



**Consultation Paper**

**Regulation of Universal Postal Services-  
Accounting Separation & Costing Methodology**

**New Accounting Direction to An Post**

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All responses to this consultation should be clearly marked:-  
“Reference: Submission re ComReg 06/55” as indicated above,  
and sent by post, facsimile, e-mail or on-line at [www.comreg.ie](http://www.comreg.ie)  
(current consultations), to arrive on or before 5.00pm, 31 October  
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Please note ComReg will publish on its website all submissions  
with the Response to Consultation, subject to the provisions of  
ComReg’s guidelines on the treatment of confidential information  
– ComReg 05/24

## Contents

1	Foreword.....	2
2	Executive Summary.....	3
3	Introduction .....	4
3.1	LEGAL BASIS.....	4
3.2	REASONS FOR REVIEW OF ACCOUNTING DIRECTION ISSUED 20 SEPTEMBER 2001 .....	4
4	Summary of LECG's Proposed Amendments to the current Accounting Direction .....	6
5	Consultation Issues .....	8
5.1	COMREG'S POSITION .....	8
5.1.1	<i>Weighted (Equivalent) Volumes (see section 11 of LECG report)</i> .....	9
5.1.2	<i>Definition of Regulatory Accounts (see section 14 of LECG report)</i> .....	9
5.1.3	<i>Form of Audit Opinion (see section 14 of LECG report)</i> .....	10
5.1.4	<i>Prior Year Accounts (see section 14 of LECG report)</i> .....	10
5.1.5	<i>Template Schedules (see section 14 of LECG report)</i> .....	11
6	Submitting Comments.....	12
	Appendix A – Legislation .....	13
	Appendix B – Consultation Questions .....	14

## 1 Foreword

All businesses, regardless of sector, require good quality cost and management accounts, prepared on a consistent and timely basis, to inform pricing and costing decisions.

Irish Law requires ComReg to issue directions setting out how An Post, the Universal Service Provider (USP), should maintain cost accounts so as to achieve transparency of accounting in respect of the costs incurred in providing the various postal services within the scope of universal service. In light of these requirements<sup>1</sup> and following a consultation process, an Accounting Direction<sup>2</sup> was issued to An Post in September 2001.

As over four years have elapsed since the Accounting Direction was first issued, ComReg considers it now appropriate to issue a new Accounting Direction under the current Regulations<sup>3</sup> because of concerns that:

- the processes applied by An Post to identify its revenues, measure its mail volumes and allocate and apportion its costs at the service level, together with the manner in which information is provided to ComReg, may not be sufficiently robust to demonstrate compliance with its legal obligations.
- the provisions of the current Accounting Direction may not meet today's needs. Additionally, market developments such as the introduction of EPOS<sup>4</sup> postage labels, together with the gradual reduction in the size of the reserved area, mean that specific requirements of the current Accounting Direction may no longer be appropriate.

The report prepared for ComReg by its consultants, LECG of London, recommends that ComReg issues a new Accounting Direction before the end of this year. Before deciding whether or not to accept LECG's recommendations, in whole or in part, ComReg would very much welcome the views and observations of all interested parties in the time set aside for submission.

**Isolde Goggin,  
Chairperson**

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<sup>1</sup> Regulation 12(2) of the European Communities (Postal Services) Regulations, 2000 (S.I. No. 310 of 2000)

<sup>2</sup> D15/01 ODTR 01/74 Decision Notice & Report on Consultation "Regulation of Universal Postal Services- Accounting Separation & Costing Methodology Proposed Direction to An Post"

<sup>3</sup> Regulation 11(2) of the European Communities (Postal Services) Regulations, 2002 (S.I. No. 616 of 2002).

<sup>4</sup> EPOS - Electronic Point of Sale

## 2 Executive Summary

Following a public consultation process an Accounting Direction was issued to An Post on 20 September 2001.

As over four years have elapsed since the Accounting Direction was issued, it was considered appropriate to commission an external review, with a view to issuing a new Direction.

