KCOM

Creating connections that matter

KCOM Group PLC
Annual report and accounts 2015/16

We are KCOM

By listening to, and learning from, our customers, we design and deliver the right services to connect them with the things that matter.

On 4 April 2016 we brought together all our brands to create a single, integrated business, making it easier for all our customers to access the full range of our capability and expertise.

Strategic report

Directors' report

Financial statements

See also

Online review
ar16.kcomplc.com

Highlights

Revenue £m

£349.2m

+0.3%

EBITDA[1] £m

£74.9m

+0.8%

Operating profit[1] £m

£50.9m

-11.0%

Profit before tax[1] £m

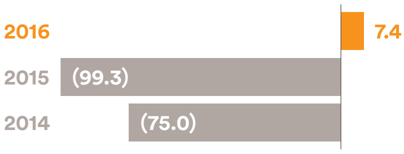
£47.9m

-7.0%

Net funds/(debt) £m

£7.4m

+107.5%



Proposed full year dividend (pence per share)

5.91p

+10.1%

1. Before exceptional items.

See also

Key performance indicators
page 20

Performance review
page 22

Operational highlights

- Progress in all key focus areas leads to year on year growth
- Important progress with our enterprise customers, increasing our services to HMRC and securing further new business including Association of Train Operating Companies (ATOC), Bupa and Shoosmiths
- Accelerated fibre deployment and strong take-up of ultrafast broadband in Hull and East Yorkshire
- Successful launch of single business under new KCOM brand
- National network asset disposal for £90.0 million, strengthening the balance sheet, supporting accelerated investment and underpinning medium-term dividend commitment

Our business at a glance

Our goal is to make life easier and better for our customers

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

In 2015/16, we reported our activities under two reporting segments:

Kcom segment

Businesses and public sector organisations across the UK

Revenue

£249.9m

KC segment

Consumers and businesses in Hull and East Yorkshire

Revenue

£104.5m

See also

Our business model
page 10

Market opportunities and trends
page 12

Our strategy
page 18

Our markets

Our customers

Enterprise

Organisations with complex needs look to us to help them integrate and leverage technology

Served by
Smart421 and Kcom

Segment
Kcom

- ARM Holdings
- Bupa
- HMRC
- National Rail Enquiries
- NFU Mutual

Business

We help businesses embrace the power of technology to become more successful

Served by
KC and Eclipse

Segments
Kcom and KC

- Arrow XL
- Foot Anstey
- Furniture Village
- Hull College Group
- RSPB

Consumer

Households across Hull and East Yorkshire can choose from our range of voice, broadband and TV services to suit their needs

Served by
KC

Segment
KC

130,000+
households in Hull and East Yorkshire

Our key partners

- Amazon Web Services
- BT Group
- Cisco
- CityFibre
- Comms-care
- Daisy
- Metaswitch
- Microsoft Azure

Chairman's statement

Continued progress

- Growth demonstrates ability to exploit market opportunities
- Strategic focus on two key market opportunities
- Continued commitment to dividend growth reflects confidence in future prospects

Dear Shareholder

KCOM has delivered another year of progress, showing year on year growth in revenue for the first time since the transformation began in 2008. While there is still plenty to do, these results demonstrate the business's ability and agility in adapting to and exploiting opportunities in an ever evolving marketplace.

Strategic focus

Over the past year, the Board has considered a number of significant decisions, reflecting the focus and determination of the leadership team, and wider business, to continue the transformation at pace.

There has been a great deal of discussion about the focus of the business going forward. It is clear that our greatest opportunity for growth is in the enterprise market, where KCOM is increasingly regarded as an innovative provider of IT and communications services. We continue to build strong relationships with our clients, and our growing reputation in the market has resulted in a number of significant customer opportunities.

Graham Holden
Non-Executive Chairman

In Hull and East Yorkshire, we have accelerated our plans to deploy fibre-based broadband services to our customers. Take-up remains well in excess of national metrics and we are exploring a number of 'over the top' services that are enabled by access to high bandwidth internet connectivity.

While we focus our time and investment on these two key market opportunities, we expect other legacy activities to continue to decline. This may well impact our ability to grow revenue and profitability in the short term, but is an important step in our journey to build a more sustainable business.

Dividend

We remain committed to delivering increasing returns to shareholders. In accordance with our previously stated dividend commitment, the Board is recommending a final dividend of 3.94 pence per share, giving a full year dividend of 5.91 pence per share, subject to shareholder approval at the Annual General Meeting in July. If accepted, this proposal will represent a sixth year of growth in full year dividends, with annual increases of at least 10 per cent.

Looking forward, while we continue our transformation, we have also committed to a full year dividend of at least 6.0 pence per share per annum over the next two financial years, a further sign of the Board's confidence in the Group's prospects.

Board changes

During the year, there have been some changes to the Board membership. Having a diverse range of experience and views is vital to robust debate and discussion and we focus a great deal of time on making sure each member of the Board has a solid understanding of the business and the markets in which it operates.

In May we announced that Paul Simpson, our Chief Financial Officer (CFO), will be leaving the Board and the business. Paul has been with KCOM for over 15 years, joining shortly after the Company's flotation on the London Stock Exchange. He became CFO and Executive Director in 2004.

Paul has made a significant contribution to the business, playing a key role in the transformation journey to date, but he feels the time is now right for him to seek other opportunities outside the business. The process is underway to appoint a successor and Paul will remain with the business until the end of September to enable a smooth transition. On behalf of the Board and personally, I would like to thank him for his significant contribution and wish him every success for the future.

> **"The progress we are demonstrating reflects the excellent efforts of our colleagues who are striving to make life easier and better for our customers."**

There are also some changes to the make-up and responsibilities of our Non-Executive Directors.

Tony Illsley, our Senior Independent Non-Executive Director, has announced his intention to retire from the Board at the close of the Annual General Meeting in July this year. Tony joined the Board in June 2009. During his time with the Company there has been a significant increase in market valuation and I would like to thank him for his contribution to the Board and the business.

In January, we welcomed Patrick De Smedt as a new Non-Executive Director. His background in, and experience of, working with both technology and publicly quoted companies will, alongside the contributions of our existing established members, further strengthen the Board. Patrick will become our Senior Independent Non-Executive Director following the Annual General Meeting.

Board effectiveness

We continually consider the effectiveness of the Board and have a formal evaluation annually, which in 2015 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. These have been incorporated into a set of Board objectives which are detailed further in the Corporate governance section.

To support our new Non-Executive appointments, we have a robust induction process tailored to their individual needs which gives them access to members of the leadership team. We believe that having time with people close to the business strategy allows them to quickly build their understanding of the business and its operations and to be able to contribute more fully to Board discussions.

We always seek 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.

Good governance and responsible business

Good governance is essential to the business and we seek to adopt best practice where it is beneficial to do so. As part of the recent rebranding to KCOM, we have identified four new ways of working which underpin the organisational values and behaviours of everyone in the business. As a Board, we are committed to demonstrating these ways of working in everything we do.

In April, we became a Charity Partner of Teenage Cancer Trust and have just completed our most successful fundraising year to date. We introduced matched funding for all employees undertaking activities in support of the charity and as a result, we have raised more than £92,000.

We remain in an environment of change and transition. The progress we are demonstrating reflects the excellent efforts of our colleagues who are striving to make life easier and better for our customers.

I would like to thank them all for their continuing contribution. I have every confidence in their ability and desire to embrace the opportunities we are creating as we continue this important transformation journey.

Graham Holden
Non-Executive Chairman
8 June 2016

CEO's statement

A transforming business

> Evolving from a network-based connectivity provider to a communications and IT services integrator

> Bringing together all our capability within a more integrated, unified business

> Ambitious plans to build our reputation in our chosen markets

Dear Shareholder

2016 has been a year of continued progress in our business transformation, with significant steps taken in evolving the business from a network-based provider of connectivity into a communications and IT services integrator.

Our efforts have been on simplifying and unifying our business, removing complexity in terms of the way we operate and, in particular, the way we position ourselves in the market.

In December, we announced the disposal of our national network assets, marking the end of our transition from being the owner and operator of physical network infrastructure outside our regional market. While connectivity remains a key element in enabling the IP-based services we provide to UK businesses, we no longer need to own the underlying network infrastructure.

As a result of this transaction, the business now carries low levels of indebtedness, giving us the ability to accelerate investment in key growth opportunities. One of those opportunities is our investment in fibre across Hull and East Yorkshire. Over the last year, we have been able to offer ultrafast broadband to another 30,000 homes and businesses in the region, and we have committed to reaching 150,000 premises by the end of 2017.

Bill Halbert
Chief Executive

This is an ambitious programme which will give us the capability to satisfy the increasing demand for high bandwidth services, both now and in the future. In the enterprise market, we will invest further in the development of IP-based services, including our Workplaces platform, and will look also for opportunities to strengthen our capability.

During the year, there has been further progress in developing our reputation for the provision of technology-enabled business transformation. We have extended our relationships with key customers including the Association of Train Operating Companies and HMRC, as well as attracting new business.

At the beginning of the new financial year, as a reflection of our move to becoming a more integrated, unified business, we rebranded our business as KCOM. This brings together the capability that sat across our five brands, and will provide customers in any of our segments with access to the full capability of the business. It is a strong platform from which we will move forward into the next phase of growth.

To unlock the capability we have, we continue to bring together teams with similar skills and experience to form skills-based communities. This not only provides greater visibility of the resources we have, allowing us to deploy resources where they can deliver most value, but also gives employees a better line of sight as to their future career development and opportunities. These communities are aligned to members of our leadership team, giving clear ownership and accountability for every aspect of our business.

Outlook

Our level of investment will increase in the year ending 31 March 2017, as we exploit the market opportunities. Over the next three to four years, in addition to our accelerated fibre deployment, we will continue to invest in our systems capability to facilitate our journey towards becoming an efficient single business. We anticipate investing also in appropriate transformation of our existing network technologies, which will see us retire legacy network platforms reducing very substantially the associated overall operating cost even after taking into account the impact of our national network disposal.

Increased investment (and the associated depreciation and amortisation impact) means that some operating metrics in the near term may be lower on a like for like basis. We expect EBITDA for the financial year 2016/17 to be slightly below £70.0 million. The Board is confident that this is the right approach to ensure that greater sustainable value is created in the medium and longer term. Our confidence in this regard is reflected in our commitment to pay a minimum 6.0 pence dividend per share in each of the next two financial years.

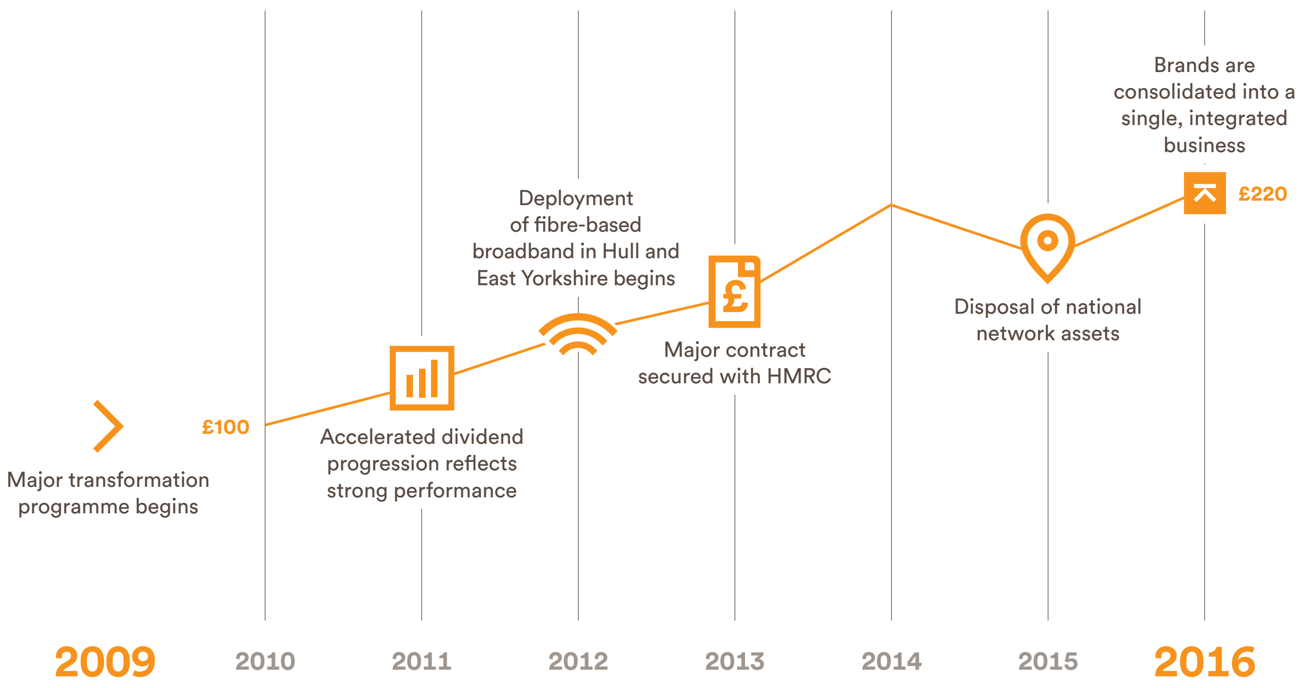
Looking ahead, we remain focused on helping our customers to interact, collaborate and connect with the things that matter to them. We have ambitious plans to build our reputation and presence in our chosen markets, which in turn will deliver increasing value to our shareholders.

Finally, I would like to thank everyone at KCOM for their commitment during another year of transformation. Their passion and energy has produced a further year of significant progress.

Bill Halbert
Chief Executive
8 June 2016

Transformation and share price progression

Value of £100 invested at 31 March 2010



Our business model

Harnessing technology

Connecting people and organisations to the things that matter

Our key relationships and inputs

Our customers

We listen to and learn from our customers to better understand their needs

Our strategic partners

We work closely with carefully selected partners to create combined service offerings

The communities we serve in Hull and East Yorkshire

We have a significant presence in Hull and East Yorkshire and retain a key focus on this market

The skills, expertise and experience of our people

Our people are one of our key differentiators in delivering value to our customers

Our technology platforms

Our continued investment in our technology platforms underpins our ability to provide integrated solutions to customers

How we generate revenue

Enterprise

Consulting, integration and managed services for the enterprise customer, focused on contact, collaboration and communication

Business

Cloud, hosted and communication-based services for businesses, packaged increasingly on a subscription or managed service basis

Consumer

Phone and broadband-based services for the Hull and East Yorkshire consumer market, to help people communicate and live their lives in a digital age

Supported by:

- Thought leadership
- Customer service operations
- Technology and innovation
- Finance
- IT
- HR
- Product and proposition development

Our key strengths

Managing complexity

We manage complexity for our customers. We take time to understand their desired outcomes and enable them to exploit technology through the integration of new and existing capability

Deploying our expertise

Our people are experts not just in communications and IT but also in the increasingly important fields of business innovation, technology change and digital transformation

Our approach to technology

We believe technology is key to creating value. Our skills in integration and design mean we can bring together multiple services to deliver tangible business outcomes

How we create value

For shareholders

- Strong funding and cash generation
- Clear dividend commitment
- Investment in future growth opportunities

For customers

- We help enterprises use collaboration and communication tools to enhance their business performance
- We help small and medium-sized businesses to operate more effectively, provide better customer service and achieve growth
- We help consumers live more connected lives

For employees

- Personal growth and development opportunities
- Flexible benefits and wellbeing initiatives

For local communities in Hull and East Yorkshire

- High quality employment opportunities
- Contribution to local economy
- Support of local business and community initiatives

Enterprise

Delivering flexibility and lower costs for National Rail Enquiries

National Rail Enquiries is the definitive source of customer information for passenger rail services but its website infrastructure was overly complex and unable to scale to meet peaks in demand. We modernised its architecture and moved multiple applications into the cloud to reduce infrastructure costs, increase flexibility and improve information for passengers.

Enterprise

Enabling digital transformation in an age of disruption

Change drivers and opportunities

Digital disruption is driving digital transformation

> The availability and adoption of digital technologies is fundamentally changing the way customers behave and how companies do business

> The need for transformation is being triggered as digital technologies and business models disrupt markets and impact the ability of enterprises to compete

> Digital transformation affects all aspects of an organisation and represents a journey to adopt and deploy new digital capabilities to improve performance

> Digital disruption is evident in most sectors of the economy, affecting not just individual enterprises, but entire industries

Three focus areas for digital transformation

Organisational agility

> The ability to quickly respond to changing market conditions, threats and opportunities is central to any successful digital transformation. Enterprises need an IT environment that enables new ways of operating, collaborating and communicating so they can become more agile, efficient and secure

Customer experience

> Today's customers expect a joined-up, more personalised and consistent experience across all channels, at their convenience. Enterprises need to offer seamless, multi-channel customer service with minimal customer effort

Insight and innovation

> Unlocking the potential of business systems and gaining insight from the data captured within them enables organisations to adopt a more agile approach to innovation

"Digital transformation affects all aspects of an organisation."

Responding to market drivers

Supporting digital transformation

We work consultatively with our customers to help them transform, drawing on our breadth of capabilities to increase their agility, improve their customer experience and drive innovation. These include:

Architecture and consultancy

> We provide architecture and technology consulting services that help our customers develop a flexible, forward looking IT roadmap aligned to their business strategy

Connected enterprise

> The convergence of networks and applications and the growth in cloud adoption is driving the need for enterprises to develop and modernise their current IT systems and infrastructure. Our experience of developing and managing intelligent networks enables our customers to better connect internally, with partners and with their customers

Cloud adoption

> We can help customers assess the full potential of the cloud for their organisation, migrate workloads to the cloud and develop and manage new cloud services that scale and adapt to their needs

Customer contact

> We design, deliver and manage flexible and scalable multi-channel customer contact solutions that meet the demands of today's empowered consumers and help make customer experience a differentiator

Collaboration

> Effective collaboration is one of the keys to transforming business processes and encouraging new ideas and innovation. We provide tools for enterprises that enable real time collaboration between communities both within and outside their organisations

Data and voice analytics

> We help our customers turn data into actionable insight that enables rapid innovation, helps protect against fraudulent activity and delivers a more personalised customer service

Identity and access management

> We provide smart and agile identity and access management to help enterprises maintain organisational integrity, compliance and customer privacy in a digital age

Business

Keeping RNLI lifeboat stations connected

The Royal National Lifeboat Institution (RNLI) is the charity that saves lives at sea, with its volunteers providing a 24-hour search and rescue service in the United Kingdom and Republic of Ireland. A wide area network from KCOM connects the RNLI's 237 lifeboat stations, helping the charity to spread the word about its lifesaving work.

Image: Nigel Millard

Business

Supporting businesses on their technology journey

Change drivers and opportunities

Connectivity is still key for businesses

- We are still seeing businesses investing in improved connectivity, whether in the form of faster broadband speeds, dedicated connections and wide area networks

Cloud adoption continues

- Many businesses have started transitioning to cloud services to reap the benefits of scalability and reduced infrastructure costs
- Some of the most popular cloud-based applications for businesses include hosted voice services, business-class email and instant collaboration tools
- When looking at new technology solutions businesses are increasingly looking at how they integrate with existing applications. Purchasing applications from the same software supplier is a simple route to affordable integration

A competitive market

- The business market is served by a range of suppliers, including volume-focused online providers of cloud applications, IT resellers and regional IT services firms

Technology drivers for businesses vary

- The importance of IT within businesses depends on their size, sector and stage of growth and their priorities and purchasing habits vary accordingly

> "The importance of IT within businesses depends on their size, sector and stage of growth."

Responding to market drivers

Focusing on businesses where IT is an enabler

- Our skills in integrating communications and IT services can add greatest value in larger businesses where technology is more likely to be valued as an enabler of growth, innovation or improved customer service
- We will focus our efforts on mid-market businesses who choose to work with us due to our expertise in providing managed network services but whose needs are likely to extend to a wider range of business applications that we can also provide and support
- Characteristics of target customers in this segment include large numbers of connected employees, multiple sites, and a growing or transforming business where IT is becoming business critical

Serving smaller businesses indirectly

- In recent years we have established a network of partners who resell our services to their own customers. This is a more cost-effective way of serving smaller businesses and as we increase our focus on our Enterprise and Hull and East Yorkshire markets we will favour this approach

Consumer

No arguing over who's using the internet

When the Wilkinson family heard KCOM's superfast broadband was available in their area they jumped at the chance to have it installed. It means the whole family can be online at the same time with no issues - and no arguing over who's using the internet.

