



Audit Committee report

Director	Appointed to the Committee	Number of meetings	Out of possible
Liz Barber – Chairman	April 2015	4	4
Patrick De Smedt	January 2016	4	4
Peter Smith	January 2015	4	4

Dear shareholder

On behalf of the Audit Committee and the Board, I am pleased to present the Audit Committee report for the year ended 31 March 2018.

The Audit Committee is a sub-committee of the Board and our role is to review all aspects of the financial reporting of the business and of internal control. As a Committee we seek to represent the interests of our shareholders in relation to the integrity of information and the effectiveness of the audit processes in place.

Committee meetings

This year we increased the number of meetings that the Committee has had from three to four, with the extra meeting being held in September to plan for the audit of the half-year numbers and to hear additional updates from the internal auditor. We intend to continue to hold four meetings a year in the future.

Internal and external audit

The Committee is responsible for overseeing the relationships with the internal and external auditors. Our external auditor, PricewaterhouseCoopers LLP, has been our auditor for 12 years. In the year ended 31 March 2017 we held a comprehensive, competitive tender process at which PricewaterhouseCoopers LLP was re-appointed, but with a revised audit team who were new to the business. We have monitored the relationship with PricewaterhouseCoopers LLP throughout the year and I have met with the audit team separately from the management team on a number of occasions. During the year the Financial Reporting Council (FRC) performed a review of the audit quality of our external audit for the year ended 31 March 2017 and they provided me with a copy of their report. While some areas for improvement were identified, the Committee was pleased to note that there were no findings that gave concern around the objectivity, quality or independence of the audit.

KPMG has continued to provide us with internal audit services during the year. Their audit plan is compiled from reviewing the key risks in the business, meeting with senior management and from their experience and knowledge of key risk areas in other similar businesses. Their audits this year have ranged from a detailed review of specific contracts in our Enterprise segment to a phishing exercise to test response rates across the business to identify specific security training needs. KPMG has brought in subject-matter experts as and when relevant to input to the audit scope and the actual audit work performed. We have received reports at each meeting on the adequacy of the controls in the audit areas and the progress in resolving the audit issues raised. I have had meetings with the internal auditor, away from the management of the business, a number of times during the year, to discuss the audit issues raised and the plan for future audits.

Significant issues relating to the financial statements

At each meeting there is a paper prepared by the Finance team on the significant accounting judgements made and the potential significant issues arising in the financial statements. This is reviewed and discussed in detail at each meeting and the external auditor is asked for their input. The significant issues discussed in the year have remained consistent with previous years and the Committee has been satisfied that the issues have been effectively managed throughout the year.

Feedback

The views of our shareholders are extremely important to us and any feedback on the work of the Audit Committee would be very welcome. Feedback can be given via our Company Secretary, Kathy Smith, who can be contacted at kathy.smith@kcom.com.

Liz Barber

Chairman, Audit Committee
8 June 2018

Composition

For the year under review, the Audit Committee has consisted of three Non-Executive Directors.

The table on page 52 shows the membership and attendance at Committee meetings during the year.

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

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

Meetings

There were four meetings held in the year: in May, September, November and March. An overview of the key points considered at each meeting is shown below:

May 2017

- > The risk appetite statement was reviewed and the updates from the previous version discussed and approved.
- > The draft longer-term viability statement was reviewed and approved for inclusion in the Annual Report for the year ended 31 March 2017.
- > The year end numbers were reviewed and the key accounting judgements made were discussed, with input from the external auditor.
- > The external auditor gave an update on their year end audit work, including an overview of the controls work performed, and confirmed their continued independence.
- > The non-audit fees for the year ended 31 March 2017 were reviewed and deemed satisfactory by the Committee.
- > There was an update on the internal audit work performed since the previous meeting.
- > The Committee reviewed all of the declarations that the Board would be expected to make in the year end accounts and noted these.

“The views of our shareholders are extremely important to us and any feedback on the work of the Audit Committee would be very welcome.”

September 2017

- > An overview of the key accounting judgements for the interim results was presented and discussed, with input from the external auditor on their planned interim work.
- > An update of the work around the introduction of IFRS 15 on revenue recognition was presented and discussed.
- > The external auditor provided an update on some work they had performed on the maturity of controls in relation to the SAP system.
- > The proposed external audit fee for the year ended 31 March 2018 was agreed and the external audit plan was discussed.
- > There was an update on the internal audit work performed since the previous meeting.
- > An update on two whistleblowing matters was provided and discussed.

November 2017

- > The half year numbers and key accounting judgements (in particular the accounting for provisions and losses in relation to complex customer contracts) were discussed, with input from the external auditor.
- > An update of the ongoing work in relation to IFRS 15 on revenue recognition was presented and discussed.
- > There was an update on the internal audit work performed since the previous meeting.

March 2018

- > The declarations that would be required from the Committee and the Board at the year end were reviewed and discussed to ensure all were aware of the requirements.
- > The proposed methodology for the longer-term viability statement was reviewed and discussed for the year ended 31 March 2018.
- > The key accounting judgements in relation to the year end numbers were reviewed and discussed, with input from the external auditor.
- > An update of the work in relation to IFRS 15 was given, including the assumptions made.
- > The external auditor set out their approach for the year end.
- > There was an update on the internal audit work performed since the previous meeting and the internal audit plan for the following financial year was discussed and approved.

