Cost rules and other requirements to meet USP provider accounting obligations

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Executive Summary

Irish Law requires the Commission for Communications Regulation (ComReg) to lay down an Accounting Direction (Direction) setting out how An Post, the Universal Postal Service provider (USP), should maintain cost accounts. This is to achieve transparency of accounting in respect of the costs An Post incurs in providing the various postal services which are part of the universal postal service and which are not part of the universal postal service.

Frontier Economics has been commissioned by ComReg to prepare an independent report for publication setting out its recommendations on cost rules and other requirements to inform ComReg's Direction to the USP.

This document sets out our recommendations on cost rules and other requirements and recommends that ComReg issue a new Direction to An Post to reflect changes in the law and the market since 2006, which was when the last Direction was issued. These recommendations are intended to be fully capable of being implemented by An Post given An Post's current cost accounting system and other information systems.

This report is to form part of a public consultation that will be carried out by ComReg in respect of a future Direction to An Post.

Summary of 2006 Direction

ComReg's 2006 Direction to An Post includes five fundamental requirements, namely:

- all decisions are supported by sufficient data to enable An Post management to ensure that they comply with the Tariff Principles, Terminal Dues Principles and the other Obligations on USPs, particularly those relating to cross-subsidisation;
- ComReg can monitor compliance with the Tariff Principles, Terminal Dues Principles, and other Obligations on USPs;
- separate accounts can be maintained for each of the services within the Reserved Sector on the one hand and each of the services within the Non-Reserved Sector on the other;
- any request for information by ComReg can be met promptly; and
- any request for information by the European Commission can be met promptly.

Under the 2006 direction, An Post is required to provide ComReg with its Regulatory Accounts, disaggregated to the level of service, including:

- commentary on performance;
- a comprehensive explanation of the basis of preparation for the Regulatory Accounts;
- profit and loss balance sheets for each segment;
- volume and revenue information, by service;
- details of expenditure by pipeline, distinguishing between direct, indirect and common costs;
- a signed statement of compliance by An Post's Directors;
- an audit opinion;
- the results of the annual review of any statistical sampling process undertaken to identify revenue or mail volumes; and
- a detailed report setting out for each price point a detailed estimate of the costs of providing the service.

The Direction requires An Post to provide a detailed Accounting Manual outlining the procedures and policies used in the preparation of its Regulatory Accounts, which is to be reviewed annually. The Accounting Manual must include the procedures undertaken to establish the process used to identify revenues and mail volumes, by service. Costs shall be allocated by direct assignment, or direct, indirect or general allocator rules to allocate common costs to specific products and services. Inter-company and inter-segment transactions shall take place on an "arm's length" basis, and, to the extent possible, be based on market prices.

Regulatory and legal background

A new Communications Regulation (Postal Services) Act was enacted in Irish Law in 2011 ("2011 Act").

The 2011 Act sets out ComReg's powers and functions in the postal sector.

Section 12(1) of the 2011 Act sets ComReg's statutory objectives in relation to the provision of postal services, namely;

i. to promote the development of the postal sector and, in particular, the availability of a universal postal service within, to and from the State at an affordable price for the benefit of all postal service users;

ii. to promote the interests of postal service users within the Community; and

iii. subject to subparagraph (i), to facilitate the development of competition and innovation in the market for postal service provision.

Availability of robust regulatory accounting data is a critical input in ensuring that ComReg can deliver on these objectives under the 2011 Act. Section 31 of the 2011 Act makes provision for ComReg to give a Direction providing for the keeping by a USP, in its internal accounting system, of separate accounts for each service it provides. The provision by An Post of robust regulatory accounting data is essential in ensuring that ComReg can meet its duties in relation to a number of other provisions of the 2011 Act. These include:

- ensuring compliance with section 28 tariff requirements in relation to cost-orientation, transparency and non-discrimination;
- ensuring compliance with section 29 in relation to ensuring that terminal dues shall be fixed in relation to the costs of processing and delivering incoming cross-border mail and ensuring that they shall be transparent and non-discriminatory;
- ensuring adequate information is available for monitoring of compliance with the price control (section 30) and for the setting of future price controls;
- ensuring ComReg can comply with Article 14 of the Directive and section 31 of the Act (universal postal service accounting obligations);
- ensuring compliance with section 33 of the Act in relation to access to the postal network of the USP, and in particular to section 33 (7) of the Act which may require ComReg to make decisions in relation to the price of such access; and
- ensuring compliance with section 35 of the Act in relation to the net cost of provision of universal postal services, where ComReg may be required to assess any application for funding in relation to any such net costs.

In addition, Article 14 of the Postal Directive requires that Member States shall take the measures necessary to ensure that the accounting of the USPs is conducted in accordance with the provisions of Article 14 of the Directive. Article 14 goes on to set out the requirements that USPs must meet in relation to the keeping of accounts. Article 14 also sets out the criteria which a universal service provider must meet in relation to the allocation of costs.

Our review

The proposed recommendations are the result of an extensive review of existing accounting, legal and regulatory documents, consideration of international best practice and engagement with An Post.

Our review has been structured into key categories, namely:

- Mail volume and revenue measurement and allocation;

- Cost allocation;
- Regulatory reporting; and
- Compliance with the Direction.

Volume measurement and revenue allocation

We conducted a review of how An Post record and allocate revenues, and measure mail volumes.

The 2006 Direction states that "*revenue, by service, shall be recorded at the point of sale*". The Direction also states that "*revenue recorded at the point of sale that cannot be directly assigned to their use for specific services or retention by users for later use (e.g. postage stamps sold and franking machine credits) shall be apportioned to services on the basis of statistical sampling accurate to +/-1% at the 95% Confidence Level An Post's Accounting Manual outlines*".

An Post's approach to measuring volumes

An Post's Accounting Manual details its approach to revenue measurement. Its primary method for allocating revenue is An Post's Revenue Recognition Sales Model (RRSM), which was provided to us as part of our review. The RRSM is also used to calculate the revenue-derived volume measures.

- An Post's stamped and metered volumes for Domestic and International Outbound are primarily determined by applying the results of the Real Mail Study[1] data. The exception to this is where An Post's internal systems provide this specific data, such as for registered mail.
- For bulk mail, sales are recorded in An Post's Integrated Financial System (IFS), with data captured on postings by product, destination and weight step.
- Parcels revenue is captured primarily through the Track and Trace system.
- For international inbound mail, revenue is calculated on the basis of the tariff agreement that is in place with the operator in each country, whether that is UPU, REIMS, or a bilateral agreement.

The 2006 Direction states that "*the Regulatory Accounts shall contain volume information that shows mail volume, by service, recorded from revenue data recorded at the point of sale*".

1 A Real Mail Study, or RMS, is a study of mail flows as they move through the postal network, with data from the sample then being used to create a mail profile of the provider's mail flows

The volumes reported in An Post Regulatory Accounts are currently estimated using revenue-derived figures. This is consistent with the requirements of the 2006 Direction and international best practice.

1. We recommend the Direction continues to require the Regulatory Accounts to contain volume information that shows mail volume, by service, recorded from revenue data recorded at the point of sale.

Reconciliation of revenue and operationally based volumes

As per international best practice, operationally-based volumes are a useful cross-check against revenue-derived volumes. An Post currently reconciles revenue-based volumes with operationally-based volumes in a supplementary annex in the Regulatory Accounts, including a commentary on the reasons for any discrepancy between the revenue-derived figures and the operational-based figures.

We find that An Post does not currently carry out this reconciliation at service level.[2] There are merits to undertake this volume reconciliation by service, but An Post has advised us that such reconciliation would require significant additional operational and HQ resources. We consider this a valid concern as An Post's operational volumes are not recorded at service level. Therefore we are of the view that the reconciliation should take place at format level (i.e. letter, flat, packets and parcels), with increased commentary explaining the difference between the operational and revenue figures for each individual format.

2. We recommend the Direction requires the reconciliation between revenue-derived and operationally-based volumes be provided by format (letters, flats, packets and parcels) as a supplementary schedule in the Regulatory Accounts.
3. We recommend the Direction requires that An Post provide detailed commentary explaining the reasons for the differences between the operational and revenue figures for each individual format.

2 The Direction defines a service to mean any service provided by An Post that involves the use of the public postal network as defined in the Regulations; and

(a) is identified as a separate service in the Schemes or price lists published by An Post, or is provided under a contract or standard agreement with individual customers; and

(b) operationally handles all items in the service in the same way;

If the service falls partly into the Reserved Sector and partly into the Non-Reserved Sector it shall be accounted for as if it were two separate services.

Audit of the reconciliation with operationally based volumes

Although An Post reconciles revenue-derived and operationally-based volumes, this reconciliation is not audited by an independent auditor. We consider that if An Post's reconciliation was audited, this would provide ComReg with additional confidence that An Post's volume measurements are accurate over time. We consider this is particularly important because at present there is relatively little information provided in the regulatory accounts about the reasons for the divergence between revenue and operationally based volumes.

4. We recommend the Direction requires the revenue derived and operationally based volumes reconciliation be audited.

Automated machine counts

We considered the extent to which An Post transparently documents the methods for deriving operationally based volumes and we examined the tests carried out to test whether the methods provide accurate estimates of volumes.

As machine counts make up a large proportion of the mail volume count, it is important to ensure that this count is accurate.

We asked An Post to provide documentation and details of any mechanisms or controls to check the accuracy of mail volumes as it passes through the Mail Centre pipeline, including handover between different pipeline stages into and out of the Mail Centres. The pre-flight check procedure is well documented, but we note that the degree of accuracy that the machines are tested to is not documented.

5. We recommend the Direction requires the Accounting Manual to include details of how operational volumes are calculated, including the process for validating machine counts and the degree of accuracy to which machines are tested.

Manual counts

Manual counts are based on counting the number of containers of non-machinable mail items and multiplying it by the average number of items per container ("average fill"). Therefore average container fill assumptions are an important input in the manual mail count.

An Post advised that average container fill assumptions are reviewed annually, but average container fill assumptions have not been changed since 2012. The Accounting Manual currently provides no details of these reviews.

The review of the average container fill assumptions should be carried out quarterly rather than annually. Reviewing average container fills every quarter is preferable to an annual review as it takes account of seasonal changes and variation in mail characteristics, which could potentially impact average container fills. We understand, for example, that Royal Mail undertake reviews on a much more frequent basis, and at least quarterly. We therefore recommend that this activity be stipulated in the new Direction.

6. We recommend the Direction requires An Post to include in its Accounting Manual details of the process for reviewing average container fills.
7. We recommend the Direction requires An Post to review average container fills every quarter.
8. We recommend the Direction requires An Post to report the results of the average container fill reviews in the Accounting Manual.

Reconciliation of MC and DSU operational volumes

An Post has volume checks at two different stages of its operational pipeline – the mail centre-level and the DSU-level. Therefore, these two check-points would seemingly provide a good cross-check for An Post's operational volumes.

However, we understand that there is no formalised reconciliation between operational volumes recorded at the DSU and Mail Centre level. We consider such checks should take place and be included in An Post's Regulatory Accounts in order to provide ComReg with added assurances as to the accuracy of An Post's volume counts. This reconciliation should be completed at the format level, so An Post could identify where divergences, if any, are occurring.

9. We recommend the Direction requires a report on quarterly reconciliations between mail centre and DSU volumes at the format level (i.e. letters, flats, packets and parcels) to be included in the supplementary schedule of volume reconciliation in An Post's Regulatory Accounts.

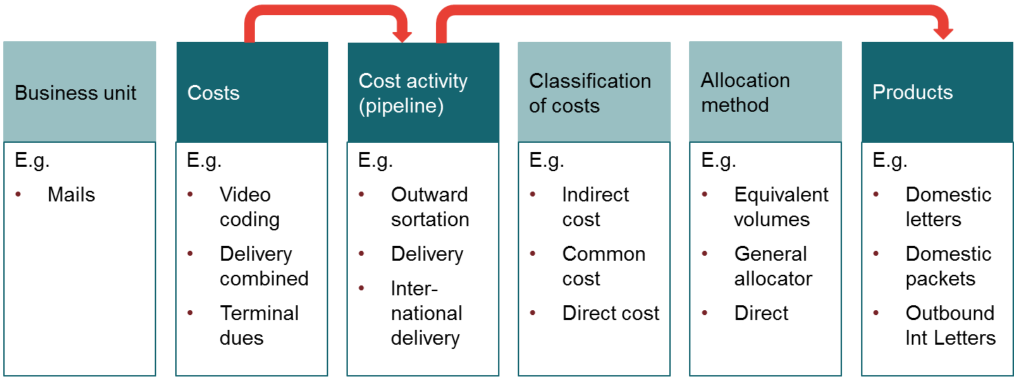
Cost allocation

Section 31 of the 2011 Act states that ComReg's Direction to the USP must set rules relating to the identification and allocation of costs.

The details of An Post's cost allocation process are set out in its Accounting Manual. The first stage of An Post's cost allocation process as part of its regulatory accounts is to attribute costs to its business units: mails business, retail business and corporate.

The next stage is to allocate costs from the business units to individual products and services as summarised in Figure 1.

Figure 1. Allocation from business units to products/services



Classification of costs

When classifying costs, the 2006 Direction requires costs to be allocated as follows:

- *"costs which can be directly assigned to a particular service shall be so assigned;*
- *common costs, which are costs that cannot be directly assigned to a particular service, shall be allocated as follows:*
  - *whenever possible, common costs shall be allocated on the basis of direct analysis of the origin of the costs themselves;*
  - *when direct analysis is not possible, common cost categories shall be allocated on the basis of an indirect linkage to another cost category or group of cost categories for which a direct assignment or allocation is possible; the indirect linkage shall be based on comparable cost structures; and*
- *when neither direct nor indirect measures of cost allocation can be found, the cost category shall be allocated on the basis of a general allocator computed by using the ratio of all expenses directly or indirectly assigned or allocated, on the one hand, to each of the Reserved Sector services and, on the other hand, to the other services."*

We find that the cost categories outlined in An Post's Accounting Manual and reported in its regulatory accounts are consistent with the above requirements of the 2006 Direction, and international best practice.

Identification of avoidable cost

We find that An Post's Accounting Manual currently contains no guidance on the process by which it identifies avoidable costs, despite the Direction currently requiring An Post's Accounting Manual to provide "the process by which An Post identifies how avoidable, variable and fixed costs are defined".

We consider that the issue of identifying avoidable costs is particularly important as ComReg may require details of how An Post identifies its avoidable costs in order for it to carry out its statutory functions. For example, section 31 of the Act requires ComReg to resolve disputes, should they arise, between An Post and those seeking access to its network. Calculating access prices may involve ComReg considering An Post's avoidable costs. For instance, the amount of costs that An Post would avoid by granting another postal provider access to its network. Further, an evaluation of the net cost of the USO requires cost estimates that would be avoided if the USP provider was not subject to the obligations

We consider that An Post should provide details of the process by which it identifies avoidable, variable, and fixed costs.

10. We recommend the Direction requires the Accounting Manual to provide detailed information on the process for the identification of avoidable, variable, and fixed costs, including worked examples, to enable ComReg to exercise its functions under the Act.

Allocation method

Once costs are classified, An Post use cost drivers to allocate direct and indirect costs to individual products. The complexity of the cost allocation process depends on the scope of information of the cost drivers. A cost driver is an event or factor that has a systematic relationship to a particular type of cost and which causes that cost to be incurred. In other words, drivers are the method in which costs are shared in an objective and quantifiable way.

In our view, the current level of detail provided by An Post in relation to how the drivers are set and reviewed provides very little transparency. We, therefore, consider that the Direction should be strengthened to provide ComReg with a greater level of detail on how cost drivers are set. Our recommendations on this are set out below, and are also encapsulated further below in our recommendations relating to the auditor's audit scope and responsibilities.

11. We recommend the Direction requires An Post to provide ComReg with the details of the annual review of the cost drivers.

12. We recommend the Direction requires An Post to provide ComReg with details of any year-on-year methodological changes in cost drivers, and that the nature and reason of that change is fully detailed by An Post.

Weight bands for products

In the definition of its products, An Post's splits products into two weight bands – below 50 grams and above 50 grams. The same weight bands are used for allocating cost activities to products and services for letters, flats and packets.

As different weighting factors are used for cost drivers, products are allocated different proportions of costs depending on their weight bands. In some instances the difference in weighting factors can be large.

As stated in section 3.2 of the Direction, An Post is required to set out a detailed estimate of the costs of providing the service for each price point. At present, An Post's regulatory accounts are unable to provide this because, while cost are allocated into two weight bands, An Post's tariffs:

- differ across numerous price bands for flats and packets; and
- are the same above or below 50 grams for letters.

The 50 gram weight break derives from the previous "reserved sector", whereby, up until the 2011 Act, An Post held a monopoly over letters services weighing up to 50 grams and less than 2.5 times the standard domestic tariff. This "reserved sector" no longer applies.

We are of the view that An Post should provide cost estimates of providing each service at each tariff level. This would give ComReg increased confidence that An Post is compliant with section 28 of the Act, which states that prices should be cost-orientated. Moreover, as stated in section 3.2 of the current Direction, An Post is already required to set out a detailed estimate of the costs of providing the service for each price point, which An Post is currently not complying with.

13. We recommend the Direction continues to require An Post to provide detailed cost estimates for providing the required service at each price point.
14. We recommend the Direction requires An Post's Accounting Manual (4.3.4.5) provide a detailed explanation of how costs are allocated to products with different tariffs.
15. We recommend the Direction requires An Post's Accounting Manual (4.3.4.5) provide a detailed explanation where the weight factors used in the allocation process do not align with the various tariff price points.

Inter-company and inter-segments transactions

The generally accepted principle is that inter-company or inter-segment transfer pricing should be applied on an "arm's length" basis, and prices should be consistent with the pricing and conditions that would be applied to a third party.

While the Regulatory Accounts show the inter-segment revenue by business segment, the accounts do not show the source of that revenue. As part of the review, An Post provided us with a break-down of its corporate inter-segment revenues for 2014. Such detailed information provides greater transparency as to the trends and direction of An Post's inter-segment revenue. Our view is therefore that the Regulatory Accounts should include the source of inter-segment revenue, in a matrix form, in order to show how charges flow between various An Post business segments.

In our view, the nature and detail of all inter-segment charges should be part of the auditor's scope. This is consistent with best practice as it allows for ongoing assurance that transfer prices are set at an appropriate level. In particular, the auditor should consider whether transfer charges can be set with reference to market or regulated prices for comparable services, and where no comparable open market or regulated services or products exist, transfer prices should be set such that they are cost oriented.

16. We recommend the Direction requires the Regulatory Accounts include the source of inter-segment revenue in order to show how charges flow between various An Post business segments. This will allow greater transparency to the direction, and changes in trends, of inter-segment revenue.

17. We recommend the Direction requires the audit to specifically include the nature and detail of transfer charges.

Regulatory reporting

An Post is required to provide ComReg with Regulatory Accounts, disaggregated to the level of services, within 19 weeks of the end of each financial year.

In general, our review has found that the current Direction is consistent with international best practice. Our assessment therefore focuses on specific issues that have been identified as part of our review.

Content of confidential and non-confidential versions

One issue that has arisen as part of the review is the degree of detail An Post publishes in its non-confidential version of its Regulatory Accounts. An Post expressed concerns that the degree of detail which it is currently required to publish risks it disclosing commercially sensitive information to competitors and potential competitors.

The degree of detail in An Post's public accounts is a trade-off between transparency and protecting commercially sensitive information. At present, the Direction (3.1 (d)) requires that An Post report profit and loss accounts for each service. The EC Directive and section 31(1) of the 2011 Act requires that there are separate accounts for each service that is provided as part of the universal postal service and which is not part of the universal postal service. Therefore An Post must comply with this. A detailed split between USO and non-USO is necessary in order to show no cross-subsidisation between services.

An Post is most exposed to competition in certain areas, which is where the data is more likely to be commercially sensitive. However, the detailed service-level information is currently provided for USO services. We consider it is important to maintain this level of information provision in the public domain, to ensure transparency of the profitability of USO services and to be consistent with best practice in the area. In saying this, we also recognise that the Direction needs to be consistent with a situation in the future where An Post faces a greater prospect of competition. If such a situation arises, it is conceivable that USO services are reduced, and as such An Post would no longer be required to provide the degree of information in those areas.

18. We recommend the Direction requires An Post to prepare separate confidential and non-confidential versions of the Regulatory Accounts.

19. We recommend the Direction requires profit and loss accounts for all USO services to be included in the non-confidential version of the Regulatory Accounts.

Publication of the Accounting Manual

At present, while An Post is required to provide its Accounting Manual to ComReg on an annual basis, it is not required to publicly publish the document.

We consider that there would be a benefit in making available to stakeholders a public version of An Post's Accounting Manual. Such a publication would increase the transparency in relation to the principles and methodologies used to create An Post's Regulatory Accounts.

An Post has raised concerns regarding the publication of a public-version of the Accounting Manual. These relate to concerns that too much information would be difficult to discern for stakeholders and the degree of confidential information contained in the Accounting Manual.

In our view, there would be benefit in An Post publishing more information on the regulatory principles and methodologies it uses in the creation of the Regulatory Accounts. However, on a practical basis this could be best achieved by requiring additional information on the regulatory principles and methodologies in the Regulatory Accounts themselves, rather than requiring the separate publication of the Accounting Manual.

20. We recommend that the Direction requires An Post's Regulatory Accounts includes detailed commentary in the "regulatory accounting principles and basis of preparation" section on:

    - large adjustments made to produce the Regulatory Accounts;
    - the impact of changes in accounting policies, methodologies and estimation techniques; and
    - transfer charges, including an expanded explanation summarising the basis of transfer charges similar to that found in sections 9.2, 9.3 and 9.4 of An Post 2014 Accounting Manual.