Consumer

Meeting the needs of the connected consumer

Change drivers and opportunities

Consumers are spending more time online, using more devices

- The average internet user spends almost three hours a day online, twice as much as 10 years ago[1]
- The average household in the UK owns four different types of internet-enabled device[2]

Rapid growth of data usage continues

- The proportion of internet users who regularly watch TV and video on the internet continues to grow (27 per cent, up from 10 per cent in 2007[2]), with data usage increasing accordingly
- The average KCOM consumer broadband customer downloaded 24 per cent more data in 2015/16 than in 2014/15. Video downloads have more than doubled in the same period
- Consumers using our Lightstream fibre broadband service download 65 per cent more data than those using non-fibre connections

Growth in wireless connections is reducing in-home speeds

- 95 per cent of UK households with broadband connect wirelessly to the internet[2], reducing broadband speeds and increasing interference

Fixed line broadband take-up is slowing

- More than three-quarters of offline homes do not intend to take up the internet. Almost half of consumers without home broadband think they don't need it[2]

1. Media Use and Attitudes, Ofcom, 2015.
2. The Communications Market Report, Ofcom, 2015.

"Video downloads among consumer customers have more than doubled in the last year."

Responding to market drivers

Further acceleration of our fibre deployment

- We are increasing the rate at which we deploy superfast fibre broadband across our Hull and East Yorkshire network
- By December 2017 superfast broadband will be available to 150,000 premises, up from 78,000 at the end of March 2016
- Our deployment of fibre to the premises, which delivers much faster speeds than are available through other technologies, will allow us to meet the needs of our customers both today and well into the future

Development of over the top TV service

- We are developing a low cost TV package to increase the value we can offer consumers beyond broadband and voice services

Improving in-home broadband performance

- We are working to educate consumers about the in-home factors affecting broadband performance and what customers can do to get the best speeds possible
- When attending customers' homes to install services and repair faults we are carrying out additional work that improves speeds, such as replacing network equipment and repositioning routers

Broadband proposition development

- Having grown our broadband customer base significantly in recent years through the introduction of new entry-level services, we are shifting our proposition development focus to services that support customer retention

Superfast fibre broadband is available to

78,000

premises in Hull and East Yorkshire as at March 2016

It will have been deployed to

150,000

premises by December 2017

Driving operational excellence

Our vision 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 on the value we deliver.

Priorities for 2015/16

We aimed to:

> accelerate our deployment of fibre-based broadband in accordance with our stated aim of passing a further 60,000 properties over the two years from April 2015 to March 2017;

> increase take-up rates of fibre-based broadband;

> deliver growth in the provision of complex communications solutions to the enterprise market; and

> grow our share of the small and medium-sized business market.

Progress for 2015/16

We have:

> remained on target to achieve our aim of making our fibre-based broadband service available to more than 100,000 premises in Hull and East Yorkshire by March 2017;

> increased take-up rates of fibre-based broadband to more than 40 per cent of premises passed;

> secured new contracts for the delivery of complex solutions to enterprises including Bupa, ATOC and Shoosmiths (preferred supplier) and increased the value of existing contracts with key enterprise customers including HMRC; and

> secured new contracts with mid-market business customers including RNLI.

Priorities for 2016/17

We will:

> 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.

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 2015/16

We aimed to:

> simplify our business to create a single, agile operating model where our people can be deployed flexibly and efficiently for the benefit of our customers.

Progress for 2015/16

We have:

> brought together all of our people within an integrated business;

> established a single leadership team; and

> continued our approach of developing business-wide professional communities, with the creation of two new communities responsible for the key areas of product development and technology innovation and marketing.

Priorities for 2016/17

We will:

> align and 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 talent development strategy; and

> develop clear career paths underpinned by a defined set of roles and competencies.

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 2015/16

We aimed to:

- exploit the scale and innovation offered by our strategic partnerships to deliver market-leading services to customers in our target markets.

Progress for 2015/16

We have:

- continued to grow our cloud-based solutions for enterprises, integrating services from many partners with our core capabilities to deliver further innovative solutions for customers such as ATOC and HMRC;
- worked with partners to begin to simplify and transform our own network and platforms; and
- continued our approach of using partnerships for non-core activities by divesting of our national network assets to CityFibre.

Priorities for 2016/17

We will:

- seek to expand our eco-system of technology partners that improve our speed to market and extend the reach of our propositions or 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 eco-system of partners.

Processes and systems

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

Priorities for 2015/16

We aimed to:

- optimise more of our back-office systems to support a simplified operating model;
- enhance the capability of our e-commerce platform to generate further online sales and encourage self-service; and
- improve cross-business collaboration through the introduction of new technology platforms.

Progress for 2015/16

We have:

- developed our e-commerce platform so that customers in our Hull and East Yorkshire market can manage all aspects of their accounts online;
- introduced an online service that makes it easier for our customers in Hull and East Yorkshire to obtain support whenever they need it;
- introduced an internal social media platform that has encouraged cross-business information sharing and collaboration; and
- introduced a business-wide application that improves management and reporting of commercial projects.

Priorities for 2016/17

We will:

- 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.

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 £m

£349.2m

+0.3%

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

EBITDA[1] £m

£74.9m

+0.8%

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

Comment

Progress in all key focus areas delivers year on year growth.

Profit before tax[1] £m

£47.9m

-7.0%

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

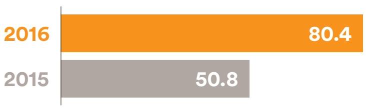
Comment

Reduction reflects increased depreciation and amortisation charge as a result of continued investment, including the acceleration of our fibre deployment.

Net cash inflow from operations £m

£80.4m

+58.3%



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

Comment

Reflects timing of VAT payment in connection with our national network assets sale and a reduction in days' sales outstanding.

Net funds/(debt) £m

£7.4m

+107.5%

A metric that shows the Group's indebtedness.

Comment

Strong position as a result of national network assets disposal.

1. Before exceptional items.

Non-financial

Impact of health and safety incidents

11

-68.6%

2016	11
2015	35

Number of days lost due to health and safety incidents.

Comment

We focus on continuous education and implementation of improved ways of working that keep health and safety incidents to a minimum.

Availability of fibre-based broadband

78,000

+73.3%

2016	78,000
2015	45,000

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

Comment

In 2016 we doubled the rate of our fire deployment to make superfast broadband available to a further 30,000 properties.

Employee engagement score

75

2016	75
2015	N/A

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

Comment

Regular employee engagement surveys were introduced in October 2015.

Employee volunteering

1,507

-4.0%

2016	1,507
2015	1,570

Number of employee hours we have donated to community projects.

Comment

In 2016, schools, charities and community groups across Hull and East Yorkshire have benefited from our employees' time and skills.

Link to strategy

Customers

People

Partners

Processes and systems

See also

Performance review
page 22

Corporate responsibility
page 28

Performance review

Progress across all areas

- Progress in all key focus areas leads to year on year growth
- Pre-exceptional EBITDA ahead of prior year at £74.9 million
- Adjusted basic EPS down 4.7 per cent to 7.54 pence (2015: 7.91 pence)
- Proposed final dividend of 3.94 pence (2015: 3.58 pence)
- Strong year end net funds position of £7.4 million, reflecting network sale proceeds and increase in net cash inflow from operations

See also

Key performance indicators
page 20

Review of the year

KCOM's transformation continued during the year, characterised by:

- the move towards a single KCOM brand, with different areas of the business working together to deliver greater value for our customers;
- growth in revenue and EBITDA;
- simplification, including consolidating activities where we can achieve efficiencies and cost savings, facilitated by continuing investment in IT systems; and
- the sale of our national network for £90.0 million, achieving a profit of £44.5 million and strengthening our balance sheet position.

Segmental analysis

Reflecting the move to a single business, our reporting segments will change for the current financial year as we move away from reporting the three historical brand-centric segments. As a single, integrated business, we will report the revenue and contribution generated from the Enterprise, Hull and East Yorkshire and SMB National segments with the unallocated shared services costs deducted, to show the overall KCOM EBITDA.

Paul Simpson
Chief Financial Officer

Key features of the year include:

The success of fibre deployment across Hull and East Yorkshire:

- accelerated deployment: at 31 March 2016, approximately 78,000 premises had been reached. We expect to pass approximately 150,000 premises by December 2017, representing more than three quarters of our network;
- high level of fibre take-up: 26,000 premises connected by March 2016. Strong business take-up was stimulated by the government's Superfast Britain initiative; and
- consumer demand and success in upselling: an increase in average revenue per user (ARPU) of 2 per cent.

The convergence of IT and cloud communications services for our enterprise customers:

- continuing to build on our cloud-based contact centre capability: a successful ongoing relationship with HMRC and recent similar contract wins with Bupa and Shoosmiths (preferred supplier);
- strong progress in our consultancy and project delivery capability: recent contract wins with ATOC which, together with the current Live Sales Management Service, allows us to deliver significant innovations to the rail industry; and
- extension of services provided to Staffordshire Council's Public Services Network and the NHS Business Services Authority for voice biometrics.

A focus on core capabilities and cost control:

- the continued convergence of our teams and capabilities to support a single KCOM brand, reduce cost and increase efficiency;
- a managed decline in non-core revenue streams, including:
  - the refocusing of technology partners and consequent non-renewal of related contracts;
  - the exit of certain legacy contracts, including BA, Ford and wholesale broadband customers;
  - certain products and services across our national SMB customers; and
- an anticipated decline in contact centre and publishing services within Hull and East Yorkshire.

Exceptional items

The net exceptional credit is £40.9 million (see Note 7). Significant items include:

- £44.5 million profit relating to the disposal of our national network to CityFibre;
- £2.8 million profit relating to regulatory settlements; offset by
- £4.1 million restructuring costs relating to rebranding, cost reduction, strategic IT investment and the move towards a single KCOM brand; and
- a £2.3 million increase in onerous lease provision.

Net funds and cash flow

The disposal of our national network strengthens our balance sheet significantly and our year end net funds are £7.4 million (2015: £99.3 million net debt). This includes an £18.0 million benefit relating to the timing of the associated VAT payment to HMRC. The Group recorded a working capital inflow during the year due to strong cash collection, reducing our days' sales outstanding to 32 days (2015: 38 days).

Dividend

The Board is proposing a final dividend of 3.94 pence per share (2015: 3.58 pence), representing a total dividend for the year of 5.91 pence per share (2015: 5.37 pence), a 10 per cent year on year growth in the total dividend, consistent with the Board's previously stated commitment. The Board reconfirms a dividend of no less than 6.0 pence per annum for each of the next two financial years.

Subject to shareholder approval at the KCOM Group PLC Annual General Meeting on 22 July 2016, the final dividend will be paid on 2 August 2016 to shareholders registered on 24 June 2016. The ex-dividend date is 23 June 2016.

Pensions

The year end IAS 19 pension liability is £14.4 million (2015: £31.4 million). The year on year decrease arises as a result of a £12.7 million decrease in liabilities, principally due to a 0.2 percentage point increase in the discount rate and a £4.4 million increase on assets due to Company contributions and higher investment returns.

The agreed level of deficit repair payment (across both schemes) for the year ending 31 March 2017 is £6.7 million (2016: £2.0 million).

Capital investment

The Group's investment during the year is consistent with previous guidance. Cash capital expenditure during the year was £31.3 million (2015: £33.4 million). Specific projects include the continued deployment of fibre, investments in our IT infrastructure and targeted customer-specific investment. Capital expenditure in the year to 31 March 2017 will be at least £40.0 million, which will have an ongoing impact on profit before tax.

The Group's depreciation and amortisation charge for the year is £24.0 million (2015: £17.1 million), with the increase representing higher investment in recent years.

Tax

The Group's tax charge is £17.6 million (2015: £4.1 million), with the year on year increase reflecting the impact of our national network disposal. The current year effective tax rate is 20.4 per cent, broadly in line with the prevailing rate of corporation tax. The overall effective tax rate is 19.8 per cent, reflecting the impact of prior year items.

Paul Simpson
Chief Financial Officer
8 June 2016

Our approach to taking risks

Balancing risk and reward

See also
Risk management framework
page 40

See also
Longer-term viability
page 27

See also
Risk appetite
below

We believe that in order to achieve the right level of reward it is necessary for us to take some risks, but the risks we take need to be managed appropriately, aligned to our risk appetite and must not have an adverse impact on our longer-term viability.

There has been a significant amount of time spent this year on reviewing the risks, clarifying our risk appetite and reviewing the longer-term viability of the business to make sure that we fully understand our risks and are managing them appropriately. The Board has also spent considerable time reviewing the assurance that is needed in relation to each of these three areas to ensure that it can meet its obligations in the statements it makes around our risk management and our future.

As a result of this work, 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.

Risk appetite

Our risk appetite has been a key focus area for the Board during the year and a risk appetite statement has been produced internally which 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 output from the risk appetite work shows 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 take. We also are risk averse in our approach to our reputation and will not knowingly take risks which may negatively impact upon our reputation.

Risk management

Our principal risks and uncertainties

As with all businesses, we are affected by a number of risks and uncertainties. The table opposite 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.

Further information on risk management and our internal control systems can be found on page 40.

See also
Corporate governance
page 36

Risks reported for the first time this year

Maintaining revenue in our enterprise segment while network-based revenue declines

Why is it important?

As technology develops and methods of communication continue to evolve, our business is moving away from delivering network-based services to more complex communication solutions and cloud-based services. There is a risk, during the period of transition from old to new technologies, that revenue from legacy activities may decline faster than revenue from new services grows.

What are we doing to mitigate the risk?

We are very clear about our strategy and focus and we believe we are uniquely positioned in the market to provide our customers with new and more efficient ways of communicating which will in turn lead to significant growth in the enterprise segment, to offset the decline of the legacy revenue.

Change in level of risk

Whilst the sector continues to evolve rapidly, the risk to KCOM specifically remains unchanged due to the mitigations we have in place.

How does this link to our strategy?

It is our strategic decision to move away from the declining network-based services which means we are now able to focus on developing propositions based on new 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 look continually to improve the services that we are providing to our consumers and to provide a speed and quality of service that would not be achievable over a wireless network. We also provide bundles of products and services that offer our consumers value for money and which would provide a clear alternative to substitute technologies, should one enter the market.

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.

Upgrading of our network equipment

Why is it important?

The equipment used to run our network in Hull and East Yorkshire, and to provide some of our national network-based services, requires upgrading as demand for broadband and cloud-based services continues to increase extremely quickly.

What are we doing to mitigate the risk?

We have clear plans to invest in the network to mitigate the risk of service failure from obsolete equipment. At the same time we continue to deploy our superfast fibre-based broadband in Hull and East Yorkshire which provides market-leading broadband speeds and will 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 has not increased.

How does this link to our strategy?

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

Key: Customers People Partners Processes and systems

Our approach to taking risks continued

Risks also reported in the prior year

Accuracy, security and confidentiality of customer data

Why is it important?

It is extremely important to us, and to our customers, that customer data is kept secure and confidential, as well as accurate. The risks relating to data remain high as a result of the volume of external attacks seen across all industries.

What are we doing to mitigate the risk?

We have clear and comprehensive policies in place and have run an online awareness programme, mandatory for all employees, to ensure awareness and understanding. We have a virtual team focused on data governance which reviews the accuracy of data and oversees data cleansing activities and controls around data to reduce the risk of inaccuracy. We also have forums in place to enable sharing of best practise across the business.

Change in level of risk

The level of risk remains the same.

How does this link to our strategy?

Ensuring accurate and secure data forms part of our customer service commitment and 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?

We are aware that customer service in Hull and East Yorkshire has suffered during the year in relation to call waiting times and we are specifically working to address this through implementing new technology in our call centres, retraining our people and reviewing and revising our processes to ensure the optimal experience whenever customers contact us.

Change in level of risk

The risk has increased during the year due to the customer service issues being experienced in Hull and East Yorkshire and we now have a clear plan being implemented to address this.

How does this link to our strategy?

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

Security and resilience of our networks and IT systems

Why is it important?

Much reliance is placed on the networks and IT systems we use, both within our business and in the services we provide 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?

This year we have appointed a Head of Cyber Risk to focus specifically on IT and network security and resilience and to ensure there is consistent oversight of the work we are doing in this area across the business. We continue to hold the ISO 27001 Information Security Management standard and various other security-related standards that are required by our customers, as well as the ISO 22301 Business Continuity standard.

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.

Key: Customers People Partners Processes and systems

Previous principal risks

Recruitment and retention of the right people
Last year we reported one of our key risks as being the recruitment and retention of the right people. Whilst this is still a risk, we believe this is simply a risk of doing business and therefore not something that requires reporting as a principal risk specific to KCOM. We continue to mitigate this risk as far as possible through the creation of a workplace and reward structure that both attracts and retains people with the right skills and behaviours to move our business forward. We are also seeking to be more proactive in anticipating future skills requirements and investing accordingly to ensure we have the right skills in place at the right time to best address the needs of our customers.

Reliance on key partners and suppliers
We also reported last year that one of our key risks was around our reliance on key partners and suppliers. We continue to be reliant on a number of partners and we are working closely with each of them to ensure that together we provide a service that makes life easier and better for our customers. Whilst the reliance on our partners and suppliers continues to be a risk, it is another risk that we believe is simply part of the risk of doing business and therefore does not require reporting as a principal risk.

Longer-term viability

The longer-term viability of the Group has always been considered by the Board through the detailed annual review of a long-term financial plan. For the purposes of complying with provision C2.2 of the UK Corporate Governance Code, the Board has done this again this year, along with considering other factors, to assess in detail the viability of KCOM over the three year period to March 2019.

Three years is believed to be the appropriate period for the assessment for a number of reasons:

> the KCOM financial plan has always looked at a period longer than three years, but there is always greater certainty in relation to the assumptions made over the first three years. The financial plan is used as the basis for decisions in relation to dividend policy, strategy and capital expenditure, again with the focus primarily on the first three years, with our dividend commitments covering a two or three year period which reflects the confidence with which we are able to forecast financial performance over this period;

> our major capital expenditure projects; such as the deployment of superfast fibre-based broadband and our continued implementation of SAP, have defined three year plans so we can have certainty around the impact that these will have over the next three years; and

> there has been a significant amount of focus on the strategy of the business over the three years to March 2019, with a clear three year strategy being set for the business as a whole and for each segment or business area, including annual milestones and a well-defined year end position for each of the next three years.

In assessing the viability of the Group, the Board has taken into account the following factors:

> the principal risks affecting the business, in particular the transformation of the business from a network-based service organisation to one focused on complex communication solutions and cloud-based services and the impact that this may have on the financial performance of the business, as well as the potential impact of new technologies on our industry and the need for investment to be able to meet evolving customer demands as a result of changes and advances in technology. Each risk is considered by looking at the probability and impact of the risk and the controls in place to reduce these to bring the risk down to an acceptable level. Assurance is then sought in relation to these controls to provide comfort to the Board in relation to the robustness of the risk management in place;

> the financial plan for the business, which reflects the planned strategy and investments for the next three years. This includes analysing planned revenue into 'known', 'expected' and 'prospective' segments to assess the certainty around the forecast figures. The plan has been challenged and tested through sensitivity analysis which takes severe but plausible scenarios and applies these to the plan to assess the impact, both individually and together. This includes the impact of principal risks such as significant loss of market share in Hull and East Yorkshire, loss of large customer contracts and the potential impact of a significant security breach. A review has also been performed of historical performance in comparison to previous plans to provide additional assurance to the Board around the accuracy of the planning mechanisms in place; and

> the current position of the business financially and operationally and the capital expenditure to which the business is currently committed. This includes net funds of £7.4 million and net cash inflow from operations in the year of £80.4 million.

In making its assessment the Board has made an assumption around the continued availability of funding.

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 of their assessment.

Corporate responsibility

Our aim is to operate in a way that has a positive effect on our stakeholders and society at large

Our decisions are based on our wider business responsibility to ensure our future sustainability

There are three key objectives that underpin our corporate responsibility (CR) strategy:

> to use our expertise in communications technology to create a positive impact on all our stakeholders and the communities in which we operate;

> to promote our values, both internally and in the way we do business with external stakeholders; and

> to engage and empower our people so they can make a positive contribution to our CR strategy and the causes that matter to them.

Our areas of focus for CR

Our CR strategy covers four main areas that are taken into account when making key business decisions: our people, our customers and suppliers, the communities in which we operate and the environment.

The Board receives reports on each of these as appropriate. Responsibility for the overall CR strategy sits with our Chief Executive, Bill Halbert.

Our people
Our people are one of our key differentiators. For our business to be sustainable we need to attract people with the right skills and behaviours, and motivate and provide opportunities for growth and development to all of our people.

Our 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.

The communities in which we operate
We take seriously our responsibility to operate in a manner that benefits local communities as well as our strategic aims as a business. We have a significant presence in Hull and East Yorkshire and make business decisions with the potential impact on that community very much in mind.

The environment
We believe that all businesses have a responsibility to minimise any negative impact they have on the environment and we make decisions with environmental sustainability in mind.

CR and our business strategy

Our CR strategy and initiatives are fully integrated and aligned with the key pillars of our business strategy and CR considerations are built into all strategic decisions across the business.

Community

Supporting the communities we serve

Our business was established in Hull and we continue to have a significant presence in the region. We serve more than 140,000 households and businesses in Hull and East Yorkshire and employ 886 people at our Hull offices, representing 52 per cent of our business.

We make business decisions with the potential effects on the local community in mind and this is reflected in our economic contribution to the region, the products and services we offer and the focus of our community relations programme. We have no material social issues.

