Smartcomms

In-home broadband performance

- While our fibre deployment is transforming the online experience of customers using our Lightstream broadband service, the experience of customers using copper broadband is often affected by factors including radio interference and poor internal wiring. We have begun providing higher-specification routers to all new broadband customers to mitigate these and are refreshing our in-home support service to provide greater assistance with in-home issues to customers who wish to purchase it

National Network Services

Connectivity to support businesses on their technology journey

Market opportunities and trends

Connectivity is key for businesses

- While connectivity services are viewed increasingly as a commodity, they remain the foundation of many businesses' technology platforms by enabling access to value-added services and applications
  - Large, multi-site organisations rely heavily on managed connectivity services, requiring flexible and scalable solutions and robust support to meet their business needs
  - The needs of channel partners vary: service providers want best value connectivity with supply arrangements that allow differentiation and service excellence; carriers require access or backbone services to bridge their capability or add network reach; and systems integrators and business process outsourcers are seeking strong technical advice, support with service design, and innovation that translates into value for their clients

Responding to market opportunities

Helping customers navigate the complexity of connectivity

- Our long-established communications expertise means we are well-positioned to provide not just reliable voice and data connectivity but also support and advice to businesses that enables them to innovate and go to market quickly with value-added applications for their customers
- For large, multi-site organisations who are also potential future customers of our Enterprise services, we are focusing our efforts on the development of innovative wide area network propositions
- For service providers, carriers, systems integrators and business process outsourcers our focus is on developing call management propositions that allow their customers to handle inbound contact effectively and efficiently and present a uniform contact experience regardless of the channel used

"For our customer facing service, as well as the back office processes and the service IT delivers to the business, KCOM plays a critical role in our success."

Michelle Liptrot
Transformation Director, Arrow XL

Arrow XL is the UK's largest two-man home delivery specialist, delivering around 7,000 orders every day. It chose KCOM to provide a comprehensive IT infrastructure solution that connects its four hubs and 17 satellite bases and includes managed WAN and LAN networks, IP voice, hosting and cloud-based productivity software.

Progress in key areas

- Revenue shows the effect of strategic repositioning away from traditional commoditising services
- EBITDA is additionally affected by the cost of the national fibre network outsource and overrun of certain project costs
- Re-investment of proceeds from sale of certain national network assets in the fibre deployment in Hull and East Yorkshire is progressing well, attracting strong customer take-up
- Strong net debt management with favourable year-on-year underlying working capital movement
- Proposed final dividend of 4.00 pence per share (2016: 3.94 pence)

Group performance

Our results for the period show an anticipated decrease in revenue and EBITDA. These arose, as expected, from our strategic repositioning away from our commoditising legacy business towards IP-based solutions, coupled with the additional cost of our national fibre network outsource, following the sale of certain national network assets in the prior year.

The performance in our Hull and East Yorkshire segment continues to benefit from strong fibre take-up, funded in part by the proceeds from the sale of these network assets.

In the Enterprise market, where we are uniquely positioned, we continue to shift our focus towards significant integration and collaboration contracts with key customers. The results for the year show growth and good progress strategically. Margins however were held back, as a result of cost overruns on two fixed price contracts relating to some complex software development projects for a particular customer.

In September, we completed the extension of our banking arrangements, securing a facility of £180.0 million for a further five years through to December 2021, on existing favourable terms. This medium-term certainty reduces the Group's risk and provides further opportunities for growth.

Jane Aikman
Chief Financial Officer

Performance review continued

Segmental analysis

In the prior year, we explained the changes to our segments, which arose as a result of the move to one KCOM brand. During the year, we have continued to refine our segments to align with the way the business is managed and financial performance is analysed.

This included:

> further analysing our shared cost base in order to allocate costs to the appropriate market segment; and

> refining the customers and related activities allocated to our Enterprise segment. Contracts that relate to connectivity and network only business are now managed with our other contracts of this nature in the National Network Services segment. Enterprise is now focused on growth IP solutions business.

Management makes decisions and manages the business in line with the segmental analysis set out below. This information is presented before exceptional items in order to provide a better understanding of the Group's underlying performance. A reconciliation of the Group's pre-exceptional results, along with the definition of contribution is set out in the glossary[1].

Hull and East Yorkshire

The success of our ultra-fast Fibre-to-the-Premise (FTTP) continues, in part funded by the sale of certain national network assets in the prior year. Our FTTP deployment cost compares well with our peers. We believe both our cost to pass and cost to connect are the lowest in the UK based on available comparable benchmark information. In Europe, lower costs exist in areas of multiple dwellings. Our costs to date are 7% lower than we had initially anticipated and our take-up rates are 3% higher.

Our deployment is ahead of target and we expect to pass 150,000 premises (more than two thirds of our addressable market) by December 2017.

During the year we have passed 45,000 premises, taking our total to 137,000 and take-up remains strong with 19,000 premises connected in the year (including 1,400 businesses), taking the total connected to 43,000.

Revenue has increased from prior year by 3% in our consumer channel. Our fibre deployment has enabled us to access more customers and has supported a 3% increase in Average-Revenue-per-User (ARPU[1]). We continue to achieve market leading take-up rates in excess of 30% of homes passed to date. Broadband connection volumes have grown in the year and we have progressed our product development roadmap and plan to introduce new over the top services during the remainder of 2017.

The small decline in revenue in the business channel can be explained by:

> the impact of the Government's superfast broadband scheme in the prior year, with over 1,000 small businesses connecting to our fibre service under this voucher scheme (£1.1 million revenue); and

> lower year-on-year public sector spend, following migration to a Public Services Network (£0.7 million revenue).

After taking account of these factors, underlying revenue increased in our business channel.

Wholesale revenues have declined slightly during the year as a result of lower voice revenues and, as anticipated, our non-core contact centre and publishing revenues have continued to decline.

Despite a small overall decrease in revenue within this segment, our underlying contribution has increased by 1% in comparison to the prior year.

1. Refer to glossary on page 114.

Enterprise

During the year, we have seen year-on-year revenue growth, through growing relationships with key customers such as HMRC and NFU Mutual. Our reputation in this segment is continuing to strengthen, as we develop our unique capability of delivering IP-based solutions which combine cloud, internet, IT and communications. Revenue has increased by 5% from prior year and our year-on-year revenue to our top five customers has grown by 16%.

Despite the revenue growth, margin and contribution for the year were lower than prior year due to the recognition of an estimated overall cost overrun on two fixed price, complex software developments for one customer. These estimated overrun costs have been recognised as a loss of £3.6 million for this stage of the contract.

We have strengthened the delivery management for those projects, together with other changes and we continue to maintain a strong relationship with the customer.

In the prior year we benefited from higher margin project development based revenues from our largest customer, HMRC.

National Network Services

Without scale, it is increasingly difficult to differentiate our services in this highly commoditised market and, as expected, this segment has seen a year-on-year decline in both revenue and contribution.

Our focus during the year has been at the larger end of the mid-market, where we can provide more value, this has resulted in higher churn with some of our smaller customers.

This segment includes network customers which were formerly reported in our Enterprise segment (Large Corporate). As indicated previously, revenue from these customers has declined year-on-year. We anticipate a further decline of c£25.0 million in the year ending 31 March 2018, however, we expect the rate of decline to slow after the end of that year.

Central

Central costs include PLC and corporate costs, where allocation to the underlying segments would not improve understanding of those segments. These costs include share based payments and pensions, along with the residual Group cost of finance, HR, risk, legal and communications, once appropriate recharges have been made to the three business segments.

Year-on-year, underlying central costs remain broadly flat, with slightly higher overall costs being attributable to a higher share based payment charge.

Exceptional items

Our continued business transformation has resulted in the need to continue the restructuring of our business to ensure we have the right number of employees with the right skill sets as well as bringing together our activities under a single brand. As a result, and in line with our accounting policy, the Group incurred exceptional costs of £7.3 million during the period. These costs relate to the KCOM rebrand, alongside redundancy costs, systems costs and advisory costs as we 'right-size' the business.

Exceptional items also include £0.7 million relating to regulatory matters. See Note 7 on page 95.

Refinancing, net debt and cash flow

Net debt at 31 March 2017 is £42.4 million (31 March 2016: Net funds of £7.4 million), representing a net debt to EBITDA ratio of 0.6x.

We aim to cover the Group's core obligations (pensions, tax and run-rate capital investment), as well as our dividends, from the cash generated from our trading performance. In the year ended 31 March 2017 it covered our core obligations and part of our dividend commitment. We remain committed to the stated dividend policy of a minimum of 6.00p per share for the year ended 31 March 2017 and the year ending 31 March 2018.

The year-on-year increase in net debt arises as a result of capital investment (£47.2 million), dividends (£30.7 million), pensions (£7.7 million), tax (£8.0 million) and cash exceptional items (£8.3 million). As previously reported, the movement during the year also includes an £18.0 million VAT payment to HMRC in relation to the disposal of certain network assets in the prior year.

Underlying working capital was favourable year-on-year. Our days' sales outstanding was 27 (31 March 2016: 32).

In September 2016, we agreed a new five year £180.0 million revolving credit facility, on the same terms as our existing arrangements.

Dividend

The Board is proposing a final dividend of 4.00 pence per share (2016: 3.94 pence), representing a total dividend for the year of 6.00 pence per share (2016: 5.91 pence) consistent with the Board's previously stated commitment of a dividend of no less than 6.00 pence per annum for both the year ended 31 March 2017 and the year ending 31 March 2018.

Subject to shareholder approval at the KCOM Group PLC Annual General Meeting on 21 July 2017, the final dividend will be paid on 1 August 2017 to shareholders registered on 23 June 2017. The ex-dividend date is 22 June 2017.

Pensions

The IAS 19 pension liability at 31 March 2017 is £19.7 million (31 March 2016: £14.4 million). The increase from 31 March 2016 arises as a result of a lower discount rate used to calculate the schemes' liabilities, offset by a strong asset performance.

Our triennial valuation (as at 31 March 2016) has now been agreed with deficit repair payments of £6.7 million across both schemes until the year ending 31 March 2020. In addition to this amount, the Group makes pre-agreed payments to its pension schemes through the asset backed partnerships. The full year payment for both the current year and prior year is £2.7 million.

Capital investment

The Group's capital investment during the year is consistent with previous guidance. The disposal of certain national network assets in the prior year enabled increased capital investment in order to continue to reposition the business.

Cash capital expenditure during the year was £47.2 million (31 March 2016: £31.3 million).

The Group's depreciation and amortisation charge for the period is £26.9 million (31 March 2016: £24.0 million), the increase resulting from the higher capital investment in recent years, which has an ongoing impact on profit before tax.

Tax

The Group's tax charge is £5.7 million (31 March 2016: £17.6 million). The effective tax rate is 19%, this is slightly lower than the prevailing rate of corporation tax due the impact of prior year items, offset by the re-measurement of deferred tax balances. The prior year tax charge includes the impact of the disposal of certain national network assets during the year ended 31 March 2016.

Jane Aikman
Chief Financial Officer
9 June 2017

Driving operational excellence

Our value creation is underpinned by four strategic pillars

Customers

We understand and anticipate the needs of our customers and align our products, services and solutions to meet those needs, creating a unique brand experience differentiated by the value we deliver.

Priorities for 2016/17
We aimed to:
- increase our focus on the Enterprise market;
- make network investment decisions that improve customer experience in our Hull and East Yorkshire market; and
- establish a benchmark for customer satisfaction in line with our brand against which we measure our performance.

Progress for 2016/17
We have:
- invested in strengthening our sales capability within the Enterprise part of our business and introduced a new approach to resourcing customer projects that will optimise utilisation of our skills;
- increased the value of existing contracts with key Enterprise customers including Bupa, HMRC, Rail Delivery Group and Shoosmiths; and won new business with clients across a range of sectors;
- exceeded our target of making our fibre-based broadband service available to more than 100,000 premises in Hull and East Yorkshire by March 2017; and
- developed a customer charter and set of satisfaction measures for our Hull and East Yorkshire market that are in line with our brand and based on in-depth feedback from customers.

Priorities for 2017/18
We will:
- introduce new propositions for consumers, business and wholesale partners in our Hull and East Yorkshire market;
- enhance the experience of customers in our Hull and East Yorkshire market by making improvements to buying, fault resolution and billing processes;
- develop and launch a refreshed in-home service experience for customers in our Hull and East Yorkshire market;
- leverage our track record with key reference clients to win new customers for complex IP-based contact and cloud projects; and
- seek to expand further our relationships with existing customers.

People

We want to provide an environment where we attract, develop, sustain and enable all our people to demonstrate and apply their capabilities, offering opportunities for everyone to reach their full potential.

Priorities for 2016/17
We aimed to:
- align reward, recognition and performance management frameworks with the achievement of our strategic goals and the delivery of our brand promise;
- create and begin to implement a more advanced talent development strategy; and
- develop clear professional career paths underpinned by a defined set of roles and competencies.

Progress for 2016/17
We have:
- introduced a new HR advisory service that will provide consistent support for people managers and help them develop their skills in handling employee relations issues;
- developed a career framework with defined roles and transparent career paths to better enable employee-led career development;
- introduced a new approach to performance management that allows our people to take control of their own development and progression; and
- introduced a new careers website and online recruitment process that will make it easier to attract and recruit the right people for our business.

Priorities for 2017/18
We will:
- move away from a recognition culture based on length of service and introduce a modern recognition platform that provides more relevant and transparent opportunities for reward and recognition;
- make the most of the professional communities we have established across the business to improve workforce planning, succession planning and talent management processes;
- develop academies for all our professional communities, providing clear development solutions and pathways that support ownership of development by the individual; and
- drive benefit from a broad, company-wide resource pool of skilled talent that allows for focused and effective utilisation and prioritisation where it is needed to support growth, develop communities and share knowledge.

Partners

We recognise that our customers' needs are better met if we work seamlessly with carefully selected partners to create combined service offerings.

Priorities for 2016/17

We aimed to:

> seek to expand our ecosystem of technology partners that improve our speed to market, extend the reach of our propositions and increase the depth of our capability within the Enterprise market;

> seek to identify and secure acquisition opportunities in line with our strategy within the Enterprise market; and

> continue to support our customers on their digital transformation journeys by creating disruptive solutions with agile methodologies and a responsive ecosystem of partners.

Progress for 2016/17

We have:

> worked increasingly with providers of niche technologies that, when integrated with the scalable, mature platforms offered by best-in-class providers such as Amazon Web Services, CA Technologies, Cisco and Microsoft, offer a balance of stability and innovation in customer solutions. For example, we worked with leading voice biometrics specialist Nuance to introduce a system for HMRC that allows its customers to use their voice to self-authenticate their identity. It is the first time a government organisation has adopted voice biometric technology for large scale, public facing use;

> established a new partnership with EE for the provision of mobile services to customers;

> exploited the increased flexibility we have, following the sale of some of our national network infrastructure, to choose the most appropriate provider of network services as part of customer solutions; and

> worked increasingly with hosted platform providers for the delivery of services to customers, rather than developing our own platforms.

Priorities for 2017/18

We will:

> review our long-established partnership with BT to ensure that it remains fit for purpose to meet our future needs;

> seek partners for the development of over-the-top services for consumers in our Hull and East Yorkshire market;

> continue to develop and leverage our ecosystem of technology partners to increase our capability in the Enterprise market and achieve the most effective outcomes for our customers; and

> continue to seek new critical partnerships.

Processes and systems

Our customer service excellence is underpinned by robust processes and systems.

Priorities for 2016/17

We aimed to:

> consolidate existing HR systems and applications within a single platform that allows us to deploy our resources more flexibly to support customer requirements; and

> invest in technology to improve the customer experience at each touchpoint of their journey from order to delivery.

Progress for 2016/17

We have:

> completed a programme of investment in our critical systems infrastructure that has significantly increased its reliability and improved its performance;

> begun the transition to an API-centric IT architecture model, an agile and future-proof approach that enables us to benefit from the integration of third party applications within our infrastructure. This approach has been applied to our investment in HR Systems and during the year we introduced an online recruitment system and an HR service portal;

> invested in systems that allow us to align our IT system delivery roadmap with business goals and strategy; and

> invested in implementing agile software development techniques that enable common ways of working and the earlier delivery of system enhancements.

Priorities for 2017/18

We will:

> add capabilities to consolidate and build resilience into our existing IT systems;

> continue to develop our API-centric IT architecture;

> introduce an engineering mobility and scheduling system that will increase the efficiency of our engineering workforce in Hull and East Yorkshire and improve the experience customers receive during new service installations or fault repairs; and

> deliver system enhancements that improve the experience of customers in our Hull and East Yorkshire market.

Key performance indicators

Measuring our performance

We track a series of metrics that demonstrate the progress we are making against our strategic ambitions

Financial

Revenue £ million

£331.3m

-5.1%

The total amount the Group earns from the sale of goods or services.

Comment

Revenue is lower than the prior year due to the continuing decline of legacy network contracts.

EBITDA[1] £ million

£67.6m

-9.7%

Earnings before interest, tax, depreciation and amortisation. A measure of profitability.

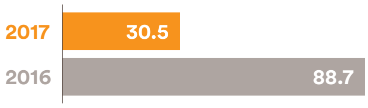
Comment

Group EBITDA is lower than prior year as a result of the lower revenue, additional costs of the national fibre network outsource and overrun of project costs in relation to a specific Enterprise customer.

Profit before tax £ million

£30.5m

-65.6%



A measure of profit that does not take into account the cost of corporation tax.

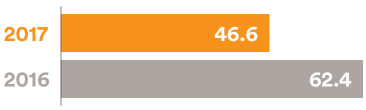
Comment

Reduction reflects lower EBITDA alongside increased depreciation and amortisation charge as a result of continued investment, including the acceleration of our fibre deployment. The prior year profit before tax includes the profit on sale of certain national network assets.

Adjusted net cash inflow from operations[2] £ million

£46.6m

-25.3%



Cash flow from operating activities adjusted for non-cash items.

Comment

Reflects impact of EBITDA performance and continued business transformation.

Net (debt)/funds £ million

£(42.4)m

A metric that shows the Group's indebtedness.

Comment

Return to a net debt position following continued strategic investment alongside strong working capital management.

1. Before exceptional items.
2. Adjusted for VAT impact of the sale of certain network assets in the prior year, Refer to glossary on page 114.

Non-financial

Impact of health and safety incidents

131

+1,090.9%

Number of days lost due to health and safety incidents.

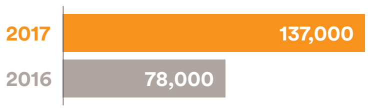
Comment

There were six incidents in the year leading to working days lost. None were major incidents but all were fully investigated and any necessary action taken to prevent reoccurrence.

Availability of fibre-based broadband

137,000

+75.6%



Number of premises passed in Hull and East Yorkshire by our fibre deployment.

Comment

During the year we continued our accelerated deployment of fibre.

Employee engagement score

73

-2.6%

Employee engagement score based on three key questions from our employee engagement survey.

Comment

Based on our most recent employee engagement survey in October 2016.

Employee volunteering

1,820

+21%

Number of employee hours we have donated to community projects.

Comment

During the year 156 schools, charities and community groups across Hull and East Yorkshire benefited from our employees' time and skills.

Link to strategy

Customers

People

Partners

Processes and systems

See also

Performance review page 17

Health and safety page 29

Sustainability page 30

Managing risk in our business

Taking the right level of risk

See also
Risk management framework
page 42

See also
Longer-term viability
page 25

See also
Risk appetite
below

As a business we seek to obtain the right balance between risk and reward. We believe that all businesses have to accept some level of risk but we want to make sure we are taking the right risks and that we understand and manage the risks that we take. Last year we clarified our risk appetite as a business and now we consider our risks in relation to that risk appetite and the longer-term viability of the business.

In order to satisfy themselves that our risks are being managed appropriately, the Board and Audit Committee spend time during the year reviewing reports on risks and controls to obtain the assurance it needs. This assurance comes from a variety of sources. Further information on our risk management processes can be found on page 42.

As a result of this review of risks and controls, the Board can confirm that it has carried out a robust assessment of the principal risks facing the Group, including those that would threaten the business model, future performance, solvency or liquidity.

See also
Corporate governance
page 38

Risk appetite

The Board set out a clear risk appetite for the business last year and has spent time reviewing this again in the current year, concluding that it should remain unchanged. The risk appetite statement approved by the Board sets out the risk appetite of the business in a number of key areas in relation to commercial risk, customer experience, people, service availability, reputation, health and safety and compliance.

The risk appetite continues to show that as a business we are moderate in our risk taking, but we are willing to take greater risk for greater reward in the commercial decisions that we make. We are also risk averse in our approach to our reputation and to health and safety risk and will seek to reduce the inherent risks in these areas through risk avoidance or mitigation.

Longer-term viability

In accordance with the UK Corporate Governance Code, the Directors have assessed the longer-term viability of the Group, taking into account KCOM's business model along with the principal risks affecting the business.

Assessment period
Although there is no reason to believe that the Group will not be viable over a longer period, three years is believed to be the appropriate period of assessment as this aligns with the Group's financial planning process and also represents the length of time in which we are able to confidently forecast financial performance taking into account both contract lives and the degree of change in our strategic segments of Enterprise and Hull and East Yorkshire.

Despite KCOM's business model, particularly in Hull and East Yorkshire, reflecting the investment and operation of long life assets, the Directors believe that the pace of technological change and the level of market uncertainty support a three year assessment period.

Stress tests
Stress tests have been performed on KCOM's three year plan in order to assess the Group's longer-term viability. This plan reflects KCOM's strategy and planned investment for the next three years. The plan is supplemented by a rolling forecast which is updated on a monthly basis.

We have stress tested our forecast cash flows in order to take into account severe but plausible scenarios which are linked to the KCOM Group risk register. These scenarios have been tested both individually and in aggregate and include the impact of principal risks such as a loss of market share in Hull and East Yorkshire, loss of strategic customer contracts in Enterprise, or a significant security or compliance breach alongside a material disruption to a key location.

Our stress testing assessed the likelihood of each scenario and the remote situation where all of our scenarios occur over a three year period.

Whilst it is impossible to foresee all risks (or take into account risks which are currently immaterial which could turn out to be significant) further mitigation activities could be performed, for example reducing capital expenditure or discretionary spend or making changes to our dividend policy.

In making its assessment, the Board has made an assumption around the continued availability of funding. This includes the extension to our banking facilities which are now in place until December 2021.

Overall assessment
The results showed that for the period under review, our existing arrangements provide sufficient headroom on both an individual and aggregated basis.

Based on the results of this review, the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the three year period ending 31 March 2020.

Risk management

Our principal risks and uncertainties
As with all businesses, we are affected by a number of risks and uncertainties. The table on pages 26 to 29 shows the principal risks and uncertainties, some of which are beyond our control, that could have a material adverse effect on the business and have been identified through our risk management framework. This list is not exhaustive and there may be risks and uncertainties of which we are currently unaware, or which are believed to be immaterial, that could have an adverse effect on the business.

Managing risk in our business continued

Risks reported in the prior year

Growing revenue in our Enterprise segment to offset the decline of network-based revenues

Why is it important?

As noted last year, we continue to move away from the delivery of network-based services and are focused strategically on the provision of complex communications solutions and cloud-based services. There is a risk that, during this transition from old to new technologies, revenue from legacy activities may decline faster than revenue from the new services grows.

What are we doing to mitigate the risk?

There has been a lot of focus internally over recent years on clearly defining the strategy for the business. The Executive Leadership Team (ELT) has participated in a number of strategy days where the strategy has been discussed and tested using various scenarios. There has also been strategic advice sought externally from industry experts, all of which has supported the strategic direction of KCOM.

We believe that our experience and skill-set give us a unique position in the market to provide our customers with new and more efficient ways to collaborate and interact, which in turn will lead to significant growth in the Enterprise segment, to offset the decline of legacy revenues.

As seen in the changes to segmental reporting in Note 4 on pages 91 to 94, we have updated our reporting in the year to separate out the legacy network customers from the complex IP solutions customers, which gives us greater transparency in relation to the progress being made in the strategic focus area.

Change in level of risk

Whilst the sector continues to evolve rapidly, this specific risk to KCOM has reduced as the proportion of network-based revenue in the business decreases.

How does this link to our strategy?

We have made the strategic decision to move away from the declining network-based services, which means we are now focusing on the propositions that use newer technologies. This is the cornerstone of our Enterprise strategy.

Substitute technologies entering the consumer market

Why is it important?

Much of our consumer business is currently based on the provision of services over a fixed-line network. If substitute technologies were developed to the extent where similar services could be provided without the use of a fixed-line network then this would clearly present a competitive threat to the consumer part of our business.

What are we doing to mitigate the risk?

We are always seeking to improve our services to our consumers and to provide a speed and quality of service that would not be achievable over a wireless network. Our fibre deployment is part of this aim.

We also provide bundles of products and services that offer our consumers value for money and which would provide a clear alternative to a substitute technology, should one enter the market. We have also appointed a Director of Product and Technology Innovation in the year to drive our thinking around new and innovative products and services that we can offer to our consumers, either on our own or through our partnership arrangements.

Change in level of risk

The level of risk continues to increase as technologies develop.

How does this link to our strategy?

We are focusing more on new technologies and applications; therefore the mitigation of this risk is very much aligned with our strategy.

Key: Customers People Partners Processes and systems

Upgrading of our network equipment

Why is it important?

The equipment used to run our copper network in Hull and East Yorkshire, and to provide some of our national network-based services, requires regular upgrading as demand for broadband and cloud-based services continues to increase at a fast pace.

What are we doing to mitigate the risk?

We are continuing with our investment plan to mitigate the risk of service failure from obsolete equipment. At the same time we are investing in the continued deployment of our superfast fibre-based broadband in Hull and East Yorkshire which provides market leading broadband speeds and which is on track to be available to approximately 150,000 properties by the end of December 2017.

Change in level of risk

The risk is increasing as the equipment nears the end of its life but the mitigation in place means that the net risk remains the same.

How does this link to our strategy?

Investing appropriately in our network equipment is part of our ongoing commitment to customer service.

Accuracy, security and confidentiality of customer data

Why is it important?

The security, confidentiality and accuracy of our customer data is of paramount importance to us and to our customers.

What are we doing to mitigate the risk?

We have clear and comprehensive policies in place and run mandatory training in this area for all employees. The forthcoming implementation of the General Data Protection Regulation, in May 2018, means that there will be more stringent requirements in this area and we have formed a Steering Group, consisting of representatives from across the business, to focus on compliance with the new requirements. We also have a Data Strategy team in place to look at other data matters across the business, whose primary focus in the year has been the accuracy of customer data.

Change in level of risk

The risk is increasing as the volume and nature of cyber-attacks continues to grow and evolve.

How does this link to our strategy?

Our commitment to customer service requires accurate and secure customer data and this therefore forms a fundamental part of our strategic thinking.

Customer service and delivery

Why is it important?

Our aim is to provide exceptional service wherever we can. The risk of not achieving this is therefore a key risk for the business.

What are we doing to mitigate the risk?

Last year we reported that we were aware of some issues in the customer experience we were providing in our Hull and East Yorkshire business. During the year we have implemented new technology in our call centres and provided additional training to our people which has resulted in a reduction in our call waiting times. Our fibre deployment is key to ensuring the service received by our customers meets or exceeds expectations but we also continue to invest in our copper network to improve the experience for all of our customers where possible.

Change in level of risk

The level of risk remains the same.

How does this link to our strategy?

This links directly to the customer service element of our strategy.

Key: Customers People Partners Processes and systems

Managing risk in our business continued

Risks reported in the prior year continued

Security and resilience of our networks and IT systems

Why is it important?

We need our networks and IT systems to continue operating in order to continue to provide service to our customers. It is therefore essential that we have secure and resilient systems and networks in place.

What are we doing to mitigate the risk?

We hold a number of standards that relate to security and resilience, including ISO 27001, the Information Security Management standard, and ISO 22301, the Business Continuity Management standard. We have a Head of Security and Compliance who is responsible for ensuring a consistent approach to security and resilience across the business and we have detailed policies and processes in place. We regularly test our resilience plans and have held a specific test in relation to our systems resilience in the year. Any lessons learnt from such tests are fed back into the resilience planning process, which in turn is continually reviewed and updated on an ongoing basis.

Change in level of risk

The level of risk remains the same.

How does this link to our strategy?

This links directly to our strategy in relation to customer experience. Secure systems and networks underpin our ability to achieve this.

Risks reported for the first time this year

A breach of our regulatory obligations

Why is it important?

As a provider of telecommunications services, we are regulated by Ofcom and there are multiple conditions and regulations with which we need to comply. We take our regulatory responsibilities extremely seriously and seek to ensure we are compliant in all regards.

What are we doing to mitigate the risk?

We have an in-house Regulatory team which is responsible for ensuring we understand our obligations and that these are communicated to the appropriate people across the business so that we can ensure the necessary controls are in place. We have undertaken a number of internal reviews in the year to check our compliance and also work closely with our suppliers to make sure that our obligations are passed on and complied with in areas where we are reliant on third parties for the provision of services.

Change in level of risk

The level of risk remains the same.

How does this link to our strategy?

Our regulatory compliance requirements are embedded in our strategy in relation to processes and systems and also our partner strategy, due to the need to ensure our partners take compliance as seriously as we do.

Key: Customers People Partners Processes and systems

Risks reported for the first time this year continued

Health and safety

Why is it important?

The health and safety of our people is of paramount importance to us and we have a number of people who undertake high risk activities, such as climbing telegraph poles, working in confined spaces, working alone or working next to roads. It is important to us to mitigate health and safety risk as far as possible to try to prevent incidents from occurring.

What are we doing to mitigate the risk?

We have an in-house Health and Safety team which has significant experience in the health and safety issues specific to our industry. We have a comprehensive training programme in place which provides general training to all of our people through mandatory e-learning and specific training to those who undertake higher risk activities, which is then followed up by on-the-job checks to ensure our engineers are practising what they have learnt. For large projects which contain increased health and safety risks, such as our fibre deployment, we have brought in external health and safety advisors to work on the project full-time to ensure we are complying with all of the appropriate health and safety requirements.

Change in level of risk

The level of risk remains the same.

How does this link to our strategy?

This relates directly to the people element of our strategy and to the processes and systems as we seek to ensure that we have the appropriate safe systems of work in place for the health and safety risks we face.

Flooding

Why is it important?

Flooding has become an increasingly regular occurrence in many parts of the country in recent years and Hull, where much of our business is based, is no exception. There were extreme floods experienced in Hull in June 2007 and there has been smaller-scale flooding experienced at times since. There is a risk that such flooding could impact upon our business if we do not take the necessary steps to mitigate the risk where possible.

What are we doing to mitigate the risk?

Prior to the 2007 floods we had already sought to mitigate the risk of flooding in the design of our telephony network and through using raised floors in some of our buildings. This meant that the impact of the floods in 2007 on our business was minimal. We have continued to improve our defences further since that time, installing powerful water pumps and flood alarms at key sites and flood defence barriers where appropriate. We monitor flood risk closely and are always alert to increased risks caused by extreme weather and high tides, so that we can activate our defences as necessary if and when required.

Where we rely on partners to provide services we seek to work with them to ensure that their services are resilient to flooding wherever possible.

Change in level of risk

The level of risk remains the same.

How does this link to our strategy?

This links to our customer pillar as it is important for our customers that service can continue uninterrupted in the event of a flood affecting our premises. We are also seeking to protect our people from the dangers arising from flooding by being alert and having comprehensive, tested plans in place to keep people safe in such an event.

Key: Customers People Partners Processes and systems

Operating with a positive effect on our stakeholders and society

Community	People	Customers and suppliers	Environment

Our sustainability strategy covers four main areas that are taken into account when making key business decisions: the communities in which we operate, our people, our customers and suppliers and the environment. The Board receives reports on each of these as appropriate. Responsibility for the overall sustainability strategy sits with our Chief Executive, Bill Halbert.

Our sustainability strategy and initiatives are fully integrated and aligned with the key pillars of our business strategy.