Cash figure

An Post currently reports its cash position as part of its balance sheet reporting for each business segment, as per the Direction section 3.1 (c).

The reason for An Post reporting its balance sheet is to enable ComReg to exercise its statutory functions. In particular, ComReg is required to monitor An Post's ability to meet its USO obligations.

We note that An Post's cash at hand as reported annually in its balance sheet has decreased significantly in recent years. ComReg has previously noted its concerns in relation to this deteriorating cash position of An Post[3]. Furthermore, a further rapid deterioration of An Post's cash position within a year would not presently be known by ComReg until the Regulatory Accounts are subsequently published.

An Post's reporting of its cash balances could, therefore be improved by making it more regular, which would enable ComReg to carry out its statutory functions.

In our view, quarterly reporting when An Post's cash balance is below a certain level is appropriate, given An Post's Board is scheduled to meet eight times each year. We suggest setting the level threshold at €100 million as An Post's cash balances have deteriorated by up to €70 million over a twelve month period in the past. Therefore a €100 million threshold would give some sensible headroom above that amount. We consider that this cash figure should be reported directly to ComReg following the conclusion of the relevant quarter. The quarterly cash figures would also usefully be included in the Regulatory Accounts, and therefore a table for reporting these balances have been included in the draft Regulatory Accounts schedule.

21. We recommend the Direction requires An Post to report its balance sheet to ComReg on a quarterly basis, when An Post's cash balance is below a €100 million.

Commentary on capital expenditure

An Post is not currently required to report its capital expenditure in its annual Regulatory Accounts.

In our view, details of An Post's capital expenditure would increase transparency and provide greater assurance to ComReg in relation to An Post's performance. As An Post's cash figure has significantly decreased since 2009, there could be a concern that it may potentially underspend on USO-related capex. However, we also recognise that An Post do not currently split capital costs between USO and

3 See ComReg Documents Nos. 14/59, 13/21, 12/138

non-USO services, therefore An Post may have to make a number of assumptions to implement this.

We are of the view that the provision of detailed commentary on their capex spend in the Regulatory Accounts would provide increased transparency for ComReg and provide greater assurance to ComReg in relation to the sustained provision of USO services.

22. We recommend the Direction requires An Post includes a commentary on its capex figures in the Regulatory Accounts.

Payroll Costs

An Post currently reports details of its payroll costs and staff numbers in its Regulatory Accounts.

For payroll costs, An Posts report these at the level of the mails business unit and, within that, the USO and non-USO segment.

An Post also reports staff costs as a percentage of total operating costs (58% in 2014). In An Post's Accounting Manual, it reports that pay costs represent approximately ✂of An Post total expenditures in the Regulatory Accounts.

We consider that the reporting of payroll costs could be improved by the Direction requiring An Post to report payroll costs for each business segment. As we understand it, An Post already records these costs differentiated by business segment as part of its cost accounting system, and therefore such a requirement would not significantly impact compliance costs.

In relation to staff numbers, An Post reports in its Regulatory Accounts staff numbers (FTEs) for the company, combined subsidiaries and the total at the group level. An Post does not provide further detail of staff numbers per business segment. Our view is that it would increase transparency if An Post reports average staff numbers (FTE equivalent) by business segment in its Regulatory Accounts.

23. We recommend that the Direction requires An Post to report its payroll costs by business segment, and within segment as recorded internally by An Post.

24. We recommend that the Direction requires An Post's to report average staff numbers (FTE equivalent) by business segment, and within segment as recorded internally by An Post.

Accounts format

As noted above, the Direction currently requires commentary in the Regulatory Accounts that at a minimum shall explain:

- trends relating to revenue by relevant postal service;
- trends relating to cost by relevant postal service;
- trends relating to volume by relevant postal service;
- significant period on period movements in the reported performances and balances;
- one-off or exceptional events in the period; and
- the impact of material changes in accounting policies, methodologies and estimation techniques.

Our review of An Post's previous Regulatory Accounts shows that this level of detail is not necessarily always included in the commentary provided in the Regulatory Accounts. For example, there is no commentary on trends relating to revenue, cost and volume by the service level, only at an aggregated level. Given volume declines by service, it is important that sufficient commentary is provided by service so that the volume declines in particular services is easily understood.

A draft Regulatory Accounts schedule has been developed in order to minimise ambiguity with regard to Accounts' content, format and level of detail required. The Regulatory Accounts schedule includes required areas of commentary, and service-level sub-headings, to help ensure sufficient commentary is provided.

In our view, the service level should include parcels as a separate category, as the current Regulatory Accounts do no provide disaggregated information on parcels.

25. We recommend the Direction requires An Post's Regulated Accounts to comply with the required format, as stipulated by ComReg.

Other reporting requirements

Non-USO aspects of An Post's business are currently required to be reported only at the aggregated level; not by service as the USO business.

The non-USO proportion of An Post's business has been growing in recent years as a proportion of its total business. If the proportion of non-USO business in An Post's total mail business continues to grow, then the impact of the non-USO business on An Post's ability to meet its USO obligations may also increase.

In our view, it is therefore important for ComReg's statutory functions that it is able to adequately monitor An Post's non-USO business at a service level when required.

26. We recommend the Direction continues require ad hoc reports (section3.3) that shall be prepared and provided by An Post, as may be required by ComReg from time to time.

Compliance requirements

The 2011 Act states that ComReg's Direction to the USP must set rules in relation to compliance requirements. The current Direction requires An Post to:

- engage a competent body to verify compliance with this direction and to perform a review of the Regulatory Accounts, in accordance with the principles and guidance set out from time to time by ComReg, following discussions with An Post and bodies representative of the Irish accountancy profession;
- publish the report and opinion of the competent body on An Post's compliance with the requirements of this direction in its annual report submitted to the Minister under section 33 of the 1983 Act; and
- include the report and opinion of the competent body, on the Regulatory Accounts and An Post's compliance with the requirements of this direction, within the Regulatory Accounts. The report and opinion shall comply with the principles and guidance set out from time to time by ComReg following discussions with An Post and bodies representative of the Irish accountancy profession.

Scope of audit

International best practice suggests that an auditor's opinion can be provided on a "fairly presents" or "agreed-upon procedure" basis. A "fairly presents" opinion is a more fulsome audit, and as such would provide greater transparency and more confidence to ComReg. We recommend that the scope of the auditor's opinion as defined in the Direction, and subsequently the audit should be on a "fairly presents" basis.

27. We recommend the Direction requires the audit to be conducted on a 'fairly presents' basis rather than on an 'agreed-upon procedure' basis.

Auditor's verification of compliance with internal cost accounting systems

At present, the Direction (section 3.1 (j)) requires a report and opinion by a competent body on the Regulatory Accounts and An Post's compliance with the requirements of this direction. This would include an audit of An Post's Accounting Manual to ensure it is consistent with the Direction.

Our review of international best practice found that the main elements to be included in the regulatory audit are:

- the scope of costs included in the regulatory accounts and the scope of costs allocated to individual regulated products (where appropriate);
- the reconciliation between regulatory accounts and statutory accounts;
- correctness of figures, including operational data like volumes;
- methodologies used regarding amortization, cost capitalization, allocation and for the evaluation of the assets;
- transfer charges in separated accounts (entities and/or products);
- appropriateness of usage of the drivers;
- the frequency of index updates used for cost allocation purpose; and
- appropriateness of possible important changes in the methodology.

These elements could be set out in a letter of engagement with the auditor.

28. We recommend the Direction requires the "letter of engagement" with the auditor to include in the scope of the audit:

    - the scope of costs included in the regulatory accounts and the scope of costs allocated to individual regulated products (where appropriate);
    - the reconciliation between regulatory accounts and statutory accounts;
    - correctness of figures, including operational data like volumes;
    - methodologies used regarding amortization, cost capitalization, allocation and for the evaluation of the assets;
    - transfer charges in separated accounts (entities and/or products);
    - appropriateness of usage of the drivers;
    - the frequency of index updates used for cost allocation purpose; and
    - appropriateness of possible important changes in the methodology.

Appointment of the Auditor

At present, the auditor of the regulatory accounts is appointed by An Post. We note that the statutory auditor is the same as the regulatory auditor.

We find that international best practice is for:

- the regulatory auditor to be appointed by the NRA; and
- the statutory auditor being either excluded from doing the regulatory audit, or being subject to peer review.

We also find that it is common elsewhere in the EU for the NRA to either appoint the auditor, or undertake the audit themselves.

We consider that having ComReg appoint the auditor would be more aligned with best practice, and therefore provide greater assurances over the outputs of the regulatory accounts.

29. We recommend the Direction requires the auditor of the Regulatory Accounts to be appointed by ComReg.

ComReg's approval of the Accounting Manual

The Direction (section 4.1 (e)) requires An Post to obtain ComReg's approval for each annual edition of the Accounting Manual in advance of the start of the relevant regulatory period.

However, in our view, it would be more efficient if An Post was only required to notify ComReg of any significant changes to the Accounting Manual and provide the Accounting Manual to ComReg at the same time as providing the Regulatory Accounts.

30. We recommend the Direction requires An Post to notify ComReg of any significant changes to the Accounting Manual and provide the Accounting Manual to ComReg at the same time as providing the Regulatory Accounts.

Statement of compliance

At present, the Direction (section 3.1 (i)) requires a signed statement from the Directors of An Post acknowledging their responsibilities for the preparation of the Regulatory Accounts and confirming their compliance with the requirements of this direction. This requirement is similar in scope to that of Eircom's. The Direction in relation to Eircom states that Eircom's Separated Accounts shall be accompanied by a signed statement from the directors of Eircom Limited acknowledging their responsibilities for the preparation of the Separated Accounts and confirming their compliance with the requirements of the Decision Instrument in this respect.

31. We recommend the Direction requires the Regulatory Accounts include a signed statement from the Directors of An Post acknowledging their responsibilities for the preparation of the Regulatory Accounts and confirming their compliance with the requirements of this Direction.

Other recommendations

We also recommend updating the Direction to remove reference to the Reserved and Non-Reserved Sectors, which no longer apply, and updating the IAS14 standard to the IFRS8 standard.

32. We recommend the Direction is amended to remove reference to the Reserved Sector (and the Non-Reserved Sector) in:

- Section 1.1
- Section 2.1
- Section 3.1 (d)
- Section 4.3.2
- Section 4.3.3

33. We recommend the Direction is amended to remove reference to IAS14 and replace with IFRS8 in:

- Section 1.1
- Section 3.1 (c)
- Section 4.3.1
- Section 4.3.2
- Section 4.3.3

1 Introduction

Irish Law requires the Commission for Communications Regulation (ComReg) to lay down an Accounting Direction (Direction) setting out how An Post, the Universal Postal Service provider (USP), should maintain cost accounts. This is to achieve transparency of accounting in respect of the costs An Post incurs in providing the various postal services which are part of the universal postal service and which are not part of the universal postal service.

ComReg issued a Direction to An Post in 2006, replacing the 2001 Direction. Since 2006, two major legal and regulatory changes have taken place: a new Communications Regulation (Postal Services) Act was enacted in Irish Law in 2011 ("2011 Act") and the EC "Postal Directive" 97/67/EC of the European Parliament and of the Council of 15 December 1997 ("Postal Directive"), as amended by subsequent Directives in 2002 and 2008, was transposed into Irish Law. The 2011 Act sets out ComReg's powers and functions in the postal sector.

Frontier Economics has been commissioned by ComReg to prepare a report for publication, having due regard to the 2011 Act and the Postal Directive, setting out its recommendations on cost rules and other requirements to inform ComReg's Direction to the universal service provider.

This document sets out our recommendations on cost rules and other requirements and recommends that ComReg issue a new Direction to An Post to reflect changes in the law and the market since 2006. These recommendations are intended to be fully capable of being implemented by An Post given An Post's current cost accounting system and other information systems.

This report is to form part of a public consultation that will be carried out by ComReg in respect of a future Direction to An Post.

1.1 Background

The 2011 Act states that ComReg's statutory objectives in relation to the provision of postal services are to:

- promote the development of the postal sector and, in particular, the availability of a universal postal service within, to and from the State at an affordable price for the benefit of all postal service users;
- promote the interests of postal service users within the Community; and
- facilitate the development of competition and innovation in the market for postal service provision.

Robust regulatory accounting data is a critical input in ensuring that ComReg is in a position to fulfil its duties under the 2011 Act. Section 31 of the 2011 Act makes provision for ComReg to give a Direction providing for the keeping by a universal postal service provider, in its internal accounting system, of separate accounts for each service it provides. The last Direction to An Post was issued in 2006.

The provision by An Post of robust regulatory accounting data is essential in ensuring that ComReg can meet its duties in relation to a number of other provisions of the 2011 Act. These include:

- ensuring compliance with section 28 tariff requirements in relation to cost-orientation, transparency and non-discrimination;
- ensuring compliance with section 29 in relation to ensuring that terminal dues shall be fixed in relation to the costs of processing and delivering incoming cross-border mail and ensuring that they shall be transparent and non-discriminatory;
- ensuring adequate information is available for monitoring of compliance with the price control (section 30) and for the setting of future price controls;
- ensuring ComReg can comply with Article 14 of the Directive and section 31 of the Act (universal postal service accounting obligations);
- ensuring compliance with section 33 of the Act in relation to access to the postal network of the USP, and in particular to section 33 (7) of the Act which may require ComReg to make decisions in relation to the price of such access; and
- ensuring compliance with section 35 of the Act in relation to the net cost of provision of universal postal services, where ComReg may be required to assess any application for funding in relation to any such net costs.

In addition, Article 14 of the Postal Directive requires that Member States shall take the measures necessary to ensure that the accounting of the universal service providers is conducted in accordance with the provisions of Article 14 of the Directive. Article 14 goes on to set out the requirements which universal service providers must meet in relation to the keeping of accounts. Article 14 also sets out the criteria which a universal service provider must meet in relation to the allocation of costs.

1.2 Methodology

The proposed draft recommendations are the results of an extensive review of existing accounting, legal and regulatory documents, and engagement with An Post. Figure 2 summarises the tasks undertaken as part of this review.

Figure 2. Main tasks undertaken as part of Frontier Economics' review

Initial documents	• Accounting Direction issued by ComReg in December 2006 • LECG – Revised Accounting Direction and Related Issues report, 2006 • Analysys Mason's 2011 review • An Post Accounting Manual • An Post regulatory accounts • ComReg's Accounting Direction in fixed telecoms and in broadcasting transmission, and Eircom's accounting documentation
International best practice	• CERP "Recommendation on best Practices for Cost Accounting Rules III", 2009. • ERGP "Report on Common Costs Allocation", ERPG (11) 16, 2011. • ERPG "Common Position on Cost Allocation Rules", ERPG (12) 28, 2012. • ERGP "Report on specific issues related to cost allocation", ERGP (13) 28, 2013.
Analysis Mason 2011 file	• Numerous files that were provided by An Post to Analysys Mason as part of its review between 2012 and 2013.
An Post meetings and response	• Meetings with An Post on 3 March and 26 May 2015. • Responses received from An Post on 7 May, 11 May, 14 May, 22 May, 5 June and 23 June.
Draft report to An Post	• Issued draft report to An Post on 28 July 2015.
Further engagement	• Further responses from An Post received on 2 September and 1 October 2015. • Further meeting with An Post on 6 November 2015. • Further submission received from An Post on 27 November 2015.

As a first task we reviewed a number of existing and publicly available documents including the existing legislation and regulation, the existing Direction as it applies to An Post and An Post's documents, such as its accounting manual and regulatory accounts. We considered the findings of the previous reviews of An Post accounting data which were undertaken by LECG and Analysys Mason in 2006 and 2011 respectively. We also consulted similar Directions, such as that issued by ComReg to Eircom, and also Royal Mail's published Regulatory Accounts and ABC Costing Manual.

Following an initial meeting with An Post on 3 March 2015, we received from ComReg, with permission from An Post, a number of files that had been provided by An Post as part of Analysys Mason's previous compliance review. This allowed us to gather significant details on An Post's cost and accounting systems, while minimising the additional compliance costs faced by An Post in engaging with the review.

We held a number of meetings with An Post and submitted a number of information requests. An Post supplied us with significant amounts of information and explanations.

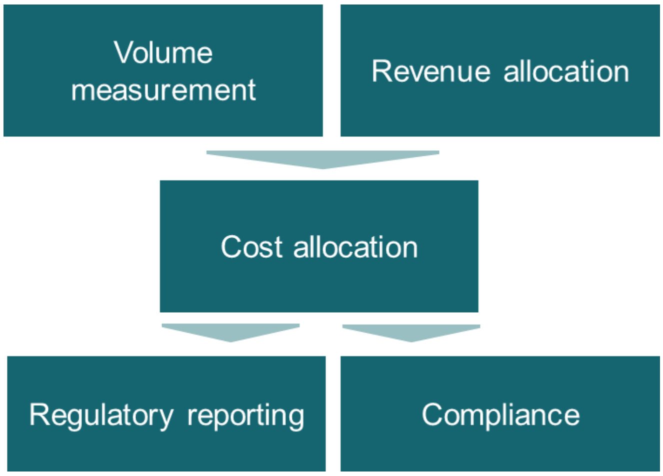
In parallel we also carried a detailed review of international best practice in relation to postal cost accounting, specifically relating to mail volume and revenue measurement, cost allocation and regulatory reporting and audit procedures. In particular, the European Regulators Group for Postal Services (ERGP), which was established in 2010, has published a number of papers on cost allocation issues. The European Committee for Postal Regulation (CERP) also published its recommendations on best practices of cost accounting rules in 2009. Therefore, we have taken account of these publications as being instructive to international best practice in drafting our recommendations. Specific issues addressed by these reports are discussed in detail throughout this report.

An Post was provided the opportunity to comment on a preliminary version of this report, prior to wider public consultation. An Post provided written comments and submissions on the preliminary version, and we also met with An Post to discuss their views further. This version of our report takes into account those views expressed by An Post.

1.2.1 Scope of our review

Our review of the above documents and the various engagements focussed on five main domains which are critical to the production of robust cost and accounting data as in Figure 3.

Figure 3. Scope of Frontier Economics' review



1.3 Structure of this document

The remainder of this report is structured as follows:

- Section 2 provides an overview of the 2006 Direction issued by ComReg to An Post.
- Section 3 summarises the key elements of the regulatory and legal framework pertinent for our draft recommendations on cost rules.

- The sections that follow set out our findings and draft recommendations in relation to our five domains of investigation:
  - Mail volume and revenue measurement and allocation (Section 4);
  - Cost allocation (Section 5);
  - Regulatory reporting (Section 6); and
  - Compliance with the Direction (Section 7).
- Section 8 provides other recommendations updating the wording of the direction.
- Annex 1 sets out the "Pre Flight Machine Accuracy Checks" documentation of An Post.
- Annex 2 sets out An Post assumptions regarding average container fills.
- Annex 3 includes a copy of the Dublin Mail Centre Daily Volume template.
- Annex 4 outlines An Post's mail profiles and tariffs in 2014.
- Annex 5 provides the scope of the auditor's work as set out in its Letter of Engagement.

2 Overview of the 2006 Direction to An Post

This section summarises the 2006 Direction issued from ComReg to An Post[4].

In the main, the Direction includes five fundamental requirements, namely:

- all decisions are supported by sufficient data to enable An Post management to ensure that they comply with the Tariff Principles, Terminal Dues Principles and the other Obligations on Universal Service Providers, particularly those relating to cross-subsidisation;
- ComReg can monitor compliance with the Tariff Principles, Terminal Dues Principles, and other Obligations on Universal Service Providers;
- separate accounts can be maintained for each of the services within the Reserved Sector on the one hand and each of the services within the Non-Reserved Sector on the other;
- any request for information by ComReg can be met promptly; and
- any request for information by the European Commission can be met promptly.

The Direction then sets out more detailed requirements relating to:

- reporting and transparency;
- An Post's Accounting Manual; and
- review and confirmation of compliance.

Reporting and transparency

An Post is required to provide ComReg with its Regulatory Accounts, disaggregated to the level of service, including:

- commentary on performance;
- a comprehensive explanation of the basis of preparation for the Regulatory Accounts;
- profit and loss balance sheets for each segment;
- volume and revenue information, by service;
- details of expenditure by pipeline, distinguishing between direct, indirect and common costs;

4 http://www.comreg.ie/_fileupload/publications/ComReg0663.pdf

- a signed statement of compliance by An Post's Directors;
- an audit opinion;
- the results of the annual review of any statistical sampling process undertaken to identify revenue or mail volumes; and
- a detailed report setting out for each price point a detailed estimate of the costs of providing the service.

Accounting Manual

The Direction requires An Post to provide a detailed Accounting Manual outlining the procedures and policies used in the preparation of its Regulatory Accounts, which is to be reviewed annually. The Accounting Manual must include the procedures undertaken to establish the process used to identify revenues and mail volumes, by service[5].

The Accounting Manual shall be reviewed by a competent body as and when required by ComReg, and is to be submitted to ComReg annually for approval.

Business segments & inter-company/inter-segment transactions

The Direction sets out specific rules on how to record the inter-company transactions between different business segments of An Post such as its mail division and retail division. In particular the Direction states the following:

- Revenue and costs shall initially be directly assigned to business segments in accordance with the principles set out in IAS14.[6]
- Fixed assets (buildings, vehicles, sorting equipment, etc.) shall be shown in the balance sheet of the "prime user", with use by other business segments charged for on an arm's length basis.
- Inter-company and similar transactions between An Post and its subsidiaries or associated companies must take full cognisance of the Tariff Principles, Terminal Dues Principles and the Obligations on

5 The Direction defines a service to mean any service provided by An Post that involves the use of the public postal network as defined in the Regulations; and

(a) is identified as a separate service in the Schemes or price lists published by An Post, or is provided under a contract or standard agreement with individual customers; and

(b) operationally handles all items in the service in the same way;

If the service falls partly into the Reserved Sector and partly into the Non-Reserved Sector it shall be accounted for as if it were two separate services.