Each year the Audit Committee is also responsible for:

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

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

Audit Committee report continued

External audit

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

PricewaterhouseCoopers LLP was appointed as auditor in 2006 and the Committee undertook a competitive tender process, in accordance with the requirements of the Statutory Audit Services Order, in the year ended 31 March 2017. The outcome of this was that PricewaterhouseCoopers LLP was re-appointed as the external auditor as they were deemed to be the firm that best matched the criteria set out by the Committee.

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

During the year the Audit Quality Review team of the FRC reviewed the work performed by PricewaterhouseCoopers LLP for the audit of KCOM for the year ended 31 March 2017. The FRC has provided a copy of their confidential report to the Chairman of the Committee, which has been reviewed and discussed by the Committee and with PricewaterhouseCoopers LLP. Whilst there were no significant findings, some areas of the external audit procedures were identified as requiring improvement and these have been reviewed in detail by the Chairman of the Committee. We are satisfied with the responses implemented by PricewaterhouseCoopers LLP for the audit of the Group's financial statements for the year ended 31 March 2018 and the Committee is content that the matters raised do not give it concerns over the quality, objectivity or independence of the audit.

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

Policy on non-audit work

We have a policy in relation to the engagement of External Auditors which is regularly reviewed and updated to reflect the latest legislation as appropriate. This policy covers the selection of firms to perform non-audit work. It specifically excludes the auditor from providing specific services, such as certain tax services, any services that play a part in the management or decision-making of KCOM, book-keeping and preparing accounting records or financial statements, payroll services, the design and implementation of certain internal control or risk management procedures, valuation services, certain legal or human resources services, internal audit services and certain services linked to the financing, capital structure and investment strategy of KCOM. All other non-audit work is assessed separately and is awarded to the firm considered best suited to perform the work. Any such work must be agreed in advance by the Audit Committee Chair, work with a fee greater than 20 per cent of the annual audit fee must be approved by the Audit Committee before the external auditor 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 £266,000 (2017: £262,000). In addition to this, the external auditor provided services to the value of £70,000 (2017: £77,000) relating to pension scheme and overseas subsidiary advice as well as consultancy in relation to ISAE3402 and SSAE16. In these areas the auditor was considered the most appropriate firm to perform the work.

Risk management and internal control

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

Internal audit

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

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

The internal auditor reports 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 auditor 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 auditor.

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

During the year, the work performed by KPMG included a detailed review of specific contracts in the Enterprise segment, reviews of the risk management processes in place across the Group, the compliance project in relation to GDPR, the controls in relation to capital expenditure and procurement and a review of resource planning. In addition a phishing exercise was performed to test response rates and to identify specific areas where targeted training may be required.

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. The Committee was satisfied that all of the issues considered were being effectively managed. More details on our critical accounting judgements and the key sources of estimation in relation to these are included in Note 3 to the accounts.

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		
<p>Testing goodwill for potential impairment is complex and requires a number of management judgements and estimates to be applied.</p> <p>This is a recurring matter.</p>	<p>Goodwill impairment calculations compare the value in use of the Group's Cash Generating Units with their carrying values. Value in use calculations are based upon the Board approved budgets with judgements made over discount rates and future growth assumptions. The goodwill impairment calculation was consistent with previous years except for the inclusion of additional sensitivity analysis to demonstrate the possible impact of key assumptions. The goodwill impairment calculation and sensitivity analysis was reviewed by the Committee, along with the judgements and estimates made. These were discussed in detail and it was concluded that there was no impairment and that the planned disclosure of the enhanced sensitivity analysis was appropriate.</p>	<p>The Committee reviewed the calculations in detail and challenged the judgements and estimates. The conclusion was that no changes were required.</p>
Pension accounting assumptions		
<p>Pension accounting is complex and there are a number of judgements and estimates that have to be made, which can have a significant impact on the valuation of scheme liabilities.</p> <p>This is a recurring matter.</p>	<p>The assumptions that had been made in relation to the pension accounting were reviewed by the Committee, which was satisfied that these were in line with recognised market practice and with the previous assumptions made.</p> <p>No changes were therefore required.</p>	<p>The assumptions were reviewed and challenged by the Committee.</p> <p>No changes were made as the Committee concluded that it agreed with the treatment adopted by management.</p>
Classification of exceptional costs		
<p>The accounting policy in relation to exceptional items has been refined in order to provide greater transparency and clarity to the users of the accounts. The refined policy and the judgement required in the application of the policy were both reviewed by the Committee.</p> <p>The consideration of the classification of exceptional items is a recurring matter when there are significant exceptional items.</p>	<p>The Committee believes that the revised policy provides a greater clarity of those items classified as exceptional. Management has followed the new policy during the year and therefore the Committee was satisfied with the treatment adopted by management.</p>	<p>No changes were made as the Committee was in agreement with the treatment and the policy changes made.</p>
Significant contracts		
<p>The Group has a number of significant customer contracts. These usually involve some judgement in relation to the timing of revenue recognition.</p> <p>This is a recurring matter.</p>	<p>A number of significant customer contracts have continued or been entered into during the year. Judgements made in relation to the larger contracts have been reviewed by the Committee in the year.</p>	<p>The Committee challenged some of the assumptions made and requested detailed information on some specific contracts from key members of staff directly involved in the contracts. The information provided satisfied the Committee that the policies applied, and the assumptions made, were appropriate and had been consistently followed.</p>