There are three key objectives that underpin our sustainability strategy:

1. To use our expertise in communications technology to create a positive impact on all our stakeholders and the communities in which we operate.
2. To promote our values, both internally and in the way we do business with external stakeholders.
3. To engage and empower our people so they can make a positive contribution to our sustainability strategy and the causes that matter to them.

Community

We operate in a way that benefits local communities as well as supporting our strategic aims as a business. Our significant presence in Hull and East Yorkshire means we make business decisions with the potential impact on that community in mind.

Achievements in the year

- Our employees spent 1,820 hours volunteering in the community.
- We delivered learning activities in 48 local schools and colleges to help young people develop technology and employability skills.
- Our employees raised more than £70,000 to our charity partner, Teenage Cancer Trust.

The continued focus of our community relations programme is on activities that support the growth and sustainability of Hull and East Yorkshire's economy and which increase life opportunities for local residents.

Contributing to the local economy

Our commitment to supporting the region's economy is reflected in our investment in becoming a Principal Partner of Hull UK City of Culture 2017, the programme for which is expected to deliver economic, cultural and social benefits to the region throughout the year and beyond.

We continue to be an active member of local business organisations including Humber Bondholders, which promotes the region as a destination for inward investment; For Entrepreneurs Only, a community interest company that helps local entrepreneurs create jobs and wealth; and C4DI (Centre For Digital Innovation), a technology hub that is helping to drive the development of the digital economy locally.

We are also supporting the region's economy through our ongoing deployment of fibre-based broadband, which is giving local businesses the fastest connectivity in the UK. More than 4,000 firms are using it to become more productive and serve their customers better.

Our commitment to support the region's economy is reflected in our investment in becoming a Principal Partner of Hull UK City of Culture 2017.

Supporting the region's young people

As potential future customers and employees, we want to support the region's young people to fulfil their potential and become work-ready. During the year we engaged with 48 local schools and colleges, delivering educational activities designed to raise aspirations, support employability skills and encourage young people to consider careers in science, technology, engineering and maths (STEM). As an employer sponsor of the Ron Dearing University Technical College (UTC), which opens in Hull in September 2017, we expect to further increase our activities supporting STEM education in the region.

Charity and community support

During the year we supported 156 community groups and charities in Hull and East Yorkshire through the donation of funds, employee time and business services. Our employees spent 1,820 hours volunteering during the year by taking part in charity collections, delivering educational activities in schools and supporting internet skills sessions in the community.

Beyond Hull and East Yorkshire, we have continued our support of Teenage Cancer Trust, which provides life-changing care and support to young people in the UK who are affected by cancer. In the second year of our three year partnership our employees raised more than £70,000 to the charity, taking the total raised through the partnership to date to more than £162,000.

We have also continued our patronage of The Prince's Trust, the UK's leading youth charity, which aims to change lives by offering training, personal development, business start-up support, mentoring and advice to young people.

During the year we engaged with 48 local schools and colleges.

People

Much of the value we deliver to customers is through the expertise and experience of our people. Our sustainability relies on our ability to attract people with the right skills and behaviours and to provide ongoing motivation, development, recognition and reward.

Achievements in the year

> We have established professional communities and clear career pathways for each main area of the business.

> We have introduced a new recruitment system and careers portal that will make it easier to attract and recruit people with the skills we need.

> We have introduced a new HR advisory service to provide support for people managers and help them develop their skills in handling employee relations issues.

We encourage our people to make the most of the learning and development opportunities we offer throughout their employment with us.

During the year we have continued our drive to develop professional communities as a method of fostering collaborative learning among colleagues within particular fields, as well as a way of identifying and addressing potential skills gaps. From two communities at the start of the year we now have eight, covering all the key areas of our business.

Having brought together all our people within a single, integrated business, we have introduced regular events where they are encouraged to explore our shared ways of working and collaborate with colleagues from other business areas. These were attended by 180 people during the year.

Fifty-six people took part in our leadership development programme aimed at new people managers and potential future leaders.

We encourage our people to make the most of the learning and development opportunities we offer throughout their employment with us.

Gender diversity

We have clear policies in place which mean that men and women are given equal opportunities, both when we are recruiting and in developing and progressing once with us. As at the year end the gender diversity of the Group was as set out in the table below:

	Male	Female	Female %
Board Directors	4	2	33%
Executive Leadership Team (ELT)[1]	4	3	43%
Other employees	1,057	540	34%

1. The ELT is defined as the senior leaders who have overall responsibility for key functional areas.

Employee engagement

We communicate and consult with representatives from across the business on proposed organisational changes, and regularly carry out employee engagement surveys.

In addition, our Change Network, made up of employees from across the business, exists to support and increase engagement with our strategy and the adoption of ways of working that are aligned with our strategy. Projects supported by the Change Network during the year included the internal launch of our new brand and the creation of a new framework for managing performance and development.

Our Change Network supports and increases engagement with our strategy.

Customers and suppliers

Sustainable relationships with customers and suppliers are vital to our success. We have a responsibility to treat them fairly and with the highest ethical standards, and to do business in a way that has a positive effect not just on them but on wider society.

Achievements in the year

- We introduced an online feedback platform that allows us to engage more closely with customers and develop a better understanding of their needs and views so we can improve the service we deliver to them.
- As part of our efforts to improve digital inclusion we introduced regular online skills sessions at more Hull and East Yorkshire locations.

Relationships with customers

We believe we have a responsibility to our customers to tackle the issues that are important to them in relation to the products and services they buy from us.

While being online brings many benefits including better access to government services, the ability to buy goods and services at lower prices and reduced social isolation, many people lack the equipment, skills and confidence to use the internet.

We are striving to address this in our Hull and East Yorkshire market by making available affordable internet packages and by offering support to customers to develop their online skills in a relaxed environment and at a pace that suits them.

Online safety continues to be a cause for concern among customers and as we engage with a growing number of local schools through our community programme we are making the most of opportunities to raise awareness among young people of how to protect themselves from potential online risks. We are members of the Internet Watch Foundation, an international organisation focused on making the internet a safer place.

As part of our efforts to ensure customers get the best possible experience from the internet services we provide, during the year we developed materials to help customers identify and resolve broadband problems caused by factors in the home, such as wiring and radio interference, that are outside of our control.

Relationships with suppliers

As well as treating our suppliers fairly and doing business with them in a sustainable way, we also have a responsibility to make sure that our suppliers operate with the same ethics and standards as us.

All our suppliers are expected to sign up to our Supplier and Partner Code of Conduct, which sets out our expectations in relation to laws and ethical standards, labour practices, risk management and business continuity. We work closely with our key suppliers to ensure that we understand the way in which their business operates and their approach to sustainability.

Contracts with key partners and suppliers include provisions relating to mitigation of risks that may affect their ability to provide us with goods and services, and we carry out regular credit checks on all suppliers.

During the year we rationalised our supplier base to achieve economies of scale wherever possible and worked with individual suppliers to identify ways in which we can reduce their costs by introducing efficiencies such as streamlining ordering and delivery processes. These activities are aimed at ensuring we achieve maximum value from our purchasing.

Tackling digital exclusion

88-year-old George Marsh recently joined the other 1.94 billion people on Facebook.

The retired driving instructor took his first steps on social media at one of KCOM's monthly internet drop-in sessions.

George is a regular visitor to the sessions, where he has been proving you are never too old to learn new skills.

Brandishing his iPad, he said: "I just like to keep my mind active. I have used computers before but at my age I keep forgetting things so it's nice to come back in for a refresher.

"I really enjoy coming in because the people are really helpful and help you get to where you want to be.

"I mainly use the computer for keeping up to date with the news and the weather. It keeps me informed with what's going on in the world.

"These sessions are a godsend really, without them I wouldn't have much use for my iPad. It's a lifeline."

Environment

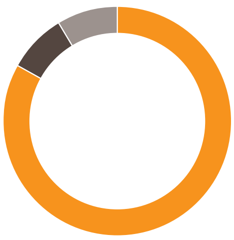
Our use of electricity still makes up the vast majority of our environmental impact, with 83.3 per cent of our CO_2e emissions coming from the electricity we use at our offices, data centres and various network sites both nationally and in the Hull and East Yorkshire region.

Each year we seek to reduce our emissions wherever possible and we continually review and improve the recycling facilities we have in place at our offices, with the aim of making it as easy as possible for our people to recycle any waste we produce.

Achievements in the year

- Over 93 per cent of our waste has been recycled, with the actual tonnage of waste that has gone to landfill remaining broadly consistent at 17.9 tonnes compared to 17.4 tonnes in the prior year.
- In the year the CO2e tonnes produced from our electricity usage has fallen by 1,861 tonnes or 11.1 per cent.

Breakdown of our emissions %



Emissions in the year

The table below sets out our annual emissions in tonnes of CO_2e.

	Year ended 31 March 2017 CO_2e	Year ended 31 March 2016 CO_2e
Combustion of fuel and operation of facilities	**2,976**	2,719
Purchase of electricity	**14,898**	16,759
Total	**17,874**	19,478
Tonnes of CO_2e per £'000 of revenue	**0.054**	0.056

During the year the CO_2e created from the combustion of fuel and operation of facilities has risen by 9.5 per cent. This is mainly due to an increase in the usage of refrigerant gases in the year, as a result of our phase-out of the R22 refrigerant gas to comply with the Ozone Depleting Substances regulations, which has meant the replacement of R22 when any work is performed on R22 air conditioning assets.

The CO_2e created from our business travel has increased in the year by 3.7 per cent, reflecting a slight increase in mileage, rail travel and air travel in the year. We continue to encourage our employees to travel only when necessary, although we acknowledge that some travel is essential in order to do business and it is important that we are able to meet face-to-face with our customers whenever necessary.

In the year the CO_2e tonnes produced from our electricity usage has fallen by 1,861 tonnes or 11.1 per cent. This reflects a relatively flat number of kilowatt hours of electricity used in the year, but a lower carbon factor published by the Department for Business, Energy and Industrial Strategy, which are the factors we use each year to calculate the conversion of our electricity usage and other carbon emissions into CO_2e tonnes.

Information for our carbon emissions reporting comes from our own internal systems, third party travel companies, suppliers of fuel, waste collection and recycling services and from our electricity supplier.

Area	Actual	Target for the year under review	Target met?	Future target for 2017/18
Total CO_2e	17,874 tonnes	Not to exceed 2015/16 levels of 19,478 tonnes	Yes	Not to exceed 2016/17 levels of 17,874 tonnes
Waste sent to landfill	17.9 tonnes	Not to exceed 2015/16 levels of 17.4 tonnes	No	To return to 2015/16 levels of 17.4 tonnes or less

Reducing our energy consumption

During the year the following energy-saving measures have helped us to keep our electricity usage low despite installing additional street cabinets in the year.

LED lighting

We have replaced fluorescent lighting with LED lighting in our main offices, reducing our energy usage for lighting by up to 40 per cent at these sites. We will include LED lighting in the specification for future refurbishments across our estate.

Motion sensor controls

We have installed PIR (passive infrared) motion sensors to control lighting in buildings where this will achieve significant reductions in energy usage, such as in exchange sites, where visitors are infrequent, and our largest offices. We have reduced our energy usage for lighting by up to 40 per cent in these areas.

Air conditioning

We have installed inverter-driven and variable speed drive air conditioning in technical buildings (exchanges, switch sites and hosting facilities) where it can have the greatest impact in addition to reducing the volume of cooling required. Where we have done this it has achieved reductions in energy usage for air conditioning by up to 77 per cent.

Signed on behalf of the Board

Kathy Smith
Company Secretary
9 June 2017

Directors' report

Board of Directors

Graham Holden
Non-Executive Chairman

R N

Appointed Graham joined the Board as a Non-Executive Director in November 2007 and became our Non-Executive Chairman on 1 April 2014.

Skills and experience Graham was Chief Executive of Marshalls plc from 2001 until 2013 and before that was the Group Financial Director there from 1992 to 2001. This means that Graham brings significant experience to the Board of leading a listed business of a similar size to KCOM. Based in Yorkshire, Graham understands the regional market in which KCOM operates in Hull and East Yorkshire and, as a Chartered Accountant, Graham brings considerable financial knowledge and expertise to the Board.

Other roles Graham is a Visiting Fellow in the School of Management at Cranfield University.

Bill Halbert
Chief Executive

Appointed Bill joined the Board as a Non-Executive Director in September 2006 before stepping up to become Executive Chairman in July 2009. Bill was then appointed as Chief Executive on 1 April 2014.

Skills and experience Bill brings a huge amount of industry knowledge and expertise to the Board, having worked in the information technology sector for over 40 years. Prior to KCOM, he founded Syntegra, BT's global consultancy and systems integration subsidiary, and was the CEO there for 13 years. Bill has also had many years of experience of working on a PLC Board and operating in a regulated environment.

Other roles Bill holds directorships at Excelsys Ltd, Jade Solutions Limited and Tacit Connexions Ltd.

Jane Aikman
Chief Financial Officer

Appointed Jane joined the Board on 17 October 2016.

Skills and experience Jane has held a number of executive level positions in various companies. Her most recent role was as Chief Financial Officer and Chief Operating Officer for Phoenix IT Group Plc, which she held until its acquisition by Daisy Group. Prior to that she was Chief Financial Officer of Infinis plc, Wilson Bowden plc and Pressac plc. She also spent five years in Southeast Asia with Asia Pulp and Paper Co Limited. Jane is a member of the Institute of Chartered Accountants in England and Wales and has brought a wealth of financial and operational leadership experience to the Board, as well as sector-specific expertise through her time spent with Phoenix IT Group Plc.

Other roles Jane has no other roles outside of KCOM at present, but will join the Board of Morgan Advanced Materials plc as a non-executive director on 31 July 2017.

Peter Smith
Non-Executive Director

A R N

Appointed Peter joined the Board in January 2015.

Skills and experience Peter has worked for L.E.K. Consulting LLP for 28 years and brings to the Board a broad range of experience in assisting companies across a range of sectors in setting their strategic plans and optimising their performance. Prior to joining L.E.K., Peter worked for Schlumberger Wireline in the Middle East as a field engineer and also worked as a line manager in the oil industry.

Other roles Peter works full-time at L.E.K. Consulting LLP.

Patrick De Smedt
Senior Independent Non-Executive Director

A R N

Appointed Patrick joined the Board in January 2016 and became the Senior Independent Non-Executive Director on 22 July 2016.

Skills and experience Patrick has a wealth of experience in the technology sector, having held a number of senior positions in Microsoft between 1983 and 2006, during which he founded the Benelux subsidiaries, led the development of the Western European business and served as Chairman of Microsoft for Europe, the Middle East and Africa. He brings experience of leadership and strategy-setting in the sector and has also undertaken a range of non-executive roles with a number of different organisations, which has given him significant experience of PLC boards.

Other roles Patrick is the Senior Independent Director at Morgan Sindall Group plc and Pagegroup plc and Non-Executive Director at Victrex plc.

Liz Barber
Non-Executive Director

A R N

Appointed Liz joined the Board in April 2015.

Skills and experience Liz brings a breadth of financial experience to the Board, having previously been a Partner at Ernst & Young from 2001 and their Head of Audit for the North of England from 2006 to 2010. She joined Kelda Group in 2010 as Group Director of Finance, Regulation and Markets and therefore brings knowledge of operating in both a regulatory environment and the Yorkshire region. She is a Fellow of the Institute of Chartered Accountants in England and Wales.

Other roles As well as her full-time role at Kelda Group, Liz is a Non-Executive member of the Board Council for Leeds University, a member of the Prince of Wales Accounting for Sustainability Group and a Steering Group member of the Two Percent Club, which seeks to support balanced board memberships.

Kathy Smith
Company Secretary

Appointed Kathy took on the role of Company Secretary in July 2010.

Skills and experience Kathy is a Fellow of the Institute of Chartered Accountants in England and Wales, qualifying with Deloitte. She joined KCOM in September 2005 as Head of Internal Audit and now leads our risk and governance teams, alongside her Company Secretary role. She is an Associate member of the Chartered Institute of Secretaries and Administrators.

Other Directors Paul Simpson was the Chief Financial Officer for the Board until 30 September 2016, when he stepped down from the Board. He was not a member of any of the Board Committees.

Tony Illsley was the Senior Independent Director for the Board until his retirement from the Board on 22 July 2016. Tony was a member of the Audit, Remuneration and Nomination Committees until the date of his retirement.

(A) Audit
(R) Remuneration
(N) Nomination
● Committee Chairman

Directors' experience/backgrounds

- Finance **3**
- Strategy **4**
- Sector specific **3**
- PLC Board **5**
- Regulatory **2**

Board composition

- Chairman **1 / 16.7%**
- Independent Non-Executive Directors **3 / 50.0%**
- Executive Directors **2 / 33.3%**

Corporate governance

Board length of service

Director	Appointment	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Graham Holden (Chairman)	27 November 2007											
Jane Aikman	17 October 2016											
Liz Barber	7 April 2015											
Patrick De Smedt	28 January 2016											
Bill Halbert	1 September 2006											
Peter Smith	5 January 2015											

Appointment and replacement of Directors

It is the policy of the Board that all Directors wishing to continue in office will stand for election or re-election each year at the AGM.

The Articles of Association allow the Board to appoint a new Director at any time; however, the Articles state that the new Director will only hold office until the next AGM, at which point he or she must stand for election or vacate the office.

The Nomination Committee, and the Board as a whole, has reviewed the performance and contribution of Graham Holden, Liz Barber, Patrick De Smedt, Bill Halbert and Peter Smith, and has no hesitation in proposing the re-appointment of each of these Board members. We believe we have a diverse and balanced Board with a combination of skills that meets the current needs of the business and therefore all of these Directors are recommended for re-election on the basis of their contribution.

In addition, the Nomination Committee is delighted to have recommended Jane Aikman for election to the Board. Jane joined us on 17 October 2016 as our Chief Financial Officer and brings with her a huge amount of financial and sector experience, having previously been Chief Financial Officer and Chief Operating Officer for Phoenix IT Group Plc. She has also previously been the Chief Financial Officer of Infinis plc, Wilson Bowden plc and Pressac plc. The Nomination Committee believes that Jane is already making a significant contribution to the business and has further enhanced the range of skills that we have on our Board. Further biographical details for each of the Directors can be found on pages 36 and 37.

The Articles of Association state that the Company may remove a Director by ordinary resolution with special notice before the expiration of their period of office. There have been no Directors removed from office during the year.

Independence

The Board reviews the independence of the Non-Executive Directors each year, taking into account their tenure, relationships and circumstances as well as considering the behaviour of each Director at Board meetings and whether or not they contribute to unbiased and independent debate. All of the Non-Executive Directors and the Non-Executive Chairman were independent upon appointment and the Board believes that all three Non-Executive Directors remain wholly independent in relation to the criteria set out in Provision B.1.1 of the UK Corporate Governance Code.

Commitments of the Non-Executive Chairman

Our Non-Executive Chairman, Graham Holden, does not currently have any other significant commitments.

UK Corporate Governance Code

The Board considers that it has complied with all the detailed provisions of the UK Corporate Governance Code throughout the year ended 31 March 2017.

The Board as a whole is committed entirely to the principle of achieving and maintaining a high standard of corporate governance.

The UK Corporate Governance Code is available on the Financial Reporting Council's website at www.frc.org.uk.

Board Committees

The Board has established and delegated specific responsibilities to Audit, Nomination and Remuneration Committees. Each Committee reports back to the Board after each meeting to ensure that the whole Board is aware of the matters considered by the Committees.

Each Committee has its own report which sets out the membership and attendance at the Committee meetings during the year, as well as further information on the role of the Committee. The Audit Committee report can be found on page 45, the Nomination Committee report on page 43 and the Remuneration report on page 50.

How the Board operates

The Board has eight scheduled meetings a year, with other ad hoc meetings held as needed. During the year, the Board met nine times. The additional meeting was specifically held to consider the appointment of our new Chief Financial Officer. Attendance at the meetings during the year is shown in the table on page 39. Eight of the meetings were preceded the evening before by an informal meeting, allowing more time to debate issues in depth.

The Board agenda is set for each meeting by the Chairman with input from the Executive Directors and the Company Secretary. In addition, any of the Non-Executive Directors can request a matter to be added to the agenda at any time. At each meeting the Board considers business performance, which includes reviewing past performance but also looking at the future long-term success of the business. There is considerable focus at each meeting on the strategy of the business and updates on the progress in each of the key strategic areas are provided at each meeting, which form the basis for discussion and debate around all aspects of strategy.

The Board receives monthly reports on financial performance, people matters, investor relations, governance, compliance and risk, regardless of whether or not a Board meeting is scheduled. There are also regular updates on key projects and strategic programmes, information security and health and safety. The Board also hears from external experts when it is believed useful to do so and during the year received a presentation from Forrester on the market opportunities open to the Enterprise segment, which reinforced the current strategy for the Enterprise business.

Board meetings are held at various KCOM offices throughout the year and the Board seeks to regularly meet both formally and informally with senior management from across the business to gain further insight into the day-to-day operations and the key risks and opportunities facing each part of the business.

Members of the ELT and other key senior managers are regularly invited to attend the Board dinner or Board meetings to provide updates and give the Non-Executive Board members regular direct access to the management team.

There is a schedule of Matters Reserved for the Board which is reviewed and updated each year. This schedule requires that specific matters relating to budgets, strategy, performance against objectives, financial reporting, internal controls, communications, remuneration and governance, along with any proposed changes to business operations or the structure and capital of the Company, are referred to the Board for consideration and approval.

The Board also reviews contractual clauses escalated to the Board through our Contracting Risk framework and business cases escalated in accordance with our business-wide delegations of authority.

The Board considers the role of the Company Secretary to be key in ensuring that the Group and the Board have the right governance in place and that Board processes follow best practice. The Company Secretary meets with each of the Directors individually as necessary to discuss governance-related matters and provides a governance report to the Board on a monthly basis. The Directors are also able to obtain independent professional advice at the Group's expense whenever necessary.

Attendance at Board meetings

Director	Number of meetings	Out of possible
Graham Holden (Chairman)	9	9
Jane Aikman	4	4
Liz Barber	9	9
Patrick De Smedt	9	9
Bill Halbert	9	9
Tony Illsley[1]	2	3
Paul Simpson	4	4
Peter Smith	9	9

1. Tony Illsley was unable to attend his last Board meeting due to a prior commitment.

Training and development

The Board receives monthly updates on governance-related matters and more formal training where appropriate. Potential training needs are discussed as part of individual performance evaluations, plus each Director is given the opportunity to flag any additional training requirements which they may have identified as part of the annual Board evaluation process.

New Directors joining the Group are given a broad and comprehensive induction to the business, consisting of site visits, meetings with key personnel and detailed information relating to each customer segment and the Group as a whole, as well as any training specifically required in relation to the duties of Directors and their role on the Board.

Relations with shareholders

It is essential that we communicate effectively with our shareholders and understand their views. Our Chief Executive and Chief Financial Officer meet regularly with our institutional shareholders to discuss the strategy, performance and governance of the Company and to obtain feedback. During the year, meetings have been held with 30 such shareholders. There are also general presentations following the half year and final results announcements each year.

The Chairman ensures that an investor relations report setting out any feedback from shareholders is provided to the Board each month and discussed at each Board meeting, so that all of our Directors are kept informed of investor views.

Any member of our Board, including our Senior Independent Director, is available to meet face to face with our institutional shareholders if requested to do so and one such meeting has been held during the year.

We have a large number of shareholders who live in the Hull and East Yorkshire region and the KCOM business is very much involved in local life in the area. There is more information about our community activities in the Sustainability section on page 31. We believe that being involved in the local community in Hull and East Yorkshire helps us to better understand our local shareholders and the issues that are important to them.

We consider our AGM to be an important means of communication between our shareholders and Directors. All of our Directors will be available at the AGM to answer questions and we would encourage our shareholders to come along to speak with them.

We use electronic voting at our AGM each year. The results of voting, including the proxy votes lodged, are shown to shareholders in the meeting and are made available after the meeting on our website.

All of our Company announcements are published on our website, www.kcomplc.com, together with presentation materials and financial reports, so that all of our shareholders can keep up to date with our news.

Business model and key performance indicators

The details of our business model can be found on pages 10 and 11 and our key performance indicators are on pages 22 and 23.

Proposal to re-appoint the external auditors

During the year there was a comprehensive external audit retender process held, to which six external audit firms were invited. There is further information on the process on page 46. As a result of the process, the Audit Committee has recommended to the Board that PricewaterhouseCoopers LLP are re-appointed and a resolution to re-appoint them will be proposed at the AGM. PricewaterhouseCoopers LLP have advised of their willingness to continue in office and have confirmed their continued independence. They have provided an independent audit opinion on these accounts which can be found on page 74.

Corporate governance continued

Performance evaluation

Our annual Board evaluation took place in the summer of 2016 and was conducted by our Company Secretary, Kathy Smith, who met with each Board member individually to obtain their feedback on the Board and its Committees. The last external Board evaluation took place in the summer of 2014 and the Board has committed to seek another external evaluation in 2017.

Last year the Board defined five objectives as a result of the annual Board evaluation:

Objective	What has the Board done to meet this objective?
1. To ensure full debate around agenda items, with everyone having a chance to provide their input.	The Chairman ensures that every member of the Board is asked for their input on each topic so that the views of the whole Board are known and included in the debate. This was identified as a particular strength in the 2016 evaluation.
2. To increase the contact time between Board members and senior management, both formally and informally.	The Board meets for dinner the evening before each scheduled Board meeting and throughout the year members of the senior management team have attended the dinner, where there is extended discussion on specific areas of the business. In addition there have been a number of informal meetings between the Non-Executive Directors and members of the senior management at the various KCOM sites throughout the year.
3. To focus on City matters in Board meetings to raise the knowledge and awareness of the way in which KCOM interfaces with the City.	Our brokers attended a Board meeting during the year to present to the Board. In addition, feedback from shareholder meetings is a standing agenda item for the Board at each meeting. The amount of City knowledge on the Board has also increased through the appointment of Jane Aikman during the year, who has considerable experience as a listed company director.
4. To continue to consider a broad range of stakeholders in Board discussions, including customers, shareholders, colleagues, suppliers and the communities and environment in which KCOM operates.	The diversity and experience of the Board brings different perspectives to the Board discussion and there is a review ongoing to identify any additional reporting to the Board which would further enhance discussions and understanding to ensure continued consideration of a broad range of stakeholders.
5. To complete the development and documentation of a clear plan for Board and senior management succession.	Succession planning has been discussed at both the Board and Nomination Committee and clear progress has been made in this area.

This year the evaluation review confirmed that the Board continues to operate effectively and there were a number of key strengths identified, including:

> the support and constructive challenge of the Chairman;
> the productive and inclusive debate in the boardroom;
> the balance of skills and experience on the Board;
> the approach to governance, which is perceived to be taken seriously and handled well; and
> effective interaction with the senior management team to enhance Board understanding of the business.

The areas where improvement could be made or where it was important to continue work already begun were noted to be in relation to a requirement for increased visibility of non-financial data to enhance business understanding and in relation to succession planning at a senior management level, to identify and nurture future leaders as well as developing skills across the business to meet future skills requirements.

The objectives that were consequently adopted by the Board for the current year were therefore:

> to have visibility of an increased volume of non-financial data to enhance the Board understanding of operational matters and to enable continued consideration of a broad range of stakeholders in Board discussions;
> to focus on succession planning for the senior management team, with reference to current skills in comparison to future skills requirements, as well as continuing the discussion in relation to Board succession;
> to invite a thought leader from the IT services sector to speak openly with the Board regarding the future of the sector, to enable a full debate around the future strategy of the business;
> to continue the increased contact time and frequency between the Board and the senior management team, to enable detailed understanding of relevant operational and strategic matters; and
> to continue to ensure a full debate in the boardroom with input encouraged from all Board members, to safeguard this as a key strength of the Board.

In addition to the annual Board evaluation, the Non-Executive Chairman meets with each Board member individually on at least an annual basis to discuss their own performance and to identify any areas for development or potential training needs. The Non-Executive Directors also meet separately to evaluate the performance of the Non-Executive Chairman. The feedback from this meeting is then passed on to the Non-Executive Chairman by the Senior Independent Director.

Non-Executive Director meetings

The Non-Executive Directors have regular dialogue with each other concerning Board matters and the Non-Executive Chairman met with the Non-Executive Directors, without the other Directors present, at regular intervals during the year.

Powers of the Directors

The business of the Company is managed by the Directors, who may exercise all the powers of the Company, subject to the provisions of the Articles of Association, relevant statutes and any special resolution of the Company.

Substantial shareholdings

As at 31 March 2017, the Company had been notified of the following interests amounting to three per cent or more of the voting rights in the issued ordinary share capital of the Company.

	Number of shares with voting rights	% of total voting rights
Invesco Asset Management	63,186,909	12.23
PrimeStone Capital LLP	29,330,863	5.68
Hargreave Hale	23,902,871	4.63
M&G Investments	22,115,842	4.28
Aviva Investors	21,292,308	4.12
Fidelity Worldwide Investment (FIL)	19,260,850	3.73
AXA Investment Managers UK	16,714,308	3.24

As at 9 June 2017, there had been seven additional disclosures received: three from Norges Bank, to notify an overall shareholding increase to 15,544,973, equivalent to 3.01 per cent of the total voting rights, two from Invesco Asset Management, notifying a reduction in the shareholding to 54,145,144, equivalent to 10.48 per cent of the total voting rights, and two from PrimeStone Capital LLP, notifying an increase in shareholding to 43,567,013, equivalent to 8.43 per cent of the total voting rights.

The Articles of Association give the Directors the power to authorise conflicts of interest in relation to transactions or arrangements with the Company, in accordance with the Companies Act 2006. Conflicts of interest are a standing agenda item at Board meetings and each Director proposes any potential conflicts for consideration as soon as they become aware of them. The Director with the potential conflict is excluded from the vote to authorise the transaction or arrangement.

Any conflicts that are authorised are then logged on a register, along with details of any specific terms imposed upon authorisation. Internal controls are in place to ensure that transactions or arrangements which may lead to a potential conflict of interest are conducted on an arm's length basis.

Directors' responsibilities statement

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations. Company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors have prepared the Group and Company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU). Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period.

In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs as adopted by the EU have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the financial statements and the Directors' Remuneration report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the Group's website, www.kcomplc.com. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' statement pursuant to the Disclosure and Transparency Rules

Each of the Directors as at 31 March 2017 whose names and functions are listed on pages 36 and 37 confirm that, to the best of their knowledge:

- the financial statements, which have been prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and Company; and
- the Strategic report and Directors' report contained in the Annual Report include a fair review of the development and performance of the business and the position of the Group and Company, together with a description of the principal risks and uncertainties that they face.

Conclusion on the Annual Report

The Board is responsible for reviewing the Annual Report and, after consideration, has concluded that the Annual Report, taken as a whole, is fair, balanced and understandable and that it provides the necessary information for shareholders to assess the Group's position, performance, business model and strategy. In reaching this conclusion, the Board has considered the different types of shareholders that the Group has, the reports and presentations that the Board has received during the year and the reports submitted to the Audit Committee during the year by both the internal and external auditors and combined this with the Board's collective knowledge of the business, gained through both formal and informal meetings and personal interactions across the Group at all levels. Further information on the reports submitted to the Audit Committee can be found in the Audit Committee report on pages 45 to 47.

Corporate governance continued

Amendments to the Company's Articles of Association

Any amendments to the Company's Articles of Association may be made by passing a special resolution at a general meeting of the shareholders.