6 IAS14 is the International Accounting Standards 14 – segment reporting. As discussed later in this report, this has been superseded by International Financial Reporting Standards 8 – Operating Segments (IFRS8). http://www.iasplus.com/en/standards/ias/ias14

Universal Service Providers. Business segments, as defined by IAS14, should be regarded as "subsidiaries" for this purpose.

- Payments/charges shall be calculated on an arm's length basis, and in a transparent and non-discriminatory manner, with the proviso that this transfer "charge" shall equal the price An Post would charge to any competitor who wished to use its network or pay to any external supplier.

Mail Volume and Revenue Identification

Within each of the business segments, as defined by IAS14, mail volumes and revenue shall be allocated to each of the Reserved Sector services and to the Non-Reserved Sector services respectively in the following manner[7]:

- mail volumes and revenue which can be directly assigned to a particular service shall be so assigned;
- mail volumes, by service, shall be recorded separately, from (i) revenue data recorded at the point of sale; and (ii) operational data recorded in the outward phase of the postal pipeline;
- mail volumes, by service, separately recorded, from (i) revenue data recorded at the point of sale; and (ii) operational data recorded in the outward phase of the postal pipeline, shall be compared. An Post shall understand and shall be able to report the reasons for any divergence between the two measures;
- revenue, by service, shall be recorded at the point of sale;
- mail volumes and revenue recorded at the point of sale that cannot be directly assigned to their use for specific services or retention by users for later use (e.g. postage stamps sold and franking machine credits) shall be apportioned to services on the basis of statistical sampling accurate to +/-1% at the 95% confidence level; and
- for mail volumes recorded in the outward phase of the postal pipeline, which cannot be directly assigned to their specific services (e.g. manually sorted mail items), mail volumes shall be apportioned on the basis of statistical sampling, by service, with a minimum margin of error as agreed with ComReg.

[7] Until the 2011 Act was enacted, An Post operated under a reserved sector. It held a monopoly over letters services weighing up to 50 grams and less than 2.5 times the standard domestic tariff.

Cost Allocation and Apportionment Principles

Within the business segments, as defined by IAS14, costs shall be allocated to each of the Reserved Sector services and to the Non-Reserved Sector services respectively, in the following manner:

- costs which can be directly assigned to a particular service shall be so assigned;
- common costs, which are costs that cannot be directly assigned to a particular service, shall be allocated as follows:
  - whenever possible, common costs shall be allocated on the basis of direct analysis of the origin of the costs themselves;
  - when direct analysis is not possible, common cost categories shall be allocated on the basis of an indirect linkage to another cost category or group of cost categories for which a direct assignment or allocation is possible; the indirect linkage shall be based on comparable cost structures; and
  - when neither direct nor indirect measures of cost allocation can be found, the cost category shall be allocated on the basis of a general allocator computed by using the ratio of all expenses directly or indirectly assigned or allocated, on the one hand, to each of the Reserved Sector services and, on the other hand, to the other services.

Review and conformation of compliance

The Direction states that An Post shall:

- engage a competent body to verify compliance with this Direction and to perform a review of the Regulatory Accounts, in accordance with the principles and guidance set out from time to time by ComReg, following discussions with An Post and bodies representative of the Irish accountancy profession;
- publish the report and opinion of the competent body on An Post's compliance with the requirements of this Direction in its annual report submitted to the Minister under section 33 of the 1983 Act; and
- include the report and opinion of the competent body, on the Regulatory Accounts and An Post's compliance with the requirements of this Direction, within the Regulatory Accounts. The report and opinion shall comply with the principles and guidance set out from time to time by ComReg following discussions with An Post and bodies representative of the Irish accountancy profession;

An Post is also required to make:

- the Accounting Manual subject to review by a competent body as and when required by ComReg;
- the processes used by An Post to identify revenue and mail volumes subject to review by a competent body as and when required by ComReg; and
- any statistical sampling conducted to identify mail volumes subject to (i) annual statistical review; and (ii) annual procedural review, taking into account changes to the population size of each service or other significant market changes. The statistical and procedural reviews shall be conducted either by a statistical expert or ComReg, or as part of the review of the Regulatory Accounts. Any alterations to the procedure resulting from the review shall be stated in the Accounting Manual.

3 Regulatory and legal background

This section outlines the relevant legal and regulatory provisions that have been introduced since 2006 that we have considered when making our draft recommendations on cost rules and other requirements to meet the USP Direction.

The main legal and regulatory publications that we have considered are:

- Communications Regulations (Postal Services) Act 2011 ("2011 Act"); and
- The EU Directive 97/67/EC ("Postal Directive") amended in 2002 and 2008.

The 2011 Act and the Postal Directive provide the primary legal basis for ComReg to issue a Direction to the USP. An Post has raised concerns about the legal basis of some of our recommendations. An Post submitted that it is not clear of the legal basis of Frontier Economics recommendations. This section, therefore, also outlines our view in relation to the permitted scope of the Direction, as per the 2011 Act and the Postal Directive, while specific concerns relating to individual recommendations are dealt with elsewhere in this report in the relevant sections.

3.1.1 Communications Regulations (Postal Services) Act 2011

The 2011 Act states that ComReg's statutory objectives in relation to the provision of postal services are to:

- promote the development of the postal sector and, in particular, the availability of a universal postal service within, to and from the State at an affordable price for the benefit of all postal service users;
- promote the interests of postal service users within the Community; and
- facilitate the development of competition and innovation in the market for postal service provision.

Section 31 of the 2011 Act – ComReg's power to issue a Direction

Robust regulatory accounting data is a critical input in ensuring that ComReg is in a position to fulfil its duties under the 2011 Act. To that end and pursuant to section 31 of the 2011 Act, ComReg may give a Direction providing for the keeping by the USP, in its internal accounting systems, of separate accounts for each service it provides which is:

- part of the universal postal service, and
- not part of the universal postal service.

Such a Direction shall provide for:

- rules relating to the identification of costs;
- rules relating to the allocation of costs;
- rules relating to the use of internal cost accounting systems;
- the verification by a statutory auditor of compliance with internal cost accounting systems;
- the publication of such accounts and other information as ComReg considers appropriate (subject to the protection of any information which ComReg considers confidential);
- the publication of a statement of compliance with section 31 of the 2011 Act and ComReg's Direction; and
- such other matters relating to the requirements of section 31 of the 2011 Act and ComReg's Direction as ComReg considers appropriate.

The Act also requires that ComReg shall keep available, to an adequate level of detail, information on the cost accounting systems applied by a USP, and shall submit such information to the European Commission on request. The Act further requires that a USP shall make available in confidence to the European commission, on request, detailed accounting information arising from its cost accounting systems.

In addition to section 31 of the Act, the availability of appropriately dis-aggregated regulatory accounts is an essential input into ensuring compliance with sections 28, 29, 30, 33 and 35 of the Act. We briefly discuss each in turn below.

Section 28 of the 2011 Act – tariff requirements

An Post as universal service provider is required to propose tariffs that meet a number of conditions as set out under section 28 of the Act. Those conditions include:

- prices shall be cost-oriented, that is to say, the prices shall take account of, and reflect the costs of, providing the postal service or part of the postal service concerned; and
- tariffs shall be transparent and non-discriminatory.

To be able to ascertain whether An Post complies with the above requirements it is essential that ComReg has available to it robust cost data in relation to each of the relevant services.

Section 29 of the 2011 Act – terminal dues

Under section 29, the Act requires that a USP shall ensure that its agreements on terminal dues for intra-community cross-border mail comply with the following requirements:

- Terminal dues shall be fixed in relation to the costs of processing and delivering incoming cross-border mail.
- Levels of remuneration shall be related to the quality of service achieved.
- Terminal dues shall be transparent and non-discriminatory.

To be able to ascertain whether An Post complies with the above requirements it is essential that ComReg has available to it robust cost data in relation to the costs of processing and delivering incoming cross-border mail.

Section 30 of the 2011 Act – price control

Section 30 of the Act relates to the setting of a price control for An Post. In order to be in a position to comply with section 30 of the Act, it is essential that ComReg is able to determine accurately the costs incurred by An Post in relation to the provision of those services, and only those services, that are included within the scope of the price control.

Section 33 of the 2011 Act – access to the postal network

Section 33 of the Act relates to access to the postal network of the USP. Under section 33, a postal service provider has the right to enter into negotiations with the USP with a view to concluding an agreement with that provider to access the postal network of the USP and may serve notice on ComReg upon the commencement of any such negotiations. Under 33 (3), where agreement is not reached within the period specified by ComReg under subsection (2), ComReg shall take such steps as are necessary to resolve the dispute. Under 33 (7), in making a decision in relation to dispute, ComReg may impose or amend conditions relating to access to a USP's postal network and such conditions may include

- the price of access,
- terms and conditions relating to matters other than price, and
- rules for the separation of accounts relating to access to the postal network.

In order to be in a position to comply with section 33 of the Act it is essential that ComReg have access to appropriate accounting data.

Section 35 of the 2011 Act – net cost of provision of universal postal service

Section 35 of the Act relates to the net cost of provision of universal postal services, and in particular to the application by the USP for funding for the net costs (if any) of providing a universal postal service. In order for ComReg to be in a position to assess such an application it is again critical that robust accounting information relating to the costs of provision of the universal postal service are available.

3.1.2 Relevant provision of the European Postal Directive[8]

Article 14 of the Postal Directive requires that Member States shall take the measures necessary to ensure that the accounting of the universal service providers is conducted in accordance with the provisions of Article 14 of the Directive. We note that Article 14 was amended in 2008. Therefore we have considered Article 14 of the Postal Directive and any relevant amendments when forming our draft recommendations.

Article 14 includes:

- that there are separate accounts within the internal accounting system in order to clearly distinguish between each of the services which are part of the universal service and those which are not;
- this accounting separation shall be used as an input to calculate the net cost of the universal postal service; and
- such internal accounting systems shall operate on the basis of consistently applied and objectively justifiable cost accounting principles.

With respect to the allocation process, the Article 14 indicates that:

- costs which can be directly assigned to a particular service or product shall be so assigned;
- common costs, that is costs which cannot be directly assigned to a particular service or product, shall be allocated as follows:
  - whenever possible, common costs shall be allocated on the basis of direct analysis of the origin of the costs themselves;
  - when direct analysis is not possible, common cost categories shall be allocated on the basis of an indirect linkage to another cost category or group of cost categories for which a direct assignment or

8 http://ec.europa.eu/internal_market/post/doc/legislation/2008-06_en.pdf

allocation is possible; the indirect linkage shall be based on comparable cost structures;

- when neither direct nor indirect measures of cost allocation can be found, the cost category shall be allocated on the basis of a general allocator computed by using the ratio of all expenses directly or indirectly assigned or allocated, on the one hand, to each of the universal services and, on the other hand, to the other services; and
- common costs, which are necessary for the provision of both universal services and non-universal services, shall be allocated appropriately; the same cost drivers must be applied to both universal services and non-universal services'.

Our review considered whether the existing Direction was consistent with these provisions and whether a new Direction should be issued and if so, how.

3.2 Legal basis of Direction

Our view is that ComReg's Direction should provide for all matters deemed appropriate for the keeping, reporting and verification of separated accounts by An Post. This is because the information in the separated accounts is critical for ComReg to be able to undertake its statutory functions, and to ensure the USP complies with the 2011 Act and the Directive. As stated WIK-Consult's report to the EC, appropriate regulatory accounts are needed for many purposes under the Directive, namely:[9]

- to ensure that prices of universal services are cost-oriented, non-discriminatory, and, at least where produced by a postal service provider with significant market power, not abusive;
- to ensure that, at least where a postal operator has significant market power in the provision of some universal services, prices of jointly produced competitive products are not unfairly under-priced;
- to inform evaluations of the net costs of the universal service obligation, if any; and
- to evaluate the effect of legal privileges in the operation of postal services.

As such, it is important that ComReg's Direction provides for all matters deemed appropriate for the keeping, reporting and verification of separated accounts. We consider that this view is borne out in the 2011 Act and the Postal Directive, both

[9] WIK-Consult (2009), "The Role of Regulators in a More Competitive Postal Market", Study for the European Commission, Directorate General for Internal Market and Services.

of which appear to give broad scope for the Direction to include all relevant matters. In particular:

- paragraph 1 of Article 14 states that Member States shall take the measures necessary to ensure that the accounting of the universal service providers is conducted in accordance with the provisions of this Article; and

- section 31(3)(g) of the 2011 Act states that the direction shall provide for such other matters relating to the requirements of section 31 of the 2011 Act and ComReg's Direction as ComReg considers appropriate.

Therefore, our view is that the Postal Directive and the 2011 Act provide a broad scope for ComReg to include in the direction all matters deemed appropriate for the keeping, reporting and verification of separated accounts by An Post.

While we have given due regard to the 2011 Act and the Postal Directive in formulating our recommendations, we note that it is ultimately ComReg's responsibility for determining whether it considers these recommendations are implementable under the Act.

4 Volume Measurement and Revenue Allocation

Traffic (i.e. volume, number of items) is one of the major cost drivers in Activity Based Costing (ABC) costing. It is directly used in the attribution of direct costs, and is also used to allocate joint costs, emphasising the principle of cost orientation when the operator benefits from economies of scale or scope. ERGP[10] recognises that "proper costing relies on the correct evaluation of the relevant volume". They also state that "the predominant role of product quantity in driving postal service costs for operators in every country means that it is important to understand how quantities are measured for the purposes of cost analysis from one country to another and to identify differences (and potential inconsistencies) in the measurement methodologies concerned". "Traffic (i.e. volume, number of items) is one of the major cost drivers in ABC costing … therefore, it is imperative to have transparent and coherent traffic measures depending on the activity considered".[11] Therefore, as part of a separated accounting system, it is important to ensure accurate mail volume measurement before considering cost allocation.

Accurate mail volumes, as an output of An Post's separated accounts, are required for other sections of the Act. For example, volume forecasts are a significant input into An Post's price regulation under Section 30, and therefore ComReg need confidence in the robustness of An Post's volume measures when setting and reviewing price control for USP services.

As noted earlier, ComReg's Direction to the USP must set rules relating to volume measurement and revenue allocation.

This section details our review of the volume measurement and revenue allocation element of the Direction. The remainder of this section is structured as follows:

- Review of international best practice in this area;
- Our assessment of the implementation of the current Direction in relation to revenue and volume measurement; and
- Recommendations.

10 ERGP (2012), Common position on cost allocation rules

11 ERGP (2012), Report on common costs allocation

4.1 Best Practice in measuring mail volumes and revenues

We have reviewed current best practice in the area of mail volume and revenue identification by examining best practice studies from postal bodies such as the ERGP and CERP.

Mail volumes

There are two main methods for calculating mail volumes:

- Revenue-derived volumes, where volume is derived by dividing the total revenue collected for the item in question by the average unit price of that item, which is derived through a sampling exercise.
- Operationally-based volumes, where volume is counted by sorting machines and derived by estimating the total number of containers (e.g. trays and bags) of the item of mail in question and multiplying that by the average fill of a container.

There is some debate in the postal sector as to whether revenue-derived volumes or operational-based volumes should be used as the predominant mail volume traffic measure. According to the best practice literature we find that it is clear that revenue-derived volumes are the preferred measure, with operationally-based volumes being used as a sense check for the revenue derived traffic figures.

CERP[12] stated that the regulatory accounts should be based on revenue-derived volumes as the regulatory accounts should contain "volume information that shows mail volume, by service, recorded from revenue data recorded at the point of sale". ERGP[13] stated that the "basis for traffic management is mixed", with the best estimate that is available being used in general.

Both CERP and ERGP recommended that revenue derived volumes should be reconciled with operational volumes. ERGP[14] identified that "as there are different methodologies, it might be necessary to try to reconcile the discrepancies that might exist". ERGP states that this reconciliation is completed in 60% of countries in its study in 2013, with 36% of countries including the reconciliation in the independent audit of the regulatory accounts. Similarly CERP[15] recommended that operational volumes should be provided and reconciled with revenue-derived volumes in a supplementary schedule. It also recommends this schedule should

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12 CERP (2009), Recommendation on best Practices for Cost Accounting Rules III

13 ERGP (2013), Report on specific cost allocation issues

14 ERGP (2013), Report on specific cost allocation issues

15 CERP (2009), Recommendation on best Practices for Cost Accounting Rules III

include details of both volume trends by service recorded using the two methods and that the schedule should include detailed commentary.

Real mail studies

An Post conducts a Real Mail Study (RMS) on a continuous basis throughout each year. The requirements of the RMS are set out by the CEN Standard EN13850:2012[16]. This is the only mandatory standard for the measurement of the domestic transit time of end-to-end services for single piece priority mail and first class mail for the USP in all member states.

Real mail flows are sampled as they move through An Post's network and information on these items is then collected and audited. The sample is then used to create a mail profile for An Post mail flows, which is applied to:

- mail volumes and revenue recorded at the point of sale that cannot be directly assigned to their use for specific services or retention by users for later use (e.g. stamps and franking machine credits); and
- mail services recorded in the outward phase of the postal pipeline, which cannot be assigned to their specific services (e.g. manually sorted mail items).

Annex I.2.4 of EN 13850:2012 explains that the accuracy of a measurement is described by the width of the confidence interval around the parameter being estimated. At a confidence interval of 95%, there is a 95% probability that this interval will cover the actual value of the parameter. The minimum sample size required by EN 13850:2012 is set up to tolerate a maximum width of the confidence interval of ±1%. The accuracy of the measurement is then assessed by calculating the variance of the estimator to see whether it lies within this range.

International inbound

Sampling is used to measure the average number of items per kilogram of international mail. There are three phases in the sampling process for international mail[17]:

- Sample selection: It is recommended that a sample is computer-selected every working day for testing continuously throughout the observation period. This is the preferred sampling method. Alternatively the statistical count should consist of a minimum of 48 days of observation each year, with four days per month. The sampling should be distributed evenly across months and working days of the week. Sampling is performed

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16 I.S. EN 13850:2012, Postal Services – Quality of Services – Measurement of the transit time of end-to-end services for single piece priority mail and first class mail, 2013

17 UPU, Statistics and Accounting Guide, January 2015

independently within a mail flow for each mail category – airmail, surface ad S.A.L. - and for each format, where format separation is applied.

- Data collection: Data is recorded for each mail category and format, and within a mail category and format, for each day or for each month or quarter. The container type, container identifier, number of items and gross and net weight are also recorded.
- Estimation, of the number of items and items per kilogram is completed independently for each quarter/month, mail category and format, where applicable. The total number of items is estimated by summing the sample items and sample gross weight for all observation days within the quarter/month, mail category and format. This is then divided by the sample gross weight to obtain estimated items per kilogram. The items per kilogram for each quarter/month, mail category and format is then multiplied by the total dispatched weight.

4.2 Our assessment of the implementation of Direction in relation to volume measurements

This sub-section details how the current Direction has been implemented by An Post in respect of mail volume measurement and revenue identification. It also includes our draft recommendations in relation to these issues.

We set out below our findings with respect to:

- the revenue measurements adopted by An Post;
- the volume measurements adopted by An Post;
- the reconciliation between revenue and operationally based volume estimates;
- the robustness of the method for estimating operationally based volumes; and
- the reporting of the assumptions used to estimate operationally based volumes.

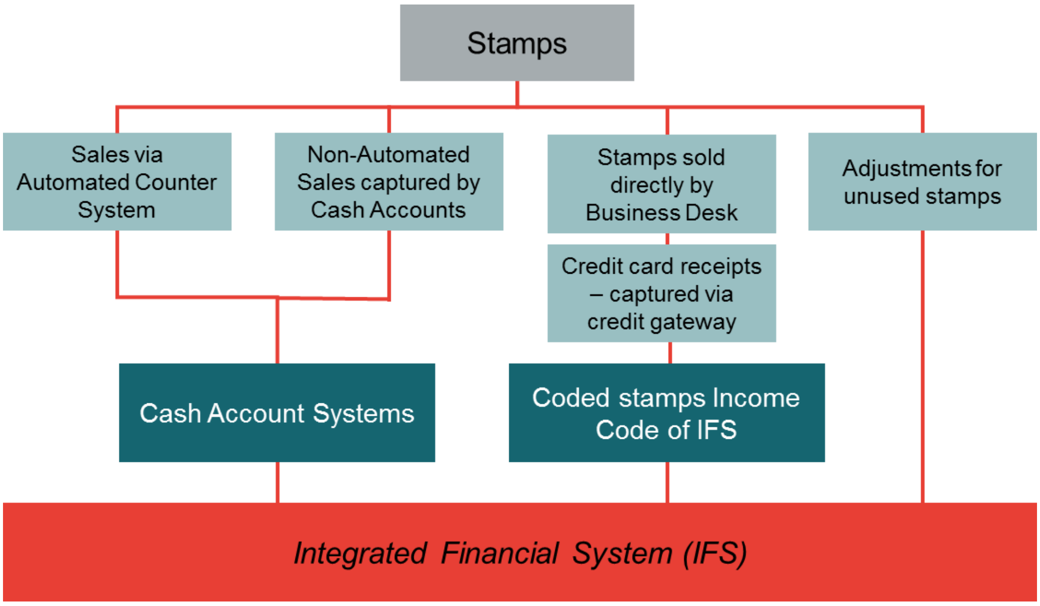
4.2.1 An Post's approach to revenue measurement

The 2006 Direction states that "*revenue, by service, shall be recorded at the point of sale*". The Direction also states that "*revenue recorded at the point of sale that cannot be directly assigned to their use for specific services or retention by users for later use (e.g. postage stamps sold and franking machine credits) shall be apportioned to services on the basis of statistical sampling accurate to +/-1% at the 95% Confidence Level An Post's Accounting Manual outlines*".

