7 May 2009

CERP

Recommendation on best Practices for

Cost Accounting Rules III

Content:

The asterisk (*) points out a term or an expression defined in the Glossary – see Annex: Glossary, p. 51 ff.

1 Foreword

Cost and management accounts are important to all enterprises offering products/services. The information from these systems is used as a management tool for a variety of purposes including identifying cost and income structures for separate products/services and as an input to pricing evaluations. Increasingly they are used as a regulatory tool in many industries. This report, prepared by CERP, identifies best practices in relation to the particular circumstances of the postal services* industry.

Regardless of whether postal services* are provided in a market with or without reserved areas or competition, either direct or substitutional, there is a great need for accurate cost and revenue accounting information so that stakeholders can understand the dynamics of the market. As more Universal Service Providers (USP)* provide services outside their national boundaries, different approaches in cost and revenue accounting rules may adversely affect the conditions of competition.

Contrary to the Telecommunications Directives, which are very distinct in prescribing general and detailed rules for cost accounting, the EC postal legislation lays down general principles about the level of differentiation and the allocation of “common costs” (costs a firm incurs as a whole, and which cannot be assigned directly to any particular department, product, or segment* of the business).

The EC Postal Directive* distinguishes between:

a) “direct costs”, costs which can be directly assigned to a particular service or product – art. 14 §3a;

b) “common costs”, costs which cannot be directly assigned to a particular service or product – art. 14 §3b.

The so called “common costs” include two different types of costs:

- the costs that accountants normally call indirect costs* (i.e. costs incurred in joint usage and, therefore, difficult to assign to or identify with a specific cost object or cost centre). According to the EC Postal Directive*, whenever possible, these costs shall be allocated on the basis of direct analysis of the origin of the costs themselves. If not, these costs shall be allocated on the basis of an indirect linkage to another cost category or group of costs categories for which a direct assignment is possible – art. 14 §3b i and art. 14 §3b ii. Along the report this part of the “common costs” will be referred as “indirect costs*”
- the more common definition of “common costs”, when neither direct or indirect measures of cost allocation can be found – art. 14 §3b iii. This cost category shall be allocated on the basis of a general allocator. Along the report this part of the “common costs” will be referred as “non-attributable common costs*”.

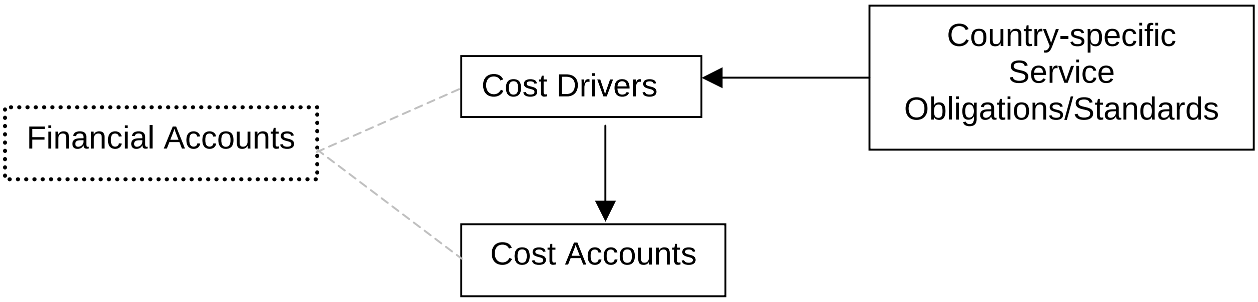
The details in cost accounting rules, which are currently applied, therefore may differ from member state to member state.

In order to encourage a consistent approach in cost accounting it is therefore necessary to identify the rules in cost accounting, especially regarding the allocation and apportionment of indirect and non-attributable common costs*, and – if possible – to formulate common principles.

These proposals have been prepared on the basis of best accounting practice and are in compliance with the requirements of existing international regulations (e.g. Directive 97/67/EC as amended by Directive 2002/39/EC, Directive 2008/6/EC etc.). The question of legal applicability in individual CERP Member States is an issue of subsidiarity. It is up to each country to decide whether or not to apply these recommendations or – if necessary – to modify its national legislation.

National Regulatory Authorities (NRAs)* implement the regulatory framework laid down in international and national law. CERP acknowledges the importance of co-operation between NRA*s to encourage a consistent approach to cost accounting in postal services*.

When identifying the rules in cost accounting, the connection between financial accounts, cost and revenue accounts, cost drivers* and the existing country-specific service obligations/ standards has to be taken into account. This interaction can be demonstrated as follows:



According to Directive 2008/6/EC, accounting by Universal Service Providers* must produce differentiated information on the cost of every single postal product except where:

- there is no use of a funding mechanism to support universal service provision;
- none of the designated Universal Service Providers* is in receipt of State assistance; or
- there is fully effective competition in the postal market.

Even where these exceptions apply a designated Universal Service Provider* before full market opening may be obliged to follow these rules unless another operator(s) has been designed as Universal Service Provider*.