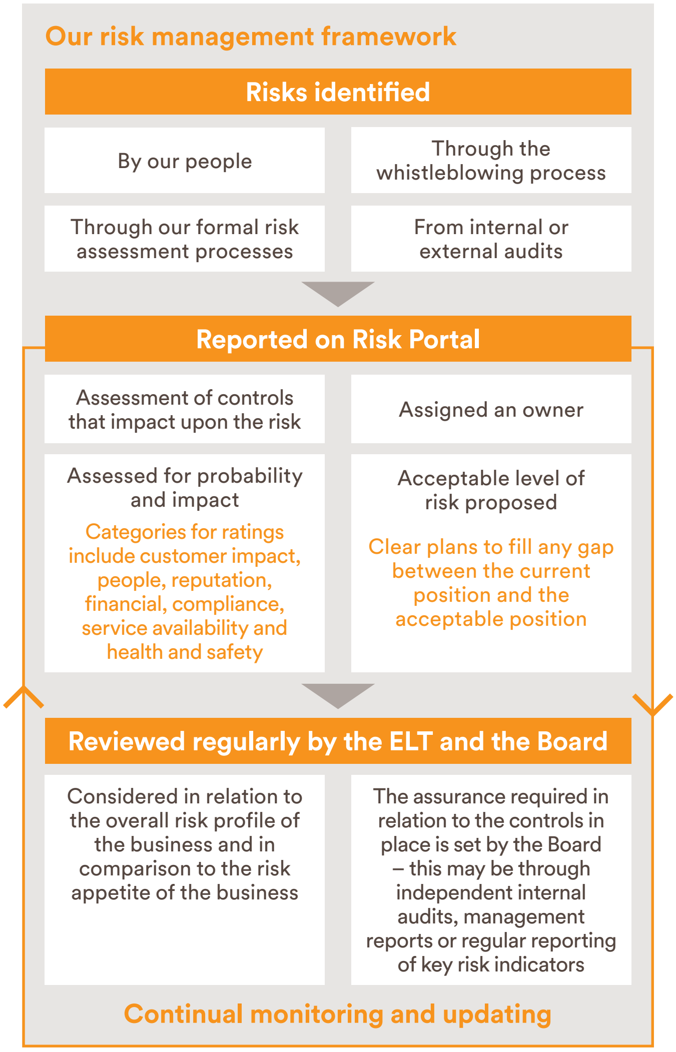
Going concern

The Directors confirm that, having reviewed the Group's budget and forecasts along with the principal risks and uncertainties facing the Group, they are satisfied that the Group has adequate resources to continue in operational existence for the foreseeable future. Accordingly, the Group continues to adopt the going concern basis in preparing the financial statements.

Our risk management framework

For us, risk management is about taking the right amount of risk to support our business strategy and to align with our risk appetite. Further information on our risk appetite can be found on page 24.

We seek to understand our risks so that informed decisions can be taken from a risk perspective and so that risks can be either managed or mitigated as appropriate. We have controls in place to mitigate risk to an appropriate level but we recognise that our internal control systems can provide only reasonable and not absolute assurance against material misstatement or loss.



We have a risk management framework in place to help us to identify, assess, measure, manage and monitor our key risks in a consistent way. We define key risks to be anything that may prevent us from meeting our objectives. The framework is aligned with guidance from the Financial Reporting Council to provide us with a single picture of the threats and uncertainties we face.

The risks that are identified and recorded by the framework are reviewed regularly by the ELT and then escalated twice-yearly to the Board.

The framework has been in place throughout the year under review, and up to the date of approval of this Annual Report.

Risk management responsibilities

The Board

The Board has overall responsibility for setting the risk appetite for the business and for ensuring that the overall risk profile is aligned with this. It is also responsible for ensuring that the business maintains sound internal control and risk management systems, as well as reviewing the effectiveness of those systems.

In order to do this, the Board has regular meetings with members of senior management and receives regular reports from each business area, the internal auditors and the external auditors on the effectiveness of the systems of internal control and risk management. The Board is satisfied that the systems are embedded within the day-to-day activities of the business and cover all material controls, including financial, operational and compliance controls, and that the business continues to be compliant with the provisions of the UK Corporate Governance Code relating to internal control.

Executive Leadership Team

The ELT is responsible for reviewing the risks that have been recorded, to ensure completeness and accuracy, as well as assessing the suitability of the mitigations in place and any proposed timescales for further controls to be implemented.

Audit Committee

The responsibilities of the Audit Committee in relation to risk management are set out in the Audit Committee report on pages 45 to 47.

Financial risk management

Each business area produces an annual budget which is reviewed by senior management and ultimately approved by the Board. A longer-term three year plan is also in place which is updated annually and approved by the Board to enable it to have a clear longer-term view of financial projections.

We also prepare a monthly rolling forecast; performance against budget and the forecast is monitored at monthly ELT meetings and reviewed by the Board each month. Further information about the financial risk management policies in place, and, in particular, the way in which credit risk, liquidity risk, interest rate risk and foreign currency risk are managed, is in Note 27 to the financial statements.

Controls around consolidation

The basis of consolidation for the financial statements is detailed in Note 2 to the financial statements. Strong controls are in place around the process for preparing consolidated accounts. The work of consolidation is performed by experienced, qualified accountants and a review of the consolidation forms part of the audit work performed by our external auditors.

Principal risks and uncertainties

The principal risks and uncertainties facing the business are set out on pages 24 to 29 of the Strategic report.

Graham Holden
Chairman, Nomination Committee

Nomination Committee report

Director	Appointed to the Committee	Number of meetings	Out of possible
Graham Holden – Chairman	April 2014	2	2
Liz Barber	April 2015	2	2
Patrick De Smedt	January 2016	2	2
Peter Smith	January 2015	2	2
Tony Illsley – retired from the Committee in July 2016	June 2009	1	1

"The Board recognises the benefits of diversity of all types, including gender, professional and ethnic diversity."

The membership and attendance at Committee meetings during the year are shown in the table above.

The Nomination Committee is a sub-committee of the Board and meets as often as required. It is responsible for reviewing the structure, size and composition of the Board and ensuring that the balance of skills, knowledge and experience of the Board is right for the Group, both for the current challenges and opportunities facing the Group and the skills and expertise that are expected to be needed on the Board in the future.

Board Appointments policy

We have a Board Appointments policy, which sets out the procedure that will be followed in the event of a Board vacancy being identified along with our approach to diversity on the Board.

The key principle set out in the policy is that the Board will always seek to appoint on merit. The Board recognises the benefits of diversity of all types, including gender, professional and ethnic diversity, and will always aim to develop the diversity of the Board in order to promote a range of perspectives in the boardroom, while remaining true to the key principle of appointing on merit.

The Board Appointments policy also states that the Nomination Committee will only use firms that have signed up to the Executive Search Firms' Voluntary Code of Conduct, addressing gender diversity and best practice; that female applicants are given the same consideration and opportunity as male applicants; and that gender diversity is considered specifically when drawing up a list of potential candidates.

Corporate governance continued

Board Appointments policy continued

In addition, through the Board Appointments policy, the Board has committed to:

- continue to seek to identify and develop the talented individuals in the business, regardless of gender;
- review regularly the proportion of women at each level in the organisation to ensure that equal opportunities are being presented to individuals at every level; and
- always ensure that there is a confidential way in which concerns can be raised without fear of repercussion if anyone, regardless of gender, has a concern about the opportunities available to them.

We are proud to note that whilst the number of females in the organisation is 34 per cent of our total number of employees, the number of females in our Executive Leadership Team sits at 43 per cent, which is reflective of the equal opportunities that we provide across the organisation. We also have two female Directors on the Board and a female Company Secretary who participates fully in our Board meetings.

When Board vacancies arise, the Nomination Committee is responsible for preparing a description of the role and capabilities required for a particular appointment and then identifying and nominating candidates for the approval of the Board. In order to identify suitable candidates the Committee uses open advertising or the services of external advisors to facilitate the search, where appropriate.

Balance of Executive and Non-Executive Directors (as at 31 March 2017)

Executive Directors	2	33%
Non-Executive Directors	4	67%

Balance of male and female Directors (as at 31 March 2017)

Male Directors	4	67%
Female Directors	2	33%

See also

Board of Directors
page 36

Succession planning

The Committee is also responsible for considering succession planning for the Directors and for key senior management across the Group, although this is a matter also considered by the full Board. This includes identifying future talent within the business and providing experience and training as appropriate to enable individuals to be ready to step up to the next level.

Appointment in the year

During the year we appointed Jane Aikman to the role of Chief Financial Officer. When the vacancy for the role arose, the Nomination Committee drafted the role profile in consultation with Bill Halbert, our Chief Executive. The Committee appointed Odgers Berndtson as independent external advisors to lead the search and they met with several key stakeholders within the KCOM business to further enhance their understanding of the role and the skills required.

Odgers Berndtson performed an external search and presented a shortlist of candidates to the Nomination Committee. The candidates were interviewed by Bill Halbert and our Chief People Officer, Clare Dyer, with the strongest candidate then meeting with Graham Holden, as Chairman of the Nomination Committee, and Liz Barber, as a member of the Nomination Committee with current experience of operating as a chief financial officer.

The preferred candidate then met with the other Non-Executive Directors and references were taken up before a Nomination Committee meeting was held to confirm the recommendation of the appointment of Jane to the Board.

The Committee believes that Jane was the outstanding candidate for the role and meets the requirements that were set out at the beginning in terms of skills and experience.

For succession planning for the Board, the Committee works to the principle of continuity on the rest of the Board when planned changes take place at a senior level and that Executive succession will be largely event driven, dependent on the delivery of key strategic milestones. The Committee has considered both short-term emergency succession planning and longer-term succession planning in the year.

Other Committee responsibilities

The Nomination Committee reviews annually the time required from each of the Directors to perform their roles effectively. Following this review, the Committee is satisfied that each of the Directors has committed sufficient time during the year to fulfil their duties as Directors of the Company.

The Committee reviews the re-appointment of all of the Directors standing for re-election at the AGM, giving regard to their performance and ability to continue to contribute to the requirements of the Board. The performance of Directors with more than six years' service is given particular attention, including a review of their independence, where applicable. The Nomination Committee then makes recommendations to the Board on whether each Director should be put forward for re-election. Information on the recommendations for re-election this year can be found on page 38.

The Committee's Terms of Reference are in line with the recommendations in the UK Corporate Governance Code and the Institute of Chartered Secretaries and Administrators' (ICSA) Guidance on Terms of Reference for Nomination Committees. Copies of the Terms of Reference are available from the Company Secretary and are on our website, www.kcomplc.com.

Liz Barber
Chairman, Audit Committee

Audit Committee report

Director	Appointed to the Committee	Number of meetings	Out of possible
Liz Barber – Chairman	April 2015	3	3
Patrick De Smedt	January 2016	3	3
Peter Smith	January 2015	3	3
Tony Illsley – retired from the Committee in July 2016	June 2009	1	1

The table above shows the membership and attendance at Committee meetings during the year.

The Audit Committee is a sub-committee of the Board and is responsible for reviewing all aspects of the financial reporting of the business and of internal control. The Committee represents the interests of our shareholders in relation to the integrity of information and the effectiveness of the audit processes in place.

Composition

For most of the year under review, the Audit Committee has consisted of three Non-Executive Directors. In the period up to 22 July 2016, Tony Illsley was also a member of the Committee but he stepped down from the Committee upon his retirement from the Board.

The Committee is chaired by Liz Barber, who is a Fellow of the Institute of Chartered Accountants in England and Wales and who currently works as Group Director of Finance, Regulation and Markets at Kelda Group, having previously been the Head of Audit for the North of England at Ernst & Young. Given her current and previous roles, the Board considers that she has the relevant recent financial experience necessary to fulfil the role of Chairman of the Audit Committee.

Committee meetings are also attended by the Executive Directors, the Director of Group Finance Services, the Company Secretary and representatives from the internal and external auditors. The external auditors also meet with individual members of the Audit Committee during the year, without the other attendees present. The internal auditors also meet separately with the Chairman of the Audit Committee without the other attendees present.

Meetings

There were three meetings held in the year: in May, November and March. From 1 April 2017 the Committee will meet four times a year. An overview of the key points considered at each meeting is shown below:

May

> An update was provided by the Director of Group Finance Services on the year-end process and the key accounting judgements. She also covered improvements in controls that had taken place since the implementation of the new finance system in January 2015.

> There was an update from the external auditors regarding the year-end audit and the scope covered. They confirmed their view on the accounting judgements and presented the schedule of uncorrected misstatements. The external auditors also confirmed their continued independence.

> The non-audit fees for the year to 31 March 2016 were reviewed and deemed satisfactory by the Committee.

> There was an update on the internal audit work performed since the previous meeting.

> The risk register for the business was reviewed and discussed.

> The draft longer-term viability statement was reviewed and discussed and the Chief Financial Officer (CFO) gave an overview of the stress testing to be performed.

> The Committee reviewed all of the declarations that the Board would be expected to make in the year-end accounts and noted these.

Corporate governance continued

Meetings continued

November

- The CFO provided an update on the key accounting judgements in relation to the half year. She also gave an overview of IFRS 15 and the work on this to date by KCOM.
- The external auditors provided an overview of their work in relation to the half year and proposed their audit fee for the year to 31 March 2017, which was approved.
- There was an internal audit update on the work performed since the prior meeting.
- The Committee reviewed the Whistleblowing policy and proposed some updates to encourage more people to feel comfortable using this process.
- There was a discussion around the retendering of the external audit.

March

- The Committee reviewed and discussed the updated risk register and the risk appetite statement.
- The methodology for the longer-term viability statement was presented by the CFO and discussed.
- The CFO provided an update on the key accounting judgements for the year end and provided an update on the work in relation to IFRS 15.
- The external auditors set out their approach for the year-end.
- There was an update on the internal audit work performed since the previous meeting and the internal audit plan for the following financial year was discussed and approved.
- The revised Terms of Reference of the Committee were reviewed and approved.
- The revised Engagement of External Auditors policy was discussed and approved.
- The Committee discussed the external audit process without any third parties present and concluded on the outcome of the process.

Each year the Audit Committee is also responsible for:

- reviewing the financial statements of the Group and the clarity of the disclosures made, although the ultimate responsibility for reviewing and approving the Annual Report and financial statements remains with the Board;
- reviewing the effectiveness and independence of any whistleblowing investigations undertaken as a result of such concerns being raised;
- reviewing the procedures in place for the detection of fraud and the prevention of bribery across the business; and
- overseeing the relationship with the external auditors.

The Committee's Terms of Reference are in line with the recommendations in the UK Corporate Governance Code and the ICSA Guidance on Terms of Reference for Audit Committees. Copies of the Terms of Reference are available from the Company Secretary and are on our website at www.kcomplc.com.

External audit

The Audit Committee is responsible for overseeing the relationship with the external auditors to ensure that the external auditors continue to be independent, objective and effective in their work.

PricewaterhouseCoopers LLP were appointed as auditors in 2006 and therefore during the year to 31 March 2017 the Committee undertook a competitive tender process in accordance with the requirements of the Statutory Audit Services Order.

The Committee invited six audit firms to confirm their independence and to participate in the process. Two were unable to confirm their independence and were therefore excluded from the process and a third firm chose not to participate. The remaining three firms were all provided with access to a data room, containing relevant information about the business, and were invited to a day of meetings with key individuals from KCOM. Each of the three firms then submitted a written proposal and all three were then invited to present to the Audit Committee, plus selected key stakeholders, before a final decision was taken.

The Committee set out criteria on which the decision would be based and measured each of the firms on the basis of team competence, service approach, communication, people, commitment, fees, message and style, rapport and cultural fit. The final decision was discussed at length at the conclusion of the Audit Committee meeting in March 2017 and it was decided to recommend that PricewaterhouseCoopers LLP be re-appointed as auditors at the AGM in 2017.

There are no contractual obligations in place which would restrict the choice of external auditors by the Committee.

The Audit Committee has reviewed the effectiveness of the external audit process in the year through meetings and reviewing the reports from the external audit team. The Committee has concluded that the external audit process was effective and is satisfied that the scope of the audit is appropriate and that significant judgements have been robustly challenged.

Policy on non-audit work

Our Engagement of External Auditors policy was updated in the year to reflect the latest legislation. This policy covers the selection of firms to perform non-audit work. It specifically excludes the auditors from providing certain services, such as certain tax services, any services that play any part in the management or decision-making of KCOM, book-keeping and preparing accounting records or financial statements, payroll services, the design and implementation of certain internal control or risk management procedures, valuation services, certain legal or human resources services, internal audit services and certain services linked to the financing, capital structure and investment strategy of KCOM. All other non-audit work is assessed separately and is awarded to the firm considered best suited to perform the work. Any such work must be agreed in advance by the Audit Committee chair, work with a fee greater than 20 per cent of the annual audit fee must be approved by the Audit Committee before the external auditors may be appointed.

During the year, the fee for the external audit of the Group and its subsidiaries, along with other services pursuant to legislation, was £262,000 (2016: £283,000). In addition to this, the external auditors provided services to the value of £77,000 (2016: £165,000) relating to tax advisory services, work in relation to the pension scheme and Group structuring advice work. In these areas the auditors were considered the most appropriate firm to perform the work.

Risk management and internal control

The Audit Committee reviews the Group's internal controls and risk management systems through the work performed by the internal and external auditors and reports to the Board on the effectiveness of such systems. The Committee is satisfied that any audit issues raised by either the internal or external auditors are being adequately followed up and closed on a timely basis.

Internal audit

During the year we appointed KPMG as our internal auditors. The Committee believes that outsourcing the work of internal audit enables a broader scope and gives access to subject matter experts, which would not be possible with a solely in-house team.

The audit plan each year is created by looking at the risks across the business and prioritising audits accordingly, focusing specifically on the areas where the Board would most like assurance in relation to the controls in place. The audit plan is brought to the Audit Committee at the beginning of the financial year and then updated for each meeting as appropriate.

The internal auditors report to the Audit Committee at each meeting on the adequacy and effectiveness of the financial, operational and compliance controls that have been tested across the Group. The Audit Committee is responsible for monitoring and reviewing the effectiveness of the internal audit work and does this through reviewing the internal audit reports presented to the Committee and through the Chairman of the Audit Committee meeting separately with the internal auditors outside of the Committee.

The Committee also reviews the adequacy of management responses to the audit issues raised and monitors the closure of issues on a timely basis through a regular report from the internal auditors.

The internal and external audit teams work closely together to ensure that all key risk areas are covered as appropriate and that the work performed by one team feeds into the work of the other.

During the year, the work performed by KPMG included detailed reviews of the key financial end-to-end processes, a review of the controls around payroll and a high level review of our compliance and governance in relation to privacy risks.

Significant issues relating to the financial statements

The specific issues considered by the Audit Committee in the year under review, in relation to the financial statements, are shown in the table below. There were fewer specific issues discussed than in the prior year, as the issue in relation to the valuation of intangible assets on internal projects was not significant in the year under review. The Committee was satisfied that all of the issues considered were being effectively managed.

Nature of the issue	How the Committee was satisfied with the treatment adopted by management	Any changes arising from discussion by the Committee
Valuation of goodwill		
Testing goodwill for potential impairment is complex and requires a number of management estimates and sensitivities to be applied, which inevitably require judgement. This is a recurring matter.	The re-segmentation of the financial reporting of the business meant that goodwill calculations had to be made on both the old and the new segmentation basis. The goodwill calculations were reviewed by the Committee, along with the assumptions made and the sensitivities applied. These were discussed in detail and it was concluded that no impairment or enhanced sensitivity disclosure was required.	The Committee reviewed the calculations in detail and challenged the assumptions and sensitivities. The conclusion was that no changes were required.
Pension accounting assumptions		
Pension accounting is complex and there are a number of assumptions that have to be made, which can have a significant impact on the valuation of scheme liabilities. This is a recurring matter.	The assumptions that had been made in relation to the pension accounting were reviewed by the Committee, which was satisfied that these were in line with recognised market practice and with the previous assumptions made. No changes were therefore required.	The assumptions were reviewed and challenged by the Committee. No changes were made as the Committee concluded that it agreed with the treatment adopted by management.
Classification of exceptional costs		
The business has incurred significant exceptional costs in the year in relation to restructuring and regulatory matters. Management judgement around when one-off items should be treated as exceptional was therefore an area for review. This will be a recurring matter when there are significant exceptional items.	There is an established and well defined policy in place in relation to the classification of items as exceptional. Management had followed this policy and therefore the Committee was satisfied with the treatment adopted by management.	No changes were made as the Committee was in agreement with the treatment.
Significant contracts		
There are a number of significant customer contracts that arise each year, as well as occasional large supplier contracts. These usually involve some judgement in relation to the timing of revenue and cost recognition on such contracts.	There have been a number of significant customer contracts that have either continued or arisen during the year. Judgements made in relation to some of the larger contracts have been reviewed by the Committee in the year.	No changes were made as the Committee was satisfied that the policies applied were appropriate and had been consistently followed.

Other disclosures

General information
General information is provided in Note 1 of the financial statements.

Disclosure of all relevant information to auditors
The Directors who approved this report are satisfied that, as far as they are aware, there is no relevant audit information (as defined in the Companies Act 2006) of which the Company's auditors are unaware. Each of the Directors has taken all the steps that they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Directors
The names of the Directors who served during the year are on pages 36 and 37 along with the biographical details of the Directors serving at the date of signing of this report. Further information regarding the Directors who served during the year can be found on pages 50 to 72 in the Remuneration report.

Indemnification of Directors
The Company has indemnified each Director against liabilities incurred in connection with any claim brought against him or her, to the fullest extent permitted by the Companies Act 2006. The indemnity deed also obliges KCOM to maintain Directors' and Officers' insurance throughout the directorship and for six years after an individual ceases to be a Director.

Employees
Our people make the difference to our customers and enable us to differentiate ourselves from our competitors. We therefore want our employment strategies to help our people develop to their full potential while also driving our business performance. Our employment policies are designed to provide equal opportunities irrespective of age, disability, ethnicity, gender, gender reassignment, marital and civil partnership status, nationality, pregnancy and maternity, race, religion and belief, and sexual orientation.

All employees, whether part time or full-time, temporary or permanent, are treated fairly and equally. We select employees for employment, promotion, training or other matters affecting their employment on the basis of aptitude and ability.

We take every opportunity to involve and consult with our employees and we believe that employee involvement is an essential contributor to the development of our business. Our Change Network is made up of employees from across the business and they support and increase engagement with our strategy.

Our intranet is integrated with Yammer, which is a social media tool open to everyone in the business to post messages, share content and provide comments and feedback to others across the business. We have a weekly round-up email which keeps everyone informed of activities and developments across the Group, and a monthly newsletter called 'Leadingedge' which is sent to all people managers for them to share with their teams, which contains updates and useful information. There is also a quarterly video broadcast covering latest stories from across the business.

We also encourage our employees to become shareholders by offering a Share Incentive Plan (SIP) as we believe this is an opportunity to encourage greater employee engagement.

Share capital
The Company has a single class of share capital which is divided into ordinary shares of 10 pence.

Rights and obligations attaching to shares
In a general meeting of the Company voting is as follows:

> on a show of hands, every member present in person shall have one vote;
> on a show of hands, every proxy present who has been duly appointed by one or more members shall have one vote; and
> on a poll, every member who is present in person or by proxy shall have one vote for every share of which he or she is the holder.

A member is not entitled to vote in respect of any share in the capital of the Company held by him or her if there are sums payable to the Company in respect of such share which remain unpaid.

Full details of the deadline for exercising voting rights in respect of the resolutions to be considered at the AGM to be held on 21 July 2017 are set out in the Notice of Meeting.

All dividends are paid proportionately to the amounts paid up on the shares and are paid to those members whose names are on the share register at the date at which the dividend is declared, or at such other date as determined by the Directors or by an ordinary resolution of the Company.

If the Company is wound up, the liquidator, with the sanction of a special resolution of the Company or any other sanction required by law, may divide the whole or any part of the assets of the Company among the shareholders and may determine how the division of the assets will be carried out.

Transfer of shares
All transfers of uncertificated shares must be made in accordance with, and be subject to, the Uncertificated Securities Regulations 2001 as amended by the Uncertificated Securities (Amendment) Regulations 2013 and in accordance with any arrangements made by the Board.

All transfers of certificated shares must be in writing in a form which has been approved by the Directors; this is known as 'the Instrument of Transfer'. The Instrument of Transfer must be signed by, or on behalf of, the transferor and the transferor will remain as the holder of the share until the name of the transferee is entered into the share register.

The Directors may refuse to register the transfer of any share which is not fully paid or which is in favour of more than four persons jointly. The Directors may also refuse to recognise an Instrument of Transfer if it is not lodged at the Company's registered office or at any other place which the Directors have determined.

If the Directors refuse to register a transfer they will send to the transferee a notice of the refusal and the Instrument of Transfer within two months of the date on which the transfer was lodged with the Company.

Acquisition of own shares

At the AGM in 2016, the Company was authorised by members to purchase its own shares, up to a maximum of 51,660,391. During the year, the Company did not purchase any of its own shares.

The Company funds Employee Share Trusts (ESTs) to meet its obligations under the Company's share schemes. During the year the ESTs purchased 2,130,491 (2016: 666,000) shares on the London Stock Exchange with a nominal value of £213,049 (2016: £66,600), for which the Company provided funding of £1,778,051 (2016: £450,000). These shares represent 0.4 per cent of the called-up share capital and are held in trust until they vest; therefore the purchase of these shares does not reduce the share capital in issue. The total number of shares held in trust to meet obligations under the Company's share schemes is:

	000s of shares
As at 1 April 2016	6,614
As at 31 March 2017	5,882

Further details around the purchase of shares in the year are set out in Note 26 to the financial statements.

Shares held by ESTs

The trustees of the Kingston Communications 2000 EST and the Kingston Communications All Employee Share Plan vote any shares held in the ESTs as they wish, having due regard to the interests of the employees as potential beneficiaries.

There are two other ESTs, the Kingston Communications Qualifying Employee Share Ownership Trust and KCOM Group PLC Employee Benefit Trust, that are currently dormant and hold no shares.

Requirements of Listing Rule 9.8.4R

None of the disclosures required by Listing Rule 9.8.4R are applicable to KCOM.

Significant agreements – change of control

The following significant agreements contain provisions entitling the counterparties to exercise termination or other rights in the event of a change of control of the Company:

> under our £180.0 million multi-currency revolving facility agreement dated 30 September 2016, the Company must notify Lloyds Bank PLC, the Agent of the agreement, within seven days of becoming aware of a change of control of the Company. Any bank or financial institution named within the facility agreement may then notify the Agent within seven days that they wish to cancel their commitments. The Agent must then give at least 21 days' notice to the Company of this and all outstanding amounts due to that bank or financial institution will become immediately due and payable. For these purposes, a 'change of control' occurs if any person or group of persons acting in concert gains control of the Company; and

> the Company's share schemes, details of which are contained in the Remuneration report on pages 50 to 72, contain provisions which take effect in the event of a change of control, as a result of which options and awards may vest and become exercisable. The provisions do not entitle participants to a greater interest in the shares of the Company than that created by the initial grant or award under the relevant scheme.

The Company does not have any agreements with any Director or employee that would provide compensation for loss of office or employment resulting from a takeover.

Strategic report

Pursuant to Section 414c of the Companies Act 2006 the Strategic report on pages 3 to 34 contains disclosures in relation to future developments, dividends, financial risk management and the disclosure of the Greenhouse Gas emissions for which the Company is responsible.

Annual General Meeting (AGM)

Our AGM will be held at the KCOM Stadium, Hull, on Friday 21 July 2017 at 1pm. The Notice of Meeting was sent to shareholders on 6 June 2017 and is also available on our Group website at www.kcomplc.com. Four resolutions will be proposed as special business. Explanatory notes on these resolutions are set out in the Notice of Meeting.

The Directors consider that all the resolutions proposed are in the best interests of the Company and it is their recommendation that shareholders support these proposals as they intend to do so in respect of their own holdings.

This report has been reviewed and approved by the Board of KCOM Group PLC.

Signed on behalf of the Board

Kathy Smith

Company Secretary
9 June 2017

Peter Smith
Chairman, Remuneration Committee

Remuneration report

Statement from the Chairman of the Remuneration Committee

Our information on Directors' remuneration is structured as follows:

- Annual statement from the Chairman of the Remuneration Committee, providing an overview of the key developments and remuneration decisions made during the financial year.
- Remuneration policy report, setting out the proposed future policy that is being put to shareholders for approval at the AGM in July 2017.
- Annual report on remuneration, showing how the current Remuneration policy has been applied in 2016/17, how we intend to apply the proposed policy in 2017/18 and a summary of the work of the Remuneration Committee in the year.

At our AGM in July 2017, shareholders will be asked to approve the Remuneration policy report in a binding vote, while the Annual statement, together with the Annual report on remuneration, will be put to an advisory shareholder vote.

Dear shareholder

On behalf of the Remuneration Committee and the Board, I am very pleased to present the Directors' Remuneration report for the year ended 31 March 2017.

Our current Remuneration policy was approved by our shareholders at our AGM in 2014 and we have undertaken a thorough review of the policy this year, with assistance from our external remuneration consultants, to ensure it continues to meet the requirements of the business, our shareholders and other key stakeholders. We are proposing a few minor amendments to bring the policy up to date with good practice, to ensure further strengthening of alignment between executive and shareholder objectives and to ensure the policy is sufficiently flexible to remain applicable over the next policy period. We are retaining the overall structure of the current policy to ensure continued simplicity in our remuneration arrangements. We will be asking our shareholders to approve the new Remuneration policy at our AGM in July 2017.

The proposed policy changes

The primary objective of the Remuneration policy is to promote the long-term success of the Company. To achieve this, our current remuneration structure is intended to be simple and consistent and to link pay to performance in relation to the shorter and longer-term success of the business and the creation of shareholder value. It is structured into five main elements – base salary, benefits, retirement benefits, annual bonus and a single Long Term Incentive Plan (LTIP). The base salary, benefits and retirement benefits are fixed and paid at market competitive rates to enable us to attract the right individuals to the business. The annual bonus provides reward for financial performance above market expectations in the year and the LTIP focuses Executive Directors on the medium to long-term value created for shareholders.

> “We have undertaken a thorough review of the Remuneration policy this year to ensure it continues to meet the requirements of the business, our shareholders and other key stakeholders.”

Having concluded that the structure of our current policy is effective and remains aligned with our strategy, we are proposing just four minor changes to enhance it further:

- LTIP post-vesting holding period – We are introducing a two year post-vesting holding period for LTIP awards made from the year ended 31 March 2018 onwards to align Executive Director and shareholder interests over a five year period from the date of grant of an LTIP award. This means that any shares vesting, after tax, will have to be held for a minimum of two years beyond the vesting date. The Committee has decided to introduce this in response to feedback from our investors and to ensure increased focus by Executive Directors on the longer-term success of the business.
- Additional flexibility on incentive plan metrics and targets – We are introducing some additional flexibility within the policy to allow for alternative metrics to be selected in future for the LTIP and annual bonus scheme, if the Committee believes this is appropriate. Currently the measures used are EBITDA for the annual bonus and Total Shareholder Return (TSR) for the LTIP. We are not planning to change these metrics for 2017/18 but seek to have the flexibility to select different metrics, including non-financial metrics, if we feel this would better align remuneration with the strategic objectives of the business in the future. We would seek to consult with our major shareholders in advance if we propose to make any material changes to the metrics we use.
- Additional flexibility on notice periods – We are increasing the maximum notice period allowed for Executive Directors to up to 12 months from six months, to ensure that we can be sufficiently competitive in recruitment situations. It became apparent to us during the recruitment process for our new Chief Financial Officer this year that the standard notice periods offered by other firms were set at 12 months and that therefore only being able to offer a six month notice period placed KCOM out of line with general market practice. It is therefore proposed to build flexibility into the policy to allow for notice periods of up to 12 months and, following approval of this change, the notice period for our Chief Financial Officer will increase from six months to 12 months for either party.
- Increased shareholding requirement for the Chief Executive – We are increasing the shareholding requirement for our Chief Executive from 100 per cent of base salary to 200 per cent to give greater alignment of his interests with those of our shareholders.

In relation to the above proposed changes, we consulted with our largest shareholders, as well as shareholder advisory groups, and have incorporated their feedback into our proposals. We value feedback from our shareholders extremely highly and are always willing to hear your thoughts or arrange a meeting if there is anything that you would like more information on or would like to discuss further.