An Post's Accounting Manual details its approach to revenue measurement. Its primary method for allocating revenue is An Post's Revenue Recognition Sales Model (RRSM), which was provided to us as part of our review. The RRSM is used to calculate the revenue-derived volume measures, as discussed further in the section below.

Revenue data from An Post's Integrated Financial System (IFS) is an input into the model at the overall service level (i.e. stamp sales, meter revenue etc.). Figure 4 provides an example of how the revenue data is captured, for stamps, and used as an input into the RRSM.

Figure 4. Example of revenue data capture from stamps



Source: Frontier Economics analysis

An Post's RRSM is divided into three main areas, namely:

- domestic and international outbound mail;
- international inbound mail; and
- value added services.

Domestic and international outbound mail

An Post' Accounting Manual states that its stamped and metered volumes for Domestic and International Outbound are primarily determined by applying the results of the RMS data. The exception to this is where An Post's internal systems provide this specific data, such as for registered mail. For bulk mail, sales are recorded on An Post's IFS, with data captured on postings by product, destination and weight step.

As outlined in Figure 5, stamped, metered and bulk mail sales are adjusted for various factors, to arrive at a revenue figure that relates to domestic and international outbound items. The adjusted revenue is assigned to products using the RMS volumes profiles and zonal splits, with product-level revenue assigned to weight steps using RMS weight profiles. The revenue for each weight step is divided by the current tariff for that type of mail to calculate the revenue-derived volumes.

Figure 5. Domestic and international outbound revenue capture

Sales	Stamped	Metered	Bulk Mail
Total Sales per IFS	x	x	x
Adjustments			
1) Stamp retailers	x		
2) Christmas free stamp	x		
Adjusted Sales	x	x	x
A. Less Registered Sales	(x)	(x)	
B. Less Express Post Sales	(x)	(x)	(x)
C. Less Parcel Mails Sales	(x)	(x)	(x)
D. Less Philatelic Sales	(x)		
E. Less Publishers Services Sales		(x)	(x)
F. Less Publicity Post Sales			(x)
G. Less Business Reply Sales			(x)
H. Less Postaim Sales			(x)
Total Domestic & International Outbound Sales (Standard services)	**X**	**X**	**X**

Source: Frontier Economics analysis of An Post's Accounting Manual

Clearly the RMS results are a key input into accurate product-level revenue recording. An Post's RMS is conducted in accordance with the standard EN 13850:2012, and is presently audited on an annual basis by an independent auditor appointed by ComReg. The audit includes an assessment of the RMS sample design, implementation and results. Such an audit is provided for in section 5.2 (c) of the current Direction.

International inbound mail

International inbound mail revenues, or Terminal Dues, are payments received by An Post for the sorting, domestic transport and delivery of mail received from other Postal Administrations.

An Post receive revenues via three different contractual mechanisms, namely:

- *UPU*: The Universal Postal Union is the primary forum for co-operation between postal-sector operators. Within the UPU terminal dues system there are two sub-systems:
  - *Target system*: The target system relates to industrialised countries and relations with other countries wishing to belong to this system. For target counties tariffs are calculated as a specific percentage of the domestic priority tariff for each year
  - *Transitional system*: The transitional system is applied to relations with developing countries not yet ready to join the target system. For transitional counties the tariffs are based on world average costs.
- *REIMS*: Under the REIMS agreement Postal Administrators operate on the basis of multi-lateral arrangements. The REIMS remuneration is based on two elements,
  - A rate per item; and
  - A rate per kilo.
- *Bilateral agreements*: An Post has bilateral agreements in place with ✂.[18]

For international inbound mail, revenue is therefore calculated on the basis of the tariff agreement that is in place with the operator in each country, whether that is UPU, REIMS, or a bilateral agreement. Measurement processes are in line with those outlined in the best practice section above.

Value added services

Revenue from value-added services can be captured in large part direct from An Post's sales systems. Table 1 provides a high level summary of how revenue from value-added services are captured and incorporated into the RRSM model.

[18] An Post, 2014, Accounting Manual, page 36.

Table 1. Value-added services revenue measurement

	Volume source	Revenue calculation method
Registered	Track & Trace[19]	Two elements: **Registered Fee** revenue is calculated using sampling to allocate volumes. **Postage fee** revenue is calculated from the weight profiles in the counter Automation system and sampling.
Express Post	Track & Trace[20]	Tariffs applied to volumes to calculate revenue.
Philatelic	No volumes captured or calculated	Sales recorded in IFS system. Total Philatelic revenue is deducted from Total Postage Stamp Sales.
Passport Express	Revenue and Volumes captured on the Counter Automation System, Ceadúnas Account Docket and subsequently the IFS.	
Redirections / Mail Minder	Must be paid for by cheque or credit card. These receipts are entered into IFS monthly showing the revenue associated with this.	
Business Collections	Revenue details entered into IFS.	
Private Box / Bag	Revenue details entered into IFS.	
Publicity Post	Since 2012, Publicity Post is no longer defined as a 'postal service'[21].	

Source: Frontier Economics analysis of An Post's Accounting Manual

Parcels

Parcels revenue is captured primarily through the Track and Trace system. Barcodes are read as parcels pass through the system, and these details are then associated with customer details set-up in An Post's IFS. Commercially invoiced revenue can then be captured direct from the accounts module of the IFS, whereas stamp/meter parcels are calculated by the average price point from the Counter

19 International Outbound volumes and volumes captured on the Counter Automation System are deducted from Track & Trace volumes and volumes related to billing customers (from IFS) are added.

20 International Outbound volumes and volumes captured on the Counter Automation System are deducted from Track & Trace volumes and volumes related to billing customers (from IFS) are added.

21 Consistent with SI 280 of 2012

Automation System, multiplied by the volumes from the Track and Trace system. Terminal dues are calculated in a similar manner to letter mail.

4.2.2 An Post's approach to measuring volumes

The 2006 Direction states that "*the Regulatory Accounts shall contain volume information that shows mail volume, by service, recorded from revenue data recorded at the point of sale*".

The volumes reported in An Post Regulatory Accounts are currently estimated using revenue-derived figures. This is consistent with the requirements of the 2006 Direction and international best practice.

As outlined in section 4.1.1, international best practice in this area recommends that the Regulatory Accounts should be based on revenue derived volumes. For example CERP[22] state that the regulatory accounts should be based on "*volume information that shows mail volume, by service, recorded from revenue data recorded at the point of sale*".

An Post also advised that it considers revenue derived figures are the most appropriate for the purposes of the Regulatory Accounts.

We are of the view that the Direction should continue to require the Regulatory Accounts to contain volume information that shows mail volume, by service, recorded from revenue data recorded at the point of sale, as is the case at present.

Recommendation 1

We recommend that the Direction continues to require the Regulatory Accounts to contain volume information that shows mail volume, by service, recorded from revenue data recorded at the point of sale.

4.2.4 Reconciliation of revenue and operationally based volumes

The 2006 Direction requires An Post to provide detailed commentary on the reasons for any discrepancy between the revenue-derived figures and the operational-based figures.

An Post currently reconciles revenue-derived volumes with operationally-based volumes in a supplementary annex in the Regulatory Accounts. The 'Supplementary Information – Volumes (Unaudited)' section in An Post's 2014 Regulatory Accounts compares the current year's revenue-derived and operationally-based volumes with the volumes in the previous year. The public version of An Post's Regulatory Accounts reconciles volumes at aggregate level,

[22] CERP (2009), Recommendation on best Practices for Cost Accounting Rules III

while the confidential version of the regulatory accounts that are provided to ComReg reports the reconciliation individually for letters, flats and packets.

The differences between An Post's revenue-derived and operationally-based volumes are shown in Table 2. The total difference between the two volume measures has decreased over time, with operational volumes 2.1% higher than revenue derived volumes in 2014. However, there is a large difference in the revenue and operationally based volumes for flats and parcels. In 2014, operationally-based volumes of flats were ✂% lower than revenue derived volumes, while packets operational volumes were ✂% higher than revenue-derived volumes in 2014. It is not clear why there is such a substantial difference in flats and packets operational and revenue figures, and no commentary is currently provided for different formats in the Regulatory Accounts.

Table 2. Reconciliation of revenue derived and operationally based volumes

	Letters		Flats		Packets & Others		Total	
	2014	**2013**	**2014**	**2013**	**2014**	**2013**	**2014**	**2013**
Operational	✂	✂	✂	✂	✂	✂	614	659.6
Revenue	✂	✂	✂	✂	✂	✂	601.4	621
Difference (€m)	✂	✂	✂	✂	✂	✂	12.6	38.6
Difference (%)	✂	✂	✂	✂	✂	✂	**2.1%**	**6.2%**

Source: An Post Regulatory Accounts

In its 2014 Regulatory Accounts, An Post outlined two reasons why the differences between revenue and operationally based volumes occur, namely

- sampling is undertaken to an accuracy of +/- 1%;[23] and
- the use of assumptions is required for operational volume counting, typically by the use of "Standard fill" assumptions[24].

These explanations appear insufficient to fulfil the Direction. For instance, the gap between revenue and operational figures has changed significantly over time, but the sampling accuracy and use of assumptions has not. Also, the explanations given do not explain the substantial difference between the flats and packets operational and revenue figures. It would be more beneficial if An Post provided

23 As noted in section 4.1, sampling within an accuracy of +/- 1% is consistent with best practice.

24 "Standard fill" assumptions are in Annexe 2.

an explanation for why the differences occur for each individual format (i.e. letters, flats, packets and parcels).

Moreover, the 2006 Direction also requires that An Post "reconciles revenue derived volumes with operational data recorded in the outward phase of the postal pipeline, together with details of volume trends **by service** recorded using the two methods". That is, rather than reconcile volumes at format level (letters, flats and packets), An Post should also provide more disaggregated details of volume reconciliation by service. We find that An Post does not currently carry out this reconciliation at service level, and therefore it appears as though An Post does not comply with the current Direction in this regard.

Volume reconciliation by service as requested under the 2006 Direction is consistent with international best practice in this area. As outlined in section 4.1.1, CERP[25] recommends that the volume reconciliation should include details of both volume trends by service recorded using the two methods, and that the schedule should include detailed commentary. While we consider that reconciliation at the service level would theoretically provide beneficial information as part of the separated accounts, An Post has advised us that such reconciliation would require significant additional operational and HQ resources. In particular, new systems would need to be put in place to provide operational estimates by service. We consider this is a valid concern of An Post given that operational volumes are not currently recorded at the service level. We are therefore of the view that there are practical benefits to requiring the operational volume reconciliation take place at the format (i.e. letter, flat, packets and parcels) level, rather than service. We note that this would be a reduction in An Post's requirements relative to the current Direction. However, we consider the reconciliation should include parcels, which An Post does not currently report separately in the reconciliation. We consider that parcels should be included given that it is also a format under the USO.

We are of the view that reconciliation between revenue-derived and operationally-based volumes should be provided in both the public and confidential Regulatory Accounts. Total volumes for USO letters, flats, packets and parcels are already provided in the public Regulatory Accounts, and there is no coherent reason why the reconciliation of those figures should be considered commercially sensitive information to An Post.

We also consider that An Post should provide detailed commentary explaining the reasons for the differences between the operational and revenue figures for each individual format, that is, letters, flats, packets and parcels, rather than just at the total volume level. Such commentary would provide the benefit of more detailed explanation of why there are large divergences in volume measures for certain format types.

25 CERP (2009), Recommendation on best Practices for Cost Accounting Rules III

Recommendations 2 and 3

We recommend the Direction requires that:

- the reconciliation between revenue-derived and operationally-based volumes be provided by format (letters, flats, packets and parcels) as a supplementary schedule in the Regulatory Accounts; and
- An Post provide detailed commentary explaining the reasons for the differences between the operational and revenue figures for each individual format.

Audit of the reconciliation with operational volumes

Although An Post reconciles revenue-derived and operationally-based volumes, this reconciliation is not audited by an independent auditor. (The auditor's scope, as set out in its Letter of Engagement, is attached in Annexe 5.)

In our draft report, we set out our views that the reconciliation should be included in the auditor's scope. An Post expressed its views that as operational volumes are not used in preparation of the Regulatory Accounts, An Post is of the opinion that auditing of the reconciliation is not necessary nor is it standard practice among other European operators.

As part of our best practice review, we considered whether auditors typically audit the volume reconciliations. ERGP[26] state that reconciliation between volume measurements is completed in 60% of the countries in its 2013 study, with 36% of countries including an independent audit of the reconciliation in the regulatory accounts. Therefore it can be concluded that the majority of postal operators that are required to reconcile their volume measurements also have these reconciliations subject to audit.

Given the importance of volume measures as an input to the separate accounts, and the importance in relation to other sections of the Act (such as An Post's price control), we consider that ComReg requires increased comfort in relation to volume figures. Therefore, we consider that there is benefit in auditing the revenue and operational volume reconciliation. We consider this is particularly important because at present there is relatively little information provided in the regulatory accounts about the reasons for the divergence between revenue and operationally based volumes.

[26] ERGP (2013), Report on specific cost allocation issues

Recommendation 4

We recommend that the Direction requires the revenue derived and operationally based volumes reconciliation be audited.

4.2.7 Reporting the process for deriving operations based volumes and their accuracy

We considered the extent to which An Post transparently documents the methods for deriving operationally based volumes and we examined the tests carried out to test whether the methods provide accurate estimates of volumes.

Operationally-based volumes are based on a combination of both machine and manual counts of items, where machine counts are not feasible. As displayed in Figure 6, currently ✂% of operational volumes are based on mechanised machine counts while ✂% are based on manual mail counts.

Figure 6. Operational volume counts

✂

Source: An Post

Automated machine counts

As machine counts make up a large proportion of the mail volume count, it is important to ensure that this count is accurate.

We asked An Post to provide documentation and details of any mechanisms or controls to check the accuracy of mail volumes as it passes through the Mail Centre pipeline, including handover between different pipeline stages into and out of the Mail Centres.

An Post stated that it conducts daily pre-flight testing before the handover of a machine to live mail processing operation[27]. The pre-flight check procedure is documented. (An Post stated that if issues are found in the pre-flight inspections, maintenance work commences to correct the specific issue).

However, we note that the degree of accuracy that the machines are tested to is not documented. For example, are the machines tested so that they are 99.9% accurate or 99% accurate, etc. We recommend that the degree of accuracy be documented as it would increase confidence and ensure accuracy in the machine counts.

27 Copies of "Pre Flight Machine Accuracy Checks" documentation are attached in Annex 1.

We consider that requiring the Accounting Manual to include details of how operational volumes are calculated, including the process for validating machine counts and the degree of accuracy to which machines are tested, would increase confidence for ComReg that An Post's volumes are correct, and as noted above, volumes are an important aspect of the separated accounts.

Recommendation 5

We recommend that the Direction should require the Accounting Manual to include details of how operational volumes are calculated, including the process for validating machine counts and the degree of accuracy to which machines are tested.

Manual counts

Manual counts are based on counting the number of containers of non-machinable mail items and multiplying it by the average number of items per container ("average fill"). Therefore average container fill assumptions are an important input in the manual mail count.

Although manual mail counts make up just ✂% of operational volumes, they are very important for the count of large packets and parcels. As large packets and parcels cannot be counted by machines, they must be counted manually. Therefore it is important to ensure that the manual counting process is correct in order that they can be reconciled with revenue-derived volumes.[28] An Post has ✂ assumptions for DSU's in relation to average container fills for different types of mail[29]. While at mail centres, An Post classifies mail in a more disaggregated fashion and has ✂ different assumptions for average container fills[30].

Regarding the review process for average container fills An Post gave the following response: *"Average container fills are reviewed once a year by the Head of Mails Processing. Changes to average container fills requires sign off by the Mails Operations Director.*

We note that the average container fill assumptions have not changed since 2012, throughout a period of significant change in the postal sector. The Accounting Manual currently provides no details of these reviews.

We are of the view that the review of the average container fill assumptions should be carried out quarterly rather than annually. Reviewing average container fills every quarter are preferable to an annual review as it takes account of seasonal

28 As noted above in relation to parcels, the revenue-derived volumes are primarily captured through the Track and Trace system.

29 DSU refers to Delivery Service Unit

30 See Annex 2 for further details

changes and variation in mail characteristics, which could potentially impact average container fills. We understand, for example, that Royal Mail undertake reviews on a much more frequent basis, and at least quarterly. We therefore recommend that this activity be stipulated in the new Direction. This would provide ComReg with increased confidence that An Post's volume figures are accurate.

Recommendations 6, 7 and 8

We recommend that the Direction requires An Post to:

- include in its Accounting Manual details of the process for reviewing average container fills;
- review average container fills every quarter; and
- report the results of the average container fill reviews in the Accounting Manual.

Reconciliation of MC and DSU operational volumes

An Post has volume checks at two different stages of its operational pipeline – the mail centre-level and the DSU-level. Therefore, these two check-points would seemingly provide a good cross-check for An Post's operational volumes. As noted, previously, there are large differences in current revenue-derived and operational volumes for some formats (e.g. over ✂% for packets), and therefore any additional operational cross-check would provide further comfort in relation to the robustness of An Post's volumes.

An Post provided documentation of the key steps in completing the Daily Volume Mail reports in Mail Centres. Annex 3 includes a copy of the Dublin Mail Centre Daily Volume template.

DSUs receive pre-advice notifications of volumes despatched from Mail Centres. DSU volumes are recorded on the Mails Performance Management System (MPMS).

We understand that this reconciliation is currently completed by An Post for internal reporting and control. We consider that a formalised reconciliation should take place and be included in An Post's Regulatory Accounts in order to provide ComReg with added assurances as to the accuracy of An Post's volume counts. This reconciliation should be competed at the format level (letters, flats, packets and parcels), so An Post could identify where divergences, if any, are occurring. This recommendation should not be onerous on An Post as they are already completing this reconciliation for internal reporting and control.

Recommendations 9

We recommend that the Direction requires a report on quarterly reconciliations between mail centre and DSU volumes at the format level (i.e. letters, flats, packets and parcels) to be included in the supplementary schedule of volume reconciliation in An Post's Regulatory Accounts.

4.3 Draft volume and revenue recommendations

Our draft recommendations from the volume and revenue measurement section are shown below.

We recommend the Direction requires:

1. the Regulatory Accounts to contain volume information that shows mail volume, by service, recorded from revenue data recorded at the point of sale;
2. the reconciliation between revenue-derived and operationally-based volumes be provided by format (letters, flats, packets and parcels) as a supplementary schedule in the Regulatory Accounts;
3. An Post provide detailed commentary explaining the reasons for the differences between the operational and revenue figures for each individual format;
4. the revenue derived and operationally based volumes reconciliation be audited;
5. the Accounting Manual to include details of how operational volumes are calculated, including the process for validating machine counts and the degree of accuracy to which machines are tested;
6. An Post to include in its Accounting Manual details of the process for reviewing average container fills;
7. An Post to review average container fills every quarter;
8. An Post to report the results of the average container fill reviews in the Accounting Manual; and
9. a report on quarterly reconciliations between mail centre and DSU volumes at the format level (i.e. letters, flats, packets and parcels) to be included in the supplementary schedule of volume reconciliation in An Post's Regulatory Accounts.

5 Cost Allocation

As noted earlier, section 31 of the 2011 Act states that ComReg's Direction to the USP must set rules relating to the identification and allocation of costs.

This section details our review of the cost allocation element of the Direction. The remainder of this section is structured as follows:

- Review of international best practice in cost allocation in post,
- Our assessment of the implementation of the current Direction in relation to cost allocation; and
- Draft cost allocation recommendations.

5.1 Best practice in allocating costs

We have considered best practice in the following areas:

- Cost accounting basis;
- Costing principles;
- Cost classification;
- Cost allocation and cost drivers; and
- Inter-segment charges.

Cost accounting basis

Financial reports can be produced under two main cost accounting basis namely:

- Historical Cost Accounting System (HCA); and
- Current Cost Accounting System (CCA)[31].

ERGP suggests that the use of HCA is a more appropriate method for the postal industry given the specific attributes of the postal sector (i.e. low level of capital investment and predictable asset lives and residual values).[32]

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31 Current Cost Accounting ("CCA") is a methodology originally devised for financial reporting in times of rapidly changing prices where traditional Historical Cost Accounting ("HCA") was considered inadequate.

32 We note here that An Post uses HCA for its financial accounts and regulatory reporting.

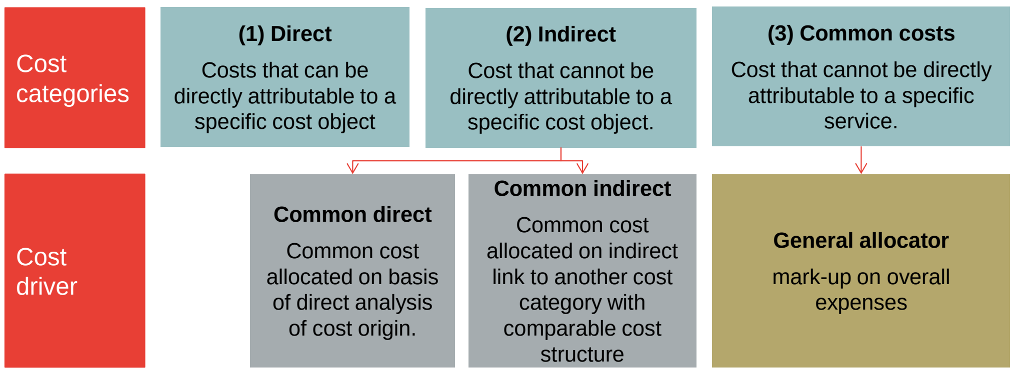
Cost classification

International best practice literature relating to this area identifies the following cost types:

- **Direct costs:** These are costs that can be assigned to a single product; therefore no allocation using cost drivers is required. CERP state that "costs and revenues should be directly allocated to products/services as far as is practicable".
- **Indirect costs/Joint costs:** These are costs that cannot be assigned to a single product as they are shared by a group of products. They are apportioned to individual products using cost drivers. If no cost driver is available, then the cost should be considered as a common cost and allocated accordingly.
- **Common costs:** These are costs that cannot be attributed to a single product or group of products using cost drivers. They are allocated using a general allocator as no other cost allocation method is available. ERGP recommends that the principle of cost causality must apply when applying the general allocator.