Economic impact

Our operations have a substantial impact on the region's economy, estimated at approximately 1,600 FTE (Full Time Equivalent) jobs in Hull and East Yorkshire with a total value of over £180 million in 2014/15[1]. This comprises KCOM's Hull-based employees and the additional jobs supported through our local supply chain of more than 150 businesses based in the region and the effects of their operations on other local businesses.

Our support of the region's economy extends to our active membership of the Humber Bondholders organisation, which promotes the region on the national and international stage as a destination for inward investment. We are a patron of the Hull and Humber Chamber of Commerce, and a key partner of For Entrepreneurs Only, a community interest company that helps local entrepreneurs create jobs and wealth.

We are playing also an important role in the development of the region's digital economy through our ongoing deployment of fibre-based broadband, which is giving Hull and East Yorkshire businesses the fastest connectivity available in the UK. Ultrafast speeds, including one gigabit per second, are helping more than 3,500 businesses in the region to become more productive and make better use of cloud services.

1. Cushman Wakeman, 2016.

"During the year we engaged with local primary schools, secondary schools and colleges to help raise pupil aspirations and support the development of employability skills."

Supporting young people to fulfil their potential

The region's young people are our customers and employees of the future and we believe we have a part to play in supporting them to fulfil their potential and helping them to become work ready. During the year we engaged with 36 local primary schools, secondary schools and colleges to help raise pupil aspirations and support the development of employability skills.

As a technology provider we have a clear interest in encouraging young people to consider careers in science, technology, engineering and maths (STEM). To achieve this we attend regional STEM-focused educational events and deliver regular interactive sessions in schools about how the internet works.

We are also an employer sponsor of the Ron Dearing University Technical College (UTC), which will open in Hull in September 2017. UTCs focus on technical skills for students aged 14-18 and the Ron Dearing UTC will create a centre of excellence specialising in digital technology and mechatronics. Our sponsorship involves the provision of high-quality work placements and mentoring for students. A member of our Executive Leadership Team is on the board of the college.

Employee volunteering

Our people are keen to support our community activities by participating in the delivery of 'Get Online' drop-in sessions and educational activities at local schools, and by taking part in food, toiletry and clothing collections for charities. In total, our people donated 1,507 hours to community volunteering during the year to 31 March 2016.

Charity and community partnerships

For the last 10 years we have focused employee fundraising around a charity partnership. Our people choose a charity partner from a shortlist of UK-registered national charities and we work with that partner for three years. In April 2015 we began a new partnership with Teenage Cancer Trust, which creates world-class cancer services for young people in the UK and provides them with life-changing care and support. At the same time we introduced matched funding so that for every £1 raised by our people through sporting challenges, raffles, cake bakes or other activities, the business contributes a further £1. During the first year of our partnership with Teenage Cancer Trust we donated over £92,000 to the charity.

We have continued this year in our patronage of The Prince's Trust, the UK's leading youth charity which this year celebrates its 40th anniversary. The Trust aims to change lives by offering training, personal development, business start-up support, mentoring and advice to young people.

In April 2016 we became the Principal Communications Partner of Hull UK City of Culture 2017, which is expected to deliver economic, cultural and social benefits to the region during 2017 and beyond. The partnership reinforces our position as leaders in digital communications and our support for the 2017 programme will include the provision of free Wi-Fi for several outdoor events, each attended by up to 20,000 people.

Corporate responsibility continued

People

Attracting and retaining the right people

Our people are one of our key differentiators and much of the value we deliver to customers is as a result of their expertise and experience. For that reason, we place great importance on attracting talented individuals to join our business and on motivating, developing and recognising the contribution of those who are already part of our team.

Our people have access to learning and development opportunities throughout their employment with us. New employees are encouraged to take part in an induction programme that welcomes them to the business, supports them to build a network and introduces the shared ways of working that we believe are the foundation of our success.

Our competency framework, which sets out the required skills and behaviours for every role, is embedded within our performance management process and used to identify learning and development and career progression opportunities. Self-directed learning and development activities can be accessed at any time through an online portal.

During the year, we introduced a leadership development programme aimed at new people managers and individuals who have been identified as potential leaders of the future. 39 people took part in the programme in its first year.

Health, safety and wellbeing

We continue to place the utmost importance on the health, safety and wellbeing of our people, contractors, partners, customers and any members of the public who may be affected by our work.

We have thorough training in place for all our people engaged in manual work and clear Safe Systems of Work that must be followed at all times. We follow clear processes to ensure that partners engaged in manual work on our behalf are competent and operate in a healthy and safe manner. We require all of our suppliers of physical services to hold accreditation to a member scheme of Safety Schemes in Procurement (SSIP) and we will work with those without this to assist them in reaching the required level of competence.

We perform risk assessments and provide additional driver training for those people who are required to drive on company business that we deem to be at a higher risk.

"We place great importance on motivating, developing and recognising the contribution of our people."

We have been accredited to the BS OHSAS 18001 Health and Safety Management standard since 2011 and there were no fatalities or Health and Safety Enforcement Notices in the year. We experienced two Reporting of Injuries, Diseases and Dangerous Occurrences Regulations (RIDDOR) incidents (2015: two). There were 11 working days lost in the year as a result of two health and safety incidents (2015: 35 working days). Health and safety incidents are closely monitored by the Health and Safety team to ensure that any appropriate actions arising as a result are identified and then fully implemented.

Education is a key part of our approach to wellbeing. Our 'Live Well, Work Well' programme provides self-help tools and ideas to our people to support their mental and physical wellbeing. Each year we hold health and wellbeing screening sessions, provided by an independent third party, that are open to all employees and contractors. 524 of our colleagues attended these sessions in the year, representing approximately 30 per cent of the workforce. Employees can purchase other medical and dental services through our flexible benefits scheme.

Employee engagement

During the year we established an employee forum through which we communicate and consult with employee representatives from across the business on proposed organisational changes. We have established also a regular survey that measures employee engagement, particularly in relation to our transformation programme, and a 'change network' of approximately 40 employees across the business. The broad role of the network is to support and increase engagement in our transformation activities and to encourage the adoption of new ways of working aligned with our single, integrated business.

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	6	1	14%
Executive Leadership Team[1]	4	3	43%
Other employees	1,118	592	35%

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

We are supportive of flexible working wherever possible and 13 per cent of our workforce works flexible hours, including 33 per cent of our female employees.

Human rights

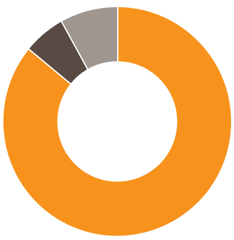
We respect fundamental human rights consistent with the United Nations Universal Declaration of Human Rights and we ensure that all of our internal policies are consistent with this. We do not have any current human rights issues.

Environment

Our main environmental impact continues to arise from our use of electricity, which makes up 86.0 per cent of our CO_2e emissions. This includes all our premises, such as offices, data centres and our various network sites both nationally and in the Hull and East Yorkshire region.

We continue to seek to reduce our emissions wherever possible and have recycling facilities at all of our main offices and a network of Green Champions across the business who help to raise awareness of environmental matters and new environmental initiatives throughout the year. This year 94 per cent of our waste has been recycled which has remained consistent with the prior year, with the actual tonnage of waste that has gone to landfill falling from 20.2 tonnes in 2014/15 to 17.4 tonnes in 2015/16.

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 2016 CO_2e	Year ended 31 March 2015 CO_2e
Combustion of fuel and operation of facilities	**2,719**	3,110
Purchase of electricity	**16,759**	18,953
Total	**19,478**	22,063
Tonnes of CO_2e per £'000 of revenue	**0.056**	0.063

During the year the CO_2e created from the combustion of fuel and operation of facilities has fallen by 12.6 per cent. This is mainly due to lower usage of refrigerant gases in the year. Usage was higher in the prior year due to the replacement of R22 gas in a number of our air conditioning systems. CO_2e created from our business travel has decreased slightly in the year by 4.3 per cent, in line with the reduction in employee numbers, and we continue to encourage our employees to travel only when necessary, although we acknowledge that some travel is essential in order to do business.

The CO_2e from electricity purchased has decreased by 11.6 per cent in the year, reflecting our efforts to reduce emissions and save costs through the rationalisation of network sites, the closure of some of our smaller offices, plus a number of energy efficiency projects such as new LED lighting schemes and DC power plant.

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. The method of calculation uses the UK Government conversion factors for company reporting.

Flooding risk

The risk of flooding in many parts of the country remains high and we continue to review the risk across our sites. Over the last few years we have installed powerful water pumps and flood alarms at the sites we have identified as having a potential flood risk, as well as installing flood barriers to basement doors and replacing air bricks at selected sites. During the year none of our buildings or equipment have been affected by flooding but we continue to monitor the risk and regularly practice our business continuity procedures to ensure we are prepared should an incident occur.

Environmental measures

Area	Actual	Target 2015/16	Target met?	**Target 2016/17**
Total CO_2e emissions	19,478 tonnes	To return to 2013/14 levels of 21,306 tonnes	Yes	**Not to exceed 2015/16 levels of 19,478 tonnes**
Waste sent to landfill	17.4 tonnes	Not to exceed 2014/15 levels of 20.2 tonnes	Yes	**Not to exceed 2015/16 levels of 17.4 tonnes**

"We continue to seek to reduce our emissions wherever possible."

Customers and suppliers

Our relationships with our suppliers

We believe that we have responsibilities in relation to our suppliers, to treat them fairly and to do business with them in the right way.

We also have a responsibility to make sure that our suppliers operate with the same ethics and standards as us. All of our suppliers are expected to sign up to our Supplier and Partner Code of Conduct; this sets out our expectations in relation to laws and ethical standards, labour practices, risk management and business continuity. We have regular meetings with our key suppliers and work closely with them to ensure that we understand the way in which their business operates and their approach to sustainability and corporate responsibility.

During the year we have updated our Supplier and Partner Code of Conduct to reflect the requirements of the Modern Slavery Act and we are also in the process of reviewing all of our partners and suppliers and assessing the risk of slavery in relation to each so that we can satisfy ourselves as far as reasonably possible that we do not have slavery present in our supply chain.

Our relationships with our customers

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

We continue to take online safety extremely seriously and in October 2014 launched free parental controls on our broadband service. We apply these controls automatically for all new customers, with customers able to opt out if they wish to.

As the region's main internet service provider, we believe we have a role to play in educating and raising awareness amongst primary school children across the Hull and East Yorkshire region of the importance of staying safe online. We deliver this through talks from our cyber security experts and also through the funding of a play performed in local primary schools by a local theatre group which addresses the topics of cyber bullying and online grooming.

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

Tackling digital exclusion

Being online brings many benefits including better access to government services, increased job opportunities, the ability to buy goods and services at lower prices and reduced social isolation. However, many people lack the equipment, skills and confidence to use the internet. We are helping to tackle the problem of digital exclusion in a number of ways:

> we have continued to offer low cost PCs and entry-level internet packages aimed at customers who are not online at home;

> we have established a UK Online Centre, accredited by the Tinder Foundation, a national charity that supports digitally excluded people to get online. We supported the charity's national 'Be Online 2016' campaign through 18 educational events held across the region, at our Online Centre and in partnership with local housing associations and the local authority in Hull. We have also introduced regular 'Get Online' drop-in sessions at our Online Centre. They are staffed by employee volunteers who help attendees improve their digital skills and provide support in getting online; and

> we are working with the local authority in Hull on a pilot project to increase digital inclusion in an area of the city where internet take-up is low by providing free access in the home and online support at a local community centre.

Signed on behalf of the Board

Kathy Smith
Company Secretary
8 June 2016

Directors' report

Board of Directors

Graham Holden (56)
Non-Executive Chairman

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

Previous experience
Graham is a Chartered Accountant and graduate of the Harvard Advanced Management Programme. He was Chief Executive of Marshalls plc from 2001 until his retirement in October 2013, having previously been the Group Financial Director from 1992 to 2001.

Board Committees
Graham is the Chairman of the Nomination Committee and a member of the Remuneration Committee.

External appointments
Graham is a Visiting Fellow in the School of Management at Cranfield University.

Liz Barber (50)
Non-Executive Director

Liz joined the Board in April 2015.

Liz is a Fellow of the Institute of Chartered Accountants, qualifying with Ernst & Young in 1991 and being promoted to Partner in 2001. She was then Head of Audit for the North of England from 2006 to 2010, when she joined Kelda Group as Group Director of Finance, Regulation and Markets.

Liz is the Chairman of the Audit Committee and a member of the Remuneration and Nomination Committees.

Liz works full time as the Group Director of Finance, Regulation and Markets for Kelda Group. She 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.

Patrick De Smedt (60)
Non-Executive Director

Patrick joined the Board in January 2016. He will become the Senior Independent Director for the Group from the AGM on 22 July 2016.

Patrick 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, Middle East and Africa. He has subsequently undertaken a range of non-executive roles with a number of European and private organisations.

Patrick became a member of the Audit, Remuneration and Nomination Committees on his appointment.

Patrick is a Non-Executive Director of Michael Page International plc and Victrex plc. He is also the Senior Independent Director at Morgan Sindall Group plc.

Bill Halbert (68)
Chief Executive

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

Bill has worked in the information technology industry for over 40 years. During this time he founded and was the CEO for 13 years for Syntegra, BT's global consultancy and systems integration subsidiary.

Bill is not a member of any of the Board Committees.

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

Tony Illsley (59)
Senior Independent Non-Executive Director

Paul Simpson (47)
Chief Financial Officer

Peter Smith (58)
Non-Executive Director

Kathy Smith (42)
Company Secretary

Term of office

Tony joined the Board in June 2009. He has indicated his intention to retire from the Board at the AGM on 22 July 2016.

Paul joined the Board in May 2004 when he was appointed Chief Financial Officer, having joined the business in September 2000. Paul will leave the business later this year and is expected to step down as a Director on 30 September 2016.

Peter joined the Board in January 2015.

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

Previous experience

Tony has held a variety of senior business positions including Chief Executive of Telewest Communications PLC, President of Pepsi Cola Asia Pacific and Senior Independent Non-Executive Director of easyJet plc.

Paul is a Fellow of the Institute of Chartered Accountants in England and Wales, qualifying with Price Waterhouse. Prior to joining us, Paul worked in transaction services at Ernst & Young, which included working on the flotation of KCOM.

Peter has worked for LEK Consulting LLP for 27 years. Prior to joining LEK, Peter worked for Schlumberger Wireline in the Middle East for seven years as a field engineer and line manager in the oil industry.

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.

Board Committees

Tony is a member of the Audit, Remuneration and Nomination Committees and will remain so until his retirement from the Board in July.

Paul is not a member of any of the Board Committees.

Peter is the Chairman of the Remuneration Committee and a member of the Audit and Nomination Committees.

Kathy is the secretary for all of the Board Committees.

External appointments

Tony is a Non-Executive Director of Watchstone Group Plc, Camelot Global Services Limited and Camelot UK Lotteries Limited.

None.

Peter works full time for LEK Consulting LLP as a member of the Global Leadership Team.

Other Directors

Martin Towers was a Non-Executive Director of the Board from June 2009 until his retirement from the Board on 31 July 2015. Martin was the Chairman of the Audit Committee and a member of the Remuneration and Nomination Committee up until his retirement.

Corporate governance

Board length of service

Director	Appointment
Graham Holden (Chairman)	27 November 2007
Liz Barber	7 April 2015
Patrick De Smedt	28 January 2016
Bill Halbert	1 September 2006
Tony Illsley	2 June 2009
Paul Simpson	24 May 2004
Peter Smith	5 January 2015

2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016

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, have reviewed the performance and contribution of Graham Holden, Liz Barber, Bill Halbert, Paul Simpson and Peter Smith and have no hesitation in proposing the re-appointment of each of these Board members. We believe we have a diverse and balanced Board which meets the current needs of the business and therefore all of these Directors are recommended for re-election on the basis of their contribution to this. Tony Illsley has indicated his intention to retire from the Board at the AGM and therefore will not stand for re-election.

In addition, the Nomination Committee is pleased to recommend Patrick De Smedt for election to the Board. Patrick joined the Board on 28 January 2016 and brings with him a vast amount of sector experience having held a number of senior positions in Microsoft between 1983 and 2006, serving as Chairman of Microsoft for Europe, Middle East and Africa. He also has significant PLC Board experience and is currently a Non-Executive Director for a number of large companies listed on the London Stock Exchange. The Nomination Committee believes that Patrick will make a significant contribution to the business and will further enhance the range of skills that we have on our Board. Further biographical details for each of the Directors can be found on pages 34 and 35.

In May 2016 it was announced that Paul Simpson will be leaving the business later this year and it is expected that he will step down from the Board on 30 September 2016. The Nomination Committee has set out a role profile for a replacement for Paul and is currently engaging with external search firms to seek a successor.

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 five 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 2016.

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 and minutes of Committee meetings are circulated to all Board members, where appropriate, 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 Committee. The Audit Committee report can be found on page 43, the Nomination Committee report on page 41 and the Remuneration report on page 48.

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 10 times. The two additional meetings were specifically held to consider the sale of the national network, which was announced in December 2015. Attendance at the meetings during the year is shown in the table on the right. Seven 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 focuses on the future long-term success of the business. There is a standing agenda item in relation to strategy and this forms the basis for discussion and debate around all aspects of strategy, along with updates on progress in relation to the strategic aims of the business.

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.

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.

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 able also 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)	10	10
Liz Barber	9	10
Patrick De Smedt	2	2
Bill Halbert	10	10
Tony Illsley	8	10
Paul Simpson	10	10
Peter Smith	9	10
Martin Towers	3	4

Objectives of the Board

During the year, the Board defined five objectives as a result of the feedback from the annual Board evaluation. These are detailed below and will be reviewed and updated as appropriate on an annual basis.

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.
2. To increase the contact time between Board members and senior management, both formally and informally.	There has been a significant amount of interaction between Board members and the rest of the business, with members of the Executive Leadership Team attending Board dinners to provide informal updates and individual Board Directors visiting different KCOM sites and having one to one meetings with key members of the management team.
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.	The amount of City knowledge on the Board has remained high with the addition of Patrick De Smedt to the Board, following the departure of Martin Towers. Presentations have been made to the Board by our financial and other City advisors and feedback from shareholders continues to be discussed at each meeting as appropriate.
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.	This has continued with the impact on relevant stakeholders being considered in all Board discussions. The broad range of experience and diversity of the Board also helps ensure that different perspectives are being considered in each discussion.
5. To complete the development and documentation of a clear plan for Board and senior management succession.	Succession planning has been a regular discussion topic for both the Board and the Nomination Committee throughout the year. Plans are now in place for the Board and senior management in relation to both emergency and longer-term succession.

Corporate governance continued

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 training specifically 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.

Any feedback from shareholders is discussed at each Board meeting to ensure that each of our Directors has a clear understanding of the views of our shareholders. Our Non-Executive Chairman and Non-Executive Directors are available to meet face to face with our institutional shareholders if requested to do so, although no such requests have been received during the year.

A large number of our individual shareholders live in the Hull and East Yorkshire region and, as a Group, we are very much involved in local life in the area. More information about our community activities is detailed in our CR section on page 29. We believe that being a part of the community enables us to learn more about our local shareholders and the issues that matter to them.

We consider our AGM to be an important means of communication between our shareholders and Directors. Tony Illsley is unable to attend our AGM this year, but all of our other Directors, including all of the Chairs of the Board Committees, 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.

Performance evaluation
In the summer of 2015 our annual Board evaluation was conducted through an internal process, whereby our Company Secretary, Kathy Smith, met with each Board member individually to obtain their feedback on the Board and its Committees.

The review indicated that the Board continues to operate effectively and key strengths included the quality and timeliness of the Board papers, the structure of the agenda and the use of Board dinners as a means to gain greater insight into specific topics through a more informal discussion.

The areas where improvement could be made or where it was important to continue work already begun were used as the basis for a set of objectives for the Board. Further detail on this can be found on page 37.

In addition to the annual Board evaluation, the Non-Executive Chairman meets with each Board member individually at least on an annual basis to discuss their own performance and to identify any areas for development or potential training needs. In addition, the Non-Executive Directors meet separately to discuss 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.

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.

Business model and key performance indicators
Details of our business model can be found on pages 10 and 11 and our key performance indicators are on pages 20 and 21.

Proposal to re-appoint the external auditors
PricewaterhouseCoopers LLP have advised of their willingness to continue in office and have confirmed their continued independence. Following consideration of the relationship with the external auditors, as described on page 45, 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. They have provided an independent audit opinion on these accounts which can be found on pages 64 to 69.

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.

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.

Substantial shareholdings

As at 31 March 2016, 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. As at 8 June 2016, there had been no additional disclosures received.

	Number of shares with voting rights	% of total voting rights
Invesco Asset Management	71,864,941	13.91
M&G Investments	22,496,327	4.35
Hargreave Hale	21,870,196	4.23
Aviva Investors	20,598,706	3.99
Aberforth Partners LLP	19,415,442	3.76
AXA Investment Managers UK	15,690,966	3.04

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 2016 whose names and functions are listed on pages 34 and 35 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 includes 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, the 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 43 to 45.