Performance and decisions in the financial year

The results for the year to 31 March 2017 show an anticipated decrease in revenue and EBITDA which arises, as expected, from a shift in focus away from commodity network business towards value driven solutions. We have shown growth and good strategic progress in our Enterprise segment and continued success in our deployment of Fibre To The Premises in our Hull and East Yorkshire segment. We remain focused on creating a simplified business as we continue to transform KCOM into a regional fibre-based services provider and a provider of complex IP-based solutions to the Enterprise market. During this transition we expect there to be continued decline in revenues and margins in our legacy activities. Consistent with our existing commitment to a minimum full year dividend of 6.00 pence per share, the Board is recommending a final dividend of 4.00 pence per share. Please see the Strategic report on pages 3 to 34 for more information on our performance in the year.

Salary review

Following a review of pay conditions across the Group, and taking into account the performance of the business, the Committee has decided not to award a salary increase to the Executive Directors in 2017/18. This is consistent with the approach taken elsewhere in the Group where salary awards will only be granted on an exceptional basis.

Annual bonus

The threshold EBITDA target for 2016/2017, required for a payment of 10 per cent of the maximum annual bonus entitlement, was set at £70.3 million with a maximum set at £85.0 million. The EBITDA achieved was £67.6 million which means no bonus is payable. Further information on the annual bonus scheme and the targets set in the year can be found on page 64.

LTIP awards

The LTIP awards granted in July 2013 had a performance period which ended on 30 June 2016. The TSR growth for KCOM during the performance period was 48.5 per cent relative to a median growth in the comparator group of 32.7 per cent. This resulted in a vesting of 62.09 per cent of the maximum award, which the Committee agreed was representative of the financial and non-financial performance of the business over the period. Further details on the LTIP, the amount vested and the performance measures can be found on pages 64 to 66.

The LTIP awards granted in July 2014 have a performance period ending on 30 June 2017. Current indications suggest that the awards will not vest, although this cannot be confirmed until the end of the performance period. Details of the final vesting result will be included in our Remuneration report next year.

As indicated in our Remuneration report last year, an LTIP award equivalent to 150 per cent of base salary was made to Bill Halbert in July 2016. An award equivalent to 150 per cent of base salary was also made to Jane Aikman in January 2017, following her recruitment. Both of these awards are subject to relative TSR performance measured over a three year performance period. Further information can be found on pages 64 to 66.

Remuneration report continued

for the year ended 31 March 2016

Board changes

We were delighted to welcome Jane Aikman to the Board on 17 October 2016, as our Chief Financial Officer. The package offered to Jane is fully in line with our Recruitment policy in relation to remuneration. Her base salary on appointment was set at £290,000, which is slightly higher than that paid to her predecessor, Paul Simpson, which is reflective of the considerable experience that Jane brings to the role. Jane was eligible to participate in the annual bonus scheme for 2016/17, pro-rated to the date of her joining; however the financial performance of the business to 31 March 2017 has not triggered a payment under the scheme. The Committee also exercised its discretion to make a LTIP award, equivalent to 150 per cent of salary, to Jane upon her joining the business and this was part of the competitive package offered. Unfortunately as the business was in a close period on the date of her joining, we were unable to do so immediately and instead made the award on 17 January 2017 to coincide with three months since she started her role with us. Further details on the amounts paid to Jane since she joined the Company can be found on page 63.

As noted in the Report and Accounts last year, our previous Chief Financial Officer, Paul Simpson, left the Board on 30 September 2016. Paul remained an employee of the Company and continued to receive his salary and benefits from the date he left the Board up until the end of his notice period on 26 May 2017. Paul was eligible to receive an annual bonus pro-rated to the date he left the Board; however no bonus was triggered for the year to 31 March 2017. He has also been treated as a good leaver for the purposes of the LTIP, with awards pro-rated and remaining subject to the original performance conditions. Details of the amounts paid to Paul during the year are shown on page 66.

Our Senior Independent Director, Tony Illsley, also retired from the Board at our AGM on 22 July 2016. The fee he received for his role in the year was pro-rated to that date.

Feedback

We want to understand the views of our shareholders, including those in relation to remuneration. Any feedback would therefore be very welcome and may be directed to me via our Company Secretary, Kathy Smith, who can be contacted at kathy.smith@kcom.com.

The Committee believes that the revised Remuneration policy supports the objectives of the business and drives the right behaviour at a senior level. I hope that we can rely on your support for the resolutions relating to remuneration at our AGM in July 2017.

Peter Smith
Chairman, Remuneration Committee
9 June 2017

Policy report

This Policy report sets out the proposed Directors' Remuneration policy for KCOM and will be put to a binding shareholder vote at the AGM on 21 July 2017. If approved, the policy will apply for a period of three years until the AGM in 2020, unless a revised Policy report is presented to shareholders before then. Any existing remuneration commitments or contractual arrangements agreed prior to the approval and implementation of this Policy report will be honoured in accordance with their original terms.

Once approved, remuneration payments and payments for loss of office can only be made during the policy period if they are consistent with the approved policy or are otherwise approved by our shareholders by an ordinary resolution.

Policy overview

The primary objective of the Remuneration policy is to promote the long-term success of the Company. In working towards this, the Committee takes into account a number of factors when setting the policy, including:

- the need to provide a remuneration structure that is sufficiently competitive to attract, retain and motivate Executive Directors of an appropriate calibre;
- the need to achieve an appropriate balance between fixed and performance-related variable pay by aligning reward with the achievement of the strategic objectives of the business and incentivising strong long-term performance and sustained shareholder value creation, whilst not encouraging unnecessary risk taking or irresponsible behaviour;
- the alignment of interests between executives and shareholders through share ownership and recovery and withholding provisions;
- internal levels of pay and employment conditions across the Group as whole;
- the principles and recommendations set out in the UK Corporate Governance Code and the views of institutional shareholders and their representative bodies; and
- periodic external comparisons of market trends and practices in similar companies taking into account their size and complexity.

Our remuneration structure is intended to be simple and transparent, and to link pay to performance in relation to the shorter and longer-term success of the business and the creation of shareholder value. Our policy ensures that performance-related components will form a significant proportion of the overall remuneration package, with maximum total potential rewards earned only through the achievement of challenging performance targets based on measures selected to promote the long-term success of the Company.

The Committee will continue to review the Remuneration policy to ensure it takes due account of remuneration best practice and that it remains aligned with the interests of our shareholders.

The remuneration of our Executive Directors is made up of five elements:

Fixed pay			Variable pay	
Salary	Benefits	Pension	Annual bonus	Long Term Incentive Plan

The Remuneration policy covers each of these elements and sets out the approach to each of these for the policy period.

How we take the views of shareholders into account

The Committee seeks to consult with its largest shareholders when any significant changes to the Remuneration policy are proposed. We also consider any shareholder feedback on remuneration received at the AGM each year, plus any other feedback received in relation to remuneration at other times. We also closely monitor developments in institutional investors' best practice expectations.

How the Executive Directors' remuneration relates to the wider workforce

The Committee considers the pay and employment conditions of employees across the business when setting the Remuneration policy for the Executive Directors, to ensure that these are aligned where appropriate. We regularly monitor pay trends across the workforce and salary increases for the Directors will normally be in line with those of the wider workforce, in percentage terms.

The Committee does not consult directly with employees when drawing up the Directors' Remuneration policy; however, we encourage our people to give us feedback, including in relation to remuneration, through mechanisms such as our Change Network. We take any such feedback into account when considering our Remuneration policy. More information on the Change Network and how we encourage our people to get involved is on page 32.

Policy changes

We have undertaken a thorough review of the existing Remuneration policy, taking full account of the strategic objectives of KCOM and developments in the executive pay environment. We took external advice from our remuneration consultants and consulted with our largest shareholders and shareholder advisory groups, incorporating the feedback received into our final proposals.

This Policy report proposes four minor changes to the previous policy:

- the introduction of a two year post-vesting holding period for LTIP awards made from the year ended 31 March 2018 onwards, to align with investor feedback and to ensure a longer-term focus from Executive Directors over a five year period from the date of grant;
- the introduction of some additional flexibility for the Remuneration Committee to adopt alternative metrics in the future for the LTIP and annual bonus scheme, to ensure that the measures chosen are fully aligned with the strategic priorities at the time they are set;
- the introduction of additional flexibility to increase the maximum length of notice periods for Executive Directors, from six to up to 12 months, to provide more flexibility in recruitment situations and to align with current market practice; and
- an increase of the shareholding requirement for our Chief Executive from 100 per cent of salary to 200 per cent of salary to ensure greater alignment of the interests of the Chief Executive with those of our shareholders.

How does the Committee intend to exercise discretion?

The Committee operates the annual bonus, LTIP and all employee share plans in accordance with the relevant plan rules and, where appropriate, the Listing Rules and HMRC legislation. The Committee, consistent with market practice, retains discretion over a number of areas relating to the operation and administration of the plans. These include, for example, the timing of awards and setting performance criteria each year, dealing with leavers, discretion to retrospectively amend performance targets in exceptional circumstances (providing the new targets are no less challenging than originally envisaged) and in respect of share awards, to adjust the number of shares subject to an award in the event of a variation in the share capital of the Company.

Remuneration report continued

Policy report continued

Executive Directors' policy table

Element and how it supports the KCOM strategy	How does this operate and what is the maximum that may be paid?
Base salary Setting the base salary at the right level enables us to attract and retain the high calibre individuals required to deliver the strategic objectives of the business.	We normally review base salaries annually with changes typically effective from 1 July. The review takes into account the salary increase budgeted for the workforce generally as well as any other key internal and external reference points, while also seeking to appropriately reflect the experience, calibre and performance of the individual. There is no prescribed maximum annual basic salary or salary increase. Increases will not normally exceed the general level of increase for employees across the business in percentage of salary terms; however, we may award higher increases in certain circumstances, for example, where there is a change in responsibility, progression in the role or a significant increase in the scale of the role or the size or complexity of the business. Details of the base salaries for each of the Executive Directors are shown in the Annual report on remuneration on page 63.
Benefits Paying the right level of benefits helps us to attract and retain the right individual for the role.	The provision of benefits is set based upon general market practice, taking into account the benefits available to other employees across the business. The benefits available to Executive Directors may include a combination of: > private medical insurance for the Executive and their immediate family; > income protection; > life assurance; > car allowance of up to £16,000 per annum for the Chief Executive and up to £14,000 per annum for the Chief Financial Officer; > medical screening; and > the opportunity to participate in any all-employee Share Incentive Plans operated by the Company, in line with HMRC guidelines. Executive Directors will be eligible for any other benefits which are introduced for the wider workforce on broadly similar terms. We also reimburse our Executive Directors for any normal business-related expenses. The cost of benefits may vary from year to year and there is no maximum level set. The Executive Directors may purchase additional benefits via a deduction in salary through the flexible benefits arrangements that are available to all employees.
Retirement benefits Retirement benefits are paid as part of a market competitive package which, in turn, helps us to attract and retain high calibre individuals.	Executive Directors are entitled to receive an employer defined contribution or cash allowance (or combination of the two) of up to 20 per cent of base salary.

What performance measures are used and why?	Are there any provisions to recover sums paid?	What has changed from the previous Remuneration policy and why?
No specific performance measures are used in relation to determining base salary, but individual and business performance are considered as part of the discussion when setting the base salary levels.	There are no provisions to recover any sums paid.	There is no change in our policy in relation to base salary.
Benefits are not performance related.	There are no provisions to recover any sums paid.	There is no change in our policy in relation to benefits.
Retirement benefits are not performance related.	There are no provisions to recover any sums paid.	There is no change in our policy in relation to retirement benefits.

Remuneration report continued

Policy report continued

Executive Directors' policy table continued

Element and how it supports the KCOM strategy	How does this operate and what is the maximum that may be paid?
Annual bonus The annual bonus is designed to incentivise and recognise the achievement of specific annual objectives in support of the short to medium-term strategy of the business.	The annual bonus is normally payable in cash. The level of award is determined by the Committee after the year end, based on performance against the targets set at the beginning of the year. All bonus payments are at the ultimate discretion of the Committee. A sliding scale of targets is set, with 10 per cent of maximum being payable for achieving the threshold hurdle, rising to 50 per cent of maximum at target level and with payments of up to 100 per cent of salary at maximum.
Long-term incentives Long-term incentive schemes are used to drive growth in shareholder value and to ensure that there is a direct link between reward and superior shareholder returns.	Awards are normally made annually with awards taking the form of conditional rights or nil or nominal cost options. The Committee reviews the quantum of awards annually and monitors the continuing suitability of the performance measures. A holding period will apply to awards granted in the year ending 31 March 2018 and onwards. The holding period will require any shares that vest, after tax, to be held for a period of two years, even if this period extends beyond the Director leaving employment with KCOM. The plan allows a maximum award of 150 per cent of salary per annum and this would be the normal level of award made to the Executive Directors. The rules allow for awards of up to 200 per cent of salary to be made in exceptional circumstances. The Committee may determine at grant whether an amount, in cash or shares, equivalent to the dividends paid or payable on vested shares up to the vesting date may become payable; any amount payable may assume the reinvestment of dividends over the vesting period. Actual award levels will be disclosed each year in the Annual report on remuneration.

What performance measures are used and why?	Are there any provisions to recover sums paid?	What has changed from the previous Remuneration policy and why?
The performance measures may be financial or non-financial measures but will be selected by the Committee each year. Group financial measures, such as profit-related measures, will apply for the majority of the bonus. If used, personal or strategic objectives will be applied for the minority of the bonus. Measures and objectives will be determined over a one year performance period. The measures in place for 2016/17 and those proposed for 2017/18 are set out in more detail on page 64. In both years we have chosen EBITDA as the most appropriate measure for the annual bonus. The Committee believes that any incentive compensation should be appropriately challenging and tied to the delivery of targets relating to profit.	Clawback provisions may be invoked for material misstatement, errors in assessing performance conditions or gross misconduct.	We have included some additional flexibility to select non-financial metrics alongside financial metrics in future years if the Committee believes it is appropriate to do so, to continue to align Executive Director remuneration with the strategic objectives of the business. For 2017/18 we are not proposing to change the use of EBITDA as the measure for the annual bonus.
Awards will typically vest after no less than three years, subject to the achievement of pre-set performance criteria and continued employment. The key performance measure used currently is relative Total Shareholder Return (TSR) and stretching targets relating to this are set and assessed by the Committee. However, different financial, share price or strategic-based performance measures may be set for future award cycles as appropriate to reflect the strategic priorities of the business at that time. In addition to the performance measures set out by the Committee, there will always be an underpin that the Committee must be satisfied that the financial and non-financial performance of the business over the performance period warrants the level of vesting. As with previous awards, the performance measure for the 2017/18 LTIP awards will be relative TSR. This was selected on the basis that it is aligned with the delivery of long-term returns to shareholders.	Clawback and withholding provisions may be invoked for material misstatement, errors in assessing performance conditions or gross misconduct.	The two year post-vesting holding period is new this year and will apply for all LTIP awards made in the year ending 31 March 2018 onwards. This will require Executive Directors to hold any shares vesting from future awards under the LTIP, after tax, for a period of two years. We have also introduced additional flexibility in the performance measures used for the LTIP, to enable us to introduce different metrics for future awards if the Committee believes this to be appropriate.

Remuneration report continued

Policy report continued

Non-Executive Directors' policy table

Element and how it supports the KCOM strategy	How does this operate and what is the maximum that may be paid?
Fees Fees are set to recognise the responsibility and experience of the individual and enable us to attract and retain the right calibre of individual and the right blend of skills on the Board.	Fees are normally reviewed annually. Any increase will be guided by changes in market rates, time commitments and responsibility levels as well as by increases for the broader employee population. The Chairman is paid an all-encompassing fee to take account of all Board responsibilities. The other Non-Executive Directors receive a base fee with additional fees paid for additional responsibility, such as the chairing of a Committee and performing the role of Senior Independent Director. In exceptional circumstances, if there is a temporary yet material increase in the time commitments for Non-Executive Directors, the Board may pay extra fees to recognise the additional workload. We reimburse our Non-Executive Directors for any normal business-related expenses. **What performance measures are used and why?** Fees are not performance related; however, performance is addressed through regular one-to-one meetings between the Chairman and each Non-Executive Director. The performance of the Chairman is reviewed at regular one-to-one meetings between the Chairman and the Senior Independent Director. **When and how might the Committee exercise discretion in this area?** Changes to the fees of Non-Executive Directors are a Board decision rather than a Remuneration Committee decision and there is discretion in relation to the level of fees set, within the parameters noted. **Are there any provisions to recover sums paid?** There are no provisions to recover any sums paid.

Share ownership requirement

The Committee requires our Executive Directors to build a shareholding in KCOM at a level of at least 100 per cent of salary for our Chief Financial Officer and 200 per cent of salary for our Chief Executive. This represents an increase from the previous Remuneration policy in the requirement for the Chief Executive. We believe that requiring the Executive Directors to hold shares further reinforces the alignment between their interests and those of shareholders and reduces the potential for behaviours and actions which are detrimental to the long-term health of the Company. It is expected that Executive Directors will reach this level through the retention of shares that have vested in the LTIP, on a net of tax basis.

The share ownership of all of our Directors, and their connected persons, as at 31 March 2017 is shown on page 71.

How does the Remuneration policy for Executive Directors differ from that of other employees?

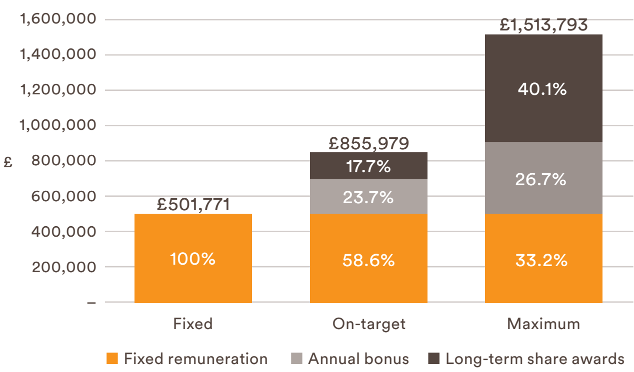
Overall, the Remuneration policy set for the Executive Directors is more heavily weighted towards performance-related variable pay than for other employees. As such, a greater proportion of their remuneration is dependent upon the successful delivery of the business strategy. The key differences are noted in the table below:

Element	Difference
Base salary	Base salaries are reviewed in the same way for Executive Directors as for other employees, taking into account market rate information, internal reference points, individual performance, the scope of the role, the financial performance of the business and the average increases across the rest of the business.
Benefits	An increasing level of benefits is offered to employees as their job level increases. Those offered to the Executive Directors are consistent with those offered to other senior employees, with a slightly higher car allowance for Executive Directors. There is a range of flexible benefits open to all employees, and the Executive Directors, that can be purchased each year.
Retirement benefits	All employees are entitled to pension contributions from KCOM. The amount contributed increases as the employee contribution increases. Executive Directors receive a slightly higher maximum pension contribution than other employees, at 20 per cent of base salary. We are aware of the support expressed by some shareholders for the downward harmonisation of executive pension allowances to bring them into line with the percentages for the wider workforce and we will continue to closely monitor how market practice and investor views develop in this area.
Annual bonus	All employees, other than those eligible for commission payments, are entitled to participate in the same bonus scheme as the Executive Directors. The maximum award is set as a percentage of salary, which increases with seniority.
Long-term incentives	Long-term incentive awards are made only to those individuals who are most able to directly influence the business strategy. Along with the Executive Directors, selected senior managers are also invited to participate in the LTIP. The performance measures and performance period are the same for all participants in the scheme each year. The level of award increases with seniority.

What might Executive Directors be paid under the Remuneration policy?

The charts below indicate how much each of the Executive Directors might receive under the proposed Remuneration policy on an annual basis on a fixed, on-target and maximum basis:

Bill Halbert



Jane Aikman

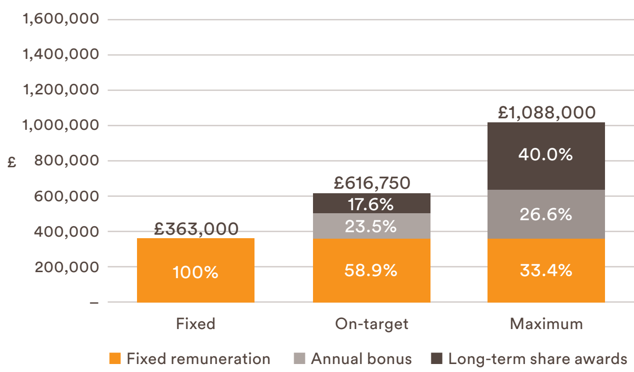


Chart assumptions

The different scenarios shown in the graphs are:

> fixed – where performance is below threshold and Executive Directors receive fixed pay only with no vesting under the LTIP and no annual bonus;

> on-target – where Executive Directors receive their fixed pay plus a bonus at the mid-point of the range, representing 50 per cent of the maximum opportunity, and vesting of 25 per cent of the maximum under the LTIP for performance at the median of the comparator group; and

> maximum – where performance meets or exceeds the maximum and the Executive Directors receive their fixed pay plus the maximum bonus and maximum vesting of the LTIP.

Remuneration report continued

Policy report continued

What might Executive Directors be paid under the Remuneration policy? continued

Fixed pay comprises:

> base salary;

> benefits, equivalent to the amount received by each Executive Director in the year to 31 March 2017, pro-rated to a full year for Jane Aikman; and

> pension, equivalent to 20 per cent of the base salary for the year.

Any LTIP vesting would also lead to a cash payment for the equivalent dividends earned in the performance period on the vested shares. This has not been included in the charts on page 59.

It should be noted that since the analysis above shows what could be earned by the Executive Directors based on the 2017/18 Remuneration policy described on pages 52 to 62, the numbers will be different to the values included in the table on page 63 detailing what was actually earned by the Executive Directors in the year to 31 March 2017, since these values are based on the actual levels of performance to 31 March 2017.

Recruitment policy

The remuneration package for a new Executive Director would be set in accordance with the terms of the prevailing approved Remuneration policy at the time of appointment, taking into account the skills and experience of the individual, the market rate for a candidate of that experience and the importance of securing the relevant individual.

This table sets out our policy on the recruitment of new permanent Executive Directors for each element of the remuneration package.

Element	Policy on recruitment
Base salary	The salary would be provided at such a level as required to attract the most appropriate candidate. Where it is appropriate to set a lower salary initially, a series of increases above the level awarded to the wider workforce may be given over the proceeding few years until the desired position is achieved, subject to individual performance. This may apply to those promoted internally in the business as well as to those recruited from outside.
Benefits	The benefits package we will offer will be set in line with the policy for existing Executive Directors. In addition to the benefits currently available to existing Executive Directors, we may also offer an allowance to cover relocation, travel and/or incidental expenses as appropriate.
Retirement benefits	The maximum pension contribution will be set in line with the policy for existing Executive Directors at 20 per cent of base salary.
Annual bonus	We will offer an annual bonus in line with our policy for existing Executive Directors of up to 100 per cent of salary. Different performance measures may be set initially, at the discretion of the Committee, depending on the point in the financial year at which the individual joins. The opportunity for an annual bonus will be pro-rated to the period of employment.
Long-term incentives	On an ongoing basis awards will be made in line with the policy for other Directors. In the year of recruitment a higher award may be made, at the discretion of the Committee, within the approved limits of the plan (200 per cent of salary in exceptional circumstances) and at a date outside of the usual annual awards.
'Buy-outs'	In addition to the above, we may also offer additional cash and/or share-based elements when we consider these to be in the best interests of shareholders and the business. Any such payments would be based solely on remuneration relinquished when leaving the former employer and would reflect (as far as possible) the nature and time horizons attaching to that remuneration and the impact of any performance conditions. Our policy on the 'buying-out' of existing incentives granted by the Executive's previous employer will depend on the circumstances of recruitment and will be negotiated on a case-by-case basis. There will not be a presumption in favour of buy-out but it will be considered if necessary to attract the right candidate.

In total the maximum variable pay level in the year of appointment – excluding the value of any buy-out awards – will be 300 per cent of salary, consisting of up to 100 per cent annual bonus and up to 200 per cent LTIP award.

For an internal executive appointment, any variable pay element awarded in respect of the prior role would be allowed to pay out according to its terms, adjusted as appropriate to take into account the appointment. In addition, any other ongoing remuneration obligations existing prior to appointment would be allowed to continue.

Recruitment of Jane Aikman

During the year we recruited Jane Aikman to the Board as our Chief Financial Officer. The recruitment package offered to Jane was consistent with the policy on page 60. Further details can be found on page 63.

Non-Executive Directors

The fee structure for Non-Executive Director appointments will be based on the Non-Executive Director fee policy as set out in the policy table.

Service contracts

It was previously the policy to set notice periods for Executive Directors at six months for either party; however, it became apparent to us during the year that this put KCOM out of line with general market practice. We are therefore proposing to change our policy to increase the maximum notice period for Executive Directors to up to 12 months, to enable us to be sufficiently competitive in recruitment situations. If our new Remuneration policy is approved by shareholders, we intend to increase the notice period for our Chief Financial Officer, Jane Aikman, to 12 months for either party.

Letters of appointment

Non-Executive Directors are appointed by letters of appointment rather than service contracts and the notice period in all letters of appointment is set at six months for either party.

Copies of the Directors' service contracts and letters of appointment are available for inspection during office hours at our head office at 37 Carr Lane, Hull HU1 3RE. None of the service contracts or letters of appointment place obligations on us to make payments beyond those disclosed in this report.

Payments to Executive Directors who leave the business

The table on page 62 sets out our policy on payments in relation to Executive Directors who leave KCOM. This policy is unchanged from our previous Remuneration policy.

The Committee is clear that there will be a consistent approach to exit payments and no reward for poor performance. We will not pay anything if an Executive Director is dismissed for serious breach of contract, serious misconduct or under-performance or for acts that bring the Executive Director or KCOM into serious disrepute.

The Non-Executive Directors' letters of appointment do not include any compensation for loss of office.

Exit of Paul Simpson

Our Chief Financial Officer, Paul Simpson, stepped down from the Board on 30 September 2016. All payments to Paul during the year have been made in accordance with our policy as stated on page 62. Further details on these payments can be found on pages 63 to 66.

Remuneration report continued

Policy report continued

Payments to Executive Directors who leave the business continued

Remuneration element	Treatment on exit
Base salary	Salary will be paid over the contractual notice period. In all cases we will seek to mitigate any payments due and the Executive Directors have a contractual duty to use reasonable endeavours to obtain alternative income, which can then be used to reduce the salary if being paid by instalments. However, we have discretion to make a lump sum payment on termination in lieu of notice.
Benefits and retirement benefits	Benefits and retirement benefits will normally continue to be provided over the notice period. In all cases we will seek to mitigate any payments due. However, we have discretion to make a lump sum payment on termination equal to the value of the benefits payable during the notice period.
Annual bonus	Whether an annual bonus payment is made is entirely at the discretion of the Remuneration Committee and would in any event be pro-rated to the time of active service in the year of cessation. The decision of the Committee would take into consideration the performance of the individual, the circumstances of the departure and the financial performance of the business.
Long-term incentives	Normally awards will lapse on cessation of employment, unless the Remuneration Committee determines that the Executive is a good leaver. Good leaver status is usually conferred for one of the following reasons: death, ill health, injury or disability, retirement, redundancy, or other circumstances at the discretion of the Committee. Good leavers will be treated in accordance with the rules of the LTIP, as approved by shareholders. In these circumstances a participant's awards vest on a time pro-rata basis subject to the satisfaction of the relevant performance criteria over the original period, with the balance of the awards lapsing. The Committee retains discretion to decide not to pro-rate, to alter the basis of time pro-rating, and to alter the date on which performance is calculated if it feels such decisions are appropriate in particular circumstances.

In relation to a termination of employment, the Committee may make payments in relation to any statutory entitlement or payments to settle compromise claims as necessary. The Committee also retains the discretion to reimburse reasonable legal expenses incurred in relation to a termination of employment and to meet any transitional costs if deemed necessary. Payment may also be made in respect of accrued benefits, including untaken holiday entitlement.

Payments on a change of control, where a Director's employment is adversely changed, will be as on termination. There will be no enhanced provisions on a change of control.

Policy on outside appointments

We believe that where Board members hold directorships in other companies, KCOM can benefit from their experience. As a result, and subject to the Board's prior approval, Executive Directors may take on external non-executive directorships and retain the fees earned.

Annual report on remuneration

This part of the Directors' Remuneration report sets out the amounts we have paid to Directors for the year ended 31 March 2017 and describes how the policy will be implemented in 2017/18. The Annual report on remuneration, along with the Annual statement from the Chairman of the Remuneration Committee, will be put to an advisory shareholder vote at the AGM on 21 July 2017.

The financial information contained in this part of the report has been audited where indicated.

Single total figure table (audited)

Executive Directors

	Current Directors				Previous Director			
	Bill Halbert		Jane Aikman[1]		Paul Simpson[2]		Total	
	FY2017 £'000	FY2016 £'000	**FY2017 £'000**	FY2016 £'000	**FY2017 £'000**	FY2016 £'000	**FY2017 £'000**	FY2016 £'000
Fixed pay								
Base salary	**403**	397	**133**	—	**132**	262	**668**	659
Taxable benefits	**16**	16	**7**	—	**8**	17	**31**	33
Retirement benefits	**66**	66	**9**	—	**25**	50	**100**	116
Sub-total	**485**	479	**149**	—	**165**	329	**799**	808
Variable pay								
Annual bonus	**—**	99	**—**	—	**—**	66	**—**	165
Long-term incentives	**377**	—	**—**	—	**249**	—	**626**	—
Sub-total	**377**	99	**—**	—	**249**	66	**626**	165
Total	**862**	578	**149**	—	**414**	395	**1,425**	973

1. Jane Aikman joined the Board on 17 October 2016.

2. Paul Simpson stepped down from the Board on 30 September 2016.

Further details on Executive Director remuneration for the year ended 31 March 2017

Base salary

The base salaries for Bill Halbert and Paul Simpson were increased by two per cent on 1 July 2016 to £404,809 and £267,369 respectively, as approved in the Annual report on remuneration last year.

Taxable benefits

Bill Halbert received a car allowance of £16,000 but elected not to receive any other taxable benefits. The taxable benefits for Jane Aikman and Paul Simpson include private medical insurance, income protection, life assurance, medical screening and a £14,000 per annum car allowance. The benefits for Jane Aikman were pro-rated in the year to the date she joined the business.

Retirement benefits

Bill Halbert has elected not to be a member of the KCOM pension scheme and, accordingly, we made no contributions on his behalf. Instead he received cash payments totalling £65,905 (2016: £65,905) which are disclosed above within retirement benefits.

Paul Simpson elected to receive part of his pension contribution entitlement in cash due to the Pension Lifetime Allowance contributions being reached. This amount was £8,914 (2016: £17,828) and is included in the table above within retirement benefits.

None of the Directors have any prospective entitlement to defined benefits or cash balance benefits in respect of qualifying services.

Long-term incentives

The figures included above for long-term incentives that vested during the year relate to the LTIP awards granted in July 2013 which vested in July 2016. These include dividends of £46,988 (2016: £Nil) for Bill Halbert and £31,035 (2016: £Nil) for Paul Simpson in accordance with the rules of the LTIP scheme. Further details of the scheme and the vesting are on pages 64 and 65.

Use of discretion:

The Committee used its discretion to set the base salary for Jane Aikman upon her recruitment. Her salary of £290,000 is slightly higher than that of her predecessor, Paul Simpson, which reflects her considerable experience prior to joining KCOM. The salary is in line with the parameters set by our Remuneration policy.

Remuneration report continued

Annual report on remuneration continued

Annual bonus

The annual bonus scheme for 2016/17 used pre-exceptional EBITDA as its key measure. A target level of pre-exceptional EBITDA was set at which a bonus pot would start to accrue, with a proportion of profits above that level being set aside for a bonus payment to all the scheme participants, up to the maximum level of bonus for all participants. The pre-exceptional EBITDA targets for 2016/17 are summarised in the table below:

Bonus level	EBITDA required £'000
Maximum level – bonus fully paid	84,967
Target level – 50 per cent bonus paid	79,467
Threshold level – bonus starts to accrue	70,300

Why EBITDA?