These concepts are summarised in Figure 7.

Figure 7. Classification of costs



Source: Frontier Economics

The EU Directive Article 14 also requires that costs be categorised in the following order:

- costs which can be directly assigned;
- common costs allocated on the basis of direct analysis of the origin of the costs themselves;

- common costs allocated on the basis of an indirect linkage to another cost category or group of cost categories for which a direct assignment or allocation is possible; and
- common costs allocated on the basis of a general allocator computed using the ratio of all expenses directly or indirectly assigned or allocated, on the one hand, to each of the universal services and, on the other hand, to the other services.

Cost allocation and cost drivers

The complexity of the cost allocation process depends on the scope of information of the cost drivers. A cost driver is an event or factor that has a systematic relationship to a particular type of cost and which causes that cost to be incurred. In other words, drivers are the method in which costs are shared in an objective and quantifiable way.

ERGP[33] recommends the use of ABC methodology in regulatory accounts and a top-down approach for cost allocation.

Blagojevic et al. (2010) stress the importance of choosing appropriate cost drivers for any activity based costing analysis[34]. A well-defined cost allocation system should guarantee that a high percentage of direct and indirect costs are allocated to services. The authors state that ideally over 90% of direct and indirect costs should be allocated. To be able to reach such a target, Blagojevic et.al (2010) stress that it is important to identify all activities in the chain of postal processes and assign appropriate cost drivers in relation to those activities.

Required steps are:

- Identify all activities of postal value chain;
- Allocate appropriate cost drivers to activities, including:
  - Identification of indirect costs;
  - Analysis of cost centres determining activities;
  - Determination of partial processes/activities and its cost driver parameters;
  - Allocation of capacities and costs to processes/activities; and

33 ERGP (2012), Common position on cost allocation rules

34 Blagojevic et.al (2010) The Model for Services Cost Accounting and Avoiding Cross-subsidy Phenomenon in the Postal Sector, , Conference on Competition and Regulation in Network Industries, Brussels.

  - Consolidation of partial processes/activities to main process/activity.
- Take into account:
  - Fixed/variable cost classification;
  - The impact of the accepted cost drivers on the contribution/gross margin at the serviced product level; and
  - The justification of causalities and cost drivers in case calculated expense clearly differs from estimated actual costs.
- ERGP recommends that in order to maintain transparency the main principles and the specific rules of the cost allocation, such as cost drivers, should be audited by the National Regulatory Authority (NRA) or an organisation commissioned by the NRA.[35]

ERGP recommends that in order to maintain transparency the main principles and the specific rules of the cost allocation, such as cost drivers, should be audited by the NRA or an organisation commissioned by the NRA.[36]

Inter-segment charges

The generally accepted principle is that services transfer pricing should be applied on an "arm's length" basis, and prices should be consistent with the pricing and conditions that would be applied to a third party.

CERP states that:

> *Products/services within the scope of the universal service should also be charged at an arm's length basis if possible and appropriate, otherwise they may be charged at cost or cost-plus basis, subject to compliance with the "cost-oriented" principle.*[37]

ERGP states:

> *The main principle for regulatory transfer pricing is the principle of equivalence. It requires transfer prices to be determined, as far as possible, based on market or regulated prices for comparable services. This will ensure that the Regulated Business is separated - for reporting purposes – on an arms' length basis. It prevents inappropriate cross-subsidisation between the Regulated Business and the remainder of the USP group.*[38]

35 ERGP (12) 28 Rev. 1 – Common Position on cost allocation rules.

36 ERGP (12) 28 Rev. 1 – Common Position on cost allocation rules.

37 CERP (2009), Recommendation on best Practices for Cost Accounting Rules III

38 ERGP (12) 28 Rev. 1 – Common Position on cost allocation rules.

As discussed further in the compliance section, ERGP also recommends that transfer charges within an entity should be subject to audit and this should be set out as part of the "letter of engagement" with the auditor.

5.2 Our assessment of the implementation of Direction in relation to cost allocation

Pursuant to section 31(3)(a) & (b) of the 2011 Act, ComReg's Direction must set rules relating to the identification and allocation of costs. The current Direction states the following in relation to cost allocation rules:

> *The Accounting Manual shall set out how the operating cost of the various aspects of the public postal network, as defined in the Regulations, shall be identified.*
>
> *The Accounting Manual shall set out the basis on which the costs of particular activities are to be apportioned between services. Costs shall be apportioned between the various services that use each aspect of the network on the basis of factors/drivers which reflect the different impact of each item on the cost of the activity.*

We note that the same drivers should apply for allocation of costs regardless of whether services are classified as USO or non-USO.

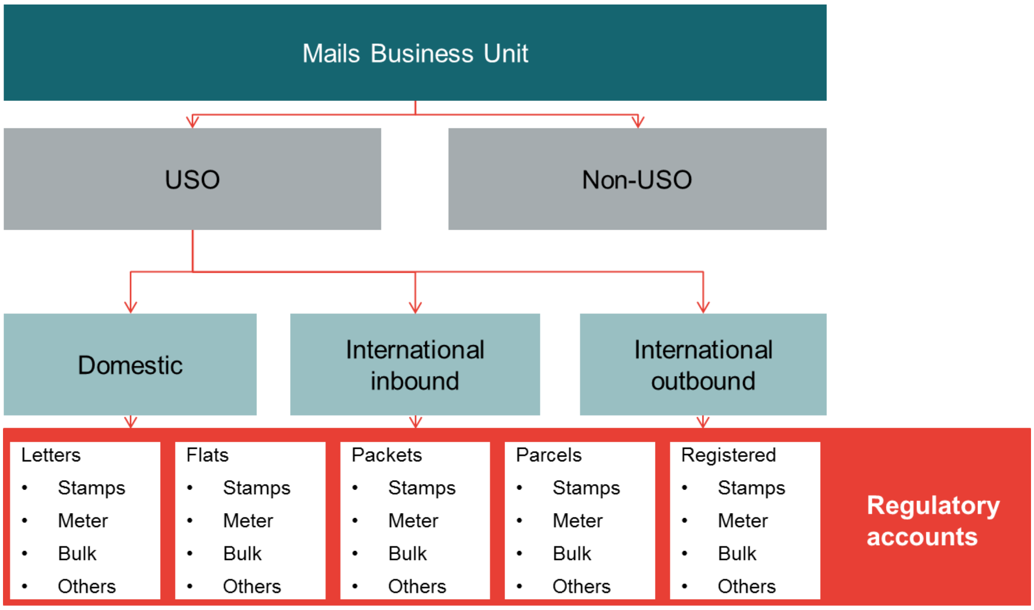
The details of An Post's cost allocation process are set out in its Accounting Manual (2014), pages 38 to 49. The first stage of An Post's cost allocation process as part of its regulatory accounts is to attribute costs to business units (Figure 8). There are three business units: mails business, retail business and corporate.

Figure 8. Allocation of costs to business units

Source: Frontier Economics

The mails business can be further disaggregated, as shown in Figure 9.

Figure 9. An Post Mails Business unit

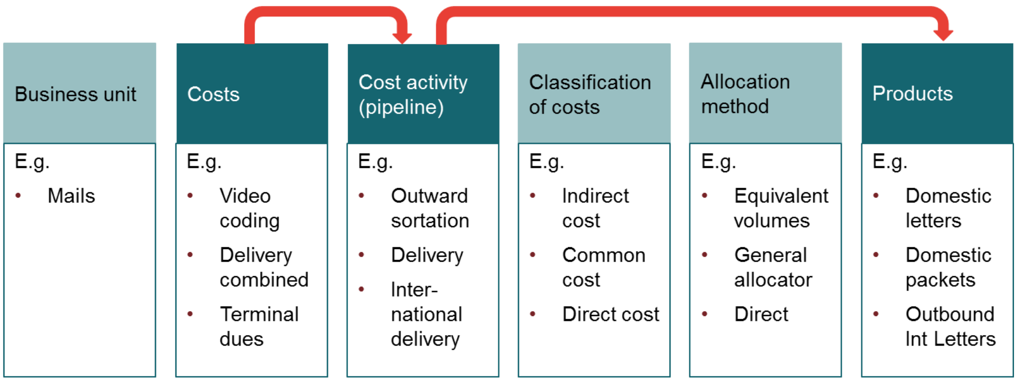


The next stage is to allocate costs from the business units to individual products and services. This process is summarised in Figure 10. An Post states in its Accounting Manual that the basis of allocation of the costs to products was determined by a qualified industrial engineer in conjunction with operational managers. An Post's basis of allocation includes:

- definition of activity;
- analysis of the various tasks involved in the activity;
- definition of assumptions relating to the activity;
- identification of the products that consume the costs associated with the activity;
- review of the cost allocation methods available;
- selection of the most appropriate cost allocation method; and
- verification of the cost allocation method by operational managers in conjunction with the Management Accounting team.

An Post state that the review process is ongoing and may result in additional activities being created or changes to the basis of allocation.

Figure 10. Allocation from business units to products/services



Source: Frontier Economics

From the above, we can therefore see that there are four key steps in An Post's cost allocation process:

- Recording costs;
- Mapping costs to cost activities;
- The classifying the cost activities (direct, indirect or common); and
- The allocation method used to drive those costs into products.

These steps are discussed in further detail below.

5.2.1 Recording of costs

An Post's expenditure is recorded in two broad categories: pay costs and non-pay costs. Pay costs include:

- operations pay;
- headquarters pay; and
- scale payments.

Together these three categories of pay costs account for approximately ✂% of An Post's total expenditure in its regulatory accounts.[39] Non-pay costs are all other costs incurred by An Post, including depreciation and terminal dues, and account for about ✂% of An Post's costs.

39 An Post, Accounting Manual, Page 38.

5.2.2 Mapping of resources (costs) to cost activities

The next step in An Post's cost allocation process is mapping resources (i.e. areas of recorded costs) to cost activities[40]. An Post maps 944 resources[41] to potentially 954 activities in its costing system,[42] [43] but only 625 are currently populated with resource costs. An Post advised that an activity is not deleted from the system if it is no longer required, in case it is needed in the future.

Our analysis of how resources are mapped to activities is outlined in Table 3. Only 13.8% of resources are directly mapped to activities. We note that a significant proportion of letters and parcels resources are aggregated together into the same activity (28.7%). For example, 'wages', 'uniform clothing', 'postage stamp sales (value)'.

40 These are also sometimes referred to as cost categories. For comparison, Frontier's study for the European Commission on the principles for calculating the net cost of the USO (2012) found that the numbers of cost categories vary between 4 and 3000, while the USPs use between 4 and 216 unique cost drivers.

41 Sourced from the file 'LP Resource Costs' received from An Post.

42 Sourced from the file 'Analysis of Cost Categories' received from An Post. For comparison, Frontier's study for the European Commission on the principles for calculating the net cost of the USO (2012) found that the operations of the USPs who responded to a survey can be broken down into between 70 and 1,624 activities – such information would be set out in an activity dictionary. These are then allocated based on between 4 and 155 activity drivers.

43 Sourced from the file 'Activities' received from An Post.

Table 3. Mapping of resources to activities

Type of mapping	Resources	Cost (€m)	Proportion of total cost
Aggregation of letters and parcels into one activity	602	✂	28.7%
One-to-one mapping of resources to activities	114	✂	13.8%
Other mappings (with resources that are common to both letters and parcels)	198	✂	33.4%
Other mappings (with resources that are not common to both letters and parcels)	30	✂	24.2%
Total number of resources	944	✂	100.0%

Source: Frontier Economics analysis of 'LP Resources' and 'Activity Cost Categories 2014' An Post files

It is possible that resources recorded separately for letters and parcels could remain separate activities, rather than being aggregated together and then use cost drivers (as discussed below) to allocate those costs amongst letter and parcel products.

As part of our review we asked An Post about letter and parcel resources that were allocated into one activity. An Post referred us to its previous response to Analysys Mason in 2012.

> *"In some instances there are separate cost activity categories for letters and parcels (i.e. Delivery Letters, Delivery Parcels). This is because they are identified as separate activities in the streams reporting system. In the case of "wages", "uniform clothing", and "security patrols" and a number of other cost categories, these are not categorised separately by letter or parcels at the activity level. The SAS ABM system has the facility to "Tag" these items by Letters (BU2) or Parcels (BU4) which ensures that they are allocated to the relevant Letters or Parcel Business Unit.*
>
> *To duplicate every activity by letters or parcels within the activity module would be a duplication of systems resources and the above approach was recommended by SAS ABM when designing the cost allocation system for An Post for system efficiency reasons. There is no issue in relation to the correct allocation of costs to the business unit level."*

An Post also provided us with a worked example, including extracts from SAS Business Unit and Regulatory Accounts Models 2014, which showed how costs activities are aggregated on a practical basis.

We do not consider there is sufficient evidence to require An Post to alter its cost allocation system in relation to the aggregation of activities.

5.2.3 Process for classification of costs

The 2006 Direction requires costs to be allocated as follows:

- *"costs which can be directly assigned to a particular service shall be so assigned;*
- *common costs, which are costs that cannot be directly assigned to a particular service, shall be allocated as follows:*
  - *whenever possible, common costs shall be allocated on the basis of direct analysis of the origin of the costs themselves;*
  - *when direct analysis is not possible, common cost categories shall be allocated on the basis of an indirect linkage to another cost category or group of cost categories for which a direct assignment or allocation is possible; the indirect linkage shall be based on comparable cost structures; and*
- *when neither direct nor indirect measures of cost allocation can be found, the cost category shall be allocated on the basis of a general allocator computed by using the ratio of all expenses directly or indirectly assigned or allocated, on the one hand, to each of the Reserved Sector services and, on the other hand, to the other services."*

The cost categories outlined in An Post's Accounting Manual and reported in its regulatory accounts are consistent with the requirements of the 2006 Direction and international best practice. An Post's Accounting Manual states that its cost is allocated between direct and common costs. Direct costs are costs that can be directly assigned to a particular service. Common costs are all other costs allocated on the basis of either:

- direct analysis;
- indirect linkage; and
- general allocation.

Our view is that these definitions are consistent with the current Direction, and that the current Direction is consistent with best practice and regulatory requirements.

An Post's classification of costs

As noted above, An Post currently has 954 cost activity codes. These costs are split between direct, indirect and general allocator,[44] as outlined in Table 4 below.[45] Proportionally, the largest number of activity codes is assigned to the general allocator (or, common costs). Approximately 42% of all activity codes are classified by An Post as general allocator, such as overheads and corporate expenses. Activity codes classified as indirect account for about 39% of all activity codes, and direct account for about 19%.

Table 4. Activity codes by cost category in 2014

Cost category		Number of activities
Direct		179
Indirect	Common Direct	✂
	Common Indirect	✂
	Total Indirect	376
General Allocator		399
Total no. of activity codes		**954**

Source: Frontier Economics

We have also analysed the proportions of An Post's total costs that are allocated directly, indirectly or by a general allocator (Table 5). The proportion of costs that are allocating using a general allocator has reduced from 41% in 2010 to 28% in 2014. This reduction appears to be primarily driven by An Post changing the costing methodology for vehicles and other pipeline specific overheads. Analysys Mason previously recommended that vehicle and driving related overheads move away from a general allocator attribution to an allocator based on the portion of the pipeline that the costs support. As we understand, An Post's implementation of this draft recommendation resulted in a significant reduction in the proportion of costs allocated to the general allocator.

44 The general allocator is an equi-proportionate mark-up on overall expenses for common costs.

45 We note that while this is a large number of activity codes, they are not necessarily all used by An Post. In 2014, 625 of the 954 activities were populated with actual resource costs.

Table 5. Proportion of total costs allocated to each cost type in 2014

Cost type		Proportion
Direct		16.6%
Indirect	**Common Direct**	✂%
	Common Indirect	✂%
	Total Indirect	55.6%
General Allocator		27.8 %

Source: Frontier Economics

We have also analysed the concentration of activity costs by pipeline, and proportion of costs allocated within each pipeline (Table 6). From this analysis we can see that delivery cost activities account for proportionally a greater amount of total cost. While delivery accounts for about 8.5% of active activity codes, it accounts for about 42% of all costs. Conversely, while general allocator cost activities account for over half of all activity codes, they account for about 28% of total costs.

Table 6. Analysis of activity cost concentration (2014)

Pipeline	Treatment	Cost (€'000)	Proportion of Total Costs	Activities	Average cost per activity (€'000)
Collection	Direct	✂	0.9%	8	✂
	Indirect	✂	2.2%	6	✂
Delivery	Direct	✂	7.7%	26	✂
	Indirect	✂	34.4%	27	✂
Inward Sortation	Direct	✂	0.9%	5	✂
	Indirect	✂	5.1%	30	✂
Outward Sortation	Direct	✂	4.7%	26	✂
	Indirect	✂	6.3%	43	✂
Revenue Collection	Direct	✂	1.8%	27	✂
	Indirect	✂	3.3%	24	✂
Transport	Direct	✂	0.2%	3	✂
	Indirect	✂	4.3%	19	✂
Other	Direct	✂	0.2%	2	✂
	General Allocator	✂	27.8%	365	✂
Other Specific	Direct	✂	0.1%	14	✂
Total		✂	100%	625	

Source: Frontier Economics

We note that direct costs make up a relatively small proportion of total costs. In part, this is because delivery costs, which form such a significant proportion of the non-general allocator costs, are primarily indirect. We also note that a significant proportion of total costs are allocated using the general allocator (27.8%). It is common for postal networks to have large components of costs that are common across the business. CERP state that "a relatively high proportion of the costs of operators are shared between different services"[46].

Identification of avoidable costs

The Direction currently requires An Post's Accounting Manual to provide "the process by which An Post identifies how avoidable, variable and fixed costs are defined".

An Post's Accounting Manual states that fixed costs are identified as those costs that do not fluctuate with changes in volumes, whereas variable costs do change

46 CERP (2009), Recommendation on best Practices for Cost Accounting Rules III

with changes in volumes[47]. While these are useful definitions, they provide little clarity in relation to how these types of costs are actually identified in the regulatory accounts process.

An Post's Accounting Manual currently contains no guidance on the process by which it identifies avoidable costs.

As a comparison, we have considered the detail on avoidable costs contained in Royal Mail's equivalent document, as set out in the text box below.

Royal Mail's process for identifying avoidable costs

Royal Mail's ABC Costing Manual includes detail of the process for identifying avoidable costs in respect of class costing. An extract from its manual for first class mail is provided below.

First Class mail

Class costing must be applied to all avoidable First Class costs. Avoidable First Class costs are costs which meet the following criteria:

- *The costs would be avoided, if Royal Mail were not to offer First Class Products, but the current operational specifications of all other Products were to remain unchanged; and*
- *The costs exclude any incremental costs which would be incurred, if all Second Class items using the First Class Activities were to be processed alongside other Second Class items.*

Avoidable First Class Costs

All avoidable First Class costs must be attributed only to First Class Products. Avoidable First Class costs may include, but need not be limited to, the following Cost Types:

- *Accommodation;*
- *Shift allowance; and*
- *Plant & machinery non-running time costs.*

We consider that the issue of identifying avoidable costs is particularly important as ComReg may require details of how An Post identifies its avoidable costs in order for it to carry out its statutory functions. For example, section 33 of the Act requires ComReg to resolve disputes, should they arise, between An Post and those seeking access to its network. Calculating access prices may involve ComReg

47 An Post, Accounting Manual 2014, page 49

considering An Post's avoidable costs. For instance, the amount of costs that An Post would avoid by granting another postal provider access to its network. Further the correct identification of avoidable costs is necessary to ensure that An Post is compliant with section 35 of the Act, which refers to the net cost of provision of the USO. An evaluation of the net cost of the USO requires cost estimates that would be avoided if the USP provider was not subject to the obligations[48].

An Post's Accounting Manual states that it is planning a project to identify avoidable costs in the Regulatory Accounts, and will provide ComReg with updates regarding its progress. We asked An Post to provide us with details about when it was planning to undertake and complete this project. An Post informed us that this project was superseded by the price cap work and that the Accounting Manual would be updated accordingly.

We consider that An Post should provide details of the process by which it identifies avoidable, variable, and fixed costs. For example, how does An Post define what is an avoidable cost, and what types of costs may be considered avoidable. Such information would provide ComReg with increased confidence that An Post is compliant with section 33 (price of access) and section 35 (net cost) of the 2011 Act

Recommendation 10

We recommend the Direction requires the Accounting Manual to provide detailed information on the process the identification of avoidable, variable, and fixed costs, including worked examples, to enable ComReg to exercise its functions under the Act.

5.2.5 Allocation method

Once costs are classified, An Post use cost drivers to allocate direct and indirect costs to individual products. (General allocator costs are allocated using an equi-proportionate mark-up.[49]) Individual drivers use allocations based on volumes, pay or revenue. For example, allocation of delivery costs to products will depend on the volumes of individual products delivered. Drivers typically also use weightings for different mail types as different products use differing amounts of resources.

48 See Frontier Economics, 2013, "Recommendations on the form and manner that a net cost submission should be made by the universal service provider – a report prepared for ComReg" https://www.comreg.ie/_fileupload/publications/ComReg1348a.pdf

49 The general allocator formula assigns costs to products on a pro-rata basis by using the ratio of all expenses directly or indirectly assigned to all products.

An Post's has a total of 139 cost drivers for allocating costs, however it only used 72 of these in these 2014[50]. An Post applies the drivers in a set sequence, as outlined in Table 7. The sequence means that certain drivers rely on costs which have already been assigned. In particular, the general allocator (number 12 in the below) needs to be allocated once other costs have already been allocated as the formula uses a pro-rate basis based on the ratio of all other costs incurred by the products.