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.

Corporate governance continued

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.

Our risk management processes seek to raise awareness of 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 quarterly by the ELT and then escalated 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, although prior to the formation of the ELT in October 2015 the risks were reviewed by various senior managers and then submitted periodically to the Board.

Our risk management framework

Risks identified

- By our people
- Through the whistleblowing process
- Through our formal risk assessment processes
- From internal or external audits

Reported on Risk Portal

- Assessment of controls that impact upon the risk
- Assigned an owner
- Assessed for probability and impact
  Categories for ratings include customer impact, people, reputation, financial, compliance, service availability and health and safety
- Acceptable level of risk proposed
  Clear plans to fill any gap between the current position and the acceptable position

Reviewed quarterly by the ELT and the Board

- Considered in relation to the overall risk profile of the business and in comparison to the risk appetite of the business
- The assurance required in relation to the controls in place is set by the Board – this may be through independent internal audits, management reports or regular reporting of key risk indicators

Continual monitoring and updating

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 43 to 45.

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 five 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 quarterly forecast; performance against budget and the quarterly 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 27 of the Strategic report.

Graham Holden
Chairman, Nomination Committee

Nomination Committee report

Director	Number of meetings	Out of possible
Graham Holden (Chairman)	2	2
Liz Barber	2	2
Tony Illsley	2	2
Peter Smith	2	2
Martin Towers	1	1

"We will always aim to develop the diversity of the Board in order to promote a range of perspectives in the Boardroom."

The membership and attendance at Committee meetings during the year is shown in the table above. Patrick De Smedt became a member of the Committee upon his appointment to the Board on 28 January 2016 but there were no Committee meetings held between that date and the year end.

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.

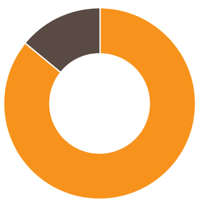
When Board vacancies arise, the Nomination Committee is responsible for preparing a description of the role and capabilities required for a particular appointment and then identifying and nominating candidates for the approval of the Board. In order to identify suitable candidates the Committee uses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

A search for a new Chief Financial Officer is currently underway and the Nomination Committee has approved the profile of the role and will oversee the recruitment process, which will be conducted by an independent external search firm.

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

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

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



Male Directors	6	86%
Female Directors	1	14%

See also

Board of Directors
page 34

Appointments during the year

Since the last annual report, one new Non-Executive Director has joined the Board; Patrick De Smedt on 28 January 2016. For the appointment the Nomination Committee set out the qualities that the Board required and an external executive search firm was appointed to lead the search. The firm chosen was Hanson Green, which provides no other services to the Group.

The Nomination Committee believes that Patrick was the outstanding candidate for the role that was described by the Committee and brings the required expertise and experience to the Board.

Other Committee responsibilities

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.

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 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 36.

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 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	Number of meetings	Out of possible
Liz Barber (Chairman from 31 July 2015)	2	3
Martin Towers (Chairman to 31 July 2015)	1	1
Patrick De Smedt	1	1
Tony Illsley	2	3
Peter Smith	1	3

The membership and attendance at Committee meetings during the year is shown in the table above. There was a quorum at each of the meetings in the year and the Committee Chairman was in attendance for each meeting.

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 all aspects 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

The Audit Committee during the year under review has consisted of four Non-Executive Directors up to 31 July 2015, at which point Martin Towers retired from the Board. From 28 January 2016, Patrick De Smedt joined the Committee upon his appointment as Non-Executive Director.

The Committee was chaired by Martin Towers until 31 July 2015, which included one Committee meeting. Liz Barber was then appointed as Chairman from 31 July 2015 and chaired the remaining two meetings in the year. Liz is a Fellow of the Institute of Chartered Accountants in England and Wales and is currently the Group Director of Finance, Regulation and Markets at Kelda Group. She was also previously the Head of Audit for the North of England at Ernst & Young and therefore the Board considers that she has the relevant financial experience 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 meet also 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. Members of the senior management team are also invited to Committee meetings when relevant to provide greater insight on specific controls or more detailed responses on specific audit issues.

Meetings

There were three meetings held in the year; in June, November and March. The June meeting was used to review the year end external audit and year end financial reporting, the November meeting to consider the half year review and financial reporting and the March meeting to consider the planning for the year end.

Each meeting included agenda items relating to internal audit, financial reporting and external audit. The areas discussed under each item are noted in the table below:

Area	Description
Internal audit	The internal audit agenda item focuses on the audits performed in the period, including any significant issues identified. A report setting out previous audit issues raised and the progress made to mitigate the issues is also discussed at each meeting. A review of the internal audit plan for the next year is also presented at the March meeting and then monitored and updated as appropriate at each following meeting.
Financial reporting	The Director of Group Finance Services talks through the key judgement areas in relation to financial reporting and sets out the decisions made and the rationale behind these. These are covered in more detail on page 22.
External audit	The representatives from PricewaterhouseCoopers LLP set out the audit approach, the key audit risks, an overview of internal controls and a view on the key audit and accounting matters, as well as how PricewaterhouseCoopers LLP ensures its continuing independence from KCOM.

Corporate governance continued

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 more specific issues discussed than in the prior year which reflects the significant change that the business is currently undertaking. The Committee was satisfied, however, that these were all being effectively managed and that the higher number of issues did not reflect an increase in the risks being taken.

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 and other intangible assets		
Testing goodwill and other intangible assets 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.	There was a significant amount of work performed during the year to move from three Cash Generating Units (CGUs) to two in the goodwill impairment calculations, to reflect the internal restructuring of the Group. The reallocation of goodwill and the impairment assessments performed pre and post the restructuring were reviewed by the Committee and the outcome of the work was discussed and approved. The assumptions made and the sensitivities relating to the assumptions were discussed in detail and the conclusion was that no impairments were required.	The Committee challenged the assumptions and sensitivities and concluded 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 Committee reviewed the assumptions made and was satisfied that these were in line with recognised market practice and with previous assumptions and that no requirements for change had been identified.	The assumptions were debated by the Committee. No changes were made as the Committee concluded that it agreed with the treatment adopted by management.
Valuation of intangible assets on internal projects		
There is a significant internal project currently ongoing to implement an ERP system across many parts of the business. This began in the prior year and has continued this year. Costs relating to this are being capitalised in line with accounting standards but there have been assumptions made in relation to the financial benefits of the project and therefore the appropriate carrying value. This will be a recurring matter while there are significant internal projects ongoing.	The approach adopted by management in relation to the capitalisation of costs was consistent with that previously adopted for other IT projects. Management noted that the expected benefits of the project were still in line with the original business case, with the benefits to date exceeding those included in the business case. In addition, management remained committed to the delivery of the remainder of the project. There was therefore no trigger to indicate a potential impairment of the asset carrying value.	The Committee discussed at length the approach to the capitalisation and the valuation of the asset and concluded that it was in agreement with the treatment adopted by management.
Exceptional items		
Management judgement around when one-off items should be treated as exceptional is always an area for review.	There is an established and well-defined policy in place in relation to the classification of items as exceptional and this has not changed in the year. 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.
Accounting treatment for significant contracts		
There have been a number of significant contracts that have either continued or arisen during the year, such as large customer contracts and the sale of the national network. There is always some judgement involved in relation to the timing of revenue and cost recognition on such contracts.	There are clear policies in place in relation to cost and revenue recognition and these have been applied consistently throughout the year. The Committee received updates at each meeting on progress in relation to these contracts and the accounting treatment adopted and was satisfied that the policies were being applied consistently.	No changes were made as the Committee was satisfied with the policies applied.

Each year the Audit Committee is also responsible for:

- seeking the view of the external auditors on any accounting judgements made in the year;
- 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 adequacy of the whistleblowing procedures in place to enable employees and third parties to raise concerns in confidence, as well as the effectiveness and independence of any investigations undertaken as a result of such concerns being raised;
- considering the consistency and appropriateness of the accounting policies adopted;
- 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 Institute of Chartered Secretaries and Administrators 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, and also considers the re-appointment of the auditors each year.

PricewaterhouseCoopers LLP were appointed as auditors in 2006 following a comprehensive tender process. Each year the Committee considers the continued independence of the external auditors and the effectiveness of the external audit process, to determine whether to recommend to the Board that the current auditors be re-appointed, also taking into consideration the desire to comply with the requirement of the UK Corporate Governance Code to tender the external audit at least every 10 years and the transitional arrangements in place in relation to this.

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.

In addition, PricewaterhouseCoopers LLP has formally confirmed its continued independence and the measures they have taken to ensure that they comply with best practice and professional and regulatory requirements in this area.

The Committee believes that audit partner rotation is a significant factor in ensuring continued independence and objectivity by reducing the risk of familiarity while retaining the detailed understanding of the business which the external auditors have gained over time. The current audit partner, Ian Morrison, was appointed to the audit in 2011 following a partner rotation and will therefore rotate away from the audit following this year end. It is proposed that Steve Denison will rotate on to the audit for the year ending 31 March 2017.

We have an Engagement of External Auditors policy which covers the selection of firms to perform non-audit work. This policy excludes the auditors from providing certain services, such as internal audit services, litigation support, remuneration advice and legal advice services. All other non-audit work is assessed separately and is awarded to the firm considered best suited to perform the work. Any such work with a fee greater than 25 per cent of the annual audit fee must be approved by the Chairman of 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 £283,000 (2015: £387,000). In addition to this, the external auditors provided services to the value of £165,000 (2015: £90,000) relating to tax advisory services 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 down on a timely basis.

Internal audit

In 2014 we appointed Deloitte as our internal auditors. The decision to outsource was taken to enable the internal audit work performed to cover a broader scope and to give us access to subject matter experts, which we did not have with an 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 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.

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 34 and 35 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 48 to 62 in the Remuneration report.

Indemnification of Directors
In July 2016 an indemnity deed was signed for all Directors which indemnifies 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 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.

Political donations
No political donations were made by the Group during the year (2015: £Nil).

Employees
Our people are our key asset and enable us to differentiate ourselves from our competitors. We therefore take great care to have employment strategies in place to help our people develop to their full potential whilst 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 Executive Directors regularly visit our different office locations to meet with our employees, provide updates on the performance of the business and receive suggestions and feedback, through both formal and informal meetings.

Regular video and news updates are provided to all employees through our intranet, and a weekly round-up email is sent to keep everyone informed of activities and developments across the business. There is also a monthly briefing document for managers to share with their teams.

We encourage our employees to become shareholders by offering a Share Incentive Plan (SIP) as we believe this is one opportunity to encourage greater employee engagement. More information about this can be found on page 61.

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 22 July 2016 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 2015, 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 666,000 (2015: 4,170,000) shares on the London Stock Exchange with a nominal value of £66,000 (2015: £417,000), for which the Company provided funding of £450,000 (2015: £4,058,000). These shares represent 0.1 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
At 1 April 2015	7,348[1]
At 31 March 2016	6,614

1. The brought forward figure has been restated to include the shares held in trust for the Group Share Incentive Plan, which were omitted in error from the figure last year.

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 the 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 £200 million multi-currency revolving facility agreement dated 4 June 2014, 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 48 to 62, 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 4 to 32 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 22 July 2016 at 1.00pm. The Notice of Meeting accompanies this Annual Report 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
8 June 2016

Peter Smith
Chairman, Remuneration Committee

Remuneration report

Statement from the Chairman of the Remuneration Committee

Dear shareholder

I am very pleased to introduce the Directors' Remuneration report for the year ended 31 March 2016. I took on the role of Chairman of the Remuneration Committee from Tony Illsley following his retirement from this position at the AGM on 31 July 2015.

Report overview

This report sets out the details of our continuing Remuneration policy for our Executive and Non-Executive Directors, as well as information on how the policy is implemented and how much each of the Directors has been paid for the year under review.

Our Remuneration policy was put to a binding shareholder vote in July 2014 and we are not proposing any changes to the policy over the coming year. We have included a summarised version of the policy in the section entitled 'Policy report', for information.

In the section entitled 'Annual report on remuneration' we have set out how we have implemented the policy over the last year and how we intend to implement it for the coming year. That section, along with this opening statement, will be put to an advisory shareholder vote at our AGM on 22 July 2016.

The Remuneration Committee has met four times during the year under review and at each meeting we considered the Remuneration policy and whether it continues to incentivise the behaviour and objectives that you, our shareholders, would want from the Directors. The Directors have a duty to promote the long-term success of the Company and we want to make sure that the Remuneration policy is aligned with that duty. We believe that the policy remains fit for purpose and will reward fairly for good performance, allow greater rewards for extraordinary performance but not provide any additional rewards if performance is below expectations.

Structure of pay

Both of the Executive Directors receive an amount of fixed pay made up of a base salary, a benefits package and pension provision, plus they are able to earn additional remuneration, subject to specific performance conditions that are set in advance, in the form of an annual cash bonus plan and shares under a Long-Term Incentive Plan (LTIP).

The annual bonus is linked to the profit performance of the business in the year, whilst the LTIP is linked to Total Shareholder Return (TSR) performance relative to a comparator group over a three year period. Further information on the annual bonus scheme can be found on pages 55 to 57 and further information on the LTIP scheme is on page 57.

Variable pay is subject to clawback provisions and we also have share ownership guidelines to ensure that there is a further alignment of interests between the Executive Directors and our shareholders.

Decisions made

Following a review of pay conditions across the Group, and taking into account the performance of the business, the Committee has decided to increase the base salary of the Executive Directors by two per cent with effect from 1 July 2016. The Executive Directors received no increase in the prior year when the average increase across the rest of the business was 1.5 per cent and the average increase for 2016/17 is anticipated to be at a similar level.

The Committee has reviewed the annual bonus scheme for the forthcoming year and we have decided that there are no changes required to the scheme for the 2015/16 year.

During the year, the EBITDA target for the bonus scheme was set at £74.9 million, which reflected the market consensus at the beginning of the financial year. This was adjusted by a decrease

“The Directors have a duty to promote the long-term success of the Company and we want to make sure that the Remuneration policy is aligned with that duty.”

of £2.0 million to take into account costs associated with the sale of the national network which had not been included in the consensus and a further £0.9 million relating to a gain which was moved from EBITDA to exceptional items in the reported numbers. EBITDA of £74.9 million was achieved in the year which triggered a bonus of 50 per cent of target entitlement for those in the scheme, equivalent to 25 per cent of base salary for each of the Executive Directors. The bonus will be paid in July 2016. Further information on the scheme can be found on page 57.

The performance period for the first grant of awards under the current LTIP scheme ended in June 2015. The relative TSR performance over the three year period to June 2015 was not sufficient to trigger a vesting and therefore the LTIP awards granted in July 2012 did not vest and have lapsed.

The second grant of awards has a performance period ending on 30 June 2016 and current indications would suggest that the scheme is likely to vest at just over 50 per cent, although this cannot be confirmed until the end of the performance period.

LTIP awards are usually granted annually in July of each year, however due to the sale of our national network, which the Board believed to be a price-sensitive event, the granting of the awards in the year under review was delayed until December 2015, after the announcement of the sale. The awards made to the Executive Directors were equivalent to 150 per cent of base salary, which was an increase from the prior year to reflect the start of a period of significant strategic change for the business and the additional challenge expected over the three year performance period. This was explained in greater detail in the 2015 Remuneration report and received support from our largest shareholders prior to the awards being granted.

In the coming year, we plan to revert to granting annual awards in July and intend to grant an award to Bill Halbert which is again equal to 150 per cent of his base salary, to reflect the continuing transformational work that will be undertaken over the next three years. This is within the rules of the LTIP scheme, for which further details can be found on page 57.

We are happy that relative TSR remains appropriate as the performance measure for the LTIP scheme. The transformation of the business is being implemented to improve total shareholder returns and the use of relative TSR provides strong alignment with this objective. Vesting is not automatic, even when the relative TSR would indicate vesting has been triggered; the Remuneration Committee must also be satisfied that the financial and non-financial performance of the business warrants the level of vesting, and therefore vesting can only be confirmed by a decision of the Committee.

Changes to the Board

We announced in May 2016 that Paul Simpson, our Chief Financial Officer, will leave the business later this year. Paul has agreed to remain with the business to oversee the handover of his role and it is anticipated that he will continue as a Director until 30 September 2016. Paul will continue to receive his salary and benefits over the course of his 12 month notice period, subject to mitigation, and will remain eligible for an annual bonus for the 2016/17 financial year to the date his active service ceases. He will be treated as a good leaver for the purposes of the LTIP, entitling Paul to receive any shares that vest under the scheme, pro-rated to his date of leaving. Further details can be found on page 57.

Views of the shareholders

We value the views of our shareholders very highly, including any views in relation to remuneration. Any feedback would therefore be very welcome and may be directed to me or to our Company Secretary, Kathy Smith.

I hope that we can rely on your support for the resolution relating to remuneration at our AGM in July 2016.

Peter Smith
Chairman, Remuneration Committee
8 June 2016

This Directors’ Remuneration report sets out details of the Remuneration policy for Executive and Non-Executive Directors, describes the implementation of the policy and discloses the amounts paid for the year ended 31 March 2016. The report complies with the provisions of the Companies Act 2006 and Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 and we have prepared it in line with the recommendations of the UK Corporate Governance Code and the requirements of the UKLA Listing Rules.

Policy report

The Directors’ Remuneration policy was put to a binding shareholder vote at the AGM on 29 July 2014, in accordance with Section 439A of the Companies Act 2006, and was approved. It therefore became effective from that date. Our intention is to operate the policy, as approved, for the full three years to the 2017 AGM and we therefore do not propose to resubmit it to shareholders for approval at the AGM in July 2016. This part of the Directors’ Remuneration report sets out an abridged version of the approved policy. A full version of the Remuneration policy can be found on pages 46 to 51 of the Annual report and accounts 2013/14 which can be found on our website at www.kcomplc.com.

Remuneration report continued

Policy report continued

Discretion retained in operating incentive plans

The Committee will operate KCOM's annual bonus plan and LTIP according to the rules of each respective plan and consistent with normal market practice and the Listing Rules, including flexibility in a number of regards.

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 right individual for the role, whilst reflecting appropriately the status, responsibility and experience of the individual.	We normally review base salaries at least annually. We typically set salaries following comparison with industry-based peer companies and companies of a similar size. We aim to pay salaries around the median; however, we also take into account a number of other specific factors, including the experience and performance of the individual, the criticality of the individual to the success of the business, pay and conditions throughout the business and the wider economic climate. Increases will not normally exceed the general level of increase for employees across the business; however, we may award increases beyond the general level in certain circumstances, for example, where there is a change in responsibility, progression in the role, experience, or where there is a significant increase in the scale of the role or the size and/or complexity of the business. Details of the base salary for each of the Executive Directors are shown in the Annual report on remuneration on page 56.
Benefits Paying the right amount of benefits helps us to attract and retain the right individual for the role.	The provision of benefits is set based upon market practice at similar companies, taking into account also the benefits available to other employees across the business. The benefits available to both Executive Directors are: > 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; > fully expensed fuel card; > medical screening; and > the opportunity to participate in any all-employee Share Incentive Plans operated by the Company, in line with HMRC guidelines. The cost of insured 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.	Both Executive Directors are entitled to receive an employer pension contribution of up to 20 per cent of base salary. This can either be paid as a contribution direct to the Group Stakeholder Pension Plan or as cash to the individual. Contributions to the Group Stakeholder Pension Plan are dependent on a minimum employee pension contribution of three per cent per annum.
Annual bonus The annual bonus is designed to reward the achievement of stretching business objectives and therefore drive operational excellence.	All payments are at the discretion of the Remuneration Committee. Payments are considered and approved by the Committee and are payable annually following the publication of our full year results. Up to 10 per cent of maximum bonus is dependent on achieving the threshold hurdle with sliding scale targets set for payments above this level. Target performance receives up to 50 per cent of salary. Performance above target results in a higher percentage up to a maximum of 100 per cent of salary.
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 and performance is measured over a three year period. The plan rules state that a maximum of 150 per cent of salary per annum may be awarded (200 per cent of salary may be made in exceptional circumstances). We disclose actual award levels each year in the Annual report on remuneration.

What performance measures are used and why?	Are there any provisions to recover sums paid?
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.
Benefits are not performance related.	There are no provisions to recover any sums paid.
Retirement benefits are not performance related.	There are no provisions to recover any sums paid.
The performance measures will be financial measures, such as EBITDA. The measures chosen will be those that the Committee believes most closely align Executive Director and shareholder interests and are important to the long-term success of the business. The measures in place for 2015/16 are set out in more detail on page 57.	> Clawback may be invoked for the annual bonus for: > material misstatement of the accounts; > error in assessing performance conditions; or > gross misconduct.
The performance measure used in the LTIP is TSR. The Committee believes that a relative TSR measure offers a robust measure of performance over the long-term as it takes into account changes in the economic cycle, while maintaining a focus on shareholder returns. Our TSR must rank at least median to the TSR performance of the companies within a comparator group. Performance at median would result in 25 per cent of the awards vesting, with performance between median and upper quartile resulting in vesting of awards on a straight-line basis with 100 per cent vesting at upper quartile performance. In addition, there is an underpin that the Committee must be satisfied that our financial and non-financial performance over the performance period warrants the level of vesting, having regard to a number of factors such as share price progression, dividend policy and Earnings Per Share (EPS) performance.	> Clawback may be invoked for the LTIP for: > material misstatement of the accounts; > error in assessing performance conditions; or > gross misconduct.