ComReg commissioned LECG, in June 2006 to examine the current Accounting Direction and recommend changes which it considered necessary. This consultation paper focuses on LECG's recommended changes to the current Accounting Direction, but ComReg welcomes submissions on any other aspect of the Accounting Direction not specifically addressed in LECG's recommended new draft Accounting Direction.

LECG propose a number of additional requirements on An Post, specifically with regard to:

- Regulatory Accounts
- Accounting Manual
- Mail Volume and Revenue Identification
- Audit of accounts and confirmation of compliance

ComReg does not comment in this paper on the position taken by LECG or its recommended new Accounting Direction, other than identifying specific areas where ComReg is of the opinion that there may be a need for further changes. Such issues include:

- Weighted (Equivalent) Volumes (see section 11 of LECG's report)
- Definition of Regulatory Accounts (see section 14 of LECG's report)
- Form of Audit Opinion (see section 14 of LECG's report)
- Prior Year Accounts (see section 14 of LECG's report)
- Template Schedules (see section 14 of LECG's report)

All comments are welcome during the consultation period which will run from 29 September until to 31 October 2006. Having analysed and considered the comments received, ComReg will publish its report on the consultation (together with its decision on a new Accounting Direction) in early December 2006.

### **3 Introduction**

#### **3.1 Legal Basis**

Regulation 12(2) of the European Communities (Postal Services) Regulations, 2000 (S.I. No. 310 of 2000) required that ComReg lay down directions about how An Post should maintain separate accounts within its accounting systems so as to achieve the transparency of accounting required by the EU Postal Directive.

Following a public consultation, an Accounting Direction was issued to An Post under the 2000 Regulations on 20 September 2001.

These 2000 Regulations were replaced by the European Communities (Postal Services) Regulations 2002 (S.I. No. 616 of 2002) which continued the Accounting Direction requirement in identical wording.

Regulation 11(5) of the 2002 Regulations requires An Post to comply with the provisions of Regulation 11(2) and (3) therein. Compliance shall be verified by auditors engaged by An Post and a statement to that effect shall be published in its annual report.

#### **3.2 Reasons for Review of Accounting Direction issued 20 September 2001**

It was always recognised that it would not be feasible for An Post to adjust its cost accounting practices overnight and the ODTR / ComReg felt that a cooperative and constructive approach was the best way to achieve compliance.

As over four years have elapsed since the Accounting Direction was issued it was considered appropriate to commission an external review, with a view to issuing a new Direction under the 2002 Regulations, taking into account:

- concerns that the processes applied by An Post to identify its revenues, measure its mail volumes and allocate and apportion its costs at the service level, together with the manner in which information is provided to ComReg<sup>5</sup>, may not be sufficiently robust to demonstrate compliance with its legal obligations.
- concerns that the provisions of the current Accounting Direction may not meet today's needs. Additionally, market developments such as the introduction of EPOS<sup>4</sup> postage labels, together with the gradual reduction in the size of the reserved area, mean that specific requirements of the current Accounting Direction may no longer be appropriate.

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<sup>5</sup> See in particular sections 7.1.3 and 9 of ComReg 05/68r 'An Post's Proposals to increase the price of Domestic Postal Services 2005' and section 6 of ComReg D12/05 05/94 "Response to Consultation & Decision Notice – An Post Domestic Pricing Application 2005"

ComReg's intention to revise the current Accounting Direction with the assistance from Consultant's was formally announced in its Response to Consultation and Decision Notice (An Post Domestic Pricing Application 2005- ComReg document 05/94) in December 2005.

Following its Invitation to Tender, ComReg commissioned LECG in June 2006 to examine the current Accounting Direction and recommend any changes which it considered necessary.

ComReg is now launching a public consultation on the content and scope of the new Accounting Direction to be issued to An Post. While this consultation paper will focus on LECG's recommended new Accounting Direction, ComReg will be glad to receive submissions on any other aspect of the Accounting Direction not specifically addressed in this paper or in LECG's recommended new Accounting Direction or on any other issue raised in this paper.