Table 7. An Post's Sequence of cost allocation

1.	Volume * Preparation weighting factors, Volume * delivery weighting factors, non-labelled drivers (i.e. volume, turnover), central admin allocation
2.	Central Provision Allocation
3.	Ops Pay
4.	Head-office Pay-Product Volumes
5.	Allocation of terminal dues, delivery, preparation time, publicity post, scale payments delivery
6.	General Allocator Domestic & Inbound, Product Volumes * Transportation Factor Delivery
7.	Volume * collection/transportation/sorting/international Mail/Other weighting factors, Operational Pay drivers (i.e. OP turnover, OP volumes), Non Pay and Operational Pay non-pay cost split,
8.	Direct Ops Pay
9.	Head-office Pay drivers
10.	Total Pay Excluding Scale Payments
11.	Non Pay drivers (i.e. Non Pay volumes, Non Pay turnover), Scale Pay drivers (Scale Pay volumes, Scale Pay turnover), Scale payments, Allocation of Mails by sea and air, Allocation of EMS/foreign Admin Parcels, Inter Service Cost Splits, Delivery Driving Time, Marketing, Election Post
12.	General Allocator All Products

Source: Frontier Economics analysis of An Post's "Driver.csv" file

The Direction (4.3.4.5) requires the Accounting Manual to provide detail of "how cost allocation drivers are reviewed, updated and verified". The drivers are clearly

50 Sourced from 'Analysis of Cost Category 2014' excel file provided by An Post.

a large determining factor in An Post's cost allocation system, and it therefore reasonable that such details are required to be provided.

An Post's Accounting Manual details its cost allocation driver review as follows:

> *"Cost Drivers are reviewed by An Post annually and revised if necessary in advance of the preparation of the Regulatory Accounts. Details of the proposed cost drivers are also forwarded to ComReg."*

In our view, the current level of detail provided by An Post in relation to how the drivers are set and reviewed provides very little transparency. Our view is therefore that the Direction should be strengthened to provide ComReg with a greater level of detail on how cost drivers are set. Our draft recommendations on this are set out below, and are also encapsulated further below in our draft recommendations relating to the auditor's audit scope and responsibilities.

Recommendations 11 and 12

We recommend the Direction requires An Post to provide ComReg with the full details of the annual review of the cost drivers.

We recommend the Direction requires An Post to provide ComReg with details of any year-on-year methodological changes in cost drivers, and that the nature and reason of that change is fully detailed by An Post.

Weight bands for products

In the definition of its products, An Post's splits products into two weight bands – below 50 grams and above 50 grams. The same weight bands are used for allocating cost activities to products and services for letters, flats and packets.

As different weighting factors are used for cost drivers, products are allocated different proportions of costs depending on their weight bands. In some instance the difference in weighting factors can be large. For instance, Ceadúnas flats above 50 grams are allocated three time more costs than those under 50 gram. An Post provided the following explanation for why that is the case in this example.

An Post example on factors differing by weight

Transportation Factor: *This is a composite factor – perhaps best explained by reference to the components in the table below:*

	Stamp Flat <50g	Ceadúnas Flat >85% <50g	Ceadúnas Flat >85% >50g
All weightings as per pay weightings	Weighting	Weighting	Weighting
CMV Conveyancing	✂	✂	✂
Station Services	✂	✂	✂
Mails Distribution Network	✂	✂	✂

Costs for each component of Transport costs, namely CMV Conveyancing, Station Services and Mails Distribution Network, as a proportion of total Transport costs are multiplied by the respective weighting for each component cost. Ceadúnas Flat (domestic, deferred pre-noon 85 auto sort) <50g has an identical Transportation Factor to a stamped Flat <50g – intuitively transport costs associated with both these mail items is unlikely to differ. Whilst the component weightings applied to Ceadúnas Flat (domestic, deferred pre-noon 85 auto sort) >50g are threefold the <50g weighting reflecting that flats can weigh up to 500g and >50g flats also likely to be bulkier as well as heavier and occupy more space when transporting. The Transportation Factor for Ceadúnas Flat (domestic, deferred pre-noon 85 auto sort) <50g is calculated as being very slightly under ✂ and for Ceadúnas Flat (domestic, deferred pre-noon 85 auto sort) >50g slightly ✂, reflecting the very low actual cost associated with Station Services relative to CMV Conveyancing and Mails Distribution Network (as discussed above).

The above explanation exemplifies how weight can sometimes be a significant driver of cost.

However, it is important that the weight breaks are set at an appropriate level. This is because, as stated in section 3.2 of the Direction, An Post is required to set out a detailed estimate of the costs of providing the service for each price point. At present, An Post's regulatory accounts are unable to provide this because, while cost are allocated into two weight bands, An Post's tariffs:

- differ across numerous price bands for flats and packets; and
- are the same above or below 50 grams for letters.

The 50 gram weight break derives from the previous "reserved sector", which, up until the 2011 Act, An Post held a monopoly over letters services weighing up to 50 grams and less than 2.5 times the standard domestic tariff. This "reserved sector" no longer applies.

Table 8 shows An Post domestic stamp and metered tariff for letters, flats and packets. Flats and packets prices increase as the weight bands increase. For example, a 500 gram stamped packet is more than twice the price of a 100 gram packet, and a 1,000 gram packet is nearly four times the price.

Table 8. Domestic stamp and meter prices by weight step

Category	Max weight	Stamp tariff	Meter tariff
Letter	100g	€0.70	€0.66
Flat	100g	€1.25	€1.20
	250g	€1.70	€1.65
	500g	€2.30	€2.25
Packet	100g	€2.80	€2.70
	250g	€3.50	€3.40
	500g	€4.50	€4.40

Source: An Post price list, http://www.anpost.ie/AnPost/PostalRates/PostalRatesHome.htm

As part of our review, we asked An Post why flats and packets are only listed in two weight bands. An Post referred us to its previous response in the 2012 Analysys Mason report. An Post stated that it would be disproportionate to conduct industrial engineering for cost allocation at more detailed weight steps. However, as outlined in An Post's response above, weight appears to be a significant driver of certain costs. Moreover, An Post's tariffs for flats and packets change significantly as the weight of the item increases. Table 9 shows the proportion of letters, flats and packets below and above the 50 grams weight break.

Table 9. Proportion of domestic mail above and below 50 grams

Mail Type	Payment Type	<50 grams	>50 grams
Letter	Stamped	✂%	✂%
	Meter	✂%	✂%
	Ceadúnas	✂%	✂%
Flat	Stamped	✂%	✂%
	Meter	✂%	✂%
	Ceadúnas	✂%	✂%
Packet	Stamped	✂%	✂%
	Meter	✂%	✂%
	Ceadúnas	✂%	✂%

Source: Frontier Economics analysis of An Post Revenue Recognition Sales model (Stamped and Metered figures are from the “product profiles” worksheet, and Ceadúnas figures are from the “Ceadúnas Dom & Int’l Out” worksheet).

As can be seen in the above table, only about ✂% of letters are over 50 grams. We also note that tariffs are the same for domestic letters up to 100 grams. For flats and packets, the majority of items are more than 50 grams[51].

We have considered Royal Mail’s product module structure from its ABC Costing Manual. Royal Mail attributes costs at the product level using a number of handling characteristics, including mail size. The weight bands for domestic products are shown in Table 10. From this we can see that Royal Mail has one tariff and one costing option for letters up to 100 grams, but for flats and packets it has more disaggregated costing options so as to align with tariffs.

51 See Annexe 4 for more details

Table 10. Royal Mail domestic size tariff and costing options

Weight band	Letter	Large letter	A3 packet	Packet
0-100g	✓	✓	✓	✓
101-250g		✓	✓	✓
251-500g		✓	✓	✓
501-750g		✓	✓	✓
751-1000g				✓
1001-2000g				✓
2001-5000g				✓
>5000g				✓

Source: Royal Mail ABC Costing Manual, 2014/15

We note that Article 12 of the postal directive states that "Member States shall take steps to ensure that the tariffs for each of the services forming part of the universal service…shall be cost-oriented and give incentives for an efficient universal service provision".

In practice, NRAs can take three approaches for determining whether tariffs are cost orientated, namely by assessing by:

- individual price point (for example, a 100g domestic flat);
- individual services (for example, single-piece domestic flats);
- baskets of services (for example, all domestic flats, all international flats, etc.).[52]

In our view, however, the 2011 Act requires individual price points to be cost orientation. This is because ComReg requires detailed estimates of the costs of providing the service for different price points in order for it to perform its statutory functions. For example, section 28 (1) (b) requires tariffs for each postal service or part of a postal service to be cost-oriented, that is to say, the prices shall take account of, and reflect the costs of, providing the postal service or part of the postal service concerned. ComReg may therefore require detailed estimates of the costs of providing each service in order to ensure that An Post's tariffs are

52 Copenhagen Economics, (2012), "Pricing behaviour of postal operators", Report to European Commission DG Internal Market and Services.

compliant with this section of the Act. Also, in relation to section 33 of the Act, should an access dispute need to be resolved, ComReg may be required to know the cost of providing the specific services for which access is being sought. We are therefore of the view that An Post's costs should be allocated at the tariff level in order to ensure An Post's tariffs are compliant with the relevant provisions of the 2011 Act.

This is consistent with the current direction. As stated in section 3.2 of the current Direction, An Post is already required to set out for each price point a detailed estimate of the costs of providing the service.

Recommendation 13, 14 and 15

We recommend the Direction continues to require An Post to provide detailed cost estimates for providing the required service at each price point.

We recommend the Direction requires An Post's Accounting Manual (4.3.4.5) provide a detailed explanation of how costs are allocated to products with different tariffs.

We recommend the Direction requires An Post's Accounting Manual (4.3.4.5) provide a detailed explanation where the weight factors used in the allocation process do not align with the various tariff price points.

Inter-company and inter-segments transactions

The current Direction requires that:

- payments/charges between business segments to be calculated on an arm's length basis, and in a transparent and non-discriminatory manner; and
- transfer "charges" shall equal the price An Post would charge any competitor who wished to use its network or pay to any external supplier.

Ensuring that internal An Post's payments and charges are set at an appropriate level is important in ensuring accurate cost allocation for regulatory accounting purposes. For instance, section 30 of the 2011 Act requires that ComReg is able to determine accurately the costs incurred by An Post in relation to the provision of those services, and only those services, that are included within the scope of the price control. As such, internal charges need to be set at an appropriate level so as to ComReg can ensure An Post's compliance with the price control regime and costs are not distorted between An Post business units or products.

An Post described the process of its inter-segment transaction at a high-level as follows:

> *In the first instance costs are attributed to Business Units. Business Units provide services to other Business Units. The costs in the first instance are charged to the Business Unit where they originate. The Business Unit then charges the other Business Units at arms length for these services.*

As an example, the mails business provides services to other An Post business units, and to subsidiaries of An Post. Table 11 details the revenue received by the mails business unit in 2014 from the other business segments. This shows that the mails business received about €15.6 million in revenue from other An Post business units and subsidiaries in 2014. The mails business unit inter-segment revenues are a relatively small proportion of the total mails revenue, as shown below in Table 12, whereas other units have a higher proportion of inter-segment revenue.

Table 11. Inter-segment revenue coming from the mails business segments

Inter Segment Revenue	€' 000
Services provided to others	✂
Use of Mails	✂
Sales to Subsidiaries	✂
Inter service revenue	✂
Total	15,591

Source: An Post 'Use of Mails' spreadsheet

Table 12. Proportion of inter-segment revenue (€'000)

	Mails	Retail	Subsidiaries and other activities (corporate)
Inter-segment revenue	15,591	34,020	95,918
Total segment revenue	538,291	200,817	227,779
Inter-segment/total	3%	17%	42%

Source: An Post, 2014 Regulatory Accounts

While the Regulatory Accounts show the inter-segment revenue by business segment, the accounts do not show the source of that revenue. An Post provided us with a break-down of its corporate inter-segment revenues for 2014, as shown in Table 13. Such detailed information provides greater transparency as to the trends and direction of An Post's inter-segment revenue. Our view is therefore that the Regulatory Accounts should include the source of inter-segment revenue, in a matrix form, in order to show how charges flow between various An Post business segments.

Table 13. An Post corporate inter-segment charges for 2014

		€'000
Pay	**Letters**	✂
	Parcels	✂
	Retail	✂
Non-pay	**Letters**	✂
	Parcels	✂
	Retail	✂
Sales to subsidiaries		✂
Interest income reclassified to retail		✂
Total		95,918

Source: An Post 'Corporate Inter-Segment Revenue' spreadsheet

As part of our review, we asked An Post to provide the basis of inter-segment revenues and cost reallocations for 2014.

An Post provided us with a high level summary of the process for inter-segment cost reallocation. An Post also stated:

> *Because of the very significant number of cost centres and large number of expense codes in use in the An Post systems, and combinations thereof, it is not practical to provide detail of each and every line item recharged from Corporate to other Business Units and the associated cost allocation basis. A sample of items is detailed below.*

These examples of inter-segment charges are set out in the below text box.

Inter-segment charges calculations provided by An Post

Example 1 – Depreciation Costs

In 2014 a total of €✂k depreciation costs were recharged from Corporate to other Business Units. Total depreciation is made up of depreciation on buildings, sorting equipment, security equipment, computer hardware, counter equipment, passenger motor vehicles etc. Each category of depreciation is individually analysed and recharges to other Business Units are based on the most appropriate driver. For example, depreciation on letter sorting equipment is recharged 100% to Letters, whilst depreciation on Buildings is based on a detailed analysis of each site taking into account the function of the property e.g. solely a Retail office, a Mail Centre etc. In the case of shared sites (e.g. a combined Retail and Delivery Office) depreciation charges are split based on square footage.

Example 2 – Marketing Costs

In the case of the Sales & Marketing Directorate (a "Corporate" directorate), costs associated with one of its constituent cost centres, cc27128 Direct Mail are recharged based on an analysis of the specific expense item. For example, the expense item "Post & Pay" (product marketing costs) totalling €✂in 2014 is recharged to Letters 100% as the cost is proper to Letters direct mail items. Whilst the cost item "Marketing Counters Merchandising" €✂ is recharged 100% to Retail.

✂

For cc27125 Sales & Marketing Director, also a Sales & Marketing Directorate constituent cost centre, the expense item "Post & Pay" totalling €✂ in 2014 is recharged from Corporate to Letters, Parcels and Retail based on 2014 Letters, Parcels and Retail revenue as a proportion of total 2014 income excluding corporate income (corporate income comprises interest income, Arcade Property rental income etc.).

We appreciate An Post's point that there are numerous inter-segment charges, and it would have been impractical for them to detail all of them to us as part of this review.

In our view, the nature and detail of all inter-segment charges should be part of the auditor's scope. This is consistent with best practice as it allows for ongoing assurance that transfer prices are set at an appropriate level. In particular, the auditor should consider whether transfer charges can be set with reference to market or regulated prices for comparable services, and where no comparable open market or regulated services or products exist, transfer prices should be set such that they are cost oriented.

Recommendation 16 and 17

We recommend the Direction requires the Regulatory Accounts include the source of inter-segment revenue in order to show how charges flow between various An Post business segments. This will allow greater transparency to the direction, and changes in trends, of inter-segment revenue.

We recommend the Direction requires the audit to specifically include the nature and detail of transfer charges.

5.3 Draft cost allocation recommendations

Our draft recommendations from the cost allocation section are shown below

We recommend the Direction requires:

10. the Accounting Manual to provide detailed information on the process the identification of avoidable, variable, and fixed costs, including worked examples, to enable ComReg to exercise its functions under the Act;
11. An Post to provide ComReg with the full details of the annual review of the cost drivers;
12. An Post to provide ComReg with details of any year-on-year methodological changes in cost drivers, and that the nature and reason of that change is fully detailed by An Post;
13. An Post to provide detailed cost estimates for providing the required service at each price point.
14. An Post's Accounting Manual (4.3.4.5) provide a detailed explanation of how costs are allocated to products with different tariffs;
15. An Post's Accounting Manual (4.3.4.5) provide a detailed explanation where the weight factors used in the allocation process do not align with the various tariff price points;
16. the Regulatory Accounts include the source of inter-segment revenue in order to show how charges flow between various An Post business segments; and
17. the audit to specifically include the nature and detail of transfer charges.

6 Regulatory Reporting

As noted earlier, An Post is required to provide ComReg with Regulatory Accounts, disaggregated to the level of services, within 19 weeks of the end of each financial year.

This section details our review of An Post's reporting requirements. The remainder of this section is structured as follows:

- Review of international best practice in relation to postal reporting requirements;
- Our assessment of the implementation of the current Direction in relation to regulatory reporting; and
- Recommendations.

6.1 Best practice in regulatory reporting

Our review of international best practice in relation to reporting requirements has included:

- scope of accounts;
- documentation principles; and
- publication of information.

Scope of accounts

At a high level, best practice is for postal operators to provide to annual regulatory accounts to the NRA, disaggregated to the level of products/services.

In a report to the European Commission, WIK-Consult recommended that a summary of the regulated product accounts of universal services provided by a postal operator with significant market power is published at least annually (taking into account the need for adequate protection of commercially sensitive information)[53].

CERP outline in detail the scope of information that should be included in the regulatory accounts:[54]

- A commentary on the performance that shall explain at a minimum:

[53] WIK-Consult (2009), "The Role of Regulators in a More Competitive Postal Market", Study for the European Commission, Directorate General for Internal Market and Services.

[54] CERP (2009), Recommendation on best Practices for Cost Accounting Rules III

  - trends relating to products, expected significant future events and how these might impact the USP's business;
  - trends relating to revenue, by service;
  - trends relating to the mail volumes, by service;
  - significant year on year movements in the reported performance and balances;
  - one-off or exceptional events in the year;
  - large adjustments made to produce the regulatory accounts; and
  - the impact of changes in accounting policies, methodologies and estimation techniques.

- A comprehensive explanation of the basis of preparation of the regulatory accounts, including an explanation of the key regulatory accounting policies adopted by the USP.

- Income statements and balance sheets for each business segment.

- Income statements for each service within the scope of universal service as defined in the regulations.

- Information relating to the regulatory reporting period shall be presented in the formats and level of detail shown in schedules as determined by the NRA.

- Volume information that shows mail volume, by service, recorded from revenue data recorded at the point of sale. A supplementary schedule should, however, be provided which reconciles revenue derived volumes with operational data recorded during the initial processing in the postal network, together with details of volume trends by service recorded using the two methods. Such schedule should include a detailed commentary.

- Information relating to the revenue attributed to each service, distinguishing between revenues which have been directly allocated to specific services, and other revenues which have been allocated or apportioned on the basis of statistical sampling or other accounting allocator.

- Details of expenditure by activities, distinguishing between direct costs which have been directly allocated to specific services, indirect costs which have been allocated on the basis of the origin of the costs themselves, and non-attributable common costs which have been allocated on the basis of a general allocator.

- A signed statement from the Directors of the USP acknowledging their responsibilities for the preparation of the regulatory accounts and confirming the USP's compliance with its legal obligations.

- A report and opinion by a competent body on the regulatory accounts and the USP's compliance with its legal obligations.

- The results of the annual review of any statistical sampling process undertaken to identify revenue or mail volumes.

We note the current Direction is consistent with this best practice, and as such our assessment further below relates to specific issues we have identified.

Documentation principles

Along with Regulatory Accounts, An Post is also required to produce an Accounting Manual, documenting the principles and processes used to create its accounts.

In a report to the European Commission, WIK-Consult recommended that a full explanation of the methodology used in cost accounting is published at least annually[55].

CERP states "that in order to ensure the appropriateness and transparency of its cost accounting and separated accounts systems, the postal operator shall maintain relevant documentation outlining the processes and procedures applied (for revenue identification, volume measurement, cost allocation, etc.). The level of detail must be sufficient to facilitate the assessment of the compliance with the regulatory obligations."[56]

Details of accounting practices and policies should include:

- a description of accounting policies used;
- a definition of business units for which regulatory statements are to be prepared;
- the process applied to identify revenues and measure mail volumes at the product/service level.
- the methods for attributing costs, revenues, assets and liabilities to the business units and universal service areas;

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55 WIK-Consult (2009), "The Role of Regulators in a More Competitive Postal Market", Study for the European Commission, Directorate General for Internal Market and Services.

56 CERP (2009), Recommendation on best Practices for Cost Accounting Rules III

- a description of the applied approach to cost accounting (specification of the methodology);
- an explanation of how internal transfers are calculated;
- description of format of prepared statements;
- indication of the methodology used to calculate costs;
- a step-by step description of how the costs of different services are computed; and
- details of sampling processes.

Publication of information

ERGP[57] note that the commercial sensitivity of any item of information /data should be considered by the NRA.

ERGP[58] also note that publication of information may contribute to an open and competitive market and also add credibility to the regulatory accounting system. However, full disclosure may be restricted by national and European Community rules regarding commercial confidentially.

ERGP[59] recommends that NRAs, having taken the opinion of operators, define what information can be considered as confidential and should not be made available and also what information could be useful to the public.

6.2 Our assessment of the implementation of the Direction in relation to Regulatory Reporting

As noted above, the current Direction requires An Post to provide ComReg with:

- annual Regulatory Accounts, disaggregated to the level of service; and
- a detailed Accounting Manual outlining the procedures and policies used in the preparation of its Regulatory Accounts, which is to be reviewed annually.

In general, our review has found that the current Direction is largely consistent with international best practice. Our assessment below therefore focuses on specific issues that have been identified as part of our review.