Pre-exceptional EBITDA was chosen as the financial performance target for the annual bonus because this is a key performance measure used across our industry and one which is closely watched by our investors. Any significant movement in EBITDA has always led to a corresponding movement in our share price and therefore it is extremely important for our investors that the Executive Directors are incentivised to achieve an EBITDA above market expectations each year. Pre-exceptional EBITDA is one of the KPIs that we monitor throughout the year. More detail on our KPIs is on page 22.

The threshold level of EBITDA was set using the market consensus for pre-exceptional EBITDA at the start of the financial year. The market consensus was lower than the EBITDA of £74.9 million achieved in 2015/16 due to the transaction to dispose of our UK national network infrastructure to CityFibre, which was announced in December 2015. This transaction included an arrangement with CityFibre to support existing commitments and customer arrangements on the national network at a cost of £5.0 million per annum, over a five year term, starting in 2016/17. Taking this into account, a target of £70.3 million represents growth in pre-exceptional EBITDA on a like-for-like basis.

The pre-exceptional EBITDA achieved in the year was £67.6 million, which means a bonus payment has not been triggered for the year to 31 March 2017.

Long-term incentives

The current long-term incentive scheme, the LTIP, was approved by shareholders on 19 July 2012. The scheme authorises the Remuneration Committee to grant nil-cost share options to the Executive Directors and selected senior managers each year.

LTIP awards are usually made in July of each year. The scheme has a three year performance period and measures TSR over the performance period, relative to the TSR performance of each company within a comparator group. The comparator group comprises the companies that were within the FTSE 250 (excluding investment trusts) at the start of the performance period.

The TSR performance for the period must rank at least median to the comparator group for there to be any vesting of the LTIP awards. Performance at median results in 25 per cent of the awards vesting, with performance between median and upper quartile resulting in a vesting of awards on a straight-line basis with 100 per cent vesting at upper quartile performance.

In addition, regardless of TSR performance, no awards vest unless the Remuneration Committee is satisfied that the financial and non-financial performance of KCOM over the performance period warrants the level of vesting set out in the vesting schedule. The Committee will consider KCOM's share price progression and dividend policy as part of this review.

On the exercise of an award participants receive an amount in cash equal to the dividends that were declared during the period from grant to exercise, but only in respect of the shares that vest.

The TSR performance is calculated as the percentage change in return index from the start to the end of the performance period. The return index is calculated by considering movements in share price together with dividends reinvested on the ex-dividend date. The base return index is averaged over each weekday in the three month period immediately preceding the start of the performance period and the end return index is averaged over each weekday in the three months prior to the end of the performance period.

Why TSR?

Our main objective is to create sustainable shareholder value. TSR measures the total shareholder return from share price movements and dividends over a period of time. By measuring TSR relative to other businesses we can see whether an investment in KCOM has yielded value for our shareholders in comparison to the same investment in another business. This therefore exactly aligns the objectives of the Executive Directors to those of our shareholders. The three year performance period, with a two year post-vesting holding period for any shares awarded from the year ending 31 March 2018 onwards, means that the Executive Directors need to be focused on the medium to long-term if they want to maximise their benefit from the LTIP.

On 30 June 2016 the LTIP awards made in July 2013 reached the end of their performance period. The TSR for KCOM during the performance period was 48.5 per cent. The median for the comparator group was 32.7 per cent and the upper quartile TSR began at 68.2 per cent. The performance for KCOM therefore fell between the median and the upper quartile which indicated vesting of 62.09 per cent of the maximum award, which was confirmed by the Committee. The Committee was satisfied that the vesting level was aligned with the underlying financial and non-financial performance of the business over the performance period.

The performance period for the LTIP awards made in July 2014 is due to end on 30 June 2017. Based on current performance it appears that the awards will not vest, but the actual figures, once confirmed, will be included in the single total figure table for 2017/18.

Use of discretion:

The Committee exercised discretion in two ways in relation to the vesting of the 2013 LTIP award:

> Vesting under the LTIP is always subject to the Remuneration Committee being satisfied that the vesting level reflects the true financial and non-financial performance of KCOM over the performance period. This discretion can only be used to reduce the amount that has vested, not to increase it. The Committee noted that the share price had increased from 81.0 pence to 105.5 pence during the performance period and that dividends had grown by 21 per cent over the same period. The Committee therefore concluded that the level of vesting accurately reflected the performance of the business and that the vesting should therefore proceed.

> The Committee has discretion regarding the treatment of companies within the comparator group which cease to be listed. It can elect to retain delisted companies within the comparator group at the value at which they delist or to remove them from the comparator group. The Committee chose to remove delisted companies from the comparator group as this is consistent with the approach taken in the prior year.

Awards made under the LTIP (audited)

An award of nil-cost options was made to Bill Halbert in July 2016, which was equivalent to 150 per cent of his base salary. This was consistent with the prior year in quantum and signalled the return to making awards in July each year, following the delay of the 2015 award due to the inside information arising from the sale of UK national network infrastructure to CityFibre.

It was the intention of the Committee to make an equivalent award to the new Chief Financial Officer upon appointment, in order to align her incentives with the creation of shareholder value from the outset. This was not immediately possible due to the business being in a close period on the date of her appointment. The award of nil-cost options equivalent to 150 per cent of base salary was consequently made on 17 January 2017, to coincide with three months from her date of appointment.

Use of discretion:

LTIP awards are usually made within six weeks of the announcement of financial results by KCOM; however, the LTIP rules give the Committee discretion to make an award at any other time if the circumstances are ‘sufficiently exceptional to justify its grant’. The Committee agreed that the recruitment of an Executive Director and the ability to offer an LTIP award as part of a competitive package, in order to attract the right talent to the role, were sufficiently exceptional to justify a grant outside of the usual award period and therefore exercised its discretion to make the award.

Share dilution

The rules of the LTIP scheme prevent awards from being granted if the award would cause the number of shares allocated in a rolling 10 year period to exceed five per cent of the ordinary share capital of the Company when combined with any other Company executive share plan or 10 per cent of the ordinary share capital when combined with any other Company employee share plan. As at 31 March 2017 the share dilution from share schemes in the preceding ten years was 0.32 per cent. Since 2009 the Company has met all share scheme obligations through the purchase of existing shares and intends to meet future obligations in the same way.

Remuneration report continued

Annual report on remuneration continued

Awards made under the LTIP (audited) continued

As in previous years, the performance condition for these awards is TSR performance relative to the FTSE 250, excluding investment trusts, at the start of the performance period. The performance period for these awards is three years beginning on the first day of the month of grant.

	Date of grant	Share price at date of grant	Nil-cost options outstanding on 1 April 2016 000s of options	Nil-cost options awarded in the year 000s of options	Nil-cost options vested during the year 000s of options	Nil-cost options lapsed during the year 000s of options	Nil-cost options outstanding on 31 March 2017 000s of options	Face value of maximum award[1] £'000	Award that would vest at threshold performance[2] 000s of options	Date of vesting
Bill Halbert	17.07.2013	82.50p	468	—	291	(177)	—	386	117	17.07.2016
	17.07.2014	95.00p	418	—	—	—	418	397	105	17.07.2017
	16.12.2015[3]	110.25p	540	—	—	—	540	595	135	16.12.2018
	08.07.2016	108.00p	—	562	—	—	562	607	141	08.07.2019
Jane Aikman	17.01.2017	89.25p	—	487	—	—	487	435	122	17.01.2020
Paul Simpson[4]	17.07.2013	82.50p	309	—	192	(117)	—	255	77	17.07.2016
	17.07.2014	95.00p	276	—	—	(13)[4]	263	250	66	17.07.2017
	16.12.2015[3]	110.25p	357	—	—	(185)[4]	172	204	43	16.12.2018

1. Face value has been calculated using the share price at the date of grant.
2. 25 per cent of the award vests at threshold performance.
3. The 2015 award was made in December instead of July due to the transaction to sell the UK national network infrastructure to CityFibre, which meant the Directors were privy to inside information from July until December 2015.
4. Paul Simpson was granted good leaver status upon leaving the business, as noted in the Remuneration report in 2016, and therefore will be eligible to receive these awards, subject to vesting conditions being met. The awards have been pro-rated to the date his notice period ended on 26 May 2017.

Payments for loss of office

There have been no compensation payments for loss of office in the period under review.

Payments to past Directors

As noted in the Annual Report in 2016, Paul Simpson stepped down from the Board on 30 September 2016 but continued to receive his base salary, taxable benefits and retirement benefits as an employee of the business until the end of his notice period on 26 May 2017. The table below shows the additional remuneration he received following his stepping down from the Board and the total that he therefore received in the year.

Payments to Paul Simpson in the year

	To 30 September 2016 £'000	From 1 October 2016 £'000	Total for the year £'000
Base salary	**132**	134	266
Taxable benefits	**8**	8	16
Retirement benefits	**25**	25	50
Sub-total	**165**	167	332
Annual bonus	**—**	—	—
Long-term incentives	**249**	—	249
Sub-total	**249**	—	249
Total	**414**	167	581

Also during the year, Kevin Walsh, a previous Director of the Company, received 79,284 nil-cost share options and a dividend equivalent cash payment of £12,815 from the vesting of the 2013 LTIP awards. The amounts received had been pro-rated to the date of his departure from the business on 31 October 2014.

Single total figure table (audited)

Non-Executive Directors

	Current Directors								Previous Director		Total	
	Graham Holden		Liz Barber		Patrick De Smedt		Peter Smith		Tony Illsley[1]		Total	
	FY2017 £'000	FY2016 £'000	**FY2017 £'000**	FY2016 £'000	**FY2017 £'000**	FY2016 £'000	**FY2017 £'000**	FY2016 £'000	**FY2017 £'000**	FY2016 £'000	**FY2017 £'000**	FY2016[2] £'000
Fees	**127**	125	**50**	46	**51**	7	**50**	47	**18**	54	**296**	279
Total	**127**	125	**50**	46	**51**	7	**50**	47	**18**	54	**296**	279

1. Tony Illsley retired from the Board on 22 July 2016.

2. In 2015/16 there were also fees of £16,000 paid to Martin Towers who retired from the Board on 31 July 2015.

Some of the fees of the Non-Executive Directors were increased from 1 July 2016, as detailed in the Annual report on remuneration last year. The increases made were an increase from £125,000 to £127,500 for the Non-Executive Chairman and increases from £6,000 to £7,000 for the roles of Audit Committee Chairman and Remuneration Committee Chairman.

Implementation of policy for 2017/18

The table below sets out how we will implement the Remuneration policy for the 2017/18 financial year:

Executive Directors

	Bill Halbert	Jane Aikman
Base salary	Bill's base salary will remain at £404,809.	Jane's base salary will remain at £290,000.
Benefits	The benefits to be provided remain unchanged from 2016/17. These include private medical insurance for the Executive and his or her immediate family, income protection, life assurance, a car allowance of £16,000 per annum for Bill and £14,000 per annum for Jane, medical screening and the opportunity to participate in the all-employee Share Incentive Plan. The Executive Directors are also able to purchase additional flexible benefits which are available to all employees.	
Retirement benefits	Both Executive Directors will receive an employer pension contribution or cash equivalent of 20 per cent of base salary.	
Annual bonus	The performance measure for the annual bonus scheme for 2017/18 will remain as EBITDA. A threshold level of EBITDA has been set which, if achieved, will result in a bonus payment of 10 per cent of maximum entitlement. Achievement of EBITDA above this level will result in additional bonuses being accrued at a rate of 40 pence for every additional £1 of EBITDA. Payments will be made to all scheme participants on a sliding scale up to the maximum level of bonus entitlement, which for both Bill and Jane is 100 per cent of base salary. The EBITDA targets are considered to be commercially sensitive and will be disclosed in the Annual report on remuneration next year.	
Long-term incentives	Consistent with previous years, it is proposed to grant LTIP awards to Bill and Jane in July 2017 under the current scheme, equivalent to 150 per cent of base salary at the date of grant. These awards will have a three year performance period and therefore will be due to vest in July 2020 subject to the achievement of relative TSR performance conditions. Any vested shares, after tax, will then be subject to a two year holding period following vesting. The performance conditions attached to the LTIP awards will be the same as for awards in previous years and are described further on pages 64 and 65.	

Remuneration report continued

Annual report on remuneration continued

Implementation of policy for 2017/18 continued

Non-Executive Directors

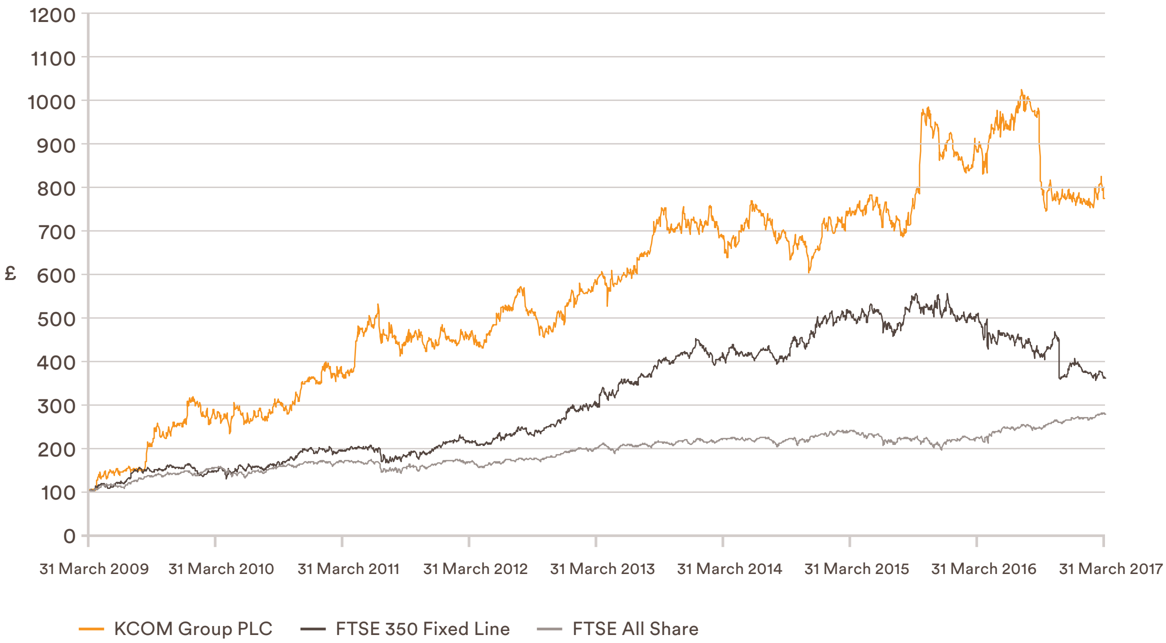
The Board has reviewed the Non-Executive Director fees and has decided that these should remain the same in 2017/18, which is consistent with the Executive Directors receiving no pay increase in 2017/18 and the pay awards across the rest of the business, where increases will only be made on an exceptional basis.

The fees to be paid in the year are shown in the table below.

	£'000
Chairman fee	127.5
Base fee	43
Senior Independent Director fee	11
Audit Committee Chairman fee	7
Remuneration Committee Chairman fee	7

Relative Group performance

The graph below shows, for the financial year ended 31 March 2017 and for each of the previous eight financial years, the TSR on a holding of KCOM's ordinary shares compared with a hypothetical holding of shares in the FTSE Fixed Line All-Share and the FTSE 250. These indices have been chosen as appropriate comparators because they reflect the performance of other companies most similar to KCOM in terms of product and service offering and market capital.



Remuneration of the Chief Executive

Bill Halbert became our Chief Executive on 1 April 2014, having previously been the Executive Chairman and performing a dual role of both Chief Executive and Chairman. The table below sets out the remuneration for Bill in his role as either Executive Chairman or Chief Executive in each of the last eight years:

	FY2017 £'000	FY2016 £'000	FY2015 £'000	FY2014 £'000	FY2013 £'000	FY2012 £'000	FY2011 £'000	FY2010 £'000
Total remuneration	**862**	578	476	495	4,791	522	476	523
Annual bonus paid against maximum opportunity	**—**	25%	—	7%	—	10%	—	40%
Long-term incentive vesting against maximum opportunity[1]	**62.09%**	—	N/A	N/A	69.34%	N/A	N/A	N/A

1. There was no long-term incentive scheme scheduled to vest based on performance ending in any of the financial years other than the years ended 31 March 2013 and from 31 March 2016 onwards.

The table below sets out the increase in the remuneration of the Chief Executive from the prior year in comparison to the average percentage change in respect of KCOM employees as a whole:

	Bill Halbert	Average per employee[1]
Percentage change in the year to 31 March 2017		
Base salary	1.51%	1.62%
Benefits	0.00%	0.00%
Annual bonus	-100.0%	-100.0%

1. The average per employee has been calculated on a per head basis using all of the employees in the business who have remained in the same role throughout the year, excluding the Executive Directors. This group has been selected to enable a like-for-like comparison with the Chief Executive.

Relative spend on pay

The table below sets out the relative spend on pay for KCOM as a whole in comparison to distributions to shareholders:

	Year ended 31 March 2017 £'000	Year ended 31 March 2016 £'000	Percentage change
Total remuneration cost for all employees[1]	**85,300**	88,135	-3.22%
Dividend payments to shareholders	**30,686**	28,672	7.02%

1. The total remuneration cost for all employees is taken from Note 8 to the financial statements on page 96 and includes wages and salaries, social security costs, other pension costs and share scheme costs. The figures from the prior year have been restated in order to reclassify certain staff costs included within other external charges.

Service contracts and letters of appointment

	Date of Board appointment	Date of current service contract or letter of appointment	Notice period (months)
Executive Directors			
Bill Halbert	1 September 2006[1]	17 June 2011	6
Jane Aikman	17 October 2016	10 October 2016	6[3]
Non-Executive Directors			
Graham Holden	27 November 2007[2]	13 May 2014	6
Liz Barber	7 April 2015	30 March 2015	6
Patrick De Smedt	28 January 2016	12 January 2016	6
Peter Smith	5 January 2015	26 December 2014	6

1. Bill Halbert was a Non-Executive Director from the date of his Board appointment until 25 November 2008, when he became Executive Deputy Chairman. On 24 July 2009 he moved into the role of Executive Chairman. From 1 April 2014 the role of the Executive Chairman was split and Bill moved into his current role as Chief Executive.
2. Graham Holden was a Non-Executive Director from the date of his Board appointment until 1 April 2014, when he was appointed as Non-Executive Chairman.
3. Subject to approval by shareholders of the new Remuneration policy, the notice period for Jane Aikman will be increased to 12 months. Further explanation of the rationale behind this is on page 61.

Remuneration Committee

	Appointed to the Committee	Number of meetings attended	Out of possible
Peter Smith – Chairman since July 2015	January 2015	6	6
Liz Barber	April 2015	6	6
Patrick De Smedt	January 2016	6	6
Graham Holden	November 2007	6	6
Tony Illsley – retired from the Committee in July 2016	June 2009	1	1

The membership and attendance at Committee meetings during the year is shown in the table above. Meetings are also attended by the Chief Executive, the Chief People Officer and the Company Secretary, although none are present when their own reward is discussed.

Remuneration report continued

Annual report on remuneration continued

Remuneration Committee continued

The Remuneration Committee is a sub-committee of the Board and has four scheduled meetings a year, in May, November, February and March. Additional meetings are held as and when required. Two such meetings were held during the year: one in July 2016 to discuss the vesting of the 2013 LTIP awards and to approve the 2016 LTIP awards and another in September 2016 to agree the remuneration package to be offered to Jane Aikman upon her appointment.

The specific matters considered by the Committee at each of the meetings are shown in the table below.

Meeting	Matter considered
Scheduled meeting in May 2016	> The Committee reviewed the base pay of the Executive Directors and selected senior managers, taking into consideration the remit of the roles and the trends in pay across the rest of the business. It was agreed that the base salaries for the Executive Directors should be increased by two per cent, which was in line with the average pay increase across the business in the prior and current financial years. > The achievement of targets in relation to the annual bonus was reviewed and it was agreed that a bonus equivalent to 25 per cent of the base salary of the Executive Directors should be paid. > The bonus scheme for the 2016/17 year was discussed and it was agreed that it was appropriate to retain the same metrics as in the previous financial year and the specific targets for the year were confirmed. > The performance of the 2013 LTIP awards up to the end of April 2016 was reviewed and it was agreed that delisted companies should be excluded from the comparator group to be consistent with the treatment in the prior year. > A draft of the LTIP awards to be made in July 2016 was reviewed and discussed. > The draft Remuneration report for 2015/16 was reviewed and feedback was given. > The payments to be made to Paul Simpson during his notice period were discussed and agreed.
Additional meeting in July 2016	> The achievement of TSR performance in relation to the 2013 LTIP awards was reviewed and the vesting of the 2013 LTIP awards was approved. > The LTIP awards to be made in July 2016 were discussed and confirmed.
Additional meeting in September 2016	> The remuneration package to be offered to Jane Aikman, the new Chief Financial Officer, was discussed and agreed.
Scheduled meeting in November 2016	> Our remuneration consultants attended the meeting and presented thoughts to the Committee on proposed revisions to the Remuneration policy, taking into account market trends, investor communications and the objectives of the Committee to ensure the policy was as simple and transparent as possible. These were discussed at length and a draft revised Remuneration policy was agreed, to form the basis of consultation with our largest shareholders. > The current share scheme dilution limits were noted for information. > An overview of the proposed bonus scheme for 2017/18 was presented and discussed. > The results of the Remuneration Committee annual evaluation were reviewed.
Scheduled meeting in February 2017	> Feedback from the largest shareholders in relation to the proposed revised Remuneration policy was reviewed and the policy was discussed.
Scheduled meeting in March 2017	> Further feedback from shareholders on the proposed revised Remuneration policy was reviewed and the final version of the policy was discussed and agreed. > The pay award for 2017 for the Executive Directors was discussed and the likely pay award across the rest of the business was considered. Further information was sought on this prior to making a decision at the next Committee meeting. > A first draft of the Remuneration report for 2016/17 was reviewed and feedback was given.

During the year under review, the Committee received advice on all aspects of senior executive and non-executive director remuneration from independent remuneration consultants New Bridge Street, a trading name of Aon Hewitt Limited, an Aon plc company, which was appointed by the Committee in August 2011 following a comprehensive tender process. New Bridge Street also provided some minor related services to the Company, such as the benchmarking of non-executive roles outside the remit of the Committee. New Bridge Street is a signatory to the Remuneration Consultants Group Code of Conduct and any advice received is governed by that code. The fee paid to New Bridge Street during the year for advice to the Committee was £50,403 (2016: £30,876), which is charged as a fixed annual fee for recurring work, with separate fees agreed as appropriate for additional ad hoc work.

The Committee has reviewed the way in which New Bridge Street operates and its relationship with the business and remains satisfied that the advice it receives is independent and objective. Aon Hewitt also provides actuarial and investment consultancy advice to the trustees of the two KCOM defined benefit pension schemes, which the Committee considers does not result in a conflict of interest.

In accordance with its Terms of Reference, the Committee is responsible for:

> determining and agreeing the Remuneration policy for the Executive Directors and selected senior managers across the business;

> having regard to remuneration trends across the business and remuneration in other companies when setting Remuneration policy, as well as to environmental, social and governance matters when appropriate;

> selecting, appointing and setting the Terms of Reference for any remuneration consultants who advise the Committee;

> approving the design of, and determining targets for, any performance-related pay schemes operated by the business and approving the total annual payments made under such schemes;

> reviewing the design of all share incentive plans for approval by the Board and shareholders and determining each year whether awards will be made and, if so, the overall amount of such awards, the individual awards and the performance targets to be used;

> determining the policy for, and scope of, pension arrangements for each Executive Director and selected senior managers; and

> ensuring that contractual terms on termination, and any payments made, are fair to the individual and the business, that failure is not rewarded and that the duty to mitigate loss is fully recognised.

The Committee's Terms of Reference are in line with the recommendations in the UK Corporate Governance Code and the ICSA Guidance on Terms of Reference for Remuneration Committees. Copies of the Terms of Reference are available from the Company Secretary or on our website, www.kcomplc.com.

Directors' interests in shares as at 31 March 2017 (audited)

	Shares owned outright	Nil-cost share options subject to performance conditions[1]	Actual share ownership as a percentage of salary on 31 March 2017[2]	Required share ownership as a percentage of salary	Requirement met?
Executive Directors					
Bill Halbert	2,638,717	1,519,955	587%	200%	Yes
Jane Aikman	—	487,394	0%	100%	No[3]
Non-Executive Directors					
Graham Holden	50,000	—	—	—	—
Liz Barber	—	—	—	—	—
Patrick De Smedt	—	—	—	—	—
Peter Smith	—	—	—	—	—

1. These are awards made under the LTIP, further details of which can be found on page 66.
2. Calculated using the closing mid-market price of KCOM Group PLC shares on 31 March 2017 and only those shares owned outright by the Executive Director and their connected persons. There have been no changes to Directors' interests since 31 March 2017.
3. There is no fixed timescale set out in the Remuneration policy by which newly appointed Executive Directors should have met the shareholding requirement. The target will be met, at least in part, through a requirement to retain shares vesting in the LTIP scheme, on a net of tax basis.

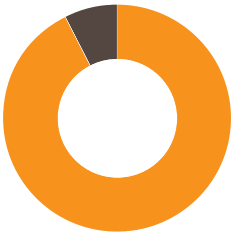
The table above sets out the interests of all the Directors as at 31 March 2017 (as listed on pages 36 and 37) and their connected persons in KCOM's shares.

Remuneration report continued

Annual report on remuneration continued

Shareholder views

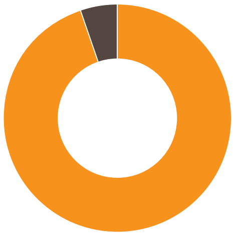
At our AGM in 2016 there was a shareholder vote taken on the Directors' Remuneration report, excluding the Remuneration policy. The outcome of the vote is shown below:



Directors' Remuneration report (excluding the Remuneration policy)

Votes for:	327,764,376	(93.66%)
Votes against:	22,195,736	(6.34%)
Votes withheld:	92,126	

The Remuneration policy was last put to a shareholder vote on 29 July 2014. The outcome of the vote is shown below:



Remuneration policy

Votes for:	329,872,924	(94.89%)
Votes against:	17,770,426	(5.11%)
Votes withheld:	160,438	

Outside appointments

In 2016/17 Bill Halbert received £35,000 for his directorship at Jade Solutions Limited. The Board agreed that Bill should retain this remuneration. He received no remuneration for his other external non-executive positions. Paul Simpson and Jane Aikman did not have any external appointments in the year.

General information

Our closing mid-market share price on 31 March 2017 was 90.0 pence. The high and low closing mid-market share prices during the year were 121.0 pence and 88.0 pence respectively.

Signed on behalf of the Board

Kathy Smith
Company Secretary
9 June 2017

Financial statements

Independent auditors' report

to the members of KCOM Group PLC

Report on the financial statements

Our opinion

In our opinion:

- KCOM Group PLC's group financial statements and Parent Company financial statements (the "financial statements") give a true and fair view of the state of the group's and of the Parent Company's affairs as at 31 March 2017 and of the group's profit and the group's and the Parent Company's cash flows for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

What we have audited

The financial statements, included within the annual report and accounts (the "annual report"), comprise:

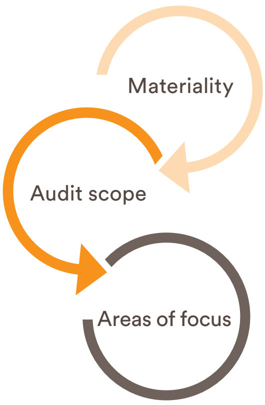
- the consolidated and Parent Company balance sheets as at 31 March 2017;
- the consolidated income statement and consolidated statement of comprehensive income for the year then ended;
- the consolidated and Parent Company cash flow statements for the year then ended;
- the consolidated and Parent Company statement of changes in shareholders' equity for the year then ended; and
- the Notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the Notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the financial statements is IFRSs as adopted by the European Union, and applicable law and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Our audit approach

Overview



Materiality

- Overall Group materiality: £1.9 million which represents 5% of profit before tax and exceptional items.

Audit scope

- We conducted audit work over all components within the Group, which together comprised 100% of profit before tax and exceptional items, revenue and net assets.
- The Group engagement team performed audits over all in scope components.

Areas of Focus

- Valuation of goodwill.
- Valuation of defined benefit pension scheme liabilities.
- Significant contracts.
- Classification of exceptional items.

The scope of our audit and our areas of focus

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)").

We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as "areas of focus" in the table below. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the financial statements as a whole, and any comments we make on the results of our procedures should be read in this context. This is not a complete list of all risks identified by our audit.

Report on the financial statements continued

Our audit approach continued

The scope of our audit and our areas of focus continued

Area of focus	How our audit addressed the area of focus
Valuation of goodwill We focused on this area because the determination of whether or not goodwill is impaired involves subjective judgements and estimates about the future results and cash flows of the business. On an annual basis, management calculate the amount of headroom between the value in use of the Group's Cash Generating Units ('CGUs') and their carrying value (or 'value in use') to determine whether there is a potential impairment of the goodwill relating to those CGUs. The value in use of the CGU is dependent on a number of key assumptions which include: > Forecast cash flows for the next three years; > A long-term (terminal) growth rate applied beyond the end of the 3 year budget period; and > A discount rate applied to the model. At the beginning of the year opening goodwill of £51.4 million was split between two CGUs, Enterprise (£29.1 million) and SMB National (£22.3 million). However due to the refinement of operating segments which took place during the year the goodwill was reallocated into new CGUs Enterprise (£19.1 million) and National Network Services (£32.3 million) to align with the management, reporting and forecasts used to run the business. Management allocated the goodwill to new CGUs management based on the profitability of customers transferred into each new CGU. As a result, in addition to the annual impairment review, an impairment review was performed by management immediately prior to restructuring which demonstrated that no impairment existed at that date. Having tested this model to ensure no impairment was required, we principally focused our testing on the model supporting the new CGUs. See the accounting policies section within the financial statements for disclosure of the related accounting policies, judgements and estimates and Note 14 for detailed goodwill disclosures.	We evaluated the appropriateness of the key assumptions including discount rates and long-term growth rates and performed a range of sensitivity analyses across both CGUs. We also verified the underlying assets and cash flows included in the models. In particular: > we verified that the three year forecasts are based on the annual budgets and forecast prepared by management and approved by the Board of KCOM Group PLC; > we challenged the forecast growth rates over the three year period, assessing the current budget and forecasts in light of our knowledge and understanding of current business plans. Specifically we focused on management's ability to accurately forecast and their history of meeting budget; the extent of recurring revenues and revenues which can be generated from existing customer relationships; the opportunity based sales pipeline; and the forecast growth in markets where the respective segments operate; > we compared the terminal growth rates in the forecasts to third party economic forecasts noting that those used by the directors were within an acceptable range; and > we tested the calculation of the discount rate (weighted average cost of capital ("WACC")) for the Group including assessing the inputs against comparable organisations noting that the rates used across the Group by the directors were within a reasonable range. In addition to testing both models, we also tested the changes to CGUs by testing the allocation of both customers and goodwill at an individual customer level by agreeing the customer was allocated to the correct segment and that the contribution for that customer was correctly included in the calculation for the allocation of goodwill. Based on the evidence obtained we determined that no impairment is required.
Valuation of defined benefit pension scheme liabilities We focused on the valuation of the Group's defined benefit pension schemes because of the level of judgement required in determining the year end liability valuation. In addition the size of the gross assets (£251.5 million) and liabilities (£271.2 million) within the schemes are significant. See the accounting policies section within the financial statements for disclosure of the related accounting policies, judgements and estimates and Note 29 for detailed pension disclosures.	We obtained the IAS 19 valuation report produced by the Group's actuaries. We used our own actuarial experts to assess the judgemental assumptions used within the reports to form the valuation of the pension schemes' liabilities, such as discount rate, inflation and mortality rates. We obtained the detailed reports underlying the valuation of the schemes' assets, agreed the valuations to third party confirmations and performed independent valuation testing. We assessed the membership data used in valuing the schemes' liabilities and tested any significant changes since the last valuation. We agreed a sample of contributions made by the Group to bank statements. We have no exceptions to report as a result of this testing.