#### **4 Summary of LECG's Proposed Amendments to the current Accounting Direction**

LECG's report of its findings, together with its recommended new Accounting Direction, is published as a supplement to this paper – ComReg document 06/55a. In its report, LECG proposes the following revisions:

- (a) Regulatory Accounts:
  - Introduction of Schedules outlining the content and format of the Regulatory Accounts.
  - Inclusion of commentary in relation to trends, changes in accounting policies and methodologies and reconciliation of operational volumes with revenue calculations.
  - Directors and Auditors reports and opinions on the Regulatory Accounts confirming compliance with the requirements of the Accounting Direction.
  - Results of annual audit of the statistical sampling process used to identify mail volumes and revenues.
  - Publication of Regulatory Accounts.
- (b) Accounting Manual:
  - Periodic review by an independent reviewer.
  - An Post should obtain ComReg's approval for each annual edition of the manual in advance of the start of the relevant regulatory period.
  - Specification of the processes employed by An Post to identify costs (i.e. directly allocated costs, common costs allocated on the basis of analysis of the origin of the costs themselves, and common costs which have been allocated on the basis of a general allocator) and equivalent volume cost drivers.
- (c) Mail Volume and Revenue identification:
  - Mail volumes which can be directly assigned to a particular service shall be so assigned. If this is not possible statistical sampling should be used to apportion to the service level.

- Mail volumes by services should be recorded separately from revenues and operational volume data.
- Revenue data should be recorded at the point of sale.
- Statistical sampling processes should be subject to annual audit and procedural review.
- Revenue and mail volumes processes should be subject to periodic review by an independent reviewer.

(d) Audit and Confirmation of Compliance:

- Performance of an audit on the Regulatory Accounts.
- Auditors report (on Regulatory Accounts) should be addressed to ComReg and An Post and should be published with the Regulatory Accounts.
- Form of audit should be developed by ComReg in consultation with An Post. ComReg should be party to the auditor's terms of engagement and agree the scope of the audit.



## 5 Consultation Issues

There are four questions that ComReg is now putting to consultation. ComReg welcomes responses from all interested parties on these topics or any other element not specifically addressed which may be deemed relevant.

*Q. 1. Do you consider that the current Accounting Direction should be revised at this time?*

*Q. 2. Do you consider that the changes recommended by LECG are warranted and appropriate?*

*Q. 3. What is your view on the practicalities, timelines, cost etc. of implementing the changes recommended by LECG?*

*Q. 4. Are there any additional changes that you would recommend?*

### 5.1 ComReg's Position

It is not the intention of ComReg to comment on the position taken by LECG or its recommended amendments to the current Accounting Direction in this paper, other than identifying specific areas of the recommended new Accounting Direction where ComReg is of the opinion that there may be a need for further amendment.

During and after the consultation phase, ComReg's will review and consider each proposed change, before making any final decision as to the content of the new Accounting Direction.

As indicated in section 6 of ComReg's decision document 05/94<sup>6</sup> a review of the Accounting Direction is included in the ComReg work programme for the current year.

There are a number of additional issues which have been highlighted by LECG in its report which ComReg believes should be considered for specific mention in the new Accounting Direction. These include:

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<sup>6</sup> ComReg 05/94 – Section 6 “A review of the Accounting Direction is included in the ComReg work programme for the coming year. .... So as to assist it in the development of a revised Accounting Direction, ComReg has decided it will launch a public tendering process inviting all suitably qualified parties to make appropriate submissions.”

*5.1.1 Weighted (Equivalent) Volumes (see section 11 of LECG report)*

The basis on which costs should be allocated to services and products are set out in the Postal Directives and the current Accounting Direction and LECG's recommended new Direction reflects this. Volume as such is not generally a driver of costs, e.g. the cost of delivery is driven by the number of premises that the postperson has to call at, the distance to be travelled, and the time waiting for the addressee to accept a package or item requiring a signature on delivery, rather than the number of items to be delivered.