57 ERGP (12) 28 Rev. 1 – Common Position on cost allocation rules

58 ERGP (12) 28 Rev. 1 – Common Position on cost allocation rules

59 ERGP (12) 28 Rev. 1 – Common Position on cost allocation rules

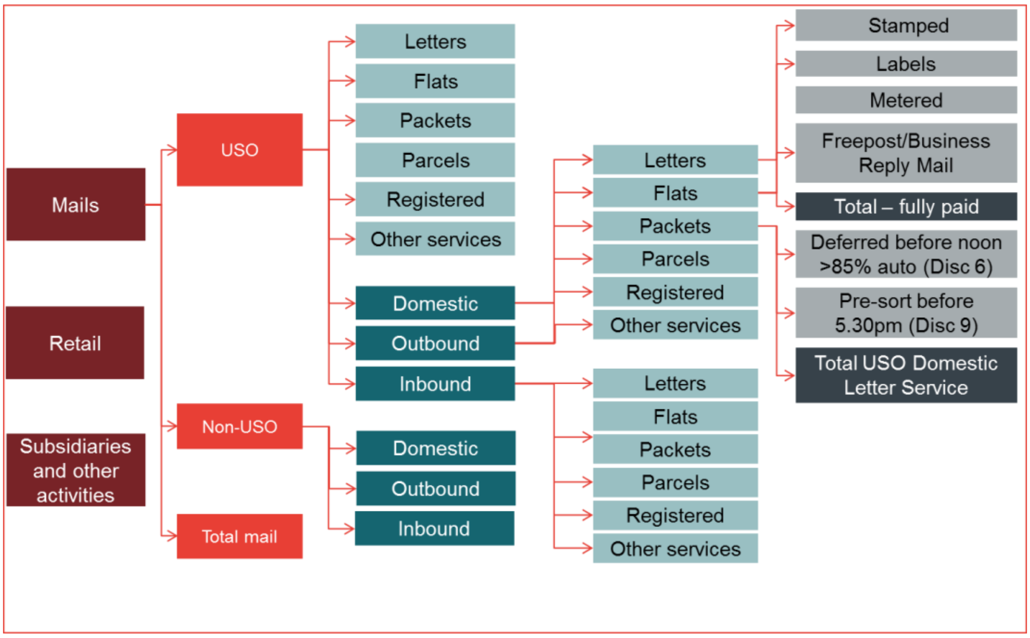
Content of confidential and non-confidential versions

One issue that has arisen as part of the review is the degree of detail An Post publishes in its non-confidential version of its Regulatory Accounts. An Post expressed concerns that the degree of detail which it is currently required to publish risks its disclosing commercially sensitive information to competitors and potential competitors.

The degree of detail in An Post's public accounts is a trade-off between transparency and protecting commercially sensitive information. At present, the Direction (3.1 (d)) requires that An Post report profit and loss accounts for each service. The EC Directive and section 31(1) of the 2011 Act require that there are separate accounts for each service that is provided as part of the universal postal service and which is not part of the universal postal service. Therefore An Post must comply with this. A detailed split between USO and non-USO is necessary in order to show no cross-substitution between services.

The segments and services for which profit and loss accounts are reported are shown in Figure 11.

Figure 11. Segments and services for which profit and loss reported



Source: Frontier Economics

We note that Eircom's regulatory accounts are split by service for both USO and non-USO services, as outlined in the below text box.

Eircom's Separated Accounts requirements

Eircom's Separated Accounts shall be disaggregated to the level of Relevant Markets. The Separated Accounts includes, amongst other things, Income Statements and Statements of Mean Capital Employed.

Relevant Markets are where Eircom have been found to have a substantial degree of market power. These markets are currently:

- Wholesale Fixed Narrowband Access
- Wholesale Unbundled Access
- Wholesale Broadband Access
- Wholesale Leased Lines
- Wholesale Call Origination
- Wholesale Call Transit
- Wholesale Call Termination
- Wholesale Residual (Regulated)
- Wholesale Residual (Unregulated)
- Retail Fixed Narrowband Access
- Retail Other (includes all other Activities within the Retail Market Group, including but not limited to Retail voice traffic and Broadband services).

An Post is most exposed to competition in certain areas, which is where the data is more likely to be commercially sensitive. However, the detailed service-level information is currently provided for USO services. We consider it is important to maintain this level of information provision in the public domain, to ensure transparency of the profitability of USO services and to be consistent with best practice in the area. In saying this, we also recognise that the Direction needs to be consistent with a situation in the future where An Post faces a greater prospect of competition. If such a situation arises, it is conceivable that USO services are reduced, and as such An Post would no longer be required to provide the degree of information in those areas.

As discussed in further detail below, we have developed draft Regulatory Accounts schedules in order to minimise ambiguity with regard to Accounts' content, format and level of detail required. These include confidential and non-confidential versions of the Regulatory Accounts.

Recommendations 18 and 19

We recommend that the Direction requires An Post to prepare separate confidential and non-confidential versions of the Regulatory Accounts.

We recommend that Direction requires profit and loss accounts for all USO services to be included in the non-confidential version of the Regulatory Accounts.

Publication of the Accounting Manual

At present, while An Post is required to provide its Accounting Manual to ComReg on an annual basis, it is not required to publicly publish the document.

In contrast, Eircom annually publishes a public-version of its equivalent document.[60] This is a requirement as set out in Eircom's Direction, as set out in further detail below.

[60] See Eircom, Primary Accounting Documentation, 2014, http://www.eircom.ie/bveircom/pdf/Final_Accounting_Documents_2014.pdf

Eircom's accounting documentation requirements

7.1 Eircom's Accounting Documentation shall be sufficiently transparent and shall explain, *inter alia*, the regulatory principles used and the methodologies applied, for the purpose of preparing:

- the Separated Accounts;
- the Additional Financial Statements; and
- the Additional Financial Information.

7.2 The Accounting Documentation shall consist of two principal documents:

'Primary Accounting Documentation' which shall set out the following:

- Regulatory Accounting Principles;
- Regulatory Accounting Policies;
- An overview of Attribution Methods;
- The transfer charge methodology; and

'Secondary Accounting Documentation' which shall set out details of the systems, processes and procedures, material methodologies (i.e. those having a material impact on any of the financial statements of the Relevant Markets, Services and Products) specifically those used for deriving or calculating the costs, revenues, assets and liabilities (including details of attribution methodologies, valuation methodology and other relevant methodologies) used to prepare the Separated Accounts, the Additional Financial Statements, and the Additional Financial Information.

7.3 Publish the Primary Accounting Documentation on its website following ComReg's approval.

Source: ComReg, (2010), "Response to Consultation Document No. 09/75 and Final Direction and Decision: Accounting Separation and Cost Accounting Review of Eircom Limited, D08/10.

As another comparison, Royal Mail is also required to publishing its equivalent document annually, as outlined below.

Royal Mail's ABC Costing Manual

Royal Mail publicly publishes annually its ABC Costing Manual, which includes details on the following:

- Resource Module – details what business costs are used in the costing.
- Resource Drivers – details how business costs are attributed to the activities.
- Activity Module – details the business activities.
- Activity Drivers – details how the activity costs are attributed to the outputs, i.e. products.
- Cost Object Module – details the costed outputs.
- Class Costing – details the approach to class costing.
- Zonal Costing – details the approach to zonal costing.

An Post has raised concerns regarding publishing a public-version of the Accounting Manual. These relate to concerns that too much information would be difficult to discern for stakeholders.

An Post also outlined its concerns in relation to "commercial considerations and sensitivities". To that end, An Post provided us with a detailed schedule of what it considers to be commercially sensitive information in the Accounting Manual.

In our view, there would be benefit in An Post publishing more information on the regulatory principles and methodologies it uses in the creation of the Regulatory Accounts. However, on a practical basis, this could be best achieved by requiring additional information on the regulatory principles and methodologies in the Regulatory Accounts themselves, rather than requiring the separate publication of the Accounting Manual. We note that the Regulatory Accounts already contains a summary of "regulatory accounting principles and basis of preparation", as required by the current Direction. However, we consider this summary could be improved by the inclusion of detailed commentary on:

- large adjustments made to produce the Regulatory Accounts;
- the impact of changes in accounting policies, methodologies and estimation techniques; and

- transfer charges, including an expanded explanation summarising the basis of transfer charges similar to that found in sections 9.2, 9.3 and 9.4 of An Post 2014 Accounting Manual.

We note that the first two points are requirements of the current Direction. We suggest that separate sub-headings be included for these points in the Regulatory Accounts template, in order to ensure commentary is provided on a year-by-year basis. Draft regulatory reporting schedules have been produced in tandem with this report, and these also form part of the public consultation.

Recommendation 20

We recommend that the Direction requires An Post's Regulatory Accounts includes detailed commentary in the "regulatory accounting principles and basis of preparation" section on:

- large adjustments made to produce the Regulatory Accounts;
- the impact of changes in accounting policies, methodologies and estimation techniques; and
- transfer charges, including an expanded explanation summarising the basis of transfer charges similar to that found in sections 9.2, 9.3 and 9.4 of An Post 2014 Accounting Manual.

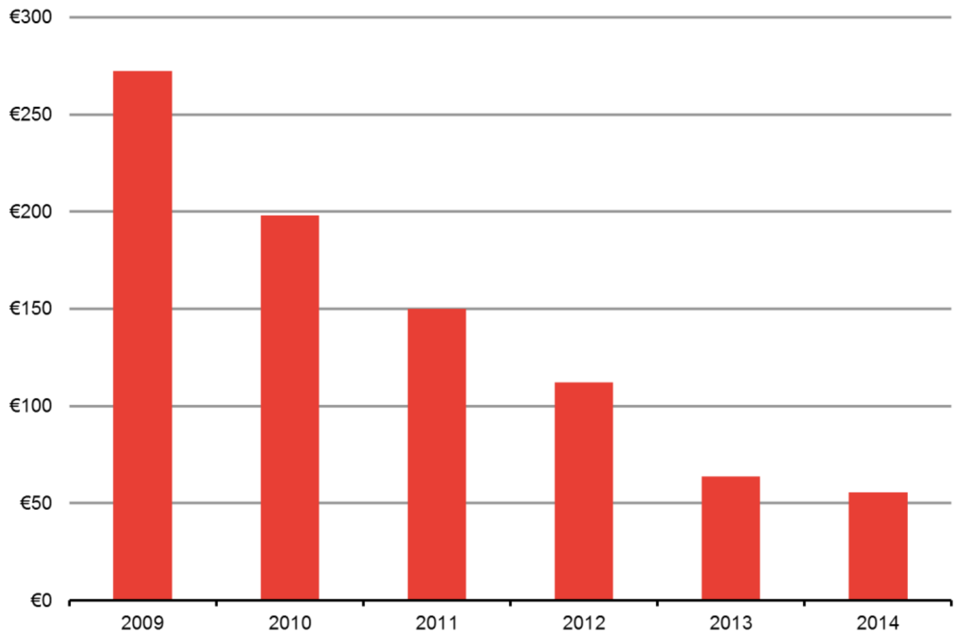
Cash figure

An Post currently reports its cash position as part of its balance sheet reporting for each business segment, as per the Direction section 3.1 (c).

The reason for An Post reporting its balance sheet is to enable ComReg to exercise its statutory functions. In particular, ComReg is required to monitor An Post's ability to meet its USO obligations.

We note that An Post's cash at hand as reported annually in its balance sheet has decreased significantly in recent years (Figure 12). We note that in 2014, An Post undertook a sale and finance leaseback arrangement for some of its mails automation equipment. The present value of future lease payments in 2014 was €16.4 million, whereas in 2013 it was zero. We therefore note that if this one off sale process was not undertaken in 2014, An Post's cash position from 2013 to 2014 would have continued a steep decline.

Figure 12. An Post cash on hand (€ million)



Source: An Post Regulatory Accounts

ComReg has previously noted its concerns in relation to this deteriorating cash position of An Post[61]. Furthermore, a further rapid deterioration of An Post's cash position within a year would not presently be known by ComReg until the Regulatory Accounts are subsequently published.

An Post's reporting of its cash balances could, therefore be improved by making it more regular, which would enable ComReg to carry out its statutory functions, in particular assuring An Post has the ability to deliver on the USO.

In our view, An Post's accounts should include details of its cash position. Its published Regulatory Accounts currently report this figure on an annual basis. We consider that more regular reporting would increase ComReg's ability to perform its statutory functions. In particular, more regular reporting would provide ComReg with more timely information in relation to deterioration in An Post's cash position, and therefore more timely information on An Post's ability to deliver on its universal service obligations.

Therefore, we are of the view that An Post should report its cash balance on a more regular basis.

[61] See ComReg Documents Nos. 14/59, 13/21, 12/138

An Post raised concerns about the practical implications of implementing such a recommendation.

In our view, quarterly reporting when An Post's cash balance is below a certain level is a pragmatic balance between ComReg's requirements for timely information in relation to An Post's ability to deliver on the USO and the issues of practically raised by An Post. We suggest setting that level threshold at €100 million. This is on the basis that An Post's cash balances have deteriorated by up to €70 million over a twelve month period in the past, and therefore a €100 million figure would give some sensible headroom above that amount. We consider that this cash figure should be reported directly to ComReg following the conclusion of the relevant quarter. There would also be benefit in the quarterly cash figures being included in the Regulatory Accounts, and therefore a table for reporting these balances have been included in the draft Regulatory Accounts schedule.

Recommendation 21

We recommend that the Direction requires An Post to report its balance sheet, including cash, to ComReg on a quarterly basis, when An Post's cash balance is below a €100 million.

Capital expenditure

An Post currently reports its balance sheet for each business segment, although it is not required to report its capital expenditure in its annual Regulatory Accounts for its USO business specifically.

In our view, details of An Post's capital expenditure for its USO business would increase transparency and provide greater assurance to ComReg in relation to An Post's performance. As An Post's cash figure has significantly decreased since 2009, there could be a concern that it may potentially underspend on USO-related capex. As part of the price control regime, An Post has an allowance for capital expenditure.

However, An Post does not currently split capital expenditure between USO and non-USO services. It would appear to be practically difficult to differentiate capital expenditure by USO and non-USO parts of the business. Such differentiation would require An Post to make a number of assumptions, which would be difficult to validate.

As such, we consider there would be benefit in An Post providing additional reporting on capital expenditure as part of the separated accounts in the form of detailed commentary on its capex spend in the Regulatory Accounts. This would provide increased transparency and greater assurance to ComReg in relation to the sustained provision of USO services.

Recommendation 22

We recommend that the Direction requires An Post to include a commentary on its capex figures in the Regulatory Accounts.

Payroll costs

An Post currently reports details of its payroll costs and staff numbers in its Regulatory Accounts.

For payroll costs, An Posts report these at the level of the mails business unit and, within that, the USO and non-USO segment.

An Post also reports staff costs as a percentage of total operating costs (58% in 2014). In An Post's Accounting Manual, it reports that pay costs represent approximately ✂% of An Post total expenditures in the Regulatory Accounts.

We consider that payroll costs could be improved by the Direction requiring An Post to report payroll costs for each business unit, as split out in An Post's internal systems and accounts. As we understand it, An Post already records these costs differentiated by service as part of its cost accounting system, and therefore such a requirement would not significantly impact compliance costs.

In relation to staff numbers, An Post reports in its Regulatory Accounts staff numbers (FTEs) for the company, combined subsidiaries and the total at the group level. An Post does not provide further detail of staff numbers per areas or business segment. We consider that staff number reporting could be improved by the Direction requiring An Post to report staff numbers for each business segment, as set out in An Post's internal systems and accounts.

Our view is that transparency in relation to An Post's costs would be improved if the Direction requires An Post's to report average staff numbers (FTE equivalent) by business segment, as set out in An Post's Regulatory Accounts. We understand that An Post breaks down staff numbers further within business segments in its internal reporting, including by region. Such further breakdowns would also be useful to include in the Regulatory Accounts.

Recommendation 23 and 24

We recommend that the Direction requires An Post to report its payroll costs by business segment, and within segment as recorded internally by An Post.

We recommend that the Direction requires An Post to report average staff numbers (FTE equivalent) by business segment, and within segment as recorded internally by An Post.

Accounts format

As noted above, the Direction currently requires commentary in the Regulatory Accounts that at a minimum shall explain:

- trends relating to revenue by relevant postal service;
- trends relating to cost by relevant postal service;
- trends relating to volume by relevant postal service;
- significant period on period movements in the reported performances and balances;
- one-off or exceptional events in the period; and
- the impact of material changes in accounting policies, methodologies and estimation techniques.

Our review of An Post's previous Regulatory Accounts shows that this level of detail is not necessarily always included in the commentary provided in the Regulatory Accounts. For example, there is no commentary on trends relating to revenue, cost and volume by the service level, only at an aggregated level. Given volume declines by service, it is important that sufficient commentary is provided by service so that the volume declines in particular services is easily understood.

A draft Regulatory Accounts schedule has been developed in order to minimise ambiguity with regard to Accounts' content, format and level of detail required. The Regulatory Accounts schedule includes required areas of commentary, and service-level sub-headings, to help ensure sufficient commentary is provided. We also consider that the accessibility of the Regulatory Accounts could be improved by including additional information such as per unit revenue, cost and profit/loss details for each USO service. While this information is already provided in the Regulatory Accounts in aggregate form, we consider it would improve transparency and be more user friendly to also include this information on a per unit basis.

In our view, the service level should include parcels as a separate category, as the current Regulatory Accounts do not provide disaggregated information on parcels. Parcels are a large component of non-USO revenues, and therefore it would seem to be appropriate for it to be a separate line item, rather than including it in "other".

Recommendation 25

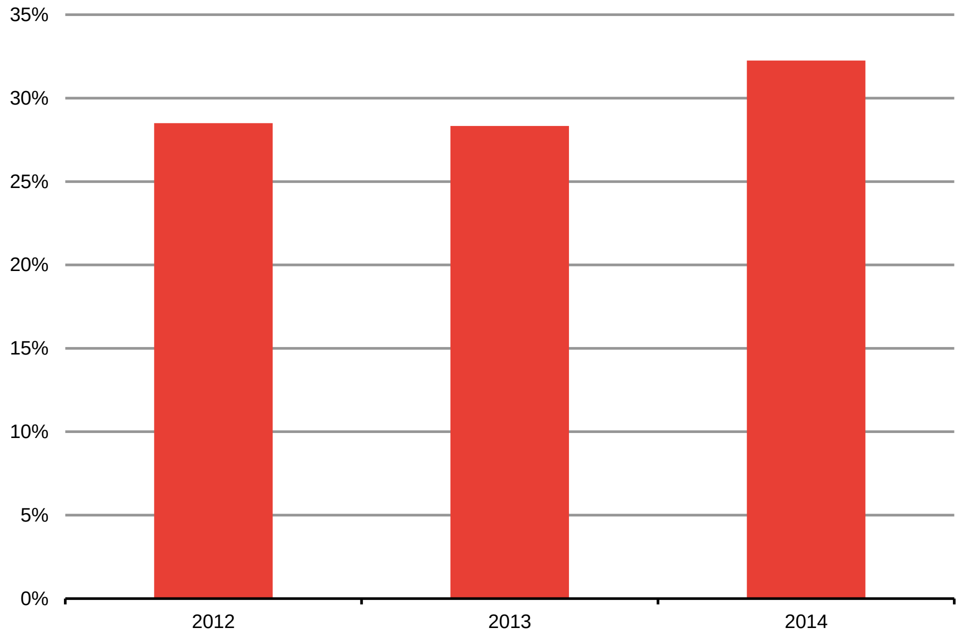
We recommend that the Direction requires An Post's Regulated Accounts to comply with the required format, as stipulated by ComReg.

Other reporting requirements

Non-USO aspects of An Post's business are currently required to be reported only at the aggregated level; not by service as the USO business.

The non-USO proportion of An Post's business has been growing in recent years as a proportion of its total business (Figure 13). If the proportion of non-USO business in An Post's total mail business continues to grow, then the impact of the non-USO business on An Post's ability to meet its USO obligations may also increase.

Figure 13. Proportion of non-USO business in An Post's total mail business



Source: An Post Regulatory Accounts

In our view, it is therefore important for ComReg's statutory functions that it is able to adequately monitor An Post's non-USO business at a service level when required.

Recommendation 26

34. We recommend the Direction continues require ad hoc reports (section3.3) that shall be prepared and provided by An Post, as may be required by ComReg from time to time.

6.3 Draft regulatory reporting recommendations

Our draft recommendations on regulatory reporting are shown below.

We recommend that the Direction requires

18. An Post to prepare separate confidential and non-confidential versions of the Regulatory Accounts;
19. profit and loss accounts for all USO services to be included in the non-confidential version of the Regulatory Accounts;
20. An Post's Regulatory Accounts includes detailed commentary in the "regulatory accounting principles and basis of preparation" section on:
    a. large adjustments made to produce the Regulatory Accounts;
    b. the impact of changes in accounting policies, methodologies and estimation techniques; and
    c. transfer charges, including an expanded explanation summarising the basis of transfer charges similar to that found in sections 9.2, 9.3 and 9.4 of An Post 2014 Accounting Manual;
21. An Post to report its balance sheet, including cash, to ComReg on a quarterly basis, when An Post's cash balance is below a €100 million;
22. An Post to include a commentary on its capex figures in the Regulatory Accounts;
23. An Post to report its payroll costs by business segment, and within segment as recorded internally by An Post;
24. An Post to report average staff numbers (FTE equivalent) by business segment, and within segment as recorded internally by An Post;
25. An Post's Regulated Accounts to comply with the required format, as stipulated by ComReg; and
26. ad hoc reports (section3.3) that shall be prepared and provided by An Post, as may be required by ComReg from time to time.