Independent auditors' report continued

to the members of KCOM Group PLC

Report on the financial statements continued

Our audit approach continued

The scope of our audit and our areas of focus continued

Area of focus	How our audit addressed the area of focus
Significant contracts The Enterprise segment in particular enters into arrangements with customers which can involve an implementation phase as well as subsequent ongoing in-life services. Judgement is required in separating these into individual elements. In addition, revenue from the initial implementation phase is generally accounted on a percentage completion basis, by reference to progress in achieving delivery milestones or in relation to the proportion of expected costs incurred to date. Where the costs to deliver a separate element exceed the anticipated revenues a provision for losses on this element is required. The accounting for these arrangements, as a result, requires judgement and can rely upon estimates of the costs to deliver the remaining services. A significant proportion of the Enterprise segment revenues of £91.0 million arise from these arrangements. See the accounting policies section within the financial statements for disclosure of the related accounting policies, judgements and estimates.	We identified the more significant contracts and performed testing over a sample. We reviewed the contracts and the project management information available in respect of these contracts. We considered and evaluated the appropriateness of the basis for revenue recognised, whether based on performance milestones (which we then tied back to contracts) or the proportion of costs incurred, as evidence of the stage of completion. Where based on the proportion of costs incurred, we discussed the forecast costs to complete with project managers and obtained corroborative explanations in support of the estimated remaining costs. We performed testing over revenue billed to date and over the costs incurred including whether such costs had been allocated to the correct contract. Where a provision for forecast cost overruns on a contract element was required, we challenged management on the calculation of the provision and considered the extent of progress on these arrangements post year end. We have no exceptions to report as a result of this testing.
Classification of exceptional items Exceptional items consist of a number of one off costs relating to restructuring (£7.3 million) and regulatory matters (£0.7 million). Given the magnitude of these items we focused additional audit effort in this area to determine whether these items were appropriately classified as exceptional in accordance with the Group's policy and that the description of the amounts incurred was consistent with the nature of the costs. See the accounting policies section within the financial statements for disclosure of the related accounting policies, judgements and estimates and Note 7 for detailed exceptional items disclosures.	We tested the classification of exceptional items by evaluating the treatment of each class of exceptional item for compliance with the Group accounting policy, noting that the policy had been applied consistently for all items across the Group. We tested the underlying transactions by: > testing a sample of redundancy costs to payments made and whether the costs incurred were linked to restructuring; > by agreeing external restructuring costs to third party invoices and by testing outstanding third party provisions to commitments and post year end payments; and > testing costs in relation to regulatory matters to correspondence supporting those matters. Having performed this testing, we considered whether in our view the nature of the items supported separate classification as exceptional in line with the Group's policy and whether the narrative descriptions were consistent with the nature of the items incurred. We are satisfied that, materially, this is the case.

Report on the financial statements continued

Our audit approach continued

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the geographic structure of the group, the accounting processes and controls, and the industry in which the group operates.

For the year ended 31 March 2017 the Group operated using its simplified statutory structure which was implemented on 31 March 2016. From that date the majority of trade and associated assets were held within one statutory entity (KCOM Holdings Limited) alongside the KCOM Contact Centres business and a simplified holding company structure. Together these entities formed the consolidated financial statements.

We performed an audit of the KCOM Holdings entity together with KCOM Contact Centres and the associated holding companies and the consolidation. KCOM Holdings was considered to be the only financially significant component given that the vast majority of the Group's revenue and the majority of profit before tax and exceptional items was derived from this entity, however full audits were performed over all other components.

Total coverage obtained through the audit of in scope components was 100% of Group revenue, Group profit before tax and exceptional items and net assets.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall group materiality	£1.9 million (2016: £2.4 million).
How we determined it	5% of profit before tax and exceptional items.
Rationale for benchmark applied	We believe that profit before tax and exceptional items is a primary measure used by the shareholders in assessing the performance of the Group. Profit before tax is a generally accepted auditing benchmark. Exceptional items have been excluded from our materiality calculation to ensure that a consistent underlying measure has been used.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £0.1 million (2016: £0.1 million) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Going concern

Under the Listing Rules we are required to review the Directors' statement, set out on page 42, in relation to going concern. We have nothing to report having performed our review.

Under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to the Directors' statement about whether they considered it appropriate to adopt the going concern basis in preparing the financial statements. We have nothing material to add or to draw attention to.

As noted in the Directors' statement, the directors have concluded that it is appropriate to adopt the going concern basis in preparing the financial statements. The going concern basis presumes that the group and Parent Company have adequate resources to remain in operation, and that the Directors intend them to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the directors' use of the going concern basis is appropriate. However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the group's and Parent Company's ability to continue as a going concern.

Independent auditors' report continued

to the members of KCOM Group PLC

Other required reporting

Consistency of other information and compliance with applicable requirements

Companies Act 2006 reporting

In our opinion, based on the work undertaken in the course of the audit:

> the information given in the Strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and

> the Strategic report and the Directors' report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the group, the Parent Company and their environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic report and the Directors' report. We have nothing to report in this respect.

ISAs (UK & Ireland) reporting

Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

> information in the Annual Report is: > materially inconsistent with the information in the audited financial statements; or > apparently materially incorrect based on, or materially inconsistent with, our knowledge of the group and Parent Company acquired in the course of performing our audit; or > otherwise misleading.	We have no exceptions to report.
> the statement given by the directors on page 41, in accordance with provision C.1.1 of the UK Corporate Governance Code (the "Code"), that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's and Parent Company's position and performance, business model and strategy is materially inconsistent with our knowledge of the group and parent company acquired in the course of performing our audit.	We have no exceptions to report.
> the section of the Annual Report on page 45, as required by provision C.3.8 of the Code, describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.	We have no exceptions to report.

The Directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

Under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to:

> the Directors' confirmation on page 24 of the Annual Report, in accordance with provision C.2.1 of the Code, that they have carried out a robust assessment of the principal risks facing the group, including those that would threaten its business model, future performance, solvency or liquidity.	We have nothing material to add or to draw attention to.
> the disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.	We have nothing material to add or to draw attention to.
> the Directors' explanation on page 25 of the Annual Report, in accordance with provision C.2.2 of the Code, as to how they have assessed the prospects of the group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.	We have nothing material to add or to draw attention to.

Under the Listing Rules we are required to review the Directors' statement that they have carried out a robust assessment of the principal risks facing the group and the directors' statement in relation to the longer-term viability of the group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the Code; and considering whether the statements are consistent with the knowledge acquired by us in the course of performing our audit. We have nothing to report having performed our review.

Adequacy of accounting records and information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion:

> we have not received all the information and explanations we require for our audit; or

> adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or

> the parent company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Other required reporting continued

Directors' remuneration

Directors' Remuneration report - Companies Act 2006 opinion

In our opinion, the part of the Directors' Remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

Other Companies Act 2006 reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Corporate governance statement

Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to ten further provisions of the Code. We have nothing to report having performed our review.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Directors' responsibilities statement set out on page 41, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Parent Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What an audit of financial statements involves

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

> whether the accounting policies are appropriate to the group's and the parent company's circumstances and have been consistently applied and adequately disclosed;

> the reasonableness of significant accounting estimates made by the directors; and

> the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the Directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report. With respect to the Strategic report and Directors' report, we consider whether those reports include the disclosures required by applicable legal requirements.

Stuart Newman (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
9 June 2017

Consolidated income statement

for the year ended 31 March 2017

	Notes	2017 £'000	2016 £'000
Revenue	4	**331,303**	349,222
Operating expenses	5	**(298,547)**	(257,438)
Operating profit		**32,756**	91,784
Analysed as:			
EBITDA before exceptional items	4	**67,645**	74,937
Exceptional credits	7	**—**	47,331
Exceptional charges	7	**(7,981)**	(6,445)
Depreciation of property, plant and equipment	5	**(14,279)**	(13,744)
Amortisation of intangible assets	5	**(12,629)**	(10,295)
Finance costs	9	**(2,263)**	(3,057)
Share of profit of associates	4	**12**	16
Profit before taxation	4	**30,505**	88,743
Taxation	10	**(5,743)**	(17,609)
Profit for the year attributable to owners of the Parent		**24,762**	71,134
Earnings per share			
Basic	12	**4.85p**	13.96p
Diluted	12	**4.81p**	13.82p

The Company has elected to take the exemption under Section 408 of the Companies Act 2006 not to present the Parent Company income statement or statement of comprehensive income.

The profit for the Parent Company for the year was £32,464,000 (2016: £36,156,000).

Consolidated statement of comprehensive income

for the year ended 31 March 2017

	Notes	2017 £'000	2016 £'000
Profit for the year		**24,762**	71,134
Other comprehensive (expense)/income			
Items that will not be reclassified to profit or loss			
Remeasurements of retirement benefit obligations	29	**(12,035)**	12,130
Tax on items that will not be reclassified	25	**1,738**	(2,426)
Total items that will not be reclassified to profit or loss		**(10,297)**	9,704
Items that may be reclassified subsequently to profit or loss			
Cash flow hedge fair value movements		**—**	(442)
Tax on items that may be reclassified		**—**	(569)
Total items that may be reclassified subsequently to profit or loss		**—**	(1,011)
Total comprehensive income for the year attributable to owners of the Parent		**14,465**	79,827

The Notes on pages 85 to 113 are an integral part of these consolidated financial statements.

Balance sheets

as at 31 March 2017

	Notes	Consolidated 2017 £'000	Consolidated 2016 £'000	Parent Company 2017 £'000	Parent Company 2016 £'000
Assets					
Non-current assets					
Goodwill	14	**51,372**	51,372	**—**	—
Other intangible assets	15	**45,709**	44,637	**—**	—
Property, plant and equipment	16	**106,323**	93,592	**—**	—
Investments	17	**45**	49	**494,461**	494,461
Deferred tax assets	25	**7,836**	8,356	**—**	—
		211,285	198,006	**494,461**	494,461
Current assets					
Inventories	18	**3,075**	2,638	**—**	—
Trade and other receivables	19	**68,406**	65,431	**5**	5
Cash and cash equivalents	22	**16,093**	14,857	**—**	—
		87,574	82,926	**5**	5
Total assets		**298,859**	280,932	**494,466**	494,466
Liabilities					
Current liabilities					
Trade and other payables	20	**(110,917)**	(126,235)	**—**	—
Current tax liabilities		**—**	(5,459)	**—**	—
Bank overdrafts	22	**(5,903)**	(1,645)	**—**	—
Derivative financial instruments	27	**—**	(11)	**—**	—
Finance leases	23	**(1,942)**	(3,271)	**—**	—
Provisions for other liabilities and charges	24	**(377)**	(738)	**—**	—
Non-current liabilities					
Trade and other payables	20	**—**	—	**(450)**	(450)
Bank loans	21	**(48,587)**	—	**—**	—
Retirement benefit obligation	29	**(19,691)**	(14,350)	**—**	—
Deferred tax liabilities	25	**(7,498)**	(6,875)	**—**	—
Finance leases	23	**(2,094)**	(3,680)	**—**	—
Provisions for other liabilities and charges	24	**(1,962)**	(2,401)	**—**	—
Total liabilities		**(198,971)**	(164,665)	**(450)**	(450)
Net assets		**99,888**	116,267	**494,016**	494,016
Equity					
Capital and reserves attributable to owners of the Parent					
Share capital	26	**51,660**	51,660	**51,660**	51,660
Share premium account		**353,231**	353,231	**353,231**	353,231
(Accumulated losses)/retained earnings[1]		**(305,003)**	(288,624)	**89,125**	89,125
Total equity		**99,888**	116,267	**494,016**	494,016

1. Included within consolidated (Accumulated losses)/retained earnings is profit after tax of £24.8 million (2016: £71.1 million) for the Group and £32.5 million (2016: £36.2 million) for the Parent Company.

The Notes on pages 85 to 113 are an integral part of these consolidated financial statements.

The financial statements were approved by the Board of Directors and authorised for issue on 9 June 2017.

They were signed on its behalf by:

Bill Halbert
Chief Executive
9 June 2017

Jane Aikman
Chief Financial Officer

KCOM Group PLC
Registered number: 2150618

Consolidated statement of changes in shareholders' equity

for the year ended 31 March 2017

	Notes	Share capital £'000	Share premium account £'000	Hedging and translation reserve £'000	Accumulated losses £'000	Total equity £'000
At 1 April 2015		51,660	353,231	442	(341,454)	63,879
Profit for the year		—	—	—	71,134	71,134
Other comprehensive (expense)/income		—	—	(442)	9,135	8,693
Total comprehensive (expense)/income for the year ended 31 March 2016		—	—	(442)	80,269	79,827
Deferred tax credit relating to share schemes		—	—	—	125	125
Current tax credit relating to share schemes		—	—	—	90	90
Purchase of ordinary shares	26	—	—	—	(450)	(450)
Employee share schemes		—	—	—	1,468	1,468
Dividends	11	—	—	—	(28,672)	(28,672)
Transactions with owners		—	—	—	(27,439)	(27,439)
At 31 March 2016		51,660	353,231	—	(288,624)	116,267
Profit for the year		—	—	—	24,762	24,762
Other comprehensive expense		—	—	—	(10,297)	(10,297)
Total comprehensive income for the year ended 31 March 2017		**—**	**—**	**—**	**14,465**	**14,465**
Deferred tax charge relating to share schemes	25	—	—	—	(122)	(122)
Purchase of ordinary shares	26	—	—	—	(1,778)	(1,778)
Employee share schemes		—	—	—	1,742	1,742
Dividends	11	—	—	—	(30,686)	(30,686)
Transactions with owners		—	—	—	(30,844)	(30,844)
At 31 March 2017		**51,660**	**353,231**	**—**	**(305,003)**	**99,888**

The Notes on pages 85 to 113 are an integral part of these consolidated financial statements.

Parent Company statement of changes in shareholders' equity

for the year ended 31 March 2017

	Notes	Share capital £'000	Share premium account £'000	Retained earnings £'000	Total equity £'000
At 1 April 2015		51,660	353,231	82,091	486,982
Profit for the year		—	—	36,156	36,156
Total comprehensive income for the year ended 31 March 2016		—	—	36,156	36,156
Purchase of ordinary shares	26	—	—	(450)	(450)
Dividends	11	—	—	(28,672)	(28,672)
Transactions with owners		—	—	(29,122)	(29,122)
At 31 March 2016		51,660	353,231	89,125	494,016
Profit for the year		—	—	32,464	32,464
Total comprehensive income for the year ended 31 March 2017		**—**	**—**	**32,464**	**32,464**
Purchase of ordinary shares	26	—	—	(1,778)	(1,778)
Dividends	11	—	—	(30,686)	(30,686)
Transactions with owners		—	—	(32,464)	(32,464)
At 31 March 2017		**51,660**	**353,231**	**89,125**	**494,016**

The Notes on pages 85 to 113 are an integral part of these consolidated financial statements.

Cash flow statements

for the year ended 31 March 2017

	Notes	Consolidated 2017 £'000	Consolidated 2016 £'000	Parent Company 2017 £'000	Parent Company 2016 £'000
Cash flows from operating activities					
Operating profit/result		**32,756**	91,784	**—**	—
Adjustments for:					
– depreciation and amortisation		**26,908**	24,039	**—**	—
– (increase)/decrease in working capital		**(18,302)**	23,262	**—**	(7,034)
– loss/(profit) on sale of property, plant and equipment		**555**	(47,065)	**—**	—
– non-employee-related pension charges		**655**	656	**—**	—
– share-based payment charge		**1,742**	1,468	**—**	—
Payments made to defined benefit pension schemes		**(7,724)**	(6,565)	**—**	—
Tax paid		**(8,019)**	(7,206)	**—**	—
Net cash generated from/(used in) operations		**28,571**	80,373	**—**	(7,034)
Cash flows from investing activities					
Purchase of property, plant and equipment		**(28,403)**	(16,959)	**—**	—
Purchase/generation of intangible assets		**(15,792)**	(11,467)	**—**	—
Proceeds from sale of property, plant and equipment		**68**	90,000	**—**	—
Dividends received		**—**	—	**32,464**	36,156
Net cash (used in)/generated from investing activities		**(44,127)**	61,574	**32,464**	36,156
Cash flows from financing activities					
Dividends paid	11	**(30,686)**	(28,672)	**(30,686)**	(28,672)
Interest paid		**(1,257)**	(2,794)	**—**	—
Capital element of finance lease repayments		**(3,025)**	(2,829)	**—**	—
Payment of loan issue costs		**(720)**	—	**—**	—
Repayment of bank loans	21	**(15,000)**	(175,000)	**—**	—
Drawdown of bank loans	21	**65,000**	70,000	**—**	—
Purchase of ordinary shares	26	**(1,778)**	(450)	**(1,778)**	(450)
Net cash generated from/(used in) financing activities		**12,534**	(139,745)	**(32,464)**	(29,122)
(Decrease)/increase in cash and cash equivalents		**(3,022)**	2,202	**—**	—
Cash and cash equivalents at the beginning of the year		**13,212**	11,010	**—**	—
Cash and cash equivalents at the end of the year	22	**10,190**	13,212	**—**	—

The Notes on pages 85 to 113 are an integral part of these consolidated financial statements.

Notes to the financial statements
for the year ended 31 March 2017

01 General information
KCOM Group PLC is a public limited company, limited by shares, which is listed on the London Stock Exchange and incorporated and domiciled in the United Kingdom. The address of the registered office is 37 Carr Lane, Hull HU1 3RE. The nature of the Group's operations is described within the Strategic report on pages 3 to 34.

02 Accounting policies
The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

Basis of accounting
The consolidated and Parent Company financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU), IFRS Interpretations Committee and the Companies Act 2006 applicable to companies reporting under IFRS. The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative instruments) at fair value through profit and loss. The financial statements have been prepared on a going concern basis.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 3.

New accounting standards
There were no new standards, amendments or interpretations that were adopted by the Group and effective for the first time for the financial year beginning 1 April 2016 that were material to the Group.

A number of new standards, amendments and interpretations are effective for annual periods beginning after 1 April 2016 and have not yet been applied in preparing these financial statements. The following accounting standards are expected to have an impact on the Group financial statements.

IFRS 15
In May 2014, IFRS 15 'Revenue from contracts with customers' was issued for periods beginning on or after 1 January 2018. This new standard will be applicable to the Group for the year ended 31 March 2019. Adoption of IFRS 15 can be applied on a full retrospective basis (by restating comparative periods) or as an adjustment to equity at the date of adoption (which is our intended approach).

IFRS 15 sets out the principles for recognising revenue from contracts with customers and will require the Group to use a five step approach to allocate the revenue earned from contracts to individual performance obligations on a relative standalone selling price basis.

We are still in the process of completing our detailed assessment and quantification, but we expect the following areas to have an impact:

Where goods or services sold together (for example as part of a 'bundle') represent distinct performance obligations, revenue will be recognised separately for each obligation either over the period the service is delivered or at the point in time control of an asset is passed to the customer. These principles are applicable to customers across all of our segments.

Within the Hull and East Yorkshire and National Network Services segments of our business this may result in more revenue up front and lower revenue though the course of the contract. Within our Enterprise business we expect the impact of IFRS 15 to be less significant.

Under IFRS 15, certain incremental costs incurred in acquiring a contract will be deferred on the balance sheet and amortised in line with the recognition of revenue. This will generally relate to the costs of items such as commissions being deferred over the contract life.

The Group is continuing to assess the impacts of these and other accounting changes which arise as a result of IFRS 15.

IFRS 16
IFRS 16 replaces IAS 17 'Leases'; the standard will be effective for KCOM's year ending 31 March 2020 with early adoption permitted if IFRS 15 'Revenue from contracts with customers' has been adopted. We have not yet decided whether to early adopt this standard. IFRS 16 has not yet been endorsed by the EU.

IFRS 16 will primarily change lease accounting for lessees. Lessor accounting under IFRS 16 is expected to be similar to IAS 17.

For lessees, operating lease arrangements will give rise to the recognition of a non-current asset representing the right to use the leased item and a loan obligation for future lease payables. Lease costs will be recognised in the form of depreciation of the right to use assets and interest on the lease liability.

The Group is continuing to assess the impact of IFRS 16, which is expected to have an impact on the Consolidated income statement and Consolidated balance sheet. We are yet to quantify this impact.

Notes to the financial statements continued

for the year ended 31 March 2017

02 Accounting policies continued

Basis of consolidation

Subsidiaries are entities controlled by the Company. Control exists when the Company is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. The consolidated financial statements include the financial statements of the Company and its undertakings made up to 31 March 2017. The results of new subsidiary undertakings are included from the dates of acquisition using the purchase method of consolidation. Where a company has ceased to be a subsidiary undertaking during the year, its results are included to the date of cessation.

On acquisition, the assets, liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (i.e. discount on acquisition) is credited to the income statement in the period of acquisition.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group. All intra-Group transactions, balances, income and expenses are eliminated on consolidation.

Associates are entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The Group's share of its associates' profits or losses is recognised in the income statement. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment.

Partnerships are controlled when the Group has the power, directly or indirectly, to govern the financial and operating policies of the partnership so as to obtain benefits from its activities. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. The consolidated financial statements include the financial statements of the KCOM Central Asset Reserve Limited Partnership and its undertakings made up to 31 March 2017. The results of new partnership undertakings are included from the dates of acquisition using the purchase method of consolidation. Where a company has ceased to be a partnership undertaking during the year, its results are included to the date of cessation.

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker (CODM). The CODM, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the KCOM Group PLC Board of Directors.

The Group's operating segments changed on 1 April 2016 and have been further refined, including an increased allocation of central costs, during the financial year, as set out in Note 4. The new operating segments continue to be based on customer type and geographic service location. The new operating segments are Hull and East Yorkshire, Enterprise, National Network Services and Central.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods supplied, stated net of discounts, returns and value-added taxes. The Group recognises revenue when the amount of revenue can be reliably measured, when it is probable that future economic benefits will flow to the entity and when specific criteria have been met for each of the Group's activities, as described below. The Group bases its estimate of return on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

Revenue from calls is recognised in the Consolidated income statement at the time the call is made over the Group's network. Revenue from rentals is recognised evenly over the rental period.

Revenue from product sales is recognised at the point of effective transfer of risk and reward. Revenue from production of directories is recognised at the point when the directory is published. For large long-term annuity and multiple element customer contracts the Group is able to distinguish between the installation and the in-life service phases of a contract. Revenue is allocated based on the fair value of the consideration, which represents the market value of such services, or amounts per contracts, and will be recognised on the following basis for each phase:

- installation – within this phase revenue relating to resources and services is accounted for on a stage of completion basis with reference to the proportion of total costs incurred to date or to contract milestones, dependent on the nature of the contract. Revenue related to equipment is accounted for based on the point of effective transfer of risks and rewards (shipment); and
- in-life service – revenue for this phase is recognised in line with the obligation to provide service as dictated by customer contracts.

Pre-contract costs, such as bid costs, on key contract wins are expensed as and when incurred.

Revenue arising from the provision of other services, including maintenance contracts, is recognised in the accounting period in which services are rendered, by reference to stage of completion of the specific transaction, and assessed on the basis of the actual service provided as a proportion of the total services to be provided.

02 Accounting policies continued

Exceptional items

Exceptional items are disclosed separately in the financial statements where it is necessary to do so to provide better understanding of the financial performance of the Group. They are material items of income or expense that have been shown separately due to the significance of their nature or amount. In particular costs associated with organisational restructuring, regulatory matters, costs and provisions associated with onerous contracts, profits or losses on the sale of an operation and one-off pension costs and credits are treated as exceptional items.

Intangible assets

Goodwill

Goodwill represents amounts arising on acquisition of subsidiary undertakings and is the difference between the cost of the acquisition and the fair value of the net identifiable assets at the date of acquisition.

Goodwill is stated at cost less any accumulated impairment losses and is tested annually or more frequently if events or changes in circumstances indicate potential impairment. Impairment losses on goodwill are not reversed.

Goodwill is allocated to cash-generating units (CGUs) for the purpose of impairment testing. The allocation is made to those CGUs that are expected to benefit from the business combination in which the goodwill arose. Each unit or group of units to which the goodwill is allocated represents the lowest level within the entity at which the goodwill is monitored for internal management purposes.

Development costs

An internally generated intangible asset arising from the Group's internal development activities is recognised only if all of the following conditions are met:

> an asset is created that can be identified (such as new processes);

> it is probable that the asset created will generate future economic benefits; and

> the development cost of the asset can be measured reliably.

Internally generated intangible assets are carried at cost less accumulated amortisation and are amortised on a straight-line basis over their useful lives. Where no internally generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred. Research costs are expensed to the income statement as and when they are incurred.

Customer and supplier relationships

Contractual customer and supplier relationships acquired in a business combination are recognised at fair value at the acquisition date. The contractual customer and supplier relations have a finite useful life and are carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method over the expected life of the relationship. These intangible assets are amortised on a straight-line basis over their useful lives.

Technology and brand

Technology and brand acquired through business combinations are recorded at fair value at the date of acquisition. Assumptions are used in estimating the fair values of acquired intangible assets and include management's estimates of revenue and profits to be generated by the acquired businesses. These intangible assets are amortised on a straight-line basis over their useful lives.

Software

Software comprises computer software purchased from third parties and also the cost of internally developed software. Computer software purchased from third parties and internally developed software is initially recorded at cost.

Software development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the Group are recognised as intangible assets when the criteria detailed above are met. These intangible assets are amortised on a straight-line basis over their useful lives.

Other software development expenditures that do not meet these criteria are recognised as an expense as incurred. Software development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

Amortisation

Amortisation of intangible assets is charged to the income statement on a straight-line basis over the estimated useful lives of each intangible asset. Intangible assets are amortised from the date they are available for use.

The estimated useful lives are as follows:

Customer and supplier relationships	up to 8 years
Technology and brand	up to 10 years
Software	up to 10 years
Development costs	3 years

Notes to the financial statements continued

for the year ended 31 March 2017

02 Accounting policies continued

Property, plant and equipment

Property, plant and equipment is stated at historical cost less accumulated depreciation and any provision for impairment. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. Network infrastructure and related equipment (included within exchange equipment and external plant) is recorded at cost including labour costs directly attributable to the cost of the network construction. Depreciation is provided so as to write off the cost of assets to residual values on a straight-line basis over the assets' useful estimated lives as follows:

Freehold buildings	40 years
Leasehold buildings and improvements	period of lease
Exchange equipment	10 years
External plant	10 to 40 years
Vehicles, other apparatus and equipment	3 to 10 years

Freehold land is not depreciated.

Exchange equipment includes assets and equipment which relate to the network. External plant relates to assets which connect the network to our customers.

During the year the useful economic life of the Group's fibre network (within external plant) was changed from 20 years to 40 years, as the directors considered this to be a better reflection of the period over which economic benefit is derived from the assets. Using the previous economic life, the depreciation charge for the year would have been £0.3 million greater than that recorded.

The residual value, if not insignificant, is reassessed annually. Depreciation of network infrastructure and related equipment is provided for from the date the network comes into operation.

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease.

Fixed asset investments

Fixed asset investments are shown at cost less provision for impairment. They are reviewed at each reporting date for possible reversal of the impairment.

Impairment of non-financial assets

Assets that have an indefinite useful life – for example, goodwill – are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Recoverable amount is the higher of fair value less selling costs and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in the income statement. Impairment losses recognised in respect of cash-generating units (CGUs) are allocated first to reduce the carrying amount of any goodwill allocated to CGUs and then to reduce the carrying amount of other assets in the unit on a pro-rata basis.

Inventories

Inventories are stated at the lower of cost or net realisable value. Cost is determined using the weighted average cost method. Costs include raw materials and, where appropriate, direct overhead expenses. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution. Provision is made for obsolete, slow moving or defective items where appropriate.

Trade receivables

Trade receivables are recognised initially at fair value and measured subsequently at amortised cost, using the effective interest method, less any impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivable is impaired. The amount of provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the income statement within operating expenses. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts written off are credited against operating expenses in the income statement.

02 Accounting policies continued

Cash and cash equivalents

Cash and cash equivalents includes cash in hand, short-term deposits and other short-term, highly liquid investments with original maturities of three months or less and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet, unless a right of offset exists.

Trade payables

Trade payables are recognised initially at fair value and measured subsequently at amortised cost using the effective interest method.

Share capital

Ordinary shares are classified as equity.

Taxation

The tax expense represents the sum of the current tax and deferred tax expense.

The current tax is based on taxable profit for the year. Taxable profit differs from profit before tax as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and/or items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit and is accounted for using the balance sheet liability method. Deferred tax liabilities are recognised generally for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced or increased to the extent that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement, except when it relates to items recognised in other comprehensive income or directly to equity. In this case the deferred tax is also recognised in other comprehensive income or directly in equity, respectively.

Financial instruments and hedge accounting

Financial assets and liabilities are recognised in the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

The Group uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from operational, financing and investment activities. In accordance with its Treasury policy, the Group does not hold or issue derivative financial instruments for trading purposes.

Derivative financial instruments are initially and subsequently recognised at fair value. Any gain or loss on remeasurement to fair value is recognised immediately in the income statement. However, where derivatives qualify for hedge accounting, recognition of the resultant gain or loss depends on the nature of the item being hedged.

The fair value of the interest rate swaps is the estimated amount that the Group would receive or pay to terminate the swap at the balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparties. The fair value of forward exchange contracts is their quoted market price at the balance sheet date, being the present value of the quoted forward price.

Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cash flows are recognised directly in other comprehensive income and the ineffective portion is recognised immediately in the income statement. If the cash flow hedge of a firm commitment or forecasted transaction results in the recognition of an asset or liability, then, at the time the asset or liability is recognised, the associated gains or losses on the derivative that had previously been recognised in other comprehensive income are included in the initial measurement of the asset or liability. For hedges that do not result in recognition of an asset or a liability, amounts deferred in equity are recognised in the income statement in the same period in which the hedged item affects net profit or loss.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement in the period.

Notes to the financial statements continued

for the year ended 31 March 2017

02 Accounting policies continued

Foreign currency translation

These financial statements are presented in Pounds Sterling which is the currency of the primary economic environment in which the Group operates.

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date.

Leasing and hire purchase commitments

Leases where the Group assumes substantially all of the risks and rewards of ownership are classified as finance leases. Assets held under finance leases and hire purchase contracts are capitalised in the balance sheet at their fair value or, if lower, the present value of the future minimum lease payments and are depreciated over their useful economic lives. The capital elements of future obligations under finance leases and hire purchase contracts are included as liabilities in the balance sheet. The interest elements of the rental obligations are charged to the income statement over the periods of the leases and hire purchase contracts. The finance charge is allocated to each period during the lease so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Rentals payable under operating leases are charged to the income statement on a straight-line basis over the lease term.

Bank borrowings and issue costs

Bank borrowings are stated at the amount of proceeds after deduction of issue costs, which are amortised over the period of the loan. Finance charges, including direct issue costs are accounted for in the income statement on an accruals basis and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

Borrowings are carried subsequently at amortised cost and any differences between the proceeds (net of transaction costs) and the redemption value are recognised in the income statement over the period of the borrowings using the effective interest method.

Pensions

Defined contribution

Obligations for contributions to the defined contribution (money purchase) scheme are charged to the income statement in the period they fall due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

Defined benefit

For defined benefit retirement schemes, the cost of providing benefits is determined using a building block approach, with actuarial valuations being carried out at each balance sheet date. Remeasurements are recognised in full in the period in which they occur and are recognised in equity and presented in the Consolidated statement of comprehensive income.