However volume-based costing systems have been employed in the postal sector whereby the costs of particular activities were apportioned amongst the services provided on a volume related basis. As this method assumes that all costs are proportional to the associated volume measure it can lead to service cost distortions, understating the cost of low volume services and overstating the cost of high volume services.

An Post uses a system of weighted (equivalent) volumes to allocate the cost of some activities. This can be an acceptable basis for estimating the required indirect attribution of common costs to particular services, providing that the weighing factors are correctly calculated on an annual basis. This system is mentioned in the current Accounting Direction and LECG has not proposed any amendment.

LECG has reported that the Postal Directive appears to require the use of equi-proportional mark-ups (EPMUs) to allocate costs that cannot be directly or indirectly attributed. The use of weighted (equivalent) volumes is not appropriate in allocating such costs and ComReg is minded therefore to remove the reference to such use from the new Accounting Direction and let the principles of cost allocation and apportionment transposed from the Postal Directives apply without qualification. This would not prevent An Post from using a weighted (equivalent) volume basis to indirectly attribute appropriate common costs so long as the weighing factors are correctly calculated on an annual basis and that they represent the driver of the associated cost.

*5.1.2 Definition of Regulatory Accounts (see section 14 of LECG report)*

So as to aid understanding, there is a need for the new Accounting Direction to ensure that the scope of the regulatory accounts should be distinguished from the scope of the statutory financial accounts.

Regulatory accounts should provide adequate information on the profitability and costs of various parts of the business, enabling An Post to demonstrate its compliance with the Tariff Principles, Terminal Dues Principles, Universal Service and other regulatory obligations. These accounts should also enable ComReg to fulfil its statutory obligations to monitor such compliance.

Regulatory accounts are more specific than financial accounts, reflecting the actual costs incurred in the provision of a service in a particular accounting period. Prior

year adjustments, transaction such as the revaluations of assets, etc., whether or not disclosed in the statutory financial accounts, are not relevant to the Regulatory accounts.

Financial accounts on the other hand are primarily concerned with providing a true and fair view of all the transactions of the business and its financial position at the end of the accounting period.

#### 5.1.3 Form of Audit Opinion (see section 14 of LECG report)

LECG in its proposed new Accounting Direction has recommended that *“The precise form of audit opinion shall be developed by ComReg after consultation with An Post’s auditors and the Irish accountancy profession, amongst others and with regard to international best practice. ComReg will issue a separate Direction containing the form of the opinions”*.

While ComReg is of the opinion that an auditor’s statement of opinion is fundamental, as it assures interested parties that an appropriate cost accounting system has been put in place, it would seem preferable to include the form of audit opinion required as an appendix to the proposed new Accounting Direction, rather than as a separate Direction. LECG have included the form of opinion recommended by the Institute of Chartered Accountants in England and Wales at appendix 6 of its report. ComReg would ask for submissions from the accounting profession and all other interested parties on the proposition that this form of audit opinion, with appropriate adaptations should be used.

#### 5.1.4 Prior Year Accounts (see section 14 of LECG report)

While LECG has stated in the body of its report that *“best practice relating to the restatement of prior year’s accounts follows GAAP and this approach should be followed in the preparation of An Post’s regulatory accounts”*<sup>7</sup>, no provision for this has been provided for in its recommended new Accounting Direction.

Article 4 of the 4<sup>th</sup> Council Directive 78/660/EEC 1978, goes further than GAAP requiring that;

*‘in respect of each balance sheet and profit and loss account item the figure relating to the corresponding item for the preceding financial year must be shown. The Member States may provide that, where these figures are not comparable, the figure for the preceding financial year must be adjusted’.*

This requirement ensures greater comparability of accounts from which assessments can be made and long term decisions determined.