7 Compliance Requirements

As noted earlier, the 2011 Act states that ComReg's Direction to the USP must set rules in relation to compliance requirements. The current Direction requires An Post to:

- engage a competent body to verify compliance with this direction and to perform a review of the Regulatory Accounts, in accordance with the principles and guidance set out from time to time by ComReg, following discussions with An Post and bodies representative of the Irish accountancy profession;
- publish the report and opinion of the competent body on An Post's compliance with the requirements of this direction in its annual report submitted to the Minister under section 33 of the 1983 Act; and
- include the report and opinion of the competent body, on the Regulatory Accounts and An Post's compliance with the requirements of this direction, within the Regulatory Accounts. The report and opinion shall comply with the principles and guidance set out from time to time by ComReg following discussions with An Post and bodies representative of the Irish accountancy profession.

This section details our review of the compliance requirements in the Direction. The remainder of this section is structured as follows:

- Review of international best practice in this area;
- Our assessment of the implementation of the current Direction in relation to compliance requirements; and
- Recommendations.

7.1 Best practice in compliance requirements

We have reviewed the following areas in relation to best practice for compliance requirements:

- scope of the audit;
- elements to be covered in the audit; and
- appointment of the auditor.

Scope of the audit

The audit should be a systematic method of checking and verifying the accounting information.

According to ERGP, an external verification can be required in the form of a "fairly presents" (or equivalent statement). Alternatively in some cases an "agreed-upon procedure" (or similar procedure) engagement is a possible alternative option.

Elements to be covered in the audit

CERP state that the *"best practice for regulatory purposes should be a financial audit combined with a compliance audit"*.[62]

CERP also states that such an audit should contain the following elements:[63]

- A check of the analytical accounts, namely the allocation of costs, revenues and volumes to the different business units, products and services, and verifies if this allocation is correct.
- A check of the details, logic and consistency of the allocation;
- A check of whether the regulatory accounts are consistent with the specific postal regulation requirements;
- A check of the reconciliation of the regulatory accounts with the financial accounts.

ERGP set out the main elements to be covered in the audit of the USP's Regulatory Accounts, stating that these elements could be set out in a letter of engagement with the auditor. The main elements that they state are to be included are:

- *"the scope of costs included in the regulatory accounts and the scope of costs allocated to individual regulated products (where appropriate);*
- *the reconciliation between regulatory accounts and statutory accounts;*
- *correctness of figures, including operational data like volumes;*
- *methodologies used regarding amortization, cost capitalization, allocation and for the evaluation of the assets;*
- *transfer charges in separated accounts (entities and/or products);*
- *appropriateness of usage of the drivers;*
- *the frequency of index updates used for cost allocation purpose;*
- *appropriateness of possible important changes in the methodology."*

62 CERP (2009), Recommendation on best Practices for Cost Accounting Rules III

63 CERP (2009), Recommendation on best Practices for Cost Accounting Rules III

Appointment of the Auditor

Best practice emphasises the importance of the independence of the auditor. CERP state that *"the engagement letter should clearly identify the duty of care expected from the auditor."*[64] This should include a duty of care to the NRA.

In a report to the European Commission, WIK-Consult recommended that cost accounting practices of USPs are verified at least annually by either the NRA or by a competent independent body retained by the NRA[65].

ERGP[66] recommends that the possibility to exclude the statutory auditor from doing the regulatory audit should be examined by the NRA when it is considered that there is a risk that the auditor is not independent from the USP. This is because in most cases the majority of data used in the regulatory accounts came from the statutory accounts, and for that reason it should be considered whether the statutory auditor should be excluded from auditing the regulatory accounts. This position is in line with the guidelines from the Sarbanes-Oxley Act[67].

CERP state that "Independence is very important. Where the auditor of the company's statutory accounts also audits the regulatory accounts, the key objective must be to ensure that the auditor has the right skill to do the work. If the company's statutory auditor audits the cost accounts, another independent auditor should perform a peer review on the work of the company's statutory auditor. The cost will of course be less than when another independent auditor is appointed. If the same company is used for the auditing of the financial and the regulatory accounts, the regulator has to ensure the objectivity and credibility of the auditor for example by ensuring that there are Chinese walls in place between the two functions." CERP states that ideal situation is for the NRA to pay for the audit as this guarantees the auditor's full independency.[68] CERP recommends that "where the audit is paid for by the USP, the best solution is that the auditor is different from the one who verifies the financial accounts and that he receives his mandate from (or in consultation with) the NRA or is appointed by the NRA".

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64 CERP (2009), Recommendation on best Practices for Cost Accounting Rules III

65 WIK-Consult (2009), "The Role of Regulators in a More Competitive Postal Market", Study for the European Commission, Directorate General for Internal Market and Services.

66 ERGP (12) 28 Rev. 1 – Common Position on cost allocation rules

67 http://www.sox-online.com/act_section_201.html

68 CERP (2009), Recommendation on best Practices for Cost Accounting Rules III

7.2 Our assessment of implementation of the Direction in relation to compliance

Scope of audit

As discussed in the best practice section the auditor's opinion can be provided on a "fairly presents" or "agreed-upon procedure" basis. A "fairly presents" opinion is a more fulsome audit, and as such would provide greater transparency and more confidence to ComReg. We recommend that the scope of the auditor's opinion as defined in the Direction, and subsequently the auditor's "letter of instruction", should be on a "fairly presents" basis.

> **Recommendation 27**
>
> We recommend that the Direction requires the audit to be conducted on a "fairly presents" basis rather than on an "agreed-upon procedure" basis.

Auditor's verification of compliance with internal cost accounting systems

At present, the Direction (section 3.1 (j)) requires a report and opinion by a competent body on the Regulatory Accounts and An Post's compliance with the requirements of this direction. This would include an audit of An Post's Accounting Manual to ensure it is consistent with the Direction.

The Direction (section 5.1) goes on to state that An Post shall:

- engage a competent body to verify compliance with this direction and to perform a review of the Regulatory Accounts, in accordance with the principles and guidance set out from time to time by ComReg, following discussions with An Post and bodies representative of the Irish accountancy profession;
- publish the report and opinion of the competent body on An Post's compliance with the requirements of this direction in its annual report submitted to the Minister under section 33 of the 1983 Act; and
- include the report and opinion of the competent body, on the Regulatory Accounts and An Post's compliance with the requirements of this direction, within the Regulatory Accounts. The report and opinion shall comply with the principles and guidance set out from time to time by ComReg following discussions with An Post and bodies representative of the Irish accountancy profession.

The scope of the current audit is outlined in Annexe 5.

Recommendation 28

We recommend that the Direction requires the "letter of engagement" with the auditor to include in the scope of the audit:

- Include the Regulatory Accounts and the Accounting Manual;
- the scope of costs included in the regulatory accounts and the scope of costs allocated to individual regulated products (where appropriate);
- the reconciliation between regulatory accounts and statutory accounts;
- correctness of figures, including operational data like volumes;
- methodologies used regarding amortization, cost capitalization, allocation and for the evaluation of the assets;
- transfer charges in separated accounts (entities and/or products);
- appropriateness of usage of the drivers;
- the frequency of index updates used for cost allocation purpose; and
- appropriateness of possible important changes in the methodology.

ComReg should appoint the auditor

At present, the auditor of the regulatory accounts is appointed by An Post. We note that the statutory auditor is the same as the regulatory auditor.

As discussed earlier in this section, best practice is for:

- the regulatory auditor to be appointed by the NRA; and
- the statutory auditor being either excluded from doing the regulatory audit, or being subject to peer review.

In 2009, it was found that in nine Member States (Denmark, Hungary, Latvia, Poland, Portugal, Spain, Sweden, Slovakia and Norway) the regulatory audit of the USP was undertaken by either the NRA (four instances) or an accounting firm retained by the NRA (five instances).[69]

We consider that having ComReg appoint the auditor would be more aligned with best practice, and therefore provide greater assurances over the outputs of the regulatory accounts.

[69] WIK-Consult, 2009, "The Role of Regulators in a More Competitive Postal Market", Study for the European Commission, Directorate General for Internal Market and Services.

Recommendation 29

We recommend that the Direction requires the auditor of the Regulatory Accounts to be appointed by ComReg.

ComReg's approval of the Accounting Manual

The Direction (section 4.1 (e)) currently requires An Post to obtain ComReg's approval for each annual edition of the Accounting Manual in advance of the start of the relevant regulatory period.

However, in our view, it would be more efficient if An Post were only required to notify ComReg of any significant changes to the Accounting Manual and provide the Accounting Manual to ComReg at the same time as providing the Regulatory Accounts.

Recommendation 30

We recommend that the Direction requires An Post to notify ComReg of any significant changes to the Accounting Manual and provide the Accounting Manual to ComReg at the same time as providing the Regulatory Accounts.

Statement of compliance

At present, the Direction (section 3.1 (i)) requires a signed statement from the Directors of An Post acknowledging their responsibilities for the preparation of the Regulatory Accounts and confirming their compliance with the requirements of this direction. In a report to the European Commission, WIK-Consult recommended that a statement verifying the compliance of USPs with Article 14 is published at least annually[70].

This requirement is similar in scope to that of Eircom's. The Direction in relation to Eircom states that Eircom's Separated Accounts shall be accompanied by a signed statement from the directors of Eircom Limited acknowledging their responsibilities for the preparation of the Separated Accounts and confirming their compliance with the requirements of the Decision Instrument in this respect.

70 WIK-Consult (2009), "The Role of Regulators in a More Competitive Postal Market", Study for the European Commission, Directorate General for Internal Market and Services.

Recommendation 31

We recommend the Direction continues to require the Regulatory Accounts include a signed statement from the Directors of An Post acknowledging their responsibilities for the preparation of the Regulatory Accounts and confirming their compliance with the requirements of this direction.

7.3 Draft compliance requirements recommendations

Our draft recommendation in relation to compliance requirements are set out below.

We recommend that the Direction requires:

27. the audit to be conducted on a 'fairly presents' basis rather than on a 'properly prepared' basis.
28. the "letter of engagement" with the auditor to include in the scope of the audit:
    - the scope of costs included in the regulatory accounts and the scope of costs allocated to individual regulated products (where appropriate);
    - the reconciliation between regulatory accounts and statutory accounts;
    - correctness of figures, including operational data like volumes;
    - methodologies used regarding amortization, cost capitalization, allocation and for the evaluation of the assets;
    - transfer charges in separated accounts (entities and/or products);
    - appropriateness of usage of the drivers;
    - the frequency of index updates used for cost allocation purpose; and
    - appropriateness of possible important changes in the methodology.
29. The auditor of the Regulatory Accounts to be appointed by ComReg.
30. An Post to notify ComReg of any significant changes to the Accounting Manual and provide the Accounting Manual to ComReg at the same time as providing the Regulatory Accounts.
31. the Regulatory Accounts include a signed statement from the Directors of An Post acknowledging their responsibilities for the preparation of the Regulatory Accounts and confirming their compliance with the requirements of this Direction.

8 Other Recommendations

We also recommend updating the Direction to remove reference to the Reserved and Non-Reserved Sectors, which no longer apply, and updating the IAS14 standard to the IFRS8 standard.

Recommendation 32

We recommend the Direction is amended to remove reference to the Reserved Sector (and the Non-Reserved Sector) in:

- Section 1.1
- Section 2.1
- Section 3.1 (d)
- Section 4.3.2
- Section 4.3.3

Recommendation 33

We recommend the Direction is amended to remove reference to IAS14 and replace with IFRS8 in:

- Section 1.1
- Section 3.1 (c)
- Section 4.3.1
- Section 4.3.2
- Section 4.3.3

Annexe 1: Pre-flight checks

✂

Annexe 2: Container fill assumptions

This annexe details the standard container fills used by An Post in DSUs and mail centres.

✂

Annexe 3: Daily Volume Report

✂

Annexe 4: An Post mail profiles and tariffs 2014

Table 1. Domestic, Stamped

Type	Weight break	Proportion of sales (per type)	Tariff
Letter	20g	✂%	€ ✂
	50g	✂%	€ ✂
	100g	✂%	€ ✂
Flat	50g	✂%	€ ✂
	100g	✂%	€ ✂
	250g	✂%	€ ✂
	500g	✂%	€ ✂
	1000g	✂%	€ ✂
Packet	50g	✂%	€ ✂
	100g	✂%	€ ✂
	250g	✂%	€ ✂
	500g	✂%	€ ✂
	1000g	✂%	€ ✂
	1500g	✂%	€ ✂
	2000g	✂%	€ ✂

Table 2. Domestic, Metered

Type	Weight break	Proportion of sales (per type)	Tariff
Letter	20g	✂%	€ ✂
	50g	✂%	€ ✂
	100g	✂%	€ ✂
Flat	50g	✂%	€ ✂
	100g	✂%	€ ✂
	250g	✂%	€ ✂
	500g	✂%	€ ✂
	1000g	✂%	€ ✂
Packet	50g	✂%	€ ✂
	100g	✂%	€ ✂
	250g	✂%	€ ✂
	500g	✂%	€ ✂
	1000g	✂%	€ ✂
	1500g	✂%	€ ✂
	2000g	✂%	€ ✂

Table 3. International Outbound, Northern Ireland

Type	Weight break	Proportion of sales (per type) - Stamped	Proportion of sales (per type) - Metered	Tariff
Letter	25g	✂%	✂%	€ ✂
	50g	✂%	✂%	€ ✂
	100g	✂%	✂%	€ ✂
Flat	50g	✂%	✂%	€ ✂
	100g	✂%	✂%	€ ✂
	250g	✂%	✂%	€ ✂
	500g	✂%	✂%	€ ✂
	1000g	✂%	✂%	€ ✂
Packet	50g	✂%	✂%	€ ✂
	100g	✂%	✂%	€ ✂
	250g	✂%	✂%	€ ✂
	500g	✂%	✂%	€ ✂
	1000g	✂%	✂%	€ ✂
	1500g	✂%	✂%	€ ✂
	2000g	✂%	✂%	€ ✂

Table 4. International Outbound, Britain (Priority)

Type	Weight break	Proportion of sales (per type) - Stamped	Proportion of sales (per type) - Metered	Tariff
Letter	25g	✂%	✂%	€ ✂
	50g	✂%	✂%	€ ✂
	100g	✂%	✂%	€ ✂
Flat	50g	✂%	✂%	€ ✂
	100g	✂%	✂%	€ ✂
	250g	✂%	✂%	€ ✂
	500g	✂%	✂%	€ ✂
Packet	50g	✂%	✂%	€ ✂
	100g	✂%	✂%	€ ✂
	250g	✂%	✂%	€ ✂
	500g	✂%	✂%	€ ✂
	1000g	✂%	✂%	€ ✂
	1500g	✂%	✂%	€ ✂
	2000g	✂%	✂%	€ ✂

Table 5. International Outbound, Other Europe (Priority)

Type	Weight break	Proportion of sales (per type) - Stamped	Proportion of sales (per type) - Metered	Tariff
Letter	50g	✂%	✂%	€ ✂
	100g	✂%	✂%	€ ✂
Flat	50g	✂%	✂%	€ ✂
	100g	✂%	✂%	€ ✂
	250g	✂%	✂%	€ ✂
	500g	✂%	✂%	€ ✂
Packet	50g	✂%	✂%	€ ✂
	100g	✂%	✂%	€ ✂
	250g	✂%	✂%	€ ✂
	500g	✂%	✂%	€ ✂
	1000g	✂%	✂%	€ ✂
	1500g	✂%	✂%	€ ✂
	2000g	✂%	✂%	€ ✂

Table 6. International Outbound, Rest of World (Priority)

Type	Weight break	Proportion of sales (per type) - Stamped	Proportion of sales (per type) - Metered	Tariff
Letter	50g	✂%	✂%	€ ✂
	100g	✂%	✂%	€ ✂
Flat	50g	✂%	✂%	€ ✂
	100g	✂%	✂%	€ ✂
	250g	✂%	✂%	€ ✂
	500g	✂%	✂%	€ ✂
Packet	50g	✂%	✂%	€ ✂
	100g	✂%	✂%	€ ✂
	250g	✂%	✂%	€ ✂
	500g	✂%	✂%	€ ✂
	1000g	✂%	✂%	€ ✂
	1500g	✂%	✂%	€ ✂
	2000g	✂%	✂%	€ ✂

Table 7. Registered, Domestic

Zone	Weight break	Prop. of sales – Stamped	Prop. of sales – Metered	Tariff – Year's average	Tariff – 1 Jan to 20 Jul	Tariff – 21 Jul to 31 Dec
Domestic	50g	✂%	✂%	€ ✂	€ ✂	€ ✂
	100g	✂%	✂%	€ ✂	€ ✂	€ ✂
	250g	✂%	✂%	€ ✂	€ ✂	€ ✂
	500g	✂%	✂%	€ ✂	€ ✂	€ ✂
	1000g	✂%	✂%	€ ✂	€ ✂	€ ✂
	1500g	✂%	✂%	€ ✂	€ ✂	€ ✂
	2000g	✂%	✂%	€ ✂	€ ✂	€ ✂

Annexe 5: Auditor's current scope

Scope of our audit

Our audit will be conducted in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board except that, as the nature, form and content of the Regulatory Accounts are determined by the Regulator, we will not evaluate the overall adequacy of the presentation of the information, which would be required if we were to express an audit opinion under Auditing Standards. Our audit will include tests of transactions and of the existence, ownership and valuation of assets and liabilities as we consider necessary. We shall obtain an understanding of the accounting and internal financial control systems to the extent necessary to assess their adequacy as a basis for the preparation of the Regulatory Accounts and to establish whether appropriate accounting records have been maintained by the Company.

We shall expect to obtain such appropriate evidence as we consider sufficient to enable us to draw reasonable conclusions therefrom. The nature and extent of our procedures will vary according to our assessment of the Company's accounting system and, where we wish to place reliance on it, the internal financial control system.

The Regulatory Accounts are prepared by disaggregating balances recorded in the general ledgers and other accounting records of An Post, maintained in accordance with the Companies Acts 1963 to 2013 and used, in accordance with those Acts, for the preparation of An Post's statutory financial statements.

Our audit includes assessing the significant estimates and judgements made by the Company's Directors in the preparation of the Regulatory Accounts and whether the accounting policies are appropriate to the Company's circumstances, are consistently applied, and are adequately disclosed.

We will read the Financial Summary, Business Review ("Other Information") contained within the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent mis-statements or material inconsistencies with the Regulatory Accounts. We will not perform any audit procedures nor provide any other assurance on the Other Information.

We will plan our work in such manner as to gain reasonable assurance that the audited information within the Regulatory Accounts is free from material error, regardless as to whether such error results from fraud, accident, negligence, or a deliberate misstatement of known facts.

The concept of materiality affects our audit planning and our consideration of matters arising from our audit. We will take into account both qualitative and quantitative factors when assessing materiality. We will only express an opinion on the Regulatory Accounts as a whole and not on individual factors/components within the Regulatory Accounts or individual areas of compliance with the Direction.

Where the Regulator requires such specific factors / individual areas of compliance to be reported upon by us, this should be addressed through the contractual arrangements with the Regulator and the Company. For such reporting, we will agree a list of procedures ('Agreed Upon Procedures') on an annual basis that we will perform for the Regulator. These procedures will be specified in a separate engagement letter between us, the Regulator and the Company. We will report the findings of the Agreed Upon Procedures separately from the Regulatory Accounts opinion, by way of a factual report to the Regulator, in which we will not express an opinion on the results of the Agreed Upon Procedures, nor the appropriateness of those procedures for the purposes of the Regulator. As with the form and content of Regulatory Accounts, the Regulator will need to make its own assessment of the appropriateness of the Agreed Upon Procedures and the reported findings.

In addition to an Agreed Upon Procedures report, there may be circumstances where the Regulator may require a separate expert opinion report. This will also need to be agreed in a separate engagement letter.

Where Agreed Upon Procedures and/or an expert opinion report are required in addition to an opinion on the Regulatory Accounts and these Agreed Upon Procedures and/or expert opinion are relevant to the expression of an opinion on the Regulatory Accounts, we may choose not to complete our work nor express an opinion on the Regulatory Accounts until the Agreed Upon Procedures and/or an expert opinion report that have been specified by the Regulator have been completed and reported upon.

Such work is separate from our audit work on the statutory financial statements of the Company which is carried out in accordance with our statutory obligations under the Companies Acts 1963 to 2013. Our audit report on those statutory financial statements is intended for the sole benefit of the Company's shareholders as a group, to whom it is addressed, and not for any other purpose. Our audit of the Company's statutory financial statements are not planned or conducted in contemplation of the requirements of anyone other than such shareholders and, consequently, our audit work is not intended to address or reflect matters in which anyone other than such shareholders may be interested.

We do not and will not, by virtue of this report or otherwise in connection with this engagement, assume any responsibility whether in contract, negligence or otherwise in relation to our audits of the Company's statutory financial statements required by the Companies Acts 1963 to 2013; we shall have no liability whether in contract, tort (including negligence) or otherwise to any parties other than the Company's members as a body in relation to our audit of the Company's statutory financial statements.

The nature and format of the Regulatory Accounts are determined by the requirements of the Regulator. It is not appropriate for us to assess, and accordingly we will not make any assessment on, whether the nature of the information being reported upon is suitable or appropriate for the Regulator's purpose. It is a matter for the Regulator to consider whether the information being reported upon is appropriate for its own purposes and we will not give any implicit or explicit affirmation that the information being reported upon is suitable for the Regulator's purpose.

The Company and the Regulator accept that there are differences between Irish Generally Accepted Accounting Principles ("Irish GAAP") and the basis of information provided in the Regulatory Accounts. The audit opinion on the Regulatory Accounts is separate from our opinion on the statutory accounts of the Company which are prepared for a different purpose. The audit report in relation to the statutory accounts of the Company (the "statutory" audit) is made solely to the Company's members, as a body, in accordance with section 193 of the Companies Act 1990. The statutory audit work is undertaken so that the auditor might state to the Company's members those matters they are required to state to them in a statutory auditor's report and for no other purpose. In these circumstances, to the fullest extent permitted by law, KPMG do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for the statutory audit work, for the statutory audit report, or for the opinions formed in respect of that statutory audit.

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