The current and past service costs of the scheme (the increase in the present value of employees' future benefits attributable to the current or prior periods) are charged to the income statement in the period. The cost or benefit of committed settlements and curtailments is recognised immediately in the income statement. The interest cost of the scheme is recognised in the income statement in the period to which it relates.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation as adjusted for unrecognised past service cost and as reduced by the fair value of scheme assets. Any asset resulting from this calculation is limited to past service cost, plus the present value of available refunds and reductions in future contributions to the plan.

Employee share schemes and share-based payments

The Group has applied the requirements of IFRS 2. In accordance with the transitional provisions, IFRS 2 has been applied to all grants of equity instruments after 7 November 2002 that were unvested as of 1 April 2005.

The Group issues equity-settled share-based payments to certain employees.

Equity-settled employee schemes, including employee share options and discretionary long-term incentive schemes, provide employees with the option to acquire shares of the Company. Employee share options and long-term incentive schemes are generally subject to performance or service conditions.

The fair value of equity-settled share-based payments is measured at the date of grant and charged to the income statement over the period during which performance or service conditions are required to be met, or immediately where no performance or service criteria exist. The fair value of equity-settled share-based payments granted is measured using either the Black-Scholes or Monte Carlo model, depending on the terms under which the options were granted. The amount recognised as an expense is adjusted to reflect the actual number of employee share options that vest, except where forfeiture is only due to market-based performance criteria not being met.

At the end of each reporting period, the Group revises its estimates of the number of options that are expected to vest based on the non-market vesting conditions. It recognises the impact of the revision to original estimates, if any, in the income statement, with a corresponding adjustment to equity.

The Group also operates a Share Incentive Plan (SIP) under which employees have the option to purchase shares in the Company each month and offers employees free matching and partnership shares on a sliding scale of between 1:3 to 2:1. The Group recognises the free shares as an expense over the period of any applicable service condition, or immediately when no service condition exists.

02 Accounting policies continued

Dividends

Dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders or, in the case of interim dividends, paid.

Dividend income is recognised when the right to receive payment is established.

Provisions

A provision is recognised in the balance sheet when the Group has a present, legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

03 Critical accounting judgements and key sources of estimation uncertainty

Impairment of non-current assets

Determining whether a non-current asset is impaired requires an estimation of the value in use and/or the estimated recoverable amount of the asset derived from the business, or part of the business, or CGU, to which the non-current asset has been allocated. The value in use calculation requires an estimate of the present value of future cash flows expected to arise from the CGU, by applying an appropriate discount rate to the timing and amount of future cash flows.

The Directors are required to make judgements regarding the timing and amount of future cash flows applicable to the CGU, based on current budgets and forecasts, and extrapolated for an appropriate period taking into account growth rates and expected changes to selling prices and operating costs. The Directors estimate the appropriate discount rate using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the individual CGU. For further disclosure, see Note 14.

Post-employment benefits

The Group operates two defined benefit schemes. All post-employment benefits associated with these schemes have been accounted for in accordance with IAS 19 'Employee benefits (revised)'. As detailed within the accounting policies note, in accordance with IAS 19, all actuarial gains and losses have been recognised immediately through the Consolidated statement of comprehensive income.

For all defined benefit pension schemes, pension valuations have been performed using specialist advice obtained from independent qualified actuaries. In performing these valuations, judgements, assumptions and estimates have been made. These assumptions have been disclosed within Note 29.

Exceptional items

Exceptional items are disclosed separately in the financial statements where it is necessary to do so to provide better understanding of the financial performance of the Group. They are material items of income or expense that are shown separately due to the significance of their nature or amount.

The Directors are required to make judgements regarding whether items are material to the users of the accounts and whether separate disclosure will aid the understanding of the financial performance.

Significant contracts

The Group, at times, enters into significant contracts with customers, which include both an 'installation' and an 'in-life service'. Revenue relating to the 'installation' phase is accounted for on a stage of completion basis. Revenue relating to the 'in-life service' is recognised in line with the satisfaction of the obligation to provide the service.

The Directors are required to make judgements in order to separate the contract into the two phases. The Directors are also required to make judgements relating to the stage of completion of the installation phase, which includes estimating the work necessary to complete the phase.

04 Segmental analysis

The Group's operating segments are based on the reports reviewed by the KCOM Group PLC Board which are used to make strategic decisions. The chief operating decision-maker of the Group is the KCOM Group PLC Board.

For the year ended 31 March 2017, the Board considered four segments in assessing the performance of the Group and making decisions in relation to the allocation of resources. These four segments are Hull and East Yorkshire, Enterprise, National Network Services and Central.

In our report and accounts for the year ended 31 March 2016, we explained the changes to our segments which arose as a result of the move from four brands (KC, Kcom, Eclipse and Smart 421), to one brand, KCOM.

The changes included three 'go to market' segments, along with a shared segment. In our disclosure notes we re-presented our results for the year ended 31 March 2016 on this new basis.

During the year, and as part of the Group's evolution, we have continued to refine those segments to align with the way the business is run and financial performance is analysed.

Notes to the financial statements continued

for the year ended 31 March 2017

04 Segmental analysis continued

We have further analysed our shared cost base in order to meaningfully allocate to our go to market segments. This provides segmental performance at a lower level in the income statement than disclosed at the half year. This means that the level of residual cost relates only to costs of the central functions with all network costs being allocated to go to market segments. As a result, the costs shown in our shared segment are materially lower than disclosed in our re-presented results for the year ended 31 March 2016 and our interim results for the period ended 30 September 2016. As a result of this change, this segment has been renamed Central.

We have further refined the customers allocated to our Enterprise segment. These are now fewer in number and relate solely to our largest customers where the revenue relates to complex communication and IP-based collaboration services. As a result, a greater proportion of our legacy network customers are now part of our National Network Services segment (renamed from SMB National).

A summary of these changes is set out below:

As reported 31 March 2016	As reported 30 September 2016	As reported 31 March 2017
KC Communication services for consumers and small local businesses within the Hull and East Yorkshire region.	*Hull and East Yorkshire* Communication services for consumers and small local businesses within the Hull and East Yorkshire region. Change from 31 March 2016: Allocation principles around shared costs.	*Hull and East Yorkshire* Communication services for consumers and businesses within the Hull and East Yorkshire region. Change from 31 March 2016: Allocation principles around shared costs.
Kcom Communication and collaboration services across the enterprise and SMB markets (excluding Hull and East Yorkshire), from our former Kcom, Eclipse and Smart421 brands.	*SMB National* Communication services to our medium-sized business customers outside of Hull and East Yorkshire. Change from 31 March 2016: A disaggregation of former Kcom segment. Allocation principles around shared costs.	*National Network Services* Connectivity-based services for organisations nationwide. Change from 30 September 2016: Allocation of certain network-based customers formerly in Enterprise. Allocation principles around shared costs. Name change to National Network Services.
	Enterprise Communication and collaboration solutions to our largest enterprise customers. Change from 31 March 2016: A disaggregation of former Kcom segment. Changes to cost allocation. Allocation principles around shared costs.	*Enterprise* IP-based communication and collaboration services for UK enterprise customers. Change from 30 September 2016: Allocation of certain network-based customers to National Network Services. Allocation principles around shared costs.
PLC Shared service functions, share scheme expenses and certain pension costs.	*Shared* Technical and engineering support, alongside IT, Finance, Estates, Legal and HR services. This segment also includes PLC costs such as share scheme expenses and certain pension costs. Change from 31 March 2016: Shared costs relating to Technical and engineering support, alongside IT, Finance, Estates, Legal and HR services held centrally and not allocated out to segments.	*Central* PLC costs and corporate costs, where allocation to the underlying segments would not improve understanding of these segments. These costs include share schemes and pensions, alongside the residual cost of finance, HR, risk, legal and communications once appropriate recharges have been made to go to market segments. Change from 30 September 2016: Costs allocated out to segments, where they can be allocated meaningfully. Name changed to Central.

As disclosed in our Annual Report for the year ended 31 March 2016, KCOM Group continues to have one business-wide EBITDA with segment profitability (contribution) used as the metric of reporting segmental performance. Following the refinement and allocation of our shared costs, contribution represents gross margin less all costs directly attributable to the segment.

04 Segmental analysis continued

The segment information provided to the KCOM Group PLC Board for the reportable segments, for the year ended 31 March 2017 and for the year ended 31 March 2016, is as follows:

	Revenue		Contribution*	
	2017 £'000	2016 £'000	**2017 £'000**	2016 £'000
Before exceptional items				
Hull and East Yorkshire	**102,275**	104,515	**60,424**	59,769
Enterprise	**90,966**	86,726	**4,500**	8,192
National Network Services	**141,811**	163,221	**15,959**	19,341
Central	**(3,749)**	(5,240)	**(13,238)**	(12,365)
Total before exceptional items	**331,303**	349,222	**67,645**	74,937
Exceptional items				
Hull and East Yorkshire	**—**	—	**(2,338)**	(2,641)
Enterprise	**—**	—	**(2,624)**	(395)
National Network Services	**—**	—	**353**	47,362
Central	**—**	—	**(3,372)**	(3,440)
Total	**—**	—	**(7,981)**	40,886
Total	**331,303**	349,222	**59,664**	115,823

* See glossary on page 114 for definition of contribution.

A reconciliation of total EBITDA to profit before tax is provided as follows:

	Notes	**2017 £'000**	2016 £'000
EBITDA post-exceptional items		**59,664**	115,823
Depreciation	5	**(14,279)**	(13,744)
Amortisation	5	**(12,629)**	(10,295)
Finance costs	9	**(2,263)**	(3,057)
Share of profit of associate	17	**12**	16
Profit before tax		**30,505**	88,743

Disclosure has not been made of segmental assets and liabilities. This is in accordance with IFRS 8 as this measure is not provided regularly to the KCOM Group PLC Board.

The split of total revenue between external customers and inter-segment revenue is as follows:

	2017 £'000	2016 £'000
Revenue from external customers		
Hull and East Yorkshire	**97,921**	98,797
Enterprise	**90,966**	86,696
National Network Services	**141,811**	163,221
Central	**605**	508
Total	**331,303**	349,222
Inter-segment revenue		
Hull and East Yorkshire	**4,354**	5,718
Enterprise	**—**	30
Central	**(4,354)**	(5,748)
Total	**—**	—
Group total	**331,303**	349,222

Inter-segment sales are charged at prevailing market prices.

None of the revenue, operating profit or net operating assets arising outside the United Kingdom are material to the Group.

The Group is not dependent upon a single or small number of external customers.

Notes to the financial statements continued

for the year ended 31 March 2017

04 Segmental analysis continued

The analysis of the Group's revenue between sale of goods and the provision of services is as follows:

	2017 £'000	2016 £'000
Sale of goods	**2,442**	1,511
Provision of services	**328,861**	347,711
Group total	**331,303**	349,222

05 Operating expenses

Consolidated	Notes	2017 £'000	2016 £'000
Staff costs		**85,300**	88,134
Restructuring costs relating to employees	7	**3,439**	684
Total staff costs	8	**88,739**	88,818
Own work capitalised	8	**(7,187)**	(6,465)
Other external charges		**181,158**	186,777
Non-employee-related pension charges	29	**655**	656
Operating lease rentals		**3,259**	4,743
Auditors' remuneration	6	**339**	448
Depreciation of property, plant and equipment	16	**14,279**	13,744
Amortisation of intangible assets	15	**12,629**	10,295
Loss/(profit) on disposal of property, plant and equipment		**134**	(8)
Onerous lease costs	7	**—**	2,315
Profit on sale of national network	7	**—**	(44,486)
Regulatory matters	7	**710**	(2,845)
Restructuring costs not relating to employees	7	**3,832**	3,446
Total		**298,547**	257,438

Other external charges mainly relate to costs from key partners, such as BT Wholesale.

Non-employee-related pension charges represent the cost of administrating the pension schemes as set out in Note 29.

06 Auditors' remuneration

During the year the Group obtained the following services from the Company's Auditors:

Consolidated	2017 £'000	2016 £'000
Fees payable to the Company's auditors for the audit of the Company's annual financial statements and the consolidated financial statements	**49**	51
Fees payable to the Company's auditors and its associates for other services:		
– the audit of the Company's subsidiaries	**198**	222
– audit-related assurance services*	**15**	10
– tax advisory services	**30**	15
– other non-audit services	**47**	150
Total	**339**	448

* Relates to half year review and regulatory audit.

07 Exceptional items

Consolidated	2017 £'000	2016 £'000
Profit on sale of national network	—	(44,486)
Regulatory matters	—	(2,845)
Credited to income statement	—	(47,331)
Restructuring costs	7,271	4,130
Regulatory matters	710	—
Onerous lease costs	—	2,315
Charged to income statement	7,981	6,445
Net charge/(credit) to income statement	7,981	(40,886)

Our continued business transformation has resulted in the need to restructure our business in order to provide the right number of people with the right skills and bring together our activities under a single brand. As a result, and in line with our accounting policy, the Group incurred costs of £7.3 million (2016: £4.1 million) during the period. These costs include:

> £3.4 million of redundancy costs;

> £2.4 million of advisory and other costs;

> £1.0 million in relation to KCOM rebranding; and

> £0.5 million of costs supporting the system changes required as part of our restructuring.

The Group also incurred £0.7 million in relation to regulatory matters. As noted in our interim results announcement, we received a provisional notification from Ofcom in October 2016, stating that KCOM may have failed to comply fully with a required "General Condition" between 2009 and 2015. Following representations in response, Ofcom, in February, withdrew that provisional notification. Ofcom has continued its investigation and issued a revised provisional notification in June 2017, in response to which we will make further representations in order to reach a final conclusion with Ofcom. The regulatory matters item represents a provision for any potential liability in relation to this matter and a credit resulting from a further settlement of claims in relation to an industry wide regulatory ruling dating back to the previous year (2016: £2.8 million credit).

Other exceptional items in the year ended 31 March 2016 relate to:

> profit on the sale of the Group's national telecommunications network (£44.5 million); and

> onerous lease costs arising as a result of rationalisation of the Group's property portfolio (£2.3 million).

The combined effect of these items is a credit of £1,596,000 (2016: charge of £16,520,000) in respect of current tax and £Nil (2016: credit of £8,343,000) in respect of deferred tax.

The cash flow impact of exceptional items is £8.3 million.

08 Employees and remuneration

The average monthly numbers (including Executive Directors) employed by the Group during the year were as follows:

	Number of employees 2017	Number of employees 2016
Hull and East Yorkshire	349	359
National Network Services	48	63
Enterprise	69	86
Central	1,246	1,198
Total	1,712	1,706

Notes to the financial statements continued

for the year ended 31 March 2017

08 Employees and remuneration continued

The costs incurred in respect of these employees were:

	Notes	2017 £'000	2016 £'000
Wages and salaries		**72,608**	74,995
Social security costs		**7,355**	7,431
Other pension costs	29	**3,588**	4,121
Share scheme costs	13	**1,749**	1,587
Restructuring costs relating to employees	7	**3,439**	684
Total		**88,739**	88,818
Less own work capitalised	15,16	**(7,187)**	(6,465)
Charged to the income statement		**81,552**	82,353

All of the Group's employees are employed by the Company with the exception of 138 (2016: 330) employees employed by KCOM Contact Centres Limited. No employee costs are borne by the Parent Company.

Disclosures required by the Companies Act 2006 on Directors' remuneration, including salaries, performance-related bonuses, pension contributions and pension entitlements, including disclosure in respect of the highest paid Director, are to be found in the tables on pages 63 to 72 within the Remuneration report and form part of these financial statements.

09 Finance costs

Consolidated	Notes	2017 £'000	2016 £'000
Bank loans, overdrafts and other loans		**1,195**	2,435
Fair value gain on financial instruments		**—**	(819)
Retirement benefit obligations	29	**375**	954
Finance lease and hire purchase contracts		**110**	137
		1,680	2,707
Amortisation of loan arrangement fees		**583**	350
Total		**2,263**	3,057

10 Taxation

Analysis of tax charge in the year

The charge based on the profit for the year comprises:

Consolidated	Notes	2017 £'000	2016 £'000
UK corporation tax:			
– current tax on profits for the year		**3,889**	10,569
– adjustment in respect of prior years		**(905)**	(314)
Total current tax		**2,984**	10,255
UK deferred tax:			
Origination and reversal of timing differences in respect of:			
– profit for the year		**1,356**	7,128
– change in rate		**672**	—
– adjustment in respect of prior years		**214**	(224)
– charge in respect of retirement benefit obligation		**517**	450
Total deferred tax	25	**2,759**	7,354
Total taxation charge for the year		**5,743**	17,609

10 Taxation continued

Factors affecting tax charge for the year

Consolidated	2017 £'000	2016 £'000
Profit before taxation	**30,505**	88,743
Profit before taxation at the standard rate of corporation tax in the UK of 20% (2016: 20%)	**6,101**	17,749
Effects of:		
– income not subject to tax	**(379)**	—
– expenses not deductible for tax purposes	**40**	398
– adjustments relating to prior year tax	**(691)**	(538)
– change in rate reflected in the deferred tax asset	**672**	—
Total taxation charge for the year	**5,743**	17,609

The current tax charge of £2,984,000 (2016: £10,255,000) includes a credit (2016: charge) relating to the vesting of the share schemes of £122,000 (2016: £90,000) which is a reclassification from the reserves on the unwind of the deferred tax asset.

Factors affecting the current and future tax charges

Changes to the UK corporation tax rates were substantively enacted as part of Finance Bill 2015 (on 26 October 2015) and Finance Bill 2016 (on 7 September 2016). These include reductions to the main rate to reduce the rate to 19% from 1 April 2017 and to 17% from 1 April 2020. Deferred taxes at the balance sheet date have been measured using these enacted tax rates and reflected in these financial statements.

11 Dividends

	2017 £'000	2016 £'000
Amounts recognised as distributions to equity holders in the period:		
– final dividend for the year ended 31 March 2015 of 3.58 pence per share	**—**	18,494
– interim dividend for the year ended 31 March 2016 of 1.97 pence per share	**—**	10,178
– final dividend for the year ended 31 March 2016 of 3.94 pence per share	**20,354**	—
– interim dividend for the year ended 31 March 2017 of 2.00 pence per share	**10,332**	—
Total	**30,686**	28,672

The proposed final dividend for the year ended 31 March 2017 is 4.00 pence per share, amounting to a total dividend of £20,664,000. In accordance with IAS 10 'Events after the balance sheet date', dividends declared after the balance sheet date are not recognised as a liability in these financial statements.

12 Earnings per share

The calculation of basic and diluted earnings per share is based on the following numbers of shares and earnings:

Consolidated	2017 Number	2016 Number
Weighted average number of shares		
For basic earnings per share	**510,384,583**	509,543,003
Share options in issue	**4,643,349**	5,225,401
For diluted earnings per share	**515,027,932**	514,768,404

	2017 £'000	2016 £'000
Earnings		
Profit attributable to owners of the Parent	**24,762**	71,134
Adjustments		
Exceptional items	**7,981**	(40,886)
Tax on exceptional items	**(1,596)**	8,177
Adjusted profit attributable to owners of the Parent	**31,147**	38,425

Notes to the financial statements continued

for the year ended 31 March 2017

12 Earnings per share continued

Consolidated	2017 Pence	2016 Pence
Earnings per share		
Basic	**4.85**	13.96
Diluted	**4.81**	13.82
Adjusted basic	**6.10**	7.54
Adjusted diluted	**6.05**	7.46

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year excluding ordinary shares purchased by the Company and held in trust.

Adjusted basic earnings per share is calculated by adjusting the profit attributable to equity holders of the Company for the exceptional items net of taxation and dividing this adjusted figure by the weighted average number of ordinary shares in issue during the year, excluding ordinary shares purchased by the Company and held in trust.

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive ordinary shares. The dilutive potential ordinary shares are in the form of share options. A calculation has been done to determine the number of shares that would have been issued assuming the exercise of the share options.

13 Share-based payments

The Group had three share-based payment schemes (2016: three) in existence during the year ended 31 March 2017. The Group recognised a total charge of £1,749,000 (2016: £1,587,000) in the year relating to equity-settled share-based payment transactions.

Share options and Long Term Incentive Scheme (LTIS)

Share options including LTIS (issued after 7 November 2002)

	Options	Weighted average exercise price (pence)
Outstanding at the beginning of year and end of year	42,189	Nil

The share options, including LTIS, outstanding at 31 March 2017 had a weighted average exercise price of Nil pence and a weighted average remaining contractual life of Nil years (the Directors have assumed all shares will vest at the earliest available date). Options were granted at £Nil cost for this equity-settled scheme. No options were granted in the year ended 31 March 2017. The options become exercisable between three and 10 years from grant date, provided that the employee remains in employment. Out of the 42,189 outstanding options (2016: 42,819), all were exercisable at 31 March 2017.

The assumptions used in the Monte Carlo model for the options outstanding at the beginning of the year are as follows:

	2006 grant	2005 grant	2004 grant	2003 grant
Share price (on date of official grant) (pence)	65.9	60.4	64.8	54.3
Exercise price (pence)	Nil	Nil	Nil	Nil
Expected dividend payments (%)	2	1	Nil	Nil
Expected term (years)	3	3	3	6.5

Share Incentive Plan (SIP)

The SIP is open to all employees and offers partnership, matching and free shares (the basis depends on the individual's contribution into the scheme). No performance criteria are attached to these matching shares other than an employee must remain employed by the Group for five years from the date of grant to be able to have their free and matching shares. In 2016/17, 1,228,669 (2016: 1,189,547) matching shares were granted during the year.

	Number	Weighted average exercise price (pence)
Outstanding at the beginning of the year	6,427,916	Nil
Granted during the year	1,228,669	Nil
Vested during the year	(1,681,721)	Nil
Lapsed during the year	(106,767)	Nil
Outstanding at the end of the year	**5,868,097**	**Nil**

13 Share-based payments continued

Long Term Incentive Plan (LTIP)

The LTIP is an equity-settled share-based payment scheme open to the Executive Directors and selected senior employees at the discretion of the Remuneration Committee. The awards were granted at £Nil cost and vest dependent on TSR performance over a three year performance period relative to the TSR performance of each company within a comparator group. For further information on the grants and the performance conditions, see the Remuneration report on page 66.

	Number	Weighted average exercise price (pence)
Outstanding at the beginning of the year	5,225,401	Nil
Granted during the year	1,590,389	Nil
Vested during the year	(1,074,176)	Nil
Lapsed during the year	(1,098,265)	Nil
Outstanding at the end of the year	**4,643,349**	**Nil**

The awards have been valued using a Monte Carlo simulation model.

The average assumptions used are as follows:

Share price at date of grant (pence)	108
Exercise price (pence)	Nil
Volatility (%)	21.8
Risk free rate (%)	0.1
Dividend yield (%)	Nil

14 Goodwill

Consolidated	Total £'000
Cost	
At 1 April 2015, 31 March 2016 and 31 March 2017	**85,272**
Provisions for impairment	
At 1 April 2015, 31 March 2016 and 31 March 2017	**33,900**
Net book value	
At 31 March 2017	**51,372**
At 31 March 2016	51,372
At 1 April 2015	51,372

Goodwill acquired in a business combination is allocated at the date of acquisition to the cash generating unit (CGU) that is expected to benefit from that business combination.

CGUs represent the smallest identifiable groups of assets that generate cash inflows that are largely independent of the cash inflows from other groups of assets. As in previous years, KCOM's CGUs are based on customer type and geographic service location.

As disclosed in our Annual Report for the year ended 31 March 2016, our goodwill CGUs changed on 1 April 2016, following the move to one brand, KCOM, and the allocation of customers to three go to market segments.

As set out in our segmental analysis in Note 4, there have been certain changes to our customer allocation during the year which have refined the split of our customers between our three go to market segments. As set out below, this refinement (performed on a basis consistent with the exercise performed on 1 April 2016) has altered the allocation of goodwill between two CGUs.

CGUs	2017 £'000	2016 £'000
Enterprise	**19,125**	29,058
National Network Services	**32,247**	—
SMB National	—	22,314
Total	**51,372**	51,372

Notes to the financial statements continued

for the year ended 31 March 2017

14 Goodwill continued

Goodwill is tested annually for impairment, or more frequently if there are indications that goodwill may be impaired. The recoverable amounts of the CGUs are determined from value in use calculations. The key assumptions for these value in use calculations relate to discount rates, growth rates and forecast cash flows. The Directors estimate discount rates using pre-tax rates that reflect current market assessments of the time value of money and the level of risk. Growth rates reflect long-term growth rate prospects for the UK economy.

Cash flow forecasts are prepared using the current operating budget approved by the Directors, which covers a three year period and an appropriate extrapolation of cash flows beyond this. The cash flow forecasts assume revenue and profit growth in line with our strategic priorities.

The Directors have considered the level of headroom arising from the impairment tests of each of our CGUs. Where appropriate, further sensitivity analysis has been performed by changing the base case assumptions applicable to each CGU. The analysis indicated that no reasonably possible changes in any individual key assumption would cause the carrying amount of the business to exceed its recoverable amount. As such no impairment is required.

Impairment testing was also performed immediately prior to the changes in goodwill allocation set out above; these tests were performed on a consistent basis and also supported the carrying value of the Group's goodwill balances.

The discount rate and growth rate (in perpetuity) used for value in use calculations are as follows:

	2017	2016
Discount rate (pre-tax) %	8.0	8.9
Growth rate (in perpetuity) %	2.0	2.0

The assumptions within the value in use calculation which have the most significant impact relate to forecast cash flows (both underlying trading performance and ongoing network costs), pre-tax discount rate and perpetuity growth rate. The estimates used within our value in use calculation take into account historical experience and the Board's estimate of future events.

15 Other intangible assets

Consolidated	Notes	Development costs[1] £'000	Software £'000	Customer and supplier relationship £'000	Technology and brand £'000	Total £'000
Cost						
At 1 April 2015		10,654	50,454	49,257	6,294	116,659
Additions		1,900	4,776	—	—	6,676
Own work capitalised	8	4,224	2,241	—	—	6,465
Disposals		(15)	(1,100)	—	—	(1,115)
Transfers		139	(61)	—	—	78
At 31 March 2016		16,902	56,310	49,257	6,294	128,763
Additions		220	9,407	—	—	9,627
Own work capitalised	8	4,584	—	—	—	4,584
Disposals		(250)	(306)	—	—	(556)
Transfers[2]		8,772	(8,766)	—	—	6
At 31 March 2017		**30,228**	**56,645**	**49,257**	**6,294**	**142,424**
Accumulated amortisation						
At 1 April 2015		7,277	11,928	49,257	6,294	74,756
Charge for the year		3,339	6,956	—	—	10,295
Disposals		—	(925)	—	—	(925)
Transfers		—	—	—	—	—
At 31 March 2016		10,616	17,959	49,257	6,294	84,126
Charge for the year		4,647	7,982	—	—	12,629
Disposals		(4)	(36)	—	—	(40)
Transfers[2]		1,631	(1,631)	—	—	—
At 31 March 2017		**16,890**	**24,274**	**49,257**	**6,294**	**96,715**
Carrying amount						
At 31 March 2017		**13,338**	**32,371**	**—**	**—**	**45,709**
At 31 March 2016		6,286	38,351	—	—	44,637
At 1 April 2015		3,377	38,526	—	—	41,903

1. Development costs are predominantly capitalised staff costs associated with new products and services.
2. Relate to the alignment of the classification of capitalised internal costs across the Group.

16 Property, plant and equipment

Consolidated	Notes	Land and buildings £'000	Exchange equipment £'000	External plant £'000	Vehicles, other apparatus and equipment £'000	Total £'000
Cost						
At 1 April 2015		14,623	205,117	171,428	41,842	433,010
Additions		119	1,798	11,418	9,746	23,081
Disposals		(194)	(113,577)	(34,085)	(547)	(148,403)
Transfers		—	(455)	591	(214)	(78)
At 31 March 2016		14,548	92,883	149,352	50,827	307,610
Additions		6	6,016	11,099	7,400	24,521
Own work capitalised	8	—	—	2,603	—	2,603
Disposals		—	—	(92)	(18)	(110)
Transfers		(24)	865	(405)	(442)	(6)
At 31 March 2017		**14,530**	**99,764**	**162,557**	**57,767**	**334,618**
Accumulated depreciation						
At 1 April 2015		10,254	153,139	115,718	26,821	305,932
Charge for the year		357	3,665	3,760	5,962	13,744
Disposals		(125)	(85,008)	(20,502)	(23)	(105,658)
Transfers		—	(49)	—	49	—
At 31 March 2016		10,486	71,747	98,976	32,809	214,018
Charge for the year		352	2,255	4,228	7,444	14,279
Disposals		—	—	(1)	(1)	(2)
Transfers		—	50	192	(242)	—
At 31 March 2017		**10,838**	**74,052**	**103,395**	**40,010**	**228,295**
Net book value						
At 31 March 2017		**3,692**	**25,712**	**59,162**	**17,757**	**106,323**
At 31 March 2016		4,062	21,136	50,376	18,018	93,592
At 1 April 2015		4,369	51,978	55,710	15,021	127,078

17 Investments

Consolidated	Shares in associate £'000
Cost	
At 1 April 2015	33
Share of net profit for the year	16
At 31 March 2016	49
Share of net profit for the year	12
Dividends received from associate	(16)
At 31 March 2017	**45**
Amounts written off	
At 1 April 2015, 31 March 2016 and 31 March 2017	—
Net book value	
At 31 March 2017	**45**
At 31 March 2016	49
At 1 April 2015	33

Notes to the financial statements continued

for the year ended 31 March 2017

17 Investments continued

Parent Company	Shares in subsidiary undertakings £'000
Cost	
At 31 March 2016 and 31 March 2017	**494,511**
Amounts written off	
At 31 March 2016 and 31 March 2017	**50**
Net book value	
At 31 March 2016 and 31 March 2017	**494,461**

Subsidiary undertakings (as at 31 March 2017)
The shares in subsidiary undertakings are held in KCH (Holdings) Limited, an intermediary holding company registered in England. A full list of undertakings is included below:

Name of company	Place of registration	Holding	Proportion held	Nature of business
KCH (Holdings) Limited	England and Wales[1]	Ordinary shares	100%	Intermediate holding company
Network Holdco 3 BV*	Holland[2]	Ordinary shares	100%	Dormant
Smart 421 Technology Group Limited*	England and Wales[1]	Ordinary shares	100%	Intermediate holding company
Kingston Network Holdings Limited*	England and Wales[1]	Ordinary shares	100%	Dormant holding company
Kingston Service Holdings Limited*	England and Wales[1]	Ordinary shares	100%	Dormant holding company
KCOM International Limited (formerly Kingston Communications International Limited)*	England and Wales[1]	Ordinary shares	100%	Dormant
KCOM (General Partner) Limited*	Scotland[3]	Ordinary shares	100%	Intermediate holding company
KCOM Central Asset Reserve Limited Partnership*	Scotland[3]	Ordinary shares	100%	Partnership
KCOM Contact Centres Limited (formerly KC Contact Centres Limited)*	England and Wales[1]	Ordinary shares	100%	Provision of call centre facilities
Kingston Communications (Data) Trustees Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
Kingston Communications (Hull) Trustees Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
Affiniti Integrated Solutions Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
Kingston Information Services Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
KCOM Holdings Limited (formerly Kingston Communications Limited)*	England and Wales[1]	Ordinary shares	100%	Design and delivery of communication and integration services
Eclipse Networking Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
Eclipse Internet Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
Kingston Communications (Hull) Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
Omnetica Investment Limited*	England and Wales[1]	Ordinary shares	100%	Dormant holding company
Omnetica Inc*	USA[4]	Ordinary shares	100%	Dormant
Smart421 Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
Smart421 Solutions Inc*	USA[5]	Ordinary shares	100%	Dormant
SmartIntegrator Technology Limited*	England and Wales[1]	Ordinary shares	50%	Software development

* Indicates indirect shareholding.
1. 37 Carr Lane, Hull HU1 3RE.
2. Prins Bernhardplein 200, 1097 JB Amsterdam, The Netherlands.
3. 50 Lothian Road, Festival Square, Edinburgh EH3 9WJ.
4. 200 Knickerbocker Avenue, Bohemia, New York, 11716, USA.
5. 9 East Loockerman Street, Dover, Delaware, 19901, USA.