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.	Fees are normally reviewed at least annually and may be adjusted as necessary to align with market rates in companies of a comparable size and to take account of factors such as the time commitment of the role. 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. No Non-Executive Directors participate in any of our incentive arrangements and no benefits or other remuneration are provided. 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.
	Are there any provisions to recover sums paid?
	There are no provisions to recover any sums paid.

Recruitment policy

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

Executive Directors

Remuneration element	Policy on recruitment
Base salary	We will typically offer salaries around the median market level for comparative roles, but salaries above or below this level may be set to recognise the experience of the individual, the wider economic climate and pay and conditions throughout the business. 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 positioning 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	We will offer a benefits package that 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 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 depending on the point in the financial year at which the individual joins. The opportunity for an annual bonus will be pro-rated for 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 within the approved limits of the plan (200 per cent of salary in exceptional circumstances).
'Buy-outs'	We may 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.

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 relevant to take into account the appointment. In addition, any other ongoing remuneration obligations existing prior to appointment would continue.

Non-Executive Directors

On the appointment of a new Non-Executive Chairman or Non-Executive Director, we will set fees to take account of the calibre and experience of the individual, prevailing market rates in companies of a similar size and the expected time commitment associated with the role.

Remuneration report continued

Policy report continued

Service contracts

It is our policy that the notice period for Executive Directors is six months for either party. Prior to 2008, the notice period for Executive Directors was set at 12 months. We have taken the decision not to retrospectively alter the notice period for those Directors appointed with a 12 month notice period.

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 for loss of office

The table below sets out our policy on exit payments in relation to each remuneration element for Executive Directors.

The Committee is clear that there will be a consistent approach to exit payments and no reward for poor performance. No amount is payable if an Executive Director is dismissed for serious breach of contract, serious misconduct or under-performance or 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.

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 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.

Executive Directors

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.

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 2016 and describes how the policy will be implemented in 2016/17. The Annual report on remuneration, along with the statement from the Chairman of the Remuneration Committee, will be put to an advisory shareholder vote at the AGM on 22 July 2016.

Implementation of policy for 2016/17

The table below sets out how we will implement the Remuneration policy for the 2016/17 financial year:

Executive Directors

	Bill Halbert	Paul Simpson
Base salary	Bill Halbert's base salary will increase by two per cent from 1 July 2016 to £404,809. This increase is consistent with the average pay increases across the rest of the Group in 2015/16 and 2016/17.	Paul Simpson's base salary will increase by two per cent from 1 July 2016 to £267,369. This increase is consistent with the average pay increases across the rest of the Group in 2015/16 and 2016/17.
Benefits	The benefits to be provided remain unchanged from 2015/16. These include private medical insurance for the Executive and his immediate family, income protection, life assurance, a car allowance of £16,000 per annum for Bill Halbert and £14,000 per annum for Paul Simpson, a fully expensed fuel card, 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	Each Executive Director is entitled to an employer pension contribution of 20 per cent of base salary.	
Annual bonus	The performance measures for the annual bonus scheme are growth in EBITDA and growth in revenue, measured for the 2016/17 financial year. Both Bill Halbert and Paul Simpson have a maximum annual bonus entitlement of 100 per cent of base salary. Up to 10 per cent of the maximum entitlement is triggered upon exceeding a specific targeted level of EBITDA. If the EBITDA achieved in the year is greater than that required to trigger the full 10 per cent payment then further bonus payments begin to accrue; however, payment of any bonus beyond the 10 per cent is dependent on an underpin of revenue growth in the year. The exact targets set are commercially sensitive and therefore cannot be disclosed here, but will be disclosed in the Annual report on remuneration next year.	
Long-term incentives	It is proposed to grant an LTIP award to Bill Halbert in July 2016 under the current scheme, which will be equivalent to 150 per cent of his base salary at the date of grant. This award will have a three year performance period and therefore will be due to vest in July 2019 subject to the achievement of relative TSR performance conditions. The rationale for this level of award is described further on page 49. The performance conditions attached to the LTIP awards are described on page 57.	

Changes to the Board

It was announced on 27 May 2016 that Paul Simpson will leave the business later this year. Paul will continue to receive his base salary and benefits, including retirement benefits, until the earlier of 26 May 2017 or the date on which he obtains alternative employment, in which case the amount payable by the Company will be reduced by the amount of the alternative income.

The Remuneration Committee has agreed that Paul will receive the bonus triggered under the business-wide bonus scheme for the 2015/16 financial year. For the 2016/17 financial year he will be eligible to participate in the bonus scheme to the date on which his active service ceases, in accordance with the Directors' Remuneration policy and subject to the discretion of the Remuneration Committee when reviewing the performance of the business over the same period.

Paul received awards under the LTIP scheme in July 2013, July 2014 and December 2015. The performance periods for these schemes end in June 2016, June 2017 and November 2018 respectively. As a good leaver, Paul will be entitled to receive any shares that vest under the scheme, pro-rated to the date of his leaving. The actual amount of shares will therefore be calculated on each vesting date, in so far as vesting conditions are met at that time. Full details will be disclosed in the Directors' Remuneration reports in 2017, 2018 and 2019.

Remuneration report continued

Annual report on remuneration continued

Implementation of policy for 2016/17 continued

Non-Executive Directors

The fees of the Non-Executive Directors were reviewed in June 2016 and increases were made to the fees for the Chairman, Audit Committee Chairman and Remuneration Committee Chairman to reflect the fact that fees had not increased since July 2014 and there have been increases awarded to other employees across the business during this time. In addition there has been an increase in the time commitment required for the roles of Audit Committee Chairman and Remuneration Committee Chairman since the fees were last adjusted. Increases will take effect from 1 July 2016.

	Fee from 1 July 2016 £'000	Fee to 1 July 2016 £'000	% Increase
Chairman fee	127.5	125	2%
Base fee	43	43	—
Senior Independent Director fee	11	11	—
Audit Committee Chairman fee	7	6	17%
Remuneration Committee Chairman fee	7	6	17%

Single total figure table (audited)

Executive Directors

	Current Directors				Previous Director			
	Bill Halbert		Paul Simpson		Kevin Walsh		Total	
	FY2016 £'000	FY2015 £'000	FY2016 £'000	FY2015 £'000	FY2016 £'000	FY2015 £'000	FY2016 £'000	FY2015 £'000
Fixed pay								
Base salary	397	394	262	260	—	81	659	735
Taxable benefits	16	16	17	23	—	6	33	45
Retirement benefits	66	66	50	50	—	14	116	130
Sub-total	479	476	329	333	—	101	808	910
Performance-related pay								
Annual bonus	99	—	66	—	—	—	165	—
Long-term incentives	—	—	—	477	—	477	—	954
Sub-total	99	—	66	477	—	477	165	954
Total	578	476	395	810	—	578	973	1,864

Non-Executive Directors

	Current Directors										Previous Director			
	Graham Holden		Liz Barber		Patrick De Smedt		Tony Illsley		Peter Smith		Martin Towers		Total	
	FY2016 £'000	FY2015 £'000	FY2016 £'000	FY2015 £'000	FY2016 £'000	FY2015 £'000	FY2016 £'000	FY2015 £'000	FY2016 £'000	FY2015 £'000	FY2016 £'000	FY2015 £'000	FY2016 £'000	FY2015 £'000
Fees	125	125	46	—	7	—	54	54	47	10	16	49	295	238
Total	125	125	46	—	7	—	54	54	47	10	16	49	295	238

Explanatory notes

Taxable benefits

Bill Halbert received a car allowance of £16,000 but elected not to receive any other benefits from the Group. The taxable benefits for Paul Simpson include private medical insurance, income protection, life assurance, medical screening, a company car equivalent to a £14,000 per annum car allowance, fully expensed fuel card and membership of the all-employee Share Incentive Plan.

Retirement benefits

Bill Halbert has elected not to be a member of the Group pension scheme and, accordingly, KCOM made no contributions on his behalf. Instead he received cash payments totalling £65,905 (2015: £65,905) which are disclosed on page 56 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 £17,828 (2015: £17,000) and is included in the table on page 56 within retirement benefits.

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

Bonus receivable for the year

The annual bonus was dependent on the achievement of Group financial performance targets around growth in pre-exceptional Group EBITDA and Group revenue. Up to 10 per cent of the maximum bonus entitlement, of 100 per cent of salary, was dependent on exceeding pre-exceptional Group EBITDA of £72.0 million in the year. This was the £74.9 million of market consensus at the start of the year adjusted for £2.0 million of costs associated with the sale of the national network which had not been included in the consensus figure and a £0.9 million gain which was moved from EBITDA to exceptional items in the reported numbers. Over-performance against this target created a bonus pot with a proportion of profits above this level being shared amongst all employees in the scheme, as well as the Executive Directors, up to the maximum level of bonus for all participants. Any additional bonus above the 10 per cent was also dependent on an underpin of year on year Group revenue growth.

The level of pre-exceptional Group EBITDA achieved in the year was £74.9 million, which triggered a bonus of 50 per cent of target entitlement, equivalent to 25 per cent of base salary for each of the Executive Directors.

Long-term incentives

The LTIP awards made in July 2012 had a performance period which ended on 30 June 2015. The relative TSR performance over this period was not sufficient to trigger the vesting of an award and therefore these awards have now lapsed.

The LTIP awards made in July 2013 have a performance period ending on 30 June 2016. Based on performance up to April 2016 it appeared that vesting of just over 50 per cent may be triggered, but the actual figures, once confirmed, will be included in the single total figure table for 2016/17.

Payments for loss of office

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

Share awards outstanding at the year end

Long-Term Incentive Plan (LTIP)

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 on an annual basis.

Awards made under the LTIP scheme (audited)

	Date of grant	Share price at date of grant	Nil cost options outstanding on 1 April 2015 000's of options	Nil cost option awarded in the year 000's of options	Nil cost options lapsed during the year 000's of options	Nil cost options outstanding on 31 March 2016 000's of options	Face value of maximum award[1] £'000	Award that would vest at threshold performance[2] 000's of options	Date of vesting
Bill Halbert	19 July 2012	76.35p	518	—	(518)	—	—	—	19 July 2015
	17 July 2013	82.50p	468	—	—	468	386	117	17 July 2016
	17 July 2014	95.00p	418	—	—	418	397	105	17 July 2017
	16 December 2015	110.25p	—	540	—	540	595	135	16 December 2018
Paul Simpson	19 July 2012	76.35p	342	—	(342)	—	—	—	19 July 2015
	17 July 2013	82.50p	309	—	—	309	255	77	17 July 2016
	17 July 2014	95.00p	276	—	—	276	262	69	17 July 2017
	16 December 2015	110.25p	—	357	—	357	394	89	16 December 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.

Remuneration report continued

Annual report on remuneration continued

Share awards outstanding at the year end continued

Awards made under the LTIP scheme (audited) continued
The scheme measures TSR performance over a three year performance period, relative to the TSR performance of each company within a comparator group, comprising those companies within the FTSE 250 (excluding investment trusts) as at the start of the performance period.

No part of the awards may vest unless our TSR performance ranks at least median to the TSR performance of the comparator group. Performance at median would result 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 shall vest unless the Remuneration Committee is satisfied that our financial and non-financial performance over the performance period warrants the level of vesting set out in the vesting schedule. The Committee will consider KCOM's share price progression, dividend policy and EPS performance as part of this review.

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

The first awards under the scheme were made on 19 July 2012 with further awards made in each of the subsequent four years. The maximum award allowed under the Remuneration policy is 150 per cent of base salary at the time of the award. The first three awards granted to each Director were equivalent to 100 per cent of base salary at the time of the award. The award in 2015 was increased to 150 per cent of base salary to reflect that the business was embarking on a period of significant strategic change and the Committee believed that the level of reward should reflect the additional challenge that lay ahead and that successful delivery of the planned transformation would reposition the business and enable KCOM to deliver increased returns to shareholders. This increase was supported by shareholders at the AGM in July 2015.

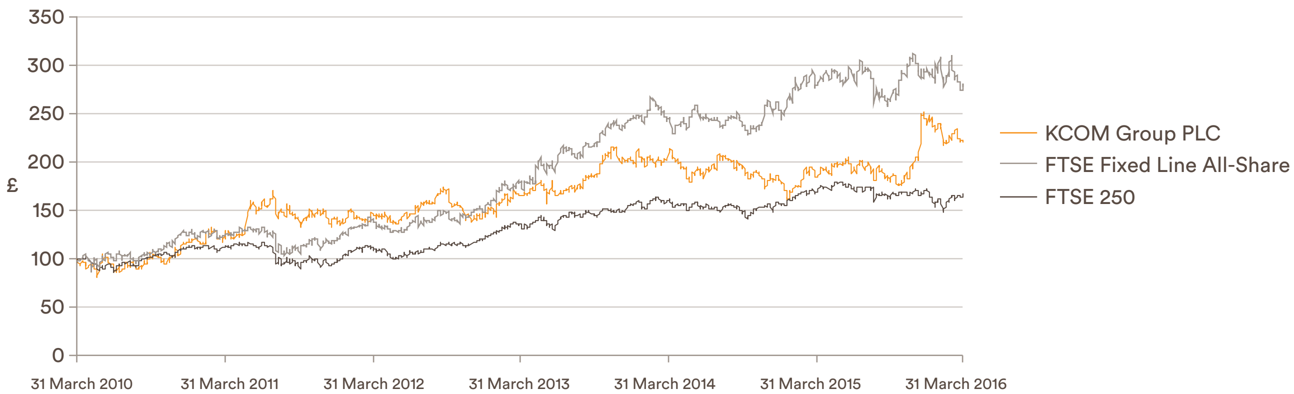
Relative Group performance

The graph below shows, for the financial year ended 31 March 2016 and for each of the previous six 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.

TSR performance since 31 March 2010

KCOM Group vs. FTSE Fixed Line All-Share and FTSE 250

Value of £100 invested at 31 March 2010



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 Halbert in his role as either Executive Chairman or Chief Executive in each of the last seven years:

	FY2016 £'000	FY2015 £'000	FY2014 £'000	FY2013 £'000	FY2012 £'000	FY2011 £'000	FY2010 £'000
Total remuneration	**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]	**—**	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 31 March 2016.

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 2016		
Base salary	1%	1.5%
Benefits	0%	0%
Annual bonus	100%	233.3%

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 2016 £'000	Year ended 31 March 2015 £'000	Percentage change
Total remuneration cost for all employees[1]	**66,312**	68,360	decrease of 3.0%
Dividend payments to shareholders	**28,672**	26,057	increase of 10.0%

1. The total remuneration cost for all employees is taken from Note 8 to the financial statements on page 84 and includes wages and salaries, social security costs, other pension costs and share scheme costs.

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
Paul Simpson	24 May 2004	20 June 2011	12
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
Tony Illsley	2 June 2009	29 May 2009	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.

Remuneration report continued

Annual report on remuneration continued

Remuneration Committee

	Number of meetings attended	Out of possible
Peter Smith (Chairman from 31 July 2015)	3	4
Tony Illsley (Chairman to 31 July 2015)	3	4
Liz Barber	3	4
Patrick De Smedt	1	1
Graham Holden	4	4
Martin Towers	2	2

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 under discussion.

The Remuneration Committee is a sub-committee of the Board and has four scheduled meetings a year and meets for additional meetings as and when required. For the year under review there were no additional meetings held.

During the year under review, the Committee received advice on all aspects of 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 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 this advice was £30,876 (2015: £41,537), which is charged as a fixed annual fee for recurring work, with separate fees agreed as appropriate for additional adhoc 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 Chief Executive, the Executive Directors and senior management 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 senior management; 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 Institute of Chartered Secretaries and Administrators' 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.

The specific matters considered by the Committee during the year were:

Description	What the Committee has done
Reviewing the remuneration packages of the Executive Directors	The Committee considered the remuneration packages of the Executive Directors in comparison to pay trends across the business and also in relation to the objectives of the business and the performance of the business and the individuals.
Reviewing the bonus scheme in place	During the year the Committee reviewed the financial performance of the business in relation to the 2014/15 financial year and concluded that a bonus had not been triggered under the scheme. The scheme for 2015/16 was also reviewed and consideration was given to whether the performance measures would continue to drive the right behaviours.
Reviewing the LTIP scheme	The progress on the LTIP awards made to-date has been monitored regularly by the Committee to determine whether vesting is likely in relation to the existing awards. The awards for 2015 were also considered and a decision was made to increase the awards to the Executive Directors in December 2015 in comparison to previous awards, to reflect the significant transition which the performance period of the 2015 LTIP award will cover. The Committee consulted with the largest shareholders prior to making this decision and it was reported in the Report and Accounts in 2015.
Reviewing the Directors' Remuneration report in the Annual report and accounts	The Committee reviews the Directors' Remuneration report each year to ensure that all of the disclosure requirements have been met and that as much transparency as possible has been included.
Reviewing remuneration trends and up-to-date guidance from governance institutions	The Committee receives regular reports from the remuneration consultants in relation to remuneration trends and changes in guidance from governance institutions. These are reviewed and discussed at each meeting as appropriate and form a key part of the discussions around remuneration policy.

Directors' interests in shares (audited)

	As at 31 March 2016				
	Shares owned outright	Nil-cost share options subject to performance conditions[1]	Actual share ownership as a percentage of salary on 31 March 2016[2]	Required share ownership as a percentage of salary	Requirement met?
Executive Directors					
Bill Halbert	2,482,371	1,425,902	672%	100%	Yes
Paul Simpson	531,787[3]	941,780	218%	100%	Yes
Non-Executive Directors					
Graham Holden	50,000	—	—	—	—
Liz Barber	—	—	—	—	—
Patrick De Smedt	—	—	—	—	—
Tony Illsley	—	—	—	—	—
Peter Smith	—	—	—	—	—

1. These are awards made under the LTIP scheme, further details of which can be found on page 58.
2. Calculated using the closing mid-market price of KCOM Group PLC shares on 31 March 2016 and only those shares owned outright by the Executive Directors and their connected persons.
3. This includes matching shares awarded under the SIP which may be subject to forfeiture in certain circumstances.

The table above sets out the interests of all the Directors as at 31 March 2016 (as listed on pages 34 and 35) and their connected persons in KCOM's shares.

Our Group Share Incentive Plan (SIP) is open to all employees and offers free matching shares on a sliding scale from 2:1 for monthly contributions of £20 to 1:3 for monthly contributions over £51.

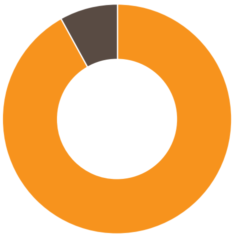
Since the end of the year shares in the SIP have continued to be awarded each month, for which we make monthly announcements as required under Section 5.6.1 of the Disclosure and Transparency Rules. This has resulted in Paul Simpson holding 425 additional shares, which includes matching shares awarded under the SIP which may be subject to forfeiture in certain circumstances.

Remuneration report continued

Annual report on remuneration continued

Shareholder views

At the 2015 AGM 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:	323,502,285	(92.52%)
Votes against:	26,135,659	(7.48%)
Votes withheld:	516,686	

Outside appointments

In 2015/16 Bill Halbert received no direct remuneration for his external non-executive positions. Paul Simpson did not have any external appointments.

General information (audited)

Our closing mid-market share price on 31 March 2016 was 107.5 pence. The high and low closing mid-market share prices during the year were 86.0 pence and 122.0 pence respectively.

Signed on behalf of the Board

Kathy Smith
Company Secretary
8 June 2016

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 2016 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 2016;

> 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

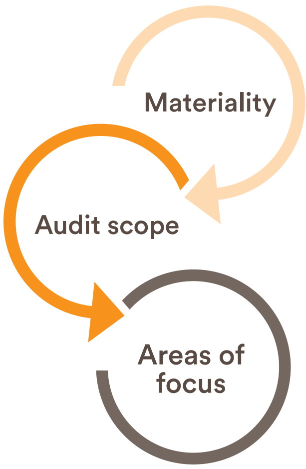
> the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

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: £2.4 million which represents 5% of profit before tax and exceptional items.

Audit scope

> We conducted audit work on the 5 most significant reporting components within the Group, which together comprised 93% of profit before tax and exceptional items, 89% of revenue and 100% of 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.

> Carrying value of certain finite lived intangible assets.

> 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 on page 65. 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.