As identified by LECG, eircom’s regulatory accounts include an accounting policy in relation to comparative figures whereby eircom is required to restate accounts for

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<sup>7</sup> See section 14.7 of LECG Report

changes in the methods of attribution, so that comparative figures are presented on the same basis as those for the current year.

LECG has recommended that An Post's regulatory accounts should follow the requirements of GAAP. In such circumstances the accounts would be restated if there was a change in accounting policy or a prior period error.

ComReg is of the opinion that at a minimum LECG's recommendation that An Post should comply with the provisions of GAAP should be incorporated into the new Accounting Direction. ComReg would welcome views of interested parties as to whether this requirement is sufficient or whether there is a need to be more prescriptive.

#### *5.1.5 Template Schedules (see section 14 of LECG report)*

LECG has identified two options and recommended that the template schedules (outlining the format and content of the Regulatory Accounts) shall be presented "*in this Direction or in a subsequent Direction*".

ComReg agrees with LECG that there is a need to devise schedules so as to eliminate ambiguity, but is conscious that these must be dynamic, reflecting changes in An Post's services and organisational structures. ComReg is therefore of the opinion that the option which sets out an enabling provision in the new Accounting Direction, leaving the detail to be agreed directly with An Post on an annual basis, is the more appropriate option.

## 6 Submitting Comments

All comments are welcome however it would make the task of analysing responses easier if comments were referenced to the relevant question numbers from this document.

The consultation period will run from 29 September to 31 October 2006 during which the Commission welcomes written comments on any of the issues raised in this paper.

Having analysed and considered the comments received, ComReg will publish its report on consultation (together with its decision on a new Accounting Direction) in early December 2006 which will, inter alia summarise the responses to the consultation.

In order to promote further openness and transparency, ComReg will publish all respondents' submissions to this consultation, subject to the provisions of ComReg's guidelines on the treatment of confidential information – ComReg 05/24. We would request that electronic submissions be submitted in an un-protected format so that they can be appended into the ComReg submissions document for publishing electronically.

### **Confidentiality**

ComReg appreciates that many of the issues raised in this paper may require respondents to provide confidential information if their comments are to be meaningful.

As it is ComReg's policy to make all responses available on its web-site and for inspection generally, respondents to consultations are requested to clearly identify confidential material and place confidential material in a separate annex to their response.

Such Information will be treated subject to the provisions of ComReg's guidelines on the treatment of confidential information – ComReg 05/24

## Appendix A – Legislation

### **European Communities (Postal Services) Regulations 2002 (S.I. No. 616 of 2002)**

#### *Regulation 11(2)*

In accordance with directions laid down by the Regulator, a universal service provider shall keep separate accounts within its accounting systems, for each of the services within the reserved sector on the one hand and the non-reserved sector on the other. The accounts for the non-reserved sector shall clearly distinguish between services which are part of the universal service and services which are not. Such internal accounting systems shall operate on the basis of consistently applied and objectively justifiable cost accounting principles.

#### *Regulation 11(5)*

A universal service provider shall comply with one of the cost accounting systems described in paragraphs (2) and (3) which shall be verified by auditors engaged by the provider and shall publish a statement to that effect in its annual report.

### **Directive 97/67/EC of the European Parliament and of the Council of 15 December 1997**

#### *Article 14(2)*

The universal service providers shall keep separate accounts within their internal accounting systems at least for each of the services within the reserved sector on the one hand and for the non-reserved services on the other. The accounts for the non-reserved services should clearly distinguish between services which are part of the universal service and services which are not. Such internal accounting systems shall operate on the basis of consistently applied and objectively justifiable cost accounting principles.

## Appendix B – Consultation Questions

### List of Questions

- Q. 1. Do you consider that the current Accounting Direction should be revised at this time?.....8*
- Q. 2. Do you consider that the changes recommended by LECG are warranted and appropriate?.....8*
- Q. 3. What is your view on the practicalities, timelines, cost etc. of implementing the changes recommended by LECG?.....8*
- Q. 4. Are there any additional changes that you would recommend?.....8*