The Directors believe the values of the investments are supported by the underlying net assets of the subsidiaries.

Associates
The Group's associate is Smartintegrator Technology Limited, in which the Company indirectly holds 50% of the ordinary shares. Under an agreement between the shareholders of Smartintegrator Technology Limited, neither the Group nor the shareholders are able to exercise control over the operational and financial policies of Smartintegrator Technology Limited. The associate is registered in England and its main business activity is software development.

18 Inventories

Consolidated	2017 £'000	2016 £'000
Raw materials and consumables	**2,829**	2,371
Equipment for resale	**246**	267
Total	**3,075**	2,638

There is no material difference between the carrying value and the replacement cost of inventories.

19 Trade and other receivables

	Consolidated		Parent Company	
	2017 £'000	2016 £'000	2017 £'000	2016 £'000
Trade receivables (net)	**31,835**	30,851	**—**	—
Other receivables	**274**	2,088	**—**	—
Prepayments	**21,767**	14,406	**5**	5
Accrued income	**14,530**	18,086	**—**	—
Total	**68,406**	65,431	**5**	5

All of the Group's receivables are due within one year in both 2017 and 2016. An allowance has been made for estimated irrecoverable amounts from the sale of goods and services of £828,000 (2016: £1,548,000). The Directors consider that the carrying amount of trade and other receivables approximates to their fair value.

Movements on the Group provision for impairment of trade receivables are as follows:

	2017 £'000
At 1 April 2016	**(1,548)**
Written off in the year	**1,405**
Amounts provided for in the year	**(685)**
At 31 March 2017	**(828)**

The majority of the Group's trade and other receivables are denominated in Sterling.

Note 27 provides further disclosures regarding the credit risk of the Group's trade receivables.

As of 31 March 2017, trade receivables of £4,787,000 (2016: £6,834,000) were impaired. The amount of the provision was £828,000 as of 31 March 2017 (2016: £1,548,000). The individually impaired receivables mainly relate to customers who are in unexpectedly difficult economic situations. It was assessed that a portion of the impaired balance is expected to be recovered. There is no concern over the debt not yet due.

The ageing of these receivables is as follows:

	2017 £'000	2016 £'000
0–3 months	**3,822**	5,265
3–6 months	**965**	1,569
6 months+	**—**	—
	4,787	6,834

As of 31 March 2017, trade receivables of £6,729,000 (2016: £7,249,000) were past due but not impaired. These relate to a number of independent customers of whom there is no recent history of default. The ageing analysis of these trade receivables is as follows:

	2017 £'000	2016 £'000
0–3 months	**5,527**	4,709
3–6 months	**1,202**	2,540
6 months+	**—**	—
	6,729	7,249

Notes to the financial statements continued

for the year ended 31 March 2017

20 Trade and other payables

	Consolidated		Parent Company	
	2017 £'000	2016 £'000	**2017 £'000**	2016 £'000
Current				
Trade payables	**40,118**	30,704	**—**	—
Other taxes and social security costs	**7,493**	24,905	**—**	—
Other payables	**2,587**	6,721	**—**	—
Accruals	**31,909**	35,117	**—**	—
Deferred income	**28,810**	28,788	**—**	—
Total	**110,917**	126,235	**—**	—
Non-current				
Amounts due to subsidiary undertakings	**—**	—	**450**	450
Total	**—**	—	**450**	450

Trade payables and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The Directors consider that the carrying amount of current liabilities approximates to their fair value.

At 31 March 2016 other taxes and social security costs included a VAT creditor of £18.0 million resulting from the exceptional gain on the sale of the Group's infrastructure relating to its national telecommunications network.

Amounts owed to subsidiary undertakings are unsecured and have no fixed date of repayment. However, the subsidiary undertakings have confirmed that none of the amounts are due within one year. Interest at market rates is charged on amounts due to subsidiary undertakings after more than one year, except for amounts due to dormant entities where Nil interest is charged.

21 Bank loans

	Consolidated	
	2017 £'000	2016 £'000
Bank borrowings		
Amount falling due:		
– between two and five years	**50,000**	—
	50,000	—
Loan issue costs	**(1,413)**	—
	48,587	—

The loan facility was secured by guarantees given by all material subsidiaries of KCOM Group PLC in favour of the lending banks.

The bank borrowings are fully repayable in December 2021 and attract an interest rate of LIBOR plus a margin dependent on specific covenants. For further information on interest rate swaps, see Note 27. The above bank facilities were refinanced in September 2016. See Note 27 for further detail.

In 2016 the Group repaid all outstanding loan borrowings and as a consequence associated outstanding loan issue costs (£1.2 million) were reclassified to other receivables. During 2017 the Group has drawn down on its loan facility and therefore loan issue costs have been classified against bank borrowings.

22 Net debt

		Consolidated	
	Notes	**2017 £'000**	2016 £'000
Cash		**16,093**	14,857
Bank overdrafts		**(5,903)**	(1,645)
Cash and cash equivalents (including bank overdrafts)		**10,190**	13,212
Borrowings	21	**(48,587)**	1,151
Finance leases	23	**(4,036)**	(6,951)
Total net (debt)/funds		**(42,433)**	7,412

Cash and cash equivalents, which are presented as a single class of assets on the face of the balance sheet, comprise cash at bank, short-term deposits and other short-term, highly liquid investments with maturity of three months or less.

23 Finance leases

	Consolidated 2017 £'000	Consolidated 2016 £'000
Finance lease liabilities:		
Minimum lease payments:		
– within 12 months	1,942	3,271
– in 1 to 5 years	2,463	3,880
	4,405	7,151
Future finance charges	(369)	(200)
Present value of finance lease liabilities	4,036	6,951
The present value of finance lease liabilities is as follows:		
– within 12 months	1,942	3,271
– in 1 to 5 years	2,094	3,680
Total	4,036	6,951

24 Provisions for other liabilities and charges

	Onerous leases £'000	Restructuring £'000	Total £'000
At 1 April 2016	2,700	439	3,139
Released in the year	—	(80)	(80)
Utilised in the year	(361)	(359)	(720)
At 31 March 2017	2,339	—	2,339
Total provisions for other liabilities and charges 2017			
Included in current liabilities	377	—	377
Included in non-current liabilities	1,962	—	1,962
At 31 March 2017	2,339	—	2,339
Total provisions for other liabilities and charges 2016			
Included in current liabilities	299	439	738
Included in non-current liabilities	2,401	—	2,401
At 31 March 2016	2,700	439	3,139

Provision has been made for the estimated fair value of unavoidable lease payments on unoccupied buildings. It is expected that these payments will arise over the next one to eight years.

The restructuring provision represents the future costs of the Group's ongoing restructuring programme which are committed to at the balance sheet date. The amounts included within current liabilities above are expected to be utilised within the next 12 months.

25 Deferred taxation assets and liabilities

Deferred tax assets/(liabilities) are attributable to the following:

	Assets		Liabilities		Net	
Consolidated	2017 £'000	2016 £'000	2017 £'000	2016 £'000	2017 £'000	2016 £'000
Property, plant and equipment	—	—	(3,602)	(2,826)	(3,602)	(2,826)
Other timing differences	438	719	—	—	438	719
Retirement benefit obligation	3,347	2,871	—	—	3,347	2,871
Intangible assets on acquisition	4,051	4,766	—	—	4,051	4,766
Asset-backed partnership	—	—	(3,896)	(4,049)	(3,896)	(4,049)
	7,836	8,356	(7,498)	(6,875)	338	1,481

Notes to the financial statements continued

for the year ended 31 March 2017

25 Deferred taxation assets and liabilities continued

Movements in net deferred tax assets/(liabilities) are as follows:

Consolidated	Notes	Property, plant and equipment £'000	Other timing differences £'000	Retirement benefit obligation £'000	Intangible assets arising on acquisition £'000	Asset-backed partnerships £'000	Total £'000
At 1 April 2015		4,175	1,064	6,287	4,766	(4,589)	11,703
(Charged)/credited to the income statement	10	(7,001)	99	(452)	—	—	(7,354)
(Charged)/credited directly to equity and other comprehensive income		—	(444)	(2,964)	—	540	(2,868)
At 31 March 2016		(2,826)	719	2,871	4,766	(4,049)	1,481
Charged to the income statement	10	(776)	(159)	(1,109)	(715)	—	(2,759)
(Charged)/credited directly to equity and other comprehensive income		—	(122)	1,585	—	153	1,616
At 31 March 2017		**(3,602)**	**438**	**3,347**	**4,051**	**(3,896)**	**338**

There are £Nil deferred tax assets in the Parent Company (2016: £Nil).

The analysis of deferred tax assets is as follows:

	2017 £'000	2016 £'000
Deferred tax assets to be recovered after more than 12 months	**6,403**	6,342
Deferred tax assets to be recovered within 12 months	**1,433**	2,014
	7,836	8,356

The analysis of deferred tax liabilities is as follows:

	2017 £'000	2016 £'000
Deferred tax liabilities to be recovered after more than 12 months	**(6,971)**	(5,276)
Deferred tax liabilities to be recovered within 12 months	**(527)**	(1,599)
	(7,498)	(6,875)

The major components of the deferred taxation asset not recognised are as follows:

	Not recognised	
	2017 £'000	2016 £'000
Losses	**580**	1,126

Deferred tax assets relating to property, plant and equipment and short-term timing differences of £0.4 million (2016: £2.1 million) have been recognised in those subsidiary companies in which there is sufficient available evidence that suitable taxable profits will arise against which these assets are expected to reverse. There are additional deferred tax assets of £0.6 million (2016: £1.1 million) which have not been recognised, as there is insufficient evidence as to the generation of suitable profits against which these assets can be offset. The utilisation of these assets would reduce the Group's tax charge in future periods. Deferred tax has been provided at the rate at which it is expected to unwind.

26 Called-up share capital

	2017 £'000	2016 £'000
Allotted, called up and fully paid		
516,603,910 (2016: 516,603,910) ordinary shares of 10 pence each	**51,660**	51,660

During the financial year, the Company did not purchase any of its own shares (2016: Nil); however, the Company funds Employee Share Trusts to meet its obligations under the Company's share schemes. During the year the Trusts purchased 2,130,491 (2016: 666,000) of the Company's ordinary shares through purchases on the London Stock Exchange for a total cash consideration of £1,778,051 (2016: £450,000) in order to meet future obligations under the Company's SIP and LTIP schemes. The total amount paid to acquire the shares, net of expenses and cash received for the exercise of share options, of £1,778,051 (2016: £450,000) has been deducted from retained earnings.

As of 31 March 2017, the total number of ordinary shares held by the Trusts to meet obligations under the Company's share schemes was 5,881,803 (2016: 6,614,000).

27 Financial instruments and risk management

The Group's principal financial instruments during the year comprised bank loans, cash on short-term deposits, and forward foreign exchange contracts. The main purpose of these financial instruments is to finance the Group's operations and to minimise the impact of fluctuations in exchange rates on future cash flows. The Group has various other financial instruments such as short-term receivables and payables which arise directly from its operations.

The Group regularly reviews its exposure to interest, liquidity and foreign currency risk. Where appropriate the Group will take action, in accordance with a Board approved Treasury policy, to minimise the impact on the business of movements in interest rates and currency rates.

The Group only enters into derivative instruments with members of the banking group to ensure appropriate counterparty credit quality.

Liquidity risk

The Group keeps its short, medium and long-term funding requirements under constant review. Its policy is to have sufficient committed funds available to meet medium-term requirements, with flexibility and headroom to make minor acquisitions for cash if the opportunity should arise.

The Group's bank facilities were refinanced in September 2016 to replace existing facilities. These bank facilities comprise a multi-currency revolving credit facility of £180.0 million, provided by a group of five core relationship banks. The facility matures in December 2021. The Group considers that this facility will provide sufficient funding to meet the organic and inorganic investment needs of the business. In addition, short-term flexibility of funding is available under the £8.0 million overdraft facility in Pound Sterling and $2.0 million overdraft facility in US Dollars provided by the Group's clearing bankers.

The net funds position of £7.4 million at the beginning of the financial year has decreased during the year to net debt of £42.4 million. The Group generated negative cash flow after investing activities of £15.6 million for the year (2016: £141.9 million positive).

The table below analyses the Group's financial liabilities which will be settled on a net basis into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. Notional interest is included for the period from the year end up to the contractual maturity date of the debt, calculated on the amount of debt drawn down at the year end.

	Less than one year £'000	One to three years £'000	Over three years £'000
At 31 March 2016			
Trade and other payables	101,330	—	—
Cash flow hedges	11	—	—
Finance leases	3,271	3,680	—
Total	104,612	3,680	—
At 31 March 2017			
Borrowings	**1,225**	**2,450**	**52,144**
Trade and other payables	**103,424**	**—**	**—**
Finance leases	**1,942**	**2,094**	**—**
Total	**106,591**	**4,544**	**52,144**

Foreign currency risk

Cash flow exposure

The Group's only major foreign currency risk arises due to the purchase of equipment invoiced in US Dollars. Whenever possible the Group resells this equipment in US Dollars. The remaining exposure is managed principally through the use of forward foreign exchange contracts in order to minimise the impact of fluctuations in exchange rates on future cash flows and gross margin.

The Group also has some Euro cash flows but these are not material on a net basis and are not hedged.

Net asset exposure

The Dollar-denominated trading described above results in a balance sheet exposure since debtor days are longer than creditor days. It is the Group's policy not to hedge this exposure.

Notes to the financial statements continued

for the year ended 31 March 2017

27 Financial instruments and risk management continued

Credit risk

Credit risk arises from cash and cash equivalents and derivative financial instruments, as well as credit exposures to business and retail customers.

Credit ratings of institutions which hold the Group's financial assets are regularly monitored to ensure they meet the minimum credit criteria set by the Board through the Group Treasury policy. At the year end all the institutions holding the Group's financial assets were rated A-/A- or higher by Standard and Poor's.

The credit quality of customers is assessed by taking into account their financial position, past experience and other factors. Individual risk limits are set and the utilisation of credit limits monitored regularly.

The Group has no significant concentration of credit risk, with exposure spread over a large number of customers. For an analysis of the quality of the ageing of the Group's trade receivables, see Note 19 for further disclosures.

The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivable mentioned above. The Group does not hold any collateral as security.

Currency and interest rate risk profile of financial assets and financial liabilities

Financial assets

The Group had net financial assets of £10.2 million at the year end (2016: £13.2 million), comprising cash on overnight money market deposits and cash at bank. This attracts floating rates of interest.

The currency profile of the Group's financial assets at 31 March 2017 and 31 March 2016 was:

	2017 £'000	2016 £'000
Currency		
Sterling	4,705	9,139
US Dollar	5,130	3,925
Euro	355	148
Total	10,190	13,212

Foreign currency cash balances are held on a short-term basis to fund cash flow requirements in these currencies. All trade receivable balances are held in Sterling and bear no interest. There is no currency risk associated with these balances.

At the year end £1.3 million (2016: £1.3 million) of cash collateral was held by Barclays in respect of a bank guarantee given under Ofcom's 'Funds for Liabilities' regulations.

Financial liabilities

The currency and interest rate risk profile of the Group's financial borrowings at 31 March 2017 and 31 March 2016 was:

	2017			2016		
	Floating £'000	Fixed £'000	Total £'000	Floating £'000	Fixed £'000	Total £'000
Sterling	50,000	—	50,000	—	—	—

Undrawn committed borrowing facilities at the year end were £130.0 million (2016: £200.0 million).

Interest on amounts drawn under the committed borrowing facility is based on the relevant LIBOR plus margin. All trade payable balances are held in Sterling and bear no interest. There is no currency risk associated with these balances.

Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern, support the growth of the business and maintain an optimal capital structure to reduce the cost of capital.

Consistent with others in the industry, the Group monitors capital on the basis of its gearing ratio. This ratio is calculated as net debt divided by total capital. Net debt is calculated as total borrowings (including 'current and non-current borrowings' as shown in the Consolidated balance sheet) less cash and cash equivalents.

IFRS 7 requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

- quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1);
- inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2); and
- inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

All of the Group's financial instruments fall into hierarchy level 2.

27 Financial instruments and risk management continued

Capital risk management continued

Total capital is shown in the table below and is calculated as 'equity' as shown in the Consolidated balance sheet plus net debt.

	2017 £'000	2016 £'000
Net debt/(funds)	**42,433**	(7,412)
Total equity	**99,888**	116,267
Total capital	**142,321**	108,855

Under the Group's £180.0 million revolving credit facility the Group is required to comply annually with certain financial and non-financial covenants. The Group is required to maintain a minimum interest cover ratio and a maximum net debt to EBITDA ratio. Both financial covenants were tested and complied with throughout the year and at the year end. The Board monitors both covenant compliance and net debt performance on a regular basis.

28 Financial commitments

Authorised future capital expenditure and financial investment amounted to:

	Consolidated	
	2017 £'000	2016 £'000
Property, plant and equipment	**3,110**	1,382
Intangible assets	**391**	989
Total	**3,501**	2,371

The Group as lessee

The future aggregate minimum lease rental commitments under non-cancellable operating leases were as follows:

	Consolidated	
	2017 £'000	2016 £'000
Leasehold buildings:		
– within 12 months	**3,321**	2,878
– in 1 to 5 years	**8,130**	9,850
– after 5 years	**4,550**	8,597
Total	**16,001**	21,325
Plant and equipment:		
– within 12 months	**409**	793
– in 1 to 5 years	**866**	193
Total	**1,275**	986

None of the Group's lease arrangements include any contingent rent payments and there are no renewal or purchase options or escalation clauses. There are also no restrictions imposed by the Group's lease arrangements.

29 Retirement benefit obligation – consolidated

Defined contribution schemes

The Company operates defined contribution schemes, which are open to all eligible employees. Contributions charged to the income statement in respect of defined contribution schemes amounted to £3.6 million (2016: £4.1 million).

Defined benefit schemes

The principal defined benefit scheme at 31 March 2017 was the Kingston Communications Pension Scheme, which is a funded scheme and provides defined benefits based on final pensionable salary. The assets of the scheme are held separately from the assets of the Group in Trustee administered funds. The Company also operates a second funded defined benefit scheme, the Kingston Communications (Data) Pension Scheme. Both schemes are closed to both new members and future accrual.

The defined benefit schemes are operated in the UK under the same regulatory frameworks. Both of the schemes are final salary pension schemes, which provide benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits provided depends on members' length of service and their salary in the final years leading up to retirement. In the schemes, pensions in payment are generally updated in line with the Retail Price Index. In addition to this inflationary risk, the schemes face the same risks, as described below.

All of the benefit payments are from Trustee administered funds. Plan assets held in trusts are governed by local regulations and practice, as is the nature of the relationship between the Group and the Trustees (or equivalent) and their composition. Responsibility for governance of the plans – including investment decisions and contribution schedules – lies jointly with the Group and the Trustees. The Trustees must be composed of representatives of the Group and scheme participants in accordance with the scheme's regulations.

Notes to the financial statements continued

for the year ended 31 March 2017

29 Retirement benefit obligation – consolidated continued

Parent Company

KCH (Holdings) Limited, a wholly owned subsidiary of the Parent, is responsible for all obligations and liabilities of the schemes. An equivalent liability has been provided in the accounts of KCH (Holdings) Limited.

The Parent Company provides a guarantee to both defined benefit schemes, whereby if KCH (Holdings) Limited is unable to meet its obligations to the schemes, such obligations would be met by the Parent Company. No liability has been recognised in respect of the guarantee at 31 March 2017 (2016: £Nil).

Most recent valuations

The most recent formal valuation for the Kingston Communications Pension Scheme was at 31 March 2013 (2016 valuation currently being finalised). The main long-term financial assumptions used in that valuation were:

	Per annum %
Rate of return on scheme assets	3.90
Rate of future salary inflation	2.90

The most recent formal valuation for the Kingston Communications (Data) Pension Scheme was at 31 March 2013 (2016 valuation currently being finalised). The main long-term financial assumptions used in that valuation were:

	Per annum %
Rate of return on scheme assets	4.10
Rate of future salary inflation	2.90

Funding

Asset-backed partnership

On 31 March 2013, the Group reached an agreement with the Trustees to provide the Group with an efficient mechanism of funding the schemes' current deficit position.

The Group established a general partner, KCOM (General Partner) Limited, and a partnership, KCOM Central Asset Reserve Limited Partnership ("the Partnership"), which are both consolidated within these financial statements. The Group takes advantage of the exception conferred by Regulation 7 of the Partnership (Accounts) Regulations 2008 and has therefore not appended the accounts of the Partnership to these accounts. Separate accounts for the Partnership are not required to be filed at Companies House. The Group provided sufficient capital to the Partnership to enable it to procure freehold property assets with a market value of £12.6 million owned by fellow Group subsidiaries. These properties were immediately leased back and continue to be operated by those Group companies and not by the Partnership. The Group retains control over these properties including the flexibility of substituting the freehold property assets with other assets. As partners in the Partnership, the pension schemes are entitled to an annual income distribution.

On 24 March 2014, the Group reached an agreement with the Trustees to provide further funding of the schemes' current deficit position through the Partnership.

As part of this agreement, a loan note of £20.0 million was secured over the Hull and East Yorkshire network asset. The security does not offer the Trustees any 'normal' rights of enforcement over the assets. Instead it provides first priority payment of any value that would be realised from the Hull and East Yorkshire network on an insolvency event.

As partners in the Partnership, the pension schemes are entitled to an annual income distribution of £1.6 million, rising in line with the Consumer Price Index (CPI) (capped at 5%) over a potential period of 15 years. The total value of this income distribution to the schemes is £16.0 million, which provided an immediate improvement to the funding deficit.

Under IAS 19, the investment held by the pension schemes in the Partnership does not represent a plan asset for the purpose of the Group's consolidated accounts. The distribution of the Partnership's profits to the pension schemes is reflected as pension contributions in these Group accounts on a cash basis.

29 Retirement benefit obligation – consolidated continued

Funding continued

Employer contributions for the year ended 31 March 2017

The disclosures in the table below are for the two schemes combined.

Contributions into the two defined benefit schemes during the year were as follows:

	2017 £'000	2016 £'000
Payments to the schemes	7,724	6,565

Main financial assumptions

	2017 per annum %	2016 per annum %
RPI inflation	3.15	2.95
CPI inflation	2.15	1.95
Rate of increase to pensions in payment	2.20	2.00
Discount rate for scheme liabilities	2.50	3.45

Our approach is to base the discount rate on the AA yield curve published by Merrill Lynch, over an 18 year duration for the schemes.

The mortality assumptions are based on standard mortality tables, which allow for future improvements in life expectancy. The effects of these tables are that:

- a future pensioner aged 65 at retirement will live on average to age 88.8 (2016: 89.1) if they are male and on average to age 90.7 (2016: 91.3) if they are female; and
- a current pensioner aged 65 will live on average to age 87.4 (2016: 87.4) if they are male and on average to age 89.1 (2016: 89.3) if they are female.

The key assumptions used for IAS 19 are discount rate, inflation and mortality. The sensitivity of the net retirement benefit obligation deficit to changes in the assumptions is as follows:

		Impact on the deficit	
	Sensitivity	Of increase	Of decrease
RPI inflation	0.1%	20.8%	(18.8%)
Discount rate for scheme liabilities	0.1%	(23.9%)	24.4%
Mortality	1 year	42.2%	(42.7%)

The sensitivity analysis in the table above is based on a change in an assumption while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the retirement benefit obligation deficit to significant actuarial assumptions the same method (present value of the defined benefit liability calculated with the projected unit credit method at the end of the reporting period) has been applied as when calculating the retirement benefit obligation deficit recognised in the Group balance sheet.

Fair value of assets

	Value at 2017 £'000	Value at 2016 £'000
Equities	52,707	34,308
Property	1,827	995
Hedge funds	56,751	48,352
Index linked gilts	—	455
Corporate bonds	42,608	42,656
Other	97,645	86,422
Total fair value of assets	251,538	213,188

Notes to the financial statements continued

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29 Retirement benefit obligation – consolidated continued

Fair value of assets continued

History of asset values, defined benefit obligation, deficit in scheme and experience gains and losses

	2017 £'000	2016 £'000	2015 £'000	2014 £'000	Restated[1] 2013 £'000
At 31 March					
Present value of defined benefit obligation	(271,229)	(227,538)	(240,217)	(217,600)	(203,300)
Fair value of plan assets	251,538	213,188	208,782	191,100	193,542
Deficit	(19,691)	(14,350)	(31,435)	(26,500)	(9,758)
Experience gains/(losses) on plan assets	33,672	721	14,407	(3,130)	7,715
Experience (losses)/gains on plan liabilities	(45,707)	11,409	(21,670)	(13,500)	(3,010)

1. The comparative results have been restated for changes in IAS 19 "Employee benefits".

The Group employs a building block approach in determining the long-term rate of return on pension plan assets. Historical markets are studied and assets with higher volatility are assumed to generate higher returns consistent with widely accepted capital market principles.

Reconciliation of funded status to balance sheet

	2017 £'000	2016 £'000
Fair value of assets	251,538	213,188
Present value of funded defined benefit obligations	(271,229)	(227,538)
Liability recognised on the balance sheet	(19,691)	(14,350)
Analysis of income and expenditure charge:		
– administration expenses	655	656
– finance costs	375	954
Charge recognised in the income statement	1,030	1,610

	2017 £'000	2016 £'000
Changes to the present value of the defined benefit obligation during the year		
Opening defined benefit obligation	227,538	240,217
Finance costs	7,685	7,663
Remeasurements arising from changes in financial assumptions	49,075	(8,677)
Remeasurements arising from changes in demographic assumptions	(3,368)	(2,732)
Net benefits paid out	(9,701)	(8,933)
Closing defined benefit obligation	271,229	227,538

	2017 £'000	2016 £'000
Changes to the fair value of scheme assets		
Opening fair value of assets	213,188	208,782
Finance income	7,310	6,709
Administration expenses	(655)	(656)
Remeasurements	33,672	721
Contributions by the employer	2,711	2,702
Deficit repair payments	5,013	3,863
Net benefits paid out	(9,701)	(8,933)
Closing fair value of assets	251,538	213,188

30 Other commitments and contingent liabilities

Contingent liabilities existed at 31 March 2017 and at 31 March 2016 in respect of guarantees given by the Parent company on behalf of subsidiary undertakings, together with contingencies arising in the normal course of the Group's business in respect of overdraft facilities. None of these guarantees are considered material in the context of the net assets of the Group.

31 Related party transactions

Remuneration of key management personnel

The remuneration of the Directors who are the key management personnel of KCOM Group PLC, is provided in the audited part of the Directors' Remuneration report on pages 50 to 72 and forms part of these financial statements.

Intra-Group transactions

Amounts payable by the Company to subsidiaries totalled £0.5 million (2016: £0.5 million) as at 31 March 2017.

Glossary

Alternative Performance Measures

In response to the Guidelines on Alternative Performance Measures (APMs) issued by the European Securities and Markets Authority (ESMA), we have provided additional information on the APMs used by the Group. The Directors use the APMs listed below as they are critical to understanding the financial performance of the Group. As they are not defined by IFRS, they may not be directly comparable with other companies who use similar measures.

APM	Definition	Reconciliation to equivalent IFRS measure of performance
EBITDA before exceptional items	Operating profit before finance costs, taxation, depreciation, amortisation and exceptional items	A reconciliation of this measure is provided in Note 4 of the financial statements
Contribution	An equivalent measure to 'EBITDA before exceptional items' for each of the Group's 'go to market' segments	A reconciliation of this measure is provided in Note 4 of the financial statements
Net (debt)/funds	Net (debt)/funds is cash and cash equivalents, bank overdrafts, finance leases (current and non-current) and bank loans	A reconciliation of this measure is provided in Note 22 of the financial statements
Average revenue per user (ARPU)	This measure is specifically used when analysing the consumer performance within the Hull and East Yorkshire segment	As ARPU values are not disclosed within these financial statements a reconciliation is not deemed necessary
Cash capital expenditure	Cash outflow for the purchase of 'property, plant and equipment' and 'other intangible assets'	Reported in the consolidated cash flow: Purchase of property, plant and equipment (£28.4 million) plus Purchase of intangible assets (£15.8 million) plus Capital element of finance lease repayments (£3.0 million)
Adjusted net cash inflow from operations	Cash inflow from operations adjusted for the repayment of VAT creditor resulting from the 2016 exceptional disposal of certain network assets	Reported net cash inflow from operations (£28.6 million) plus £18.0 million VAT repayment

Five year summary of consolidated figures

as at 31 March 2017

	2017 £'000	2016 £'000	2015 £'000	2014 £'000	2013 £'000
Income statement (total operations)					
Revenue	**331,303**	349,222	347,984	370,697	372,869
EBITDA before exceptional items	**67,645**	74,937	74,304	75,291	74,862
Group operating profit before exceptional items	**40,737**	50,898	57,193	55,019	55,250
Profit after taxation before exceptional items[1]	**32,743**	30,248	47,332	38,317	37,395
Profit after taxation (reported)	**24,762**	71,134	12,544	38,770	35,845
Balance sheet					
Non-current assets	**211,285**	198,006	236,678	247,208	235,446
Current assets (excluding cash)	**71,481**	66,918	81,353	76,782	72,510
Current liabilities (excluding finance leases and overdrafts)	**(111,294)**	(132,443)	(118,754)	(130,210)	(123,592)
Net (debt)/funds (including finance leases)	**(42,433)**	7,412	(99,348)	(74,976)	(88,218)
Provisions and other non-current liabilities (excluding finance leases)	**(29,151)**	(23,626)	(36,050)	(33,651)	(13,504)
Total equity	**99,888**	116,267	63,879	85,153	82,642
Movement in debt					
Net cash flow from:					
– operating activities	**28,571**	80,373	50,779	71,266	50,309
– capital expenditure	**(44,195)**	(28,426)	(32,022)	(27,912)	(27,996)
– interest	**(1,257)**	(2,794)	(5,574)	(4,436)	(4,006)
– equity dividends paid	**(30,686)**	(28,672)	(26,057)	(23,764)	(21,387)
– other	**(2,278)**	86,279	(11,498)	(1,912)	(9,871)
(Increase)/decrease in net debt	**(49,845)**	106,760	(24,372)	13,242	(12,951)
Ratios and other key information					
Average number of employees	**1,712**	1,706	1,776	1,907	1,886
EBITDA before exceptional items to revenue (%)	**20.4**	21.5	21.4	20.3	20.0
Group operating profit before exceptional items to revenue (%)	**12.3**	14.6	16.4	14.8	14.8
Basic earnings per share (pence)	**4.85**	13.96	2.47	7.64	7.08
Dividend per share relating to the financial year (pence)	**6.00**	5.91	5.37	4.88	4.44

1. Including the tax impact of exceptional items.

Shareholder information

Analysis of ordinary shareholders

(at 31 March 2017 by category)

	Number of holders	Number of shares	% of total shares
Private shareholders	50,972	48,542,412	9.40
Investment trusts	6	112,557	0.02
Nominee companies	924	382,258,525	73.99
Limited companies	63	410,214	0.08
Bank & bank nominees	13	84,272,349	16.31
Other institutions	15	1,007,853	0.20
Total	**51,993**	**516,603,910**	**100.00**

Financial calendar

Annual General Meeting	21 July 2017
Half year results announcement (provisional)	28 November 2017
Final results announcement (provisional)	5 June 2018

Information relating to beneficial owners of shares with 'information rights'

Please note that beneficial owners of shares who have been nominated by the registered holder of those shares to receive information rights under Section 146 of the Companies Act 2006 are required to direct all communications to the registered holder of their shares rather than to the Group's registrar, Capita Asset Services, or to KCOM Group PLC directly.

Company information

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