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 complex and subjective judgements by management about the future results 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 to determine whether there is a potential impairment of the goodwill relating to those CGUs. The determination of the amount of headroom is dependent on the value in use of the CGU, which in turn, is dependent on a number of key assumptions which include: > Budgeted cash flows for the next 5 years. > A long-term (terminal) growth rate applied beyond the end of the 5 year budget period. > A discount rate applied to the model. At the beginning of the year opening goodwill of £51.4m was split between 3 CGUs, Eclipse (£7.9m), Kcom (£38.4m) and Smart421 (£5.1m), however due to the restructuring which took place at the end of the year the goodwill was reallocated into new CGUs SMB national and enterprise to align with forecast future cash flows. 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. In allocating the previous goodwill to new CGUs management performed a non-arbitrary allocation based on the profitability of customers transferred into each new CGU. 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.	For both impairment reviews which took place in the year we evaluated the appropriateness of the key assumptions including discount rates and long-term growth rates and performed a range of sensitivity analyses across all CGUs. We also verified the underlying assets and cash flows included in the models. In particular: > We verified that the 5 year forecasts are based on the 2016 budget prepared by management and approved by the Board of KCOM Group PLC. In the case of the first impairment review, in the absence of updated Board approved forecasts we verified an appropriate roll forward of the prior year approved budget had been performed. We challenged management's budgeted growth rates over the 5 year period, evaluating the accuracy of management's forecasting process by comparing previous budgets to actual results, and assessing the current budget in light of our knowledge and understanding of current business plans and the economic climate. We also verified that the disposal of the national network had been treated correctly and resulted in a reduced asset base but additional ongoing operating costs; > 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; > We assessed the discount rate (weighted average cost of capital ("WACC")) for the company against comparable organisations noting that the rates used across the Group by the directors were within a reasonable range and; > We evaluated management's sensitivity analysis and performed additional sensitivity analysis to ascertain the extent of change in those assumptions that either individually or collectively would be required for the goodwill to be impaired noting that for all segments it would require a significantly adverse change to occur, and set of circumstances that management consider remote, before the balances would be impaired. 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 of the allocation of goodwill before focussing our testing on the model produced at the end of the year. Based on the evidence obtained we determined that no impairment is required in either the SMB national or enterprise CGUs.

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
Valuation of defined benefit pension scheme liabilities We focused on this area as the pension scheme valuation is highly sensitive to changes in the assumptions used within the model which calculates the valuation and the subsequent charge or credit to the consolidated statement of comprehensive income. At 31 March 2016 the net pension deficit amounted to £14.4m. The key assumptions to which the liability is most sensitive, and which we therefore paid particular attention to in evaluating the valuation of the net deficit, were: Discount rate: Under International Accounting Standard ("IAS") 19 – Employee Benefits, the discount rate is set with reference to the yield on high quality corporate bonds of term appropriate to the duration of the liabilities; Inflation rate: The level of future pension payments is linked to price inflation indices. Various investment market statistics are used to form a view on the long-term average rates of retail price and consumer price inflation; and Mortality: Scheme specific base tables have been used with an allowance for future improvements in life expectancy based on recent projections. These projections will depend on future expectations of improvements in life expectancy and are therefore uncertain. 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 tested the actuarial valuations used by management in the preparation of the financial statements, in conjunction with our own specialist actuaries, as follows: We tested the completeness and accuracy of the pension scheme membership data provided to management's actuary on which the pension liability is calculated by reconciling movements in membership data to supporting documentation. We noted no material exceptions from our testing. We assessed the appropriateness and consistency of the key assumptions used by management to value the pension liabilities: Discount rate: We tested the appropriateness of the discount rate assumption used by reference to the yields available on AA corporate bond indices and the duration of the scheme's liabilities. Inflation rate: We considered the appropriateness of both the CPI and RPI rates used by reference to the Bank of England implied inflation spot curve and the duration of the scheme's liabilities. Mortality: We considered the appropriateness of the mortality rates selected for use by management by reference to those provisionally adopted for the most recent actuarial valuation of the scheme and also market practice. Based on the evidence obtained from our testing of the assumptions outlined above, we considered the assumptions used to be in line with recognised market practices.
Carrying value of certain finite lived intangible assets Further to the implementation of the ERP system in the prior year which included the capitalisation of internal costs, the project continues with further implementation of supporting IT systems and restructuring of operational and reporting lines. There is a degree of judgement in supporting the carrying value within software (£22.0m) of this project in light of the continuing restructuring of the Group and the difficulty in forecasting and measuring the financial benefits of the project over its forecast life. See the accounting policies section within the financial statements for disclosure of the related accounting policies, judgements and estimates and Note 15 for detailed intangible asset disclosures.	In evaluating the recoverability of the carrying value of the capitalised asset, the Directors prepared a model to evaluate the forecast benefit of the asset over its 10 year life. We evaluated the Directors' model by testing costs capitalised to date - agreeing these to our work performed on capitalised internal salary costs and to third party advisor costs and by testing the benefits received to date to reductions in associated costs. We tested the forward looking spend and benefit assumptions in the model by examining the original business case, challenging the directors on their commitment to the project and on how benefits would be derived in future years based upon the current business model. We also tested the discount rate applied to the model and the depreciable life of the asset to check these were appropriate. Based on the evidence obtained no impairment of the intangible asset is required.
Significant contracts Significant contracts, for example HMRC due to its magnitude and the disposal of the national network asset can be complex and therefore inherently carry an element of risk. They require judgment with regards to the appropriate accounting treatment especially in respect of the timing of revenue and cost recognition. 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 performed additional testing over both the HMRC and national network disposal contracts. On HMRC, KCOM's largest customer contract, we performed testing to ensure revenue and cost is being recognised at the right time by verifying this to the underlying contract. On the sale of the national network we verified the correct profit on disposal by agreeing the proceeds and net book value of assets sold and by testing a sample of associated costs to third party costs.

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
Classification of exceptional items Exceptional items consist of a number of one off costs relating to the profit on sale of the national network (£44.5m), restructuring costs (£4.1m), onerous lease costs (£2.3m) and a one off credit in respect of an Ofcom settlement (£2.8m). Given the magnitude of these items we focused additional audit effort in this area to determine whether these items were appropriately classified as exceptional, and did not in fact relate to the underlying trade of the business, and that exceptional costs and credits were treated consistently with prior periods. 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: > agreeing the profit on sale of the national network to the proceeds and net book value of assets sold and by testing a sample of associated costs to third party costs; > testing a sample of redundancy costs to payments made and by testing outstanding redundancy costs to payroll records and notification to the employees; by agreeing third party restructuring costs to third party invoices and by testing outstanding third party provisions to commitments and post year end payments; and > by testing exceptional credits to the corresponding cash receipts. Through these procedures we checked that these items had been recognised within the correct period and that classification as exceptional items is appropriate.

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.

During the year ended 31 March 2016 the Group was structured along two business segments, being KC and Kcom. Within these segments were five individual trading subsidiary entities (the 'trading entities'). Together with the Group's centralised PLC function, these trading entities formed the consolidated financial statements. On 31 March 2016 a corporate simplification took place with the trade and assets of a number of trading entities transferring to KC on that date.

We performed an audit of the KC, Kcom, Contact Centres and KCH Holdings entities together with the consolidation. KC and Kcom were considered to be the only financially significant components given the significance of their contribution to both revenue and profit before tax and exceptional items, however full audits were performed over all other in scope components.

Total coverage obtained through the audit of in scope components was 89% of group revenue, 93% of group profit before tax and exceptional items and 100% of net assets.

This work, including the consolidation, gave us the evidence we needed for our opinion on the group financial statements as a whole. All work was performed by the group engagement team.

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	£2.4 million (2015: £2.5 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 the 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 (2015: £0.1 million) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Independent auditors' report continued

to the members of KCOM Group PLC

Report on the financial statements continued

Our audit approach continued

Going concern

Under the Listing Rules we are required to review the Directors' statement, set out on page 39, 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.

Other required reporting

Consistency of other information

Companies Act 2006 opinion

In our opinion, 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.

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 39, 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 43, 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 27 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.

Other required reporting continued

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.

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 10 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 39, 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.

Ian Morrison (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Leeds
8 June 2016

Consolidated income statement

for the year ended 31 March 2016

	Notes	2016 £'000	2015 £'000
Revenue	4	**349,222**	347,984
Operating expenses	5	**(257,438)**	(325,579)
Operating profit		**91,784**	22,405
Analysed as:			
EBITDA before exceptional items	4	**74,937**	74,304
Exceptional credits	7	**47,331**	6,658
Exceptional charges	7	**(6,445)**	(41,446)
Depreciation of property, plant and equipment	4	**(13,744)**	(12,033)
Amortisation of intangible assets	4	**(10,295)**	(5,078)
Finance costs	9	**(3,057)**	(5,725)
Share of profit of associates	4	**16**	13
Profit before taxation	4	**88,743**	16,693
Taxation	10	**(17,609)**	(4,149)
Profit for the year attributable to owners of the parent		**71,134**	12,544
Earnings per share			
Basic	12	**13.96p**	2.47p
Diluted	12	**13.82p**	2.44p

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 £36,156,000 (2015: £26,057,000).

Consolidated statement of comprehensive income

for the year ended 31 March 2016

	Notes	2016 £'000	2015 £'000
Profit for the year		**71,134**	12,544
Other comprehensive income/(expense)			
Items that will not be reclassified to profit or loss			
Remeasurements of retirement benefit obligations	29	**12,130**	(7,263)
Tax on items that will not be reclassified		**(2,426)**	1,528
Total items that will not be reclassified to profit or loss		**9,704**	(5,735)
Items that may be reclassified subsequently to profit or loss			
Cash flow hedge fair value movements	27	**(442)**	1,428
Tax on items that may be reclassified		**(569)**	(285)
Total items that may be reclassified subsequently to profit or loss		**(1,011)**	1,143
Total comprehensive income for the year attributable to owners of the parent		**79,827**	7,952

The Notes on pages 75 to 103 are an integral part of these consolidated financial statements.

Balance sheets

as at 31 March 2016

	Notes	Consolidated 2016 £'000	Consolidated 2015 £'000	Parent company 2016 £'000	Parent company 2015 £'000
Assets					
Non-current assets					
Goodwill	14	**51,372**	51,372	**—**	—
Other intangible assets	15	**44,637**	41,903	**—**	—
Property, plant and equipment	16	**93,592**	127,078	**—**	—
Investments	17	**49**	33	**494,461**	494,461
Deferred tax assets	25	**8,356**	16,292	**—**	—
		198,006	236,678	**494,461**	494,461
Current assets					
Inventories	18	**2,638**	2,235	**—**	—
Trade and other receivables	19	**65,431**	78,790	**5**	5
Cash and cash equivalents	22	**14,857**	11,701	**—**	—
Derivative financial instruments	27	**—**	328	**—**	—
		82,926	93,054	**5**	5
Total assets		**280,932**	329,732	**494,466**	494,466
Liabilities					
Current liabilities					
Trade and other payables	20	**(126,235)**	(112,969)	**—**	—
Current tax liabilities		**(5,459)**	(2,500)	**—**	—
Bank overdrafts	22	**(1,645)**	(691)	**—**	—
Derivative financial instruments	27	**(11)**	(706)	**—**	—
Finance leases	23	**(3,271)**	(1,743)	**—**	—
Provisions for other liabilities and charges	24	**(738)**	(2,579)	**—**	—
Non-current liabilities					
Trade and other payables	20	**—**	—	**(450)**	(7,484)
Bank loans	21	**—**	(103,460)	**—**	—
Retirement benefit obligation	29	**(14,350)**	(31,435)	**—**	—
Deferred tax liabilities	25	**(6,875)**	(4,589)	**—**	—
Finance leases	23	**(3,680)**	(5,155)	**—**	—
Provisions for other liabilities and charges	24	**(2,401)**	(26)	**—**	—
Total liabilities		**(164,665)**	(265,853)	**(450)**	(7,484)
Net assets		**116,267**	63,879	**494,016**	486,982
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
Hedging and translation reserve	27	**—**	442	**—**	—
(Accumulated losses)/retained earnings		**(288,624)**	(341,454)	**89,125**	82,091
Total equity		**116,267**	63,879	**494,016**	486,982

The Notes on pages 75 to 103 are an integral part of these consolidated financial statements.

The financial statements were approved by the Board of Directors and authorised for issue on 8 June 2016.

They were signed on its behalf by:

Bill Halbert
Chief Executive
8 June 2016

Paul Simpson
Chief Financial Officer

KCOM Group PLC
Registered number: 2150618

Consolidated statement of changes in shareholders' equity

for the year ended 31 March 2016

	Notes	Share capital £'000	Share premium account £'000	Hedging and translation reserve £'000	Accumulated losses £'000	Total £'000
At 1 April 2014		51,660	353,231	(986)	(318,752)	85,153
Profit for the year		—	—	—	12,544	12,544
Other comprehensive income/(expense)		—	—	1,428	(6,020)	(4,592)
Total comprehensive income for the year ended 31 March 2015		—	—	1,428	6,524	7,952
Deferred tax charge relating to share schemes		—	—	—	(270)	(270)
Current tax credit relating to share schemes		—	—	—	184	184
Purchase of ordinary shares		—	—	—	(4,058)	(4,058)
Employee share schemes		—	—	—	975	975
Dividends	11	—	—	—	(26,057)	(26,057)
Transactions with owners		—	—	—	(29,226)	(29,226)
At 31 March 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 charge relating to share schemes		—	—	—	125	125
Current tax credit relating to share schemes		—	—	—	90	90
Purchase of ordinary shares		—	—	—	(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**

The Notes on pages 75 to 103 are an integral part of these consolidated financial statements.

Parent company statement of changes in shareholders' equity
for the year ended 31 March 2016

	Notes	Share capital £'000	Share premium account £'000	Retained earnings £'000	Total £'000
At 1 April 2014		51,660	353,231	86,710	491,601
Profit for the year		—	—	26,057	26,057
Total comprehensive income for the year ended 31 March 2015		—	—	26,057	26,057
Purchase of ordinary shares		—	—	(4,058)	(4,058)
Employee share schemes		—	—	(561)	(561)
Dividends	11	—	—	(26,057)	(26,057)
Transactions with owners		—	—	(30,676)	(30,676)
At 31 March 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		—	—	(450)	(450)
Employee share schemes		—	—	—	—
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**

The Notes on pages 75 to 103 are an integral part of these consolidated financial statements.

Cash flow statements

for the year ended 31 March 2016

		Consolidated		Parent company	
	Notes	**2016 £'000**	2015 £'000	**2016 £'000**	2015 £'000
Cash flows from operating activities					
Operating profit		**91,784**	22,405	**—**	—
Adjustments for:					
– depreciation and amortisation		**24,039**	17,111	**—**	—
– impairment of goodwill		**—**	33,900	**—**	—
– decrease/(increase) in working capital		**23,385**	(15,661)	**(7,034)**	4,619
– restructuring cost and onerous lease payments		**533**	(62)	**—**	—
– (profit)/loss on sale of property, plant and equipment		**(47,065)**	429	**—**	—
– profit on sale of investments		**—**	(624)	**—**	—
– share-based payment charge		**1,468**	975	**—**	—
Pension deficit payment		**(6,565)**	(4,270)	**—**	—
Tax paid		**(7,206)**	(3,424)	**—**	—
Net cash generated from operations		**80,373**	50,779	**(7,034)**	4,619
Cash flows from investing activities					
Purchase of property, plant and equipment		**(16,959)**	(17,356)	**—**	—
Purchase/generation of intangible assets		**(11,467)**	(14,666)	**—**	—
Proceeds from sale of property, plant and equipment		**90,000**	—	**—**	—
Proceeds from sale of investments		**—**	429	**—**	—
Dividends received		**—**	—	**36,156**	26,057
Net cash generated from/(used in) investing activities		**61,574**	(31,593)	**36,156**	26,057
Cash flows from financing activities					
Dividends paid	11	**(28,672)**	(26,057)	**(28,672)**	(26,057)
Dividend equivalent paid to participants of share schemes		**—**	(561)	**—**	(561)
Interest paid		**(2,794)**	(5,574)	**—**	—
Capital element of finance lease repayments		**(2,829)**	(1,367)	**—**	—
Repayment of bank loans	21	**(175,000)**	(45,000)	**—**	—
Drawdown of bank loans	21	**70,000**	65,000	**—**	—
Purchase of ordinary shares	26	**(450)**	(4,058)	**(450)**	(4,058)
Net cash used in financing activities		**(139,745)**	(17,617)	**(29,122)**	(30,676)
Increase in cash and cash equivalents		**2,202**	1,569	**—**	—
Cash and cash equivalents at the beginning of the year		**11,010**	9,441	**—**	—
Cash and cash equivalents at the end of the year	22	**13,212**	11,010	**—**	—

The Notes on pages 75 to 103 are an integral part of these consolidated financial statements.

Notes to the financial statements

for the year ended 31 March 2016

01 General information

KCOM Group PLC is a public limited company 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 4 to 32.

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 IC interpretations 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 consolidated 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.

There were no new standards, amendments and interpretations that were adopted by the Group and effective for the first time for the financial year beginning 1 April 2015 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. None of these are expected to have a significant effect or material impact on the financial statements of the Group.

The Directors are considering the impact of other standards and interpretations such as IFRS 15 and are assessing whether these will have a significant impact on the Group's financial results.

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 2016. 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 associate's 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 2016. 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. As described in Note 4, the Board assessed that the Kcom, Smart421 and Eclipse brands are aggregated together and reported as the 'Kcom' segment. The remaining brands of KC and the PLC function are reported respectively in the 'KC' segment and the 'PLC' segment.

As a result of the move to one brand the Group's individual brands (Kcom, Smart421, Eclipse, KC and PLC) were consolidated into one brand 'KCOM' as at 1 April 2016. As such, the Group's operating segments changed on 1 April 2016. The new operating segments continue to be based on customer type and geographic service location. The new operating segments are Hull and East Yorkshire, SMB National, Enterprise and Shared.

Notes to the financial statements continued

for the year ended 31 March 2016

02 Accounting policies continued

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods or services 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 where revenue is recognised with reference to the proportion of total costs incurred to date. 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.

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, 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. These intangible assets are amortised on a straight-line basis over their useful lives.

02 Accounting policies continued

Intangible assets continued

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 opposite is 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

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 20 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.

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.

Notes to the financial statements continued

for the year ended 31 March 2016

02 Accounting policies continued

Impairment of non-financial assets continued
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 uncollectable, 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.

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 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 in 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.

02 Accounting policies continued

Financial instruments and hedge accounting continued

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.

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.

Notes to the financial statements continued

for the year ended 31 March 2016

02 Accounting policies continued

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.

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 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, or cash flows associated with the asset, by applying an appropriate discount rate to the timing and amount of future cash flows.

In the case of goodwill, 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 remeasurements 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.

03 Critical accounting judgements and key sources of estimation uncertainty continued

Capitalisation and valuation of internal projects

The Group capitalises internal costs (which relate principally to IT salary costs on significant projects) from the development of intangible assets if, and only if, it can demonstrate all of the following:

> the technical feasibility of completing the intangible asset so that it will be available for use or sale;

> its intention to complete the intangible asset and use or sell it;

> its ability to use or sell the intangible asset;

> how the intangible asset will generate probable future economic benefits;

> the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

> its ability to measure reliably the expenditure attributable to the intangible asset during its development.

The Directors are required to make judgements regarding whether an intangible asset has met all of the criteria above and are required to ensure the correct treatment has been applied in accordance with IAS 38 'Intangible Assets'. Capitalised internal costs are tested for impairment by monitoring the carrying value against management's estimates of revenue and profits to be generated by the assets. For further disclosure, see Note 15.

04 Segmental analysis

The Group's operating segments are based on the reports reviewed by the KCOM Group PLC Board that 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 2016 the Board considered the performance of the four brands and the PLC function in assessing the performance of the Group and making decisions about the allocation of resources. The Group's segmental information for the year ended 31 March 2016 has been prepared on a basis consistent with previous years, however, this segmental information will change from 1 April 2016 following the move to a single brand.

For the year ended 31 March 2016 the KC brand addresses the needs of our Hull and East Yorkshire customers and the Eclipse, Kcom and Smart421 brands serve enterprise, public sector organisations and small business markets across the UK.

The Board assessed that the Eclipse, Kcom and Smart421 brands have similar profiles, offering similar products and services, and similar production and distribution processes, and are operating in a consistent regulatory environment. In line with IFRS 8, the Eclipse, Kcom and Smart421 brands are aggregated together and reported as the 'Kcom' segment for the year ended 31 March 2016. The remaining brands of KC and the PLC function are reported respectively in the 'KC' segment and the 'PLC' segment.

The segment information provided to the KCOM Group PLC Board for the reportable segments, for the year ended 31 March 2016 and for the year ended 31 March 2015, is as follows:

		Revenue		EBITDA	
	Notes	**2016 £'000**	2015 £'000	**2016 £'000**	2015 £'000
Before exceptional items					
KC		**104,515**	104,751	**56,343**	56,368
Kcom		**249,947**	248,593	**26,112**	25,687
PLC[1]		**(5,240)**	(5,360)	**(7,518)**	(7,751)
Total before exceptional items		**349,222**	347,984	**74,937**	74,304
Exceptional items					
KC		**—**	—	**(326)**	5,027
Kcom		**—**	—	**44,019**	(37,435)
PLC[1]		**—**	—	**(2,807)**	(2,380)
Total	7	**—**	—	**40,886**	(34,788)
Total		**349,222**	347,984	**115,823**	39,516

1. PLC comprises shared service functions, share scheme expenses and administration costs associated with the Group's defined benefit pension schemes.

Financial statements

Notes to the financial statements continued

for the year ended 31 March 2016

04 Segmental analysis continued

A reconciliation of total EBITDA to profit before tax is provided as follows:

	Notes	2016 £'000	2015 £'000
EBITDA post-exceptional items		**115,823**	39,516
Depreciation	16	**(13,744)**	(12,033)
Amortisation	15	**(10,295)**	(5,078)
Finance costs	9	**(3,057)**	(5,725)
Share of profit of associate	17	**16**	13
Profit before tax		**88,743**	16,693

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:

	2016 £'000	2015 £'000
Revenue from external customers		
KC	**98,911**	99,597
Kcom	**249,803**	248,033
PLC[1]	**508**	354
Total	**349,222**	347,984
Inter-segment revenue		
KC	**5,604**	5,154
Kcom	**144**	560
PLC[1]	**(5,748)**	(5,714)
Total	**—**	—
Group total	**349,222**	347,984

1. PLC comprises shared service functions, share scheme expenses, inter segment eliminations and administration costs associated with the Group's defined benefit pension scheme.

Inter-segment sales are charged at prevailing market prices.

Neither revenue nor operating profit arising outside the United Kingdom is material to the Group.

The Group is not dependent upon a single or small number of external customers.

The analysis of the Group's revenue between sale of goods and the provision of services is as follows:

	2016 £'000	2015 £'000
Sale of goods	**1,511**	7,018
Provision of services	**347,711**	340,966
Group total	**349,222**	347,984

On 1 April 2016, the Group's four individual brands were consolidated and our operating segments were updated to reflect this change. The new operating segments continue to be based on customer type and geographic service location. The new operating segments are as follows:

> **Hull and East Yorkshire** – Communication services for consumers and small local businesses within Hull and East Yorkshire;

> **Enterprise** – Communication and collaboration services provided to the largest customers from our former Kcom brand, plus our former Smart 421 brand;

> **SMB National** – Services provided to smaller business customers by our former Eclipse and Kcom brands; and

> **Shared** – Technical and engineering support, IT, Finance, Estates, Legal and HR costs plus PLC costs which include share scheme expenses and certain pension costs.

04 Segmental analysis continued

The consolidation of brands means that from 1 April 2016 KCOM has one business-wide EBITDA and EBITDA will no longer be reported to the Board as a measure of segment performance.

The profitability metric used to assess segmental performance will be contribution, which represents gross margin less certain costs, directly attributable to that segment.

From 1 April 2016, the Group will no longer allocate its shared costs to the operating segments as this will no longer represent the Group's organisational structure, the financial information used to make decisions or the way the Group incentivises and rewards its people.

These changes will result in significantly higher costs in the new "Shared" segment (than reported previously as PLC). These costs relate to technical and engineering support, IT, Finance, Estates, Legal and HR costs.

The additional disclosures below show our pre-exceptional results on a new segment basis:

	Revenue 2016 £'000	Contribution 2016 £'000
Before exceptional items		
Hull and East Yorkshire	**104,515**	**71,220**
SMB National	**102,281**	**24,338**
Enterprise	**147,666**	**29,770**
Total	**354,462**	**125,328**
Shared	**(5,240)**	**(50,391)**
		EBITDA 2016 £'000
Total before exceptional items	**349,222**	**74,937**
Exceptional items	**—**	**40,886**
Total after exceptional items	**349,222**	**115,823**

05 Operating expenses

Consolidated	Notes	2016 £'000	2015 £'000
Staff costs		**66,312**	68,360
Restructuring costs relating to employees	7	**684**	7,546
Total staff costs	8	**66,996**	75,906
Own work capitalised	8	**(6,465)**	(8,347)
Other external charges		**208,599**	208,996
Non-employee-related pension charges	29	**656**	500
Operating lease rentals		**4,743**	3,265
Auditors' remuneration	6	**448**	477
Depreciation of property, plant and equipment	16	**13,744**	12,033
Amortisation of intangible assets	15	**10,295**	5,078
(Profit)/loss on disposal of property, plant and equipment		**(8)**	429
Profit on sale of national network	7	**(44,486)**	—
Onerous lease costs	7	**2,315**	—
Ofcom determined settlement	7	**(2,845)**	—
Restructuring costs	7	**3,446**	—
Impairment of goodwill	7	**—**	33,900
Network rates rebate	7	**—**	(5,278)
Recovery of previously provided debt	7	**—**	(756)
Profit on sale of investments	7	**—**	(624)
Total		**257,438**	325,579

Other external charges mainly relate to costs from key partners, such as BT Wholesale.

Non-employee-related pension charges represent the cost of administering the pension schemes as set out in Note 29.

Notes to the financial statements continued

for the year ended 31 March 2016

06 Auditors' remuneration

During the year the Group obtained the following services from the Company's auditors:

Consolidated	2016 £'000	2015 £'000
Fees payable to the Company's auditors for the audit of the Company's annual financial statements and the consolidated financial statements	51	62
Fees payable to the Company's auditors and its associates for other services:		
– the audit of the Company's subsidiaries	222	267
– audit-related assurance services	10	58
– tax advisory services	15	15
– other non-audit services	150	75
Total	448	477

Other non-audit services relate to restructuring advice.

07 Exceptional items

Consolidated	Notes	2016 £'000	2015 £'000
Profit on sale of national network		(44,486)	—
Ofcom determined settlement		(2,845)	—
Network rates rebate		—	(5,278)
Recovery of previously provided debt		—	(756)
Profit on sale of investments		—	(624)
Credited to income statement		(47,331)	(6,658)
Restructuring costs		4,130	7,546
Onerous lease costs		2,315	—
Impairment of goodwill	14	—	33,900
Charged to income statement		6,445	41,446
Net (credit)/charge to income statement		(40,886)	34,788

In January 2016, the Group sold the infrastructure relating to its national telecommunications network for a consideration of £90.0 million. The profit on sale (£44.5 million) includes the net book value of assets disposed (£42.4 million) in addition to other associated costs (net £3.1 million). The proceeds were used to repay the Group's revolving credit facility. The VAT associated with the sale (£18.0 million) was not paid to HMRC until April 2016 and is included within trade and other payables at the year end date.

Ofcom determined settlement relates to a settlement of claims relating to an industry-wide regulatory ruling; treated as exceptional in accordance with our accounting policy.

The Group incurred £4.1 million restructuring costs including £0.8 million in relation to the KCOM rebranding and £3.3 million supporting the Group's move towards a single operating model. As set out in our accounting policy, restructuring costs are shown as exceptional items.

Onerous lease costs arose as a result of continued rationalisation of the Group's property portfolio.

The Group's Kcom brand goodwill balance was impaired by £33.9 million during the prior year.

Network rates rebate relates to a settlement agreed during the prior year.

Recovery of previously provided debt relates to a settlement of the Group's written off debt due from Lehman Brothers, which was previously charged as an exceptional item.

The profit on sale of investments relates to the sale of the Group's previously impaired shareholding in Spectrum Venture Management Fund.

The combined tax effect of these items is a charge of £16,520,000 (2015: credit of £318,000) in respect of current tax and a credit of £8,343,000 (2015: credit of £2,921,000) in respect of deferred tax.

08 Employees and remuneration

The average monthly numbers (including Executive Directors) employed by the Group during the year were as follows:

	Number of employees	
	2016	2015
KC	401	499
Kcom	679	847
PLC	626	430
Total	1,706	1,776

08 Employees and remuneration continued

The costs incurred in respect of these employees were:

	Notes	2016 £'000	2015 £'000
Wages and salaries		**53,904**	54,882
Social security costs		**6,700**	7,765
Other pension costs	29	**4,121**	3,867
Share scheme costs	13	**1,587**	1,846
Restructuring costs relating to employees	7	**684**	7,546
Total		**66,996**	75,906
Less own work capitalised	15,16	**(6,465)**	(8,347)
Charged to the income statement		**60,531**	67,559

All of the Group's employees are employed by the Company with the exception of 330 (2015: 336) employees employed by KC Contact Centres Limited and Smart421 Limited.

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 56 to 62 within the Remuneration report and form part of these financial statements.

09 Finance costs

Consolidated	Notes	2016 £'000	2015 £'000
Bank loans, overdrafts and other loans		**2,435**	4,234
Fair value gain on financial instruments		**(819)**	—
Retirement benefit obligations	29	**954**	1,067
Finance lease and hire purchase contracts		**137**	120
		2,707	5,421
Amortisation of loan arrangement fees		**350**	304
Total		**3,057**	5,725

10 Taxation

Analysis of tax charge in the year

The charge based on the profit for the year comprises:

Consolidated	Notes	2016 £'000	2015 £'000
UK corporation tax:			
– current tax on profits for the year		**10,569**	4,938
– adjustment in respect of prior years		**(314)**	(409)
Total current tax		**10,255**	4,529
UK deferred tax:			
Origination and reversal of timing differences in respect of:			
– profit for the year		**7,128**	4,154
– change in rate		**—**	56
– adjustment in respect of prior years		**(224)**	(497)
– charge in respect of retirement benefit obligation		**450**	87
– recognition of previously unrecognised deferred tax asset		**—**	(4,180)
Total deferred tax	25	**7,354**	(380)
Total taxation charge for the year		**17,609**	4,149

Notes to the financial statements continued

for the year ended 31 March 2016

10 Taxation continued

Factors affecting tax charge for the year

Consolidated	2016 £'000	2015 £'000
Profit before taxation	**88,743**	16,693
Profit before taxation at the standard rate of corporation tax in the UK of 20% (2015: 21%)	**17,749**	3,505
Effects of:		
– income not subject to tax	**—**	(131)
– expenses not deductible for tax purposes	**398**	5,805
– recognition of previously unrecognised deferred tax asset	**—**	(4,180)
– adjustments in respect of prior years	**(538)**	(906)
– change in rate reflected in the deferred tax asset	**—**	56
Total taxation charge for the year	**17,609**	4,149

The current tax charge of £10,255,000 (2015: £4,529,000) includes a charge relating to the vesting of the share schemes of £90,000 (2015: £184,000) which is a reclassification from the reserves on the unwind of the deferred tax asset. The recognition of a previously unrecognised deferred tax asset related to greater certainty as to the availability of future taxable profits.

Factors affecting the current and future tax charges

At summer budget 2015, the Government announced legislation setting the Corporation Tax main rate at 19% for the years starting the 1 April 2017, 2018 and 2019 and 18% for the year starting 1 April 2020. This was substantively enacted at the balance sheet date and as such deferred tax has been remeasured. Subsequent to the year end the Government announced a further reduction to the Corporation Tax main rate to 17% for the year starting 1 April 2020.

11 Dividends

	2016 £'000	2015 £'000
Amounts recognised as distributions to equity holders in the period:		
– final dividend for the year ended 31 March 2014 of 3.25 pence per share	**—**	16,810
– interim dividend for the year ended 31 March 2015 of 1.79 pence per share	**—**	9,247
– 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**	—
Total	**28,672**	26,057

The proposed final dividend for the year ended 31 March 2016 is 3.94 pence per share, resulting in a total dividend of £20,354,000. 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	2016 Number	2015 Number
Weighted average number of shares		
For basic earnings per share	**509,543,003**	508,619,479
Share options in issue	**5,225,401**	5,169,178
For diluted earnings per share	**514,768,404**	513,788,657

	Notes	2016 £'000	2015 £'000
Earnings			
Profit attributable to owners of the parent		**71,134**	12,544
Adjustments			
Exceptional items	7	**(40,886)**	34,788
Tax on exceptional items	7	**8,177**	(2,921)
Exceptional tax credit	10	**—**	(4,180)
Adjusted profit attributable to owners of the parent		**38,425**	40,231

12 Earnings per share continued

Consolidated	2016 Pence	2015 Pence
Earnings per share		
Basic	**13.96**	2.47
Diluted	**13.82**	2.44
Adjusted basic	**7.54**	7.91
Adjusted diluted	**7.46**	7.83

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 was performed 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 (2015: five) in existence during the year ended 31 March 2016. The Group recognised a total charge of £1,587,000 (2015: £1,846,000) 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 the year and the end of the year	42,189	Nil

The share options, including LTIS, outstanding at 31 March 2016 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 2016. 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 (2015: 42,819), all were exercisable at 31 March 2016.

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	56.8
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 2015/16, 1,189,547 (2015: 1,452,145) matching shares were granted during the year.

	Number	Weighted average exercise price (pence)
Outstanding at the beginning of the year	7,106,230	Nil
Granted during the year	1,189,547	Nil
Lapsed during the year	(1,867,861)	Nil
Outstanding at the end of the year	**6,427,916**	**Nil**

Notes to the financial statements continued

for the year ended 31 March 2016

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 57.

	Number	Weighted average exercise price (pence)
Outstanding at the beginning of the year	5,139,527	Nil
Granted during the year	2,147,907	Nil
Lapsed during the year	(2,062,033)	Nil
Outstanding at the end of the year	**5,225,401**	**Nil**

The awards granted during the year have been valued using a Monte Carlo simulation model.

The average assumptions used are as follows:

Share price at date of grant (pence)	110
Exercise price (pence)	Nil
Volatility (%)	20.2
Risk free rate (%)	0.85
Dividend yield (%)	Nil

14 Goodwill

Consolidated	Total £'000
Cost	
At 1 April 2014, 31 March 2015 and 2016	**85,272**
Provisions for impairment	
At 1 April 2014	—
Impairment	33,900
At 31 March 2015	33,900
Impairment	—
At 31 March 2016	**33,900**
Net book value	
At 31 March 2016	**51,372**
At 31 March 2015	51,372
At 1 April 2014	85,272

Goodwill acquired in a business combination is allocated at the date of acquisition to the CGU that is expected to benefit from that business combination. The Group tests goodwill annually for impairment, or more frequently if there are indications that goodwill might be impaired. The recoverable amounts of the CGUs are determined from value in use calculations. The key assumptions for these value in use calculations are those regarding 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 risks specific to the individual CGU. Growth rates reflect long-term growth rate prospects for the UK economy.

The Group's individual brands (Kcom, Smart421, Eclipse and KC) were consolidated into one brand, 'KCOM', as at 1 April 2016 and the Group's operating segments and CGUs changed from that date. The new CGUs are broadly similar to the existing CGUs, which are based on customer type and geographic service location. The new CGUs containing goodwill will be SMB National and Enterprise.

14 Goodwill continued

Prior to the move to one brand goodwill was tested for impairment using the latest available information, it was concluded that the carrying value at that date was supportable.

The Group prepares cash flow forecasts using the current operating budget approved by the Directors, which covers a five year period and an appropriate extrapolation of cash flows beyond this. The cash flow forecasts assume revenue and EBITDA growth in line with our strategic priorities. The cash flow forecast for FY17 and beyond has been prepared in line with the new one brand 'KCOM' budget and as such, goodwill will be tested for impairment using the new CGUs cash flows.

As a result, the comparative disclosures in this note are based on the prior CGUs and the current year disclosures under the new CGUs. The prior year disclosures have not been restated.

During the year ended 31 March 2015 an impairment of £33,900,000 was recognised within the Kcom CGU and was treated as an exceptional item.

Goodwill of £22,314,000 and £29,058,000 has been allocated to the SMB National CGU and the Enterprise CGU as set out below. This is based upon the customer allocation to the revised operating segments. This goodwill allocation is based on the relative value approach using the gross margin of each of the customers in the respective segment. Following the reorganisation on 1 April 2016 SMB National and enterprise are considered to be the smallest identifiable groups of assets that generate cash inflows that are largely independent of the cash inflows from other groups of assets.

At 31 March 2016 the carrying amount of goodwill of £51,372,000 (2015: £51,372,000) is allocated across multiple CGUs as follows:

	2016			2015
	New CGUs			
	SMB National £'000	Enterprise £'000	Total £'000	£'000
Prior CGUs				
Eclipse	**7,862**	**—**	**7,862**	7,862
Kcom	**14,452**	**23,972**	**38,424**	38,424
Smart	**—**	**5,086**	**5,086**	5,086
At 31 March 2015 and 2016	**22,314**	**29,058**	**51,372**	51,372

Management has considered the level of headroom resulting from the impairment tests of the revised 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 necessary.

The discount rate and growth rate (in perpetuity) used for value in use calculations are as follows:

	2016	2015
Discount rate (pre-tax) % – Group	**8.9**	8.2
Discount rate (pre-tax) % – CGUs	**8.9**	9.0
Growth rate (in perpetuity) % – Group	**2.0**	2.0

The assumptions within the value in use calculation which had the most significant impact related to movements in cash flows, 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.

Notes to the financial statements continued

for the year ended 31 March 2016

15 Other intangible assets

Consolidated	Notes	Development costs £'000	Software £'000	Customer and supplier relationship £'000	Technology and brand £'000	Total £'000
Cost						
At 1 April 2014		6,768	37,689	49,257	6,294	100,008
Additions		498	14,292	—	—	14,790
Own work capitalised	8	3,128	3,850	—	—	6,978
Disposals		—	(7,666)	—	—	(7,666)
Transfers		260	2,289	—	—	2,549
At 31 March 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**
Accumulated amortisation						
At 1 April 2014		4,385	17,403	49,257	6,294	77,339
Charge for the year		2,515	2,563	—	—	5,078
Disposals		—	(7,666)	—	—	(7,666)
Transfers		377	(372)	—	—	5
At 31 March 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**
Carrying amount						
At 31 March 2016		**6,286**	**38,351**	**—**	**—**	**44,637**
At 31 March 2015		3,377	38,526	—	—	41,903
At 1 April 2014		2,383	20,286	—	—	22,669

Development costs are predominantly capitalised staff costs associated with new products and services.

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 2014		14,894	206,928	158,618	43,460	423,900
Additions		—	4,343	5,565	6,968	16,876
Own work capitalised	8	—	936	433	—	1,369
Disposals		(163)	(622)	(147)	(5,654)	(6,586)
Transfers		(108)	(6,468)	6,959	(2,932)	(2,549)
At 31 March 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**
Accumulated depreciation						
At 1 April 2014		10,166	157,219	106,342	26,334	300,061
Charge for the year		359	3,375	3,069	5,230	12,033
Disposals		(162)	(567)	(43)	(5,385)	(6,157)
Transfers		(109)	(6,888)	6,350	642	(5)
At 31 March 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**
Net book value						
At 31 March 2016		**4,062**	**21,136**	**50,376**	**18,018**	**93,592**
At 31 March 2015		4,369	51,978	55,710	15,021	127,078
At 1 April 2014		4,728	49,709	52,276	17,126	123,839

17 Investments

Consolidated	Shares in associates £'000
Cost	
At 1 April 2014	20
Share of net profit for the year	13
At 31 March 2015	33
Share of net profit for the year	16
At 31 March 2016	**49**
Amounts written off	
At 1 April 2014, 31 March 2015 and 2016	—
Net book value	
At 31 March 2016	**49**
At 31 March 2015	33
At 1 April 2014	20

Notes to the financial statements continued

for the year ended 31 March 2016

17 Investments continued

Parent company	Shares in subsidiary undertakings £'000
Cost	
At 31 March 2015 and 2016	**494,511**
Amounts written off	
At 31 March 2015 and 2016	**50**
Net book value	
At 31 March 2015 and 2016	**494,461**

Subsidiary undertakings (as at 31 March 2016)
Details of the subsidiary undertakings of the company are as follows. The shares in subsidiary undertakings are held in KCH (Holdings) Limited, an intermediary holding company registered in England. All subsidiary undertakings are included in the consolidation of the Group.

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
Technica UK Limited*	England and Wales[1]	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
Kingston Communications (Quest) Trustees 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
Torch Communications Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
Affiniti Integrated Solutions Limited*	England and Wales[1]	Ordinary shares	100%	Supplier of integrated and converged communication services
Kingston Information Services Limited*	England and Wales[1]	Ordinary shares	100%	Publication of telephone directories
JAM IP Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
KCOM Holdings Limited (formerly Kingston Communications Limited)*	England and Wales[1]	Ordinary shares	100%	Telecommunications services
Eclipse Networking Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
Mistral Internet Group 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 Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
Omnetica Inc*	USA[4]	Ordinary shares	100%	Dormant
Smart421 Limited*	England and Wales[1]	Ordinary shares	100%	IT Consultancy
Smart421 Solutions Inc*	USA[5]	Ordinary shares	100%	Dormant
SmartIntegrator Technology Limted*	England and Wales[1]	Ordinary shares	50%	Software development
Omnetica Holding Limited*	England and Wales[1]	Ordinary shares	100%	Dormant

The directors believe the values of the investments are supported by the underlying net assets of the subsidiaries.

* 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.

Associate
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	2016 £'000	2015 £'000
Raw materials and consumables	**2,371**	2,235
Equipment for resale	**267**	—
Total	**2,638**	2,235

There is no material difference between the carrying value and the replacement cost of inventories.

19 Trade and other receivables

	Consolidated		Parent company	
	2016 £'000	2015 £'000	2016 £'000	2015 £'000
Trade receivables (net)	**30,851**	46,082	**—**	—
Other receivables	**2,088**	1,382	**—**	—
Prepayments	**14,406**	17,570	**5**	5
Accrued income	**18,086**	13,756	**—**	—
Total	**65,431**	78,790	**5**	5

All of the Group's receivables are due within one year in both 2016 and 2015. An allowance has been made for estimated irrecoverable amounts from the sale of goods and services of £1,548,000 (2015: £1,426,000). 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:

	£'000
At 1 April 2015	**(1,426)**
Written off in the year	**1,652**
Amounts provided for in the year	**(1,774)**
At 31 March 2016	**(1,548)**

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 2016, trade receivables of £6,834,000 (2015: £11,928,000) were impaired. The amount of the provision was £1,548,000 as of 31 March 2016 (2015: £1,426,000). 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:

	2016 £'000	2015 £'000
0–3 months	**5,265**	10,222
3–6 months	**1,569**	1,706
6 months+	**—**	—
	6,834	11,928

As of 31 March 2016, trade receivables of £7,249,000 (2015: £6,371,000) 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:

	2016 £'000	2015 £'000
0–3 months	**4,709**	2,719
3–6 months	**2,540**	3,652
6 months+	**—**	—
	7,249	6,371

Notes to the financial statements continued

for the year ended 31 March 2016

20 Trade and other payables

	Consolidated 2016 £'000	Consolidated 2015 £'000	Parent company 2016 £'000	Parent company 2015 £'000
Current				
Trade payables	**30,704**	34,292	**—**	—
Other taxes and social security costs	**24,905**	6,137	**—**	—
Other payables	**6,721**	7,443	**—**	—
Accruals	**35,117**	36,651	**—**	—
Deferred income	**28,788**	28,446	**—**	—
Total	**126,235**	112,969	**—**	—
Non-current				
Amounts due to subsidiary undertakings	**—**	—	**450**	7,484
Total	**—**	—	**450**	7,484

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.

Other taxes and social security costs include 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. See Note 7 for further details.

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 2016 £'000	Consolidated 2015 £'000
Bank borrowings		
Amount falling due:		
– between two and five years	**—**	105,000
	—	105,000
Loan issue costs	**—**	(1,540)
	—	103,460

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 June 2019 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 June 2014. See Note 27 for further detail.

During the year the Group repaid all outstanding loan borrowings. Upon repayment, the associated outstanding loan issue costs (£1.2 million) were reclassified to other receivables.

The fair value of bank borrowings is £Nil (2015: £91.6 million). The prior year fair value of cash flows had been estimated using a rate based on the weighted average borrowing rate of 3.2%.

22 Net debt

	Notes	Consolidated 2016 £'000	Consolidated 2015 £'000
Cash		**14,857**	11,701
Bank overdrafts		**(1,645)**	(691)
Cash and cash equivalents (including bank overdrafts)		**13,212**	11,010
Borrowings (net of loan issue costs)	21	**1,151**	(103,460)
Finance leases	23	**(6,951)**	(6,898)
Total net funds/(debt)		**7,412**	(99,348)

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 2016 £'000	2015 £'000
Finance lease liabilities		
Minimum lease payments:		
– within 12 months	**3,271**	1,743
– in 1 to 5 years	**3,880**	5,506
	7,151	7,249
Future finance charges	**(200)**	(351)
Present value of finance lease liabilities	**6,951**	6,898
The present value of finance lease liabilities is as follows:		
– within 12 months	**3,271**	1,743
– in 1 to 5 years	**3,680**	5,155
Total	**6,951**	6,898

24 Provisions for other liabilities and charges

	Onerous leases £'000	Restructuring £'000	Total £'000
At 1 April 2015	409	2,196	2,605
Established in the year	2,523	439	2,962
Unused amounts reversed	(208)	—	(208)
Utilised in the year	(24)	(2,196)	(2,220)
At 31 March 2016	**2,700**	**439**	**3,139**
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**
Total provisions for other liabilities and charges 2015			
Included in current liabilities	409	2,170	2,579
Included in non-current liabilities	—	26	26
At 31 March 2015	409	2,196	2,605

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 three 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	**2016 £'000**	2015 £'000	**2016 £'000**	2015 £'000	**2016 £'000**	2015 £'000
Property, plant and equipment	**—**	4,175	**(2,826)**	—	**(2,826)**	4,175
Other timing differences	**719**	1,064	**—**	—	**719**	1,064
Retirement benefit obligation	**2,871**	6,287	**—**	—	**2,871**	6,287
Intangible assets on acquisition	**4,766**	4,766	**—**	—	**4,766**	4,766
Asset-backed partnership	**—**	—	**(4,049)**	(4,589)	**(4,049)**	(4,589)
	8,356	16,292	**(6,875)**	(4,589)	**1,481**	11,703

Notes to the financial statements continued

for the year ended 31 March 2016

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 2014		7,978	2,130	5,300	(14)	(5,043)	10,351
(Charged)/credited to the income statement	10	(3,803)	(510)	(87)	4,780	—	380
(Charged)/credited directly to equity and other comprehensive income		—	(556)	1,074	—	454	972
At 31 March 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**

There are £Nil deferred tax assets or liabilities in the Parent company (2015: £Nil).

The analysis of deferred tax assets is as follows:

	2016 £'000	2015 £'000
Deferred tax assets to be recovered after more than 12 months	**6,342**	10,185
Deferred tax assets to be recovered within 12 months	**2,014**	6,107
	8,356	16,292

The analysis of deferred tax liabilities is as follows:

	2016 £'000	2015 £'000
Deferred tax liabilities to be realised after more than 12 months	**(5,276)**	(4,169)
Deferred tax liabilities to be realised within 12 months	**(1,599)**	(420)
	(6,875)	(4,589)

The major components of the deferred taxation asset not recognised are as follows:

	Not recognised	
	2016 £'000	2015 £'000
Losses	**1,126**	1,126

Deferred tax assets relating to property, plant and equipment and short-term timing differences of £2.1 million (2015: £9.2 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 £1.1 million (2015: £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 Share capital

	2016 £'000	2015 £'000
Allotted, called up and fully paid		
516,603,910 (2015: 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 (2015: Nil); however, the Company funds Employee Share Trusts to meet its obligations under the Company's share schemes. During the year the Trusts purchased 666,000 (2015: 4,170,000) of the Company's ordinary shares through purchases on the London Stock Exchange for a total cash consideration of £450,000 (2015: £4,058,000) 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 £450,000 (2015: £4,058,000) has been deducted from retained earnings.

As of 31 March 2016, the total number of ordinary shares held by the Trusts to meet obligations under the Company's share schemes was 186,000 (2015: 165,000).

27 Financial instruments and risk management

The Group's principal financial instruments during the year comprised bank loans, cash on short-term deposits, interest rate swaps and forward foreign exchange contracts. The main purpose of these financial instruments is to finance the Group's operations, to manage the interest rate risk arising from its sources of finance 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 June 2014. These bank facilities comprise a multi-currency revolving credit facility of £200.0 million, provided by a group of five core relationship banks. The facility matures in June 2019. 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 £10.0 million overdraft facility provided by the Group's clearing bankers.

The net debt position of £99.3 million at the beginning of the financial year has decreased during the year to net funds of £7.4 million. The Group generated positive cash flow after investing activities of £141.9 million for the year (2015: £19.2 million).

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 2015			
Borrowings	1,734	3,465	107,146
Trade and other payables	106,832	—	—
Cash flow hedges	706	—	—
Finance leases	1,743	5,155	—
Total	111,015	8,620	107,146
At 31 March 2016			
Borrowings	**—**	**—**	**—**
Trade and other payables	**101,330**	**—**	**—**
Forward foreign exchange contracts	**11**	**—**	**—**
Finance leases	**3,271**	**3,680**	**—**
Total	**104,612**	**3,680**	**—**

The table below sets out the year end fair value of derivative financial instruments by category:

	2016		2015	
	Assets £'000	**Liabilities £'000**	Assets £'000	Liabilities £'000
Interest rate swaps – cash flow hedges	**—**	**—**	—	706
Forward foreign exchange contracts	**—**	**11**	328	—
Total (all current)	**—**	**11**	328	706

Notes to the financial statements continued

for the year ended 31 March 2016

27 Financial instruments and risk management continued

Interest rate risks

Sterling interest rate swaps with a nominal value of £60.0 million matured on 31 July 2015. The weighted average fixed interest rate payable (including margin) was 3.4% (2015: 3.6%). The weighted average rate of current interest rate swaps in place at the year end was Nil (excluding margin). Interest rate exposures will continue to be hedged in accordance with the Treasury policy.

The impact of an increase in interest rates of 100 basis points is shown in the table below:

	2016 £'000	2015 £'000
Reduction/(increase) in profit before tax	—	327

The sensitivity of profit before tax is calculated based on floating rate borrowings at the balance sheet date, after deducting floating rate financial assets and amounts hedged into fixed rates by interest rate swaps.

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.

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 £13.2 million at the year end (2015: £11.0 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 2016 and 31 March 2015 was:

	2016 £'000	2015 £'000
Currency		
Sterling	**9,139**	12,052
US Dollar	**3,925**	(1,572)
Euro	**148**	530
Total	**13,212**	11,010

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 (2015: £1.3 million) of cash collateral was held by Barclays in respect of a bank guarantee given under Ofcom's 'Funds for Liabilities' regulations.

27 Financial instruments and risk management continued

Currency and interest rate risk profile of financial assets and financial liabilities continued

Financial liabilities

The currency and interest rate risk profile of the Group's financial borrowings at 31 March 2016 and 31 March 2015 was:

	2016			2015		
	Floating £'000	**Fixed £'000**	**Total £'000**	Floating £'000	Fixed £'000	Total £'000
Sterling	—	—	—	43,460	60,000	103,460

Undrawn committed borrowing facilities at the year end were £200.0 million (2015: £95.0 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.

Fair values of financial assets and financial liabilities

The mark-to-market value of the interest rate swaps and forward contracts at 31 March 2016 was an asset of £Nil (2015: £0.4 million). Interest rate swaps are accounted for by adjusting the interest cost on the floating debt return. The fair value of financial assets and financial liabilities is obtained from third party sources. The movement in mark-to-market value is reflected in reserves and is shown in the table below:

	£'000
Hedging reserve	
At 31 March 2015	442
Movement in the year	(442)
At 31 March 2016	—

The effectiveness of the interest rate swaps was tested quarterly, until they matured, and all were considered to be effective cash flow hedges. There are no other significant differences between the fair value of the Group's financial assets and liabilities and their book value.

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.

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.

Total capital is shown in the table below and is calculated as 'equity' as shown in the Consolidated balance sheet plus net debt.

	2016 £'000	2015 £'000
Net (funds)/debt	**(7,412)**	99,348
Total equity	**116,267**	63,879
Total capital	**108,855**	163,227

Under the Group's £200.0 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.

Notes to the financial statements continued

for the year ended 31 March 2016

28 Financial commitments

Authorised future capital expenditure and financial investment amounted to:

	Consolidated	
	2016 £'000	2015 £'000
Property, plant and equipment	**1,382**	750
Intangible assets	**989**	696
Total	**2,371**	1,446

The Group as lessee

The future aggregate minimum lease rental commitments under non-cancellable operating leases were as follows:

	Consolidated	
	2016 £'000	2015 £'000
Leasehold buildings:		
– within 12 months	**2,878**	3,363
– in 1 to 5 years	**9,850**	9,094
– after 5 years	**8,597**	6,412
Total	**21,325**	18,869
Plant and equipment:		
– within 12 months	**793**	1,183
– in 1 to 5 years	**193**	487
Total	**986**	1,670

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 £4.1 million (2015: £3.9 million).

Defined benefit schemes

The principal defined benefit scheme at 31 March 2016 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 operates also 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.

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 2016 (2015: £Nil).

29 Retirement benefit obligation – consolidated continued

Most recent valuations

The most recent formal valuation for the Kingston Communications Pension Scheme was at 31 March 2014. 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 2014. 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 exemption 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 substitute the freehold property assets with other assets. As partner 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 KC network on an insolvency event.

As partner 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.

Employer contributions for the year ended 31 March 2016

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:

	2016 £'000	2015 £'000
Deficit payments	**6,565**	4,270

Existing committed deficit recovery payments due over the financial year ending 31 March 2016 are £2.0 million.

Notes to the financial statements continued

for the year ended 31 March 2016

29 Retirement benefit obligation – consolidated continued

Main financial assumptions

	2016 per annum %	2015 per annum %
RPI inflation	**2.95**	2.95
CPI inflation	**1.95**	1.95
Rate of increase to pensions in payment	**2.00**	2.00
Discount rate for scheme liabilities	**3.45**	3.25

Our central 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 89.1 (2015: 89.4) if they are male and on average to age 91.3 (2015: 91.8) if they are female; and

> a current pensioner aged 65 will live on average to age 87.4 (2015: 87.7) if they are male and on average to age 89.3 (2015: 89.9) if they are female.

The key assumptions used for IAS 19 are discount rate, inflation and mortality. The sensitivity of the 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%	19.5%	(19.5%)
Discount rate for scheme liabilities	0.1%	(28.6%)	29.3%
Mortality	1 year	42.5%	(43.2%)

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 2016 £'000	Value at 2015 £'000
Equities	**34,308**	37,701
Property	**995**	—
Hedge funds	**48,352**	51,480
Index-linked gilts	**455**	59,465
Corporate bonds	**42,656**	34,550
Other	**86,422**	25,586
Total fair value of assets	**213,188**	208,782

History of asset values, defined benefit obligation, deficit in scheme and experience gains and losses

	2016 £'000	2015 £'000	2014 £'000	Restated[1] 2013 £'000	2012 £'000
At 31 March					
Present value of defined benefit obligation	**(227,538)**	(240,217)	(217,600)	(203,300)	(199,377)
Fair value of plan assets	**213,188**	208,782	191,100	193,542	185,491
Deficit	**(14,350)**	(31,435)	(26,500)	(9,758)	(13,886)
Experience gains/(losses) on plan assets	**721**	14,407	(3,130)	7,715	(2,860)
Experience gains/(losses) on plan liabilities	**11,409**	(21,670)	(13,500)	(3,010)	(22,606)

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.

29 Retirement benefit obligation – consolidated continued

Fair value of assets continued

Reconciliation of funded status to balance sheet

	2016 £'000	2015 £'000
Fair value of assets	**213,188**	208,782
Present value of funded defined benefit obligations	**(227,538)**	(240,217)
Liability recognised on the balance sheet	**(14,350)**	(31,435)
Analysis of income and expenditure charge:		
– administration expenses	**656**	500
– finance costs	**954**	1,067
Charge recognised in the income statement	**1,610**	1,567

	2016 £'000	2015 £'000
Changes to the present value of the defined benefit obligation during the year		
Opening defined benefit obligation	**240,217**	217,600
Finance costs	**7,663**	9,182
Remeasurements arising from changes in financial assumptions	**(8,677)**	22,170
Remeasurements arising from changes in demographic assumptions	**(2,732)**	(500)
Net benefits paid out	**(8,933)**	(8,235)
Closing defined benefit obligation	**227,538**	240,217

	2016 £'000	2015 £'000
Changes to the fair value of scheme assets		
Opening fair value of assets	**208,782**	191,100
Finance income	**6,709**	8,115
Administration expenses	**(656)**	(500)
Asset-backed partnership expenses	**—**	(375)
Remeasurements	**721**	14,407
Contributions by the employer	**2,702**	2,270
Deficit repair payments	**3,863**	2,000
Net benefits paid out	**(8,933)**	(8,235)
Closing fair value of assets	**213,188**	208,782

30 Other commitments and contingent liabilities

Contingent liabilities existed at 31 March 2016 and at 31 March 2015 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 48 to 62 and forms part of these financial statements.

Intra-group transactions

Amounts payable by the Company to KCH (Holdings) Limited, a subsidiary undertaking, totalled £0.5 million (2015: £7.5 million) as at 31 March 2016.

Five year summary of consolidated figures

as at 31 March 2016

	2016 £'000	2015 £'000	2014 £'000	2013 £'000	2012 £'000
Income statement (total operations)					
Revenue	**349,222**	347,984	370,697	372,869	387,316
EBITDA before exceptional items	**74,937**	74,304	75,291	74,862	77,875
Group operating profit before exceptional items	**50,898**	57,193	55,019	55,250	57,770
Profit after taxation before exceptional items[1]	**30,248**	47,332	38,317	37,395	37,727
Profit after taxation (reported)	**71,134**	12,544	38,770	35,845	37,727
Balance sheet					
Non-current assets	**198,006**	236,678	247,208	235,446	239,639
Current assets (excluding cash and loan issue costs)	**66,918**	81,353	76,782	72,510	75,530
Current liabilities (excluding finance leases and overdrafts)	**(132,443)**	(118,754)	(130,210)	(123,592)	(146,367)
Net funds/(debt) (including finance leases)	**7,412**	(99,348)	(74,976)	(88,218)	(75,267)
Provisions and other non-current liabilities (excluding finance leases)	**(23,626)**	(36,050)	(33,651)	(13,504)	(20,078)
Total equity	**116,267**	63,879	85,153	82,642	73,457
Movement in debt					
Net cash flow from:					
– operating activities	**80,373**	50,779	71,266	50,309	55,994
– capital expenditure	**(28,426)**	(32,022)	(27,912)	(27,996)	(22,148)
– interest	**(2,794)**	(5,574)	(4,436)	(4,006)	(7,363)
– equity dividends paid	**(28,672)**	(26,057)	(23,764)	(21,387)	(19,786)
– other	**86,279**	(11,498)	(1,912)	(9,871)	33
Decrease/(increase) in net debt	**106,760**	(24,372)	13,242	(12,951)	6,730
Ratios and other key information					
Average number of employees	**1,706**	1,776	1,907	1,886	1,792
EBITDA before exceptional items to revenue (%)	**21.5**	21.4	20.3	20.0	20.1
Group operating profit before exceptional items to revenue (%)	**14.6**	16.4	14.8	14.8	14.9
Basic earnings per share (pence)	**13.96**	2.47	7.64	7.08	7.41
Dividend per share relating to the financial year (pence)	**5.91**	5.37	4.88	4.44	4.00

1. Including the tax impact of exceptional items.

Shareholder information

Analysis of ordinary shareholders

(at 31 March 2016 by category)

	Number of holders	Number of shares	% of capital
Private shareholders	52,056	49,172,209	9.52
Insurance company	0	0	0.00
Investment trust	6	109,038	0.02
Pension fund	0	0	0.00
Nominee companies	1,102	376,333,861	72.85
Limited company	63	272,325	0.05
Bank and bank nominees	15	90,488,240	17.52
Other institutions	14	228,237	0.04
Total	**53,256**	**516,603,910**	**100.00**

Financial calendar

Annual General Meeting	22 July 2016
Half year results announcement (provisional)	5 December 2016
Final results announcement (provisional)	26 May 2017

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

Registered office
KCOM Group PLC
37 Carr Lane
Hull HU1 3RE

Registered in England and Wales

Company number
2150618

Investor relations
KCOM Group PLC
37 Carr Lane
Hull HU1 3RE

Email: investor.relations@kcom.com
Tel: 01482 602711
Website: www.kcomplc.com

Corporate responsibility
KCOM Group PLC
Kathy Smith
37 Carr Lane
Hull HU1 3RE
Email: kathy.smith@kcom.com
Tel: 01482 602100

Advisors

Independent auditors
PricewaterhouseCoopers LLP
Chartered Accountants and
Statutory Auditors
Benson House
33 Wellington Street
Leeds LS1 4JP

Registrar
Capita Asset Services
The Registry
34 Beckenham Road
Beckenham
Kent BR3 4TU

Email: shareholderenquiries@capita.co.uk
Tel: +44 (0)871 664 0300 (calls cost 12 pence per minute plus network extras; lines are open 9.00am–5.30pm Monday–Friday)
Website: www.capitaassetservices.com

Financial advisors
Barclays
1 Churchill Place
Canary Wharf
London E14 5HP

Peel Hunt
Moor House
120 London Road
London EC2Y 5ET

Website

www.kcomplc.com

This document is completely CarbonNeutral®.

The unavoidable CO_2e generated by this document has been reduced to net zero through verified carbon offset projects.

The papers used in this report is Splendorgel EW (FSC®). The printer and the manufacturing mills are accredited with the ISO 14001 standard for environmental management and both are FSC® certified.

CarbonNeutral.com

FSC® C016486

For more information please visit
www.kcomplc.com