When preparing cost accounts the following subjects have to be considered:

- Data source for accounts
- Mail volume measurement
- Cost drivers*' definition and measurement
- Cost of capital*
- Statutory/financial accounts vs. regulatory/cost accounts*
- Level and detail in regulatory/cost accounts*
- Audit requirements

- Allocation of services/products to market segments
- Segmentation of costs at the value chain level (for all services/products)
- Allocation/apportionment of costs to the service/product levels
- Revenue identification
- Sampling processes
- Performance indicators (to be related, for example, to pricing calculations)

2 Common approaches

The postal sector is relatively labour intensive, compared to other network industries. Because a lot of services are jointly produced, and payroll-based joint costs represent a big part of total costs, the basis of cost allocation is very important in ensuring accurate costing. In deciding on the methods of cost allocation and attribution, the objective of the legislator and/or of the NRA* – the basis of cost allocation or apportionment should be provided so the NRA* can make an assessment as to its appropriateness – must be to minimise arbitrariness by ensuring that costs are allocated or attributed on an appropriate and relevant basis.

The following approaches should therefore be considered in relation to the allocation and apportionment of indirect and non-attributable common costs*:

- The use of an Activity Based Costing (ABC)* to allocate to products/services the indirect costs*, namely those costs for which an indirect linkage can be identified, i.e. a cost driver* which causes the cost to arise – activity based costing states that products consume activities and activities consume resources: a cost driver* is any factor which causes a change in the cost of an activity (an activity can have more than one cost driver* attached to it);
- In circumstances where an ABC* analysis is not possible (i.e. no appropriate cost driver* is identifiable), the non-attributable common costs* (e.g. part of overheads*) should be allocated on the basis of a general allocator (e.g. in accordance with art. 14 §3 of the Postal Directive*, on the basis of already allocated costs);
- So as to facilitate the assessment of the USP*'s compliance, each pipeline cost should be analysed into costs which have been directly and indirectly allocated for each product/service, and details of the non-attributable common costs*, namely those costs apportioned by means of a general allocator, should also be provided at the product/service level;
- Cost drivers* chosen to allocate costs should be consistent with as many CERP Member States as possible, and have the flexibility to accommodate changes in regulation and the size of the universal service area.

Measurement units are an important aspect in cost accounting. They are needed to measure any change in capacity to operate a specific network activity.

The following measures indicate examples of how to measure the resources employed (measures that do not reflect costs drivers*, such as revenue- or volume-based measurements or profit, should be avoided):

(a) Labour costs:
Payroll records need to be classified and sorted to determine the number of staff and hours paid, together with associated costs of employment such as social security, payroll taxes, and pension plans for each business unit and product/service. This may be measured by standardised timeframes/action or – if not applicable – by local data collection.

(b) Equipment:
Following the depreciation* rules.

(c) Accommodation
to be measured by standardized space measures (e.g. floor area) or – if not applicable – local data collection.

(d) Sub-contracted services
(e.g. transport depending on the utilization)

(e) Miscellaneous operating costs
(e.g. maintenance of infrastructure in case of externalisation, outsourcing).

3 Principles and definitions

3.1 Scope of accounts

According to the legislation in force in many CERP Member States, the Universal Service Provider* should keep separate accounts within their internal accounting systems. For instance, Directive 97/67/EC as amended by Directive 2008/6/EC requires (art. 14 §2) that "The Universal Service Provider(s)* shall keep separate accounts within their internal accounting systems in order to clearly distinguish between each of the services and products which are part of the universal service and those which are not. […] Such internal accounting systems shall operate on the basis of consistently applied and objectively justifiable cost accounting principles".

In addition, it may be considered appropriate by the legislator and/or the NRA* to require that the USP* provide a high level split of turnover, costs and profits into the postal business unit(s) and each non postal business unit (which reconciles to the statutory financial accounts).

In markets, where the USP* allow other postal operators access to its delivery network (or an upstream or downstream element of postal value chain), it is also worth to consider to separate the accounts for this product in order to be able to set price for such access, taking into account the avoided costs*, as compared to the standard service covering the complete range of features offered for the clearance, sorting, transport, and distribution of individual postal items.

3.2 Documentation principles

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.

The purpose of imposing an obligation regarding the set up of a cost accounting system is to ensure that fair, pro-competitive and transparent criteria are followed by postal operators in allocating their costs to products/services, measuring their mail volumes and identifying their revenues. A cost accounting system is therefore a set of rules to ensure the attribution and allocation of revenues, costs, assets*, etc. to individual products and services (in both universal service and non universal service areas). The major resulting benefit should be a transparent illustration of the relationship between costs and prices, as the system should be able to provide a detailed analysis of costs so as to enable the demonstration that costs attributed to the regulated services do not result in inappropriate cross subsidies, excessive prices, provide an incentive for an efficient universal service provision (see, for instance, recital 41 to Directive 2008/6/EC), etc.

The basis of preparation of regulatory statements should be set out in advance by the NRA* and, as far as possible, be agreed with the operator(s). The basis needs to be sufficiently detailed and comprehensive so as to ensure that the operator and the independent auditor can apply it consistently and thoroughly from year to year.

The bases on which regulatory accounts* are prepared require special regulatory rules as well as the application of generally accepted accounting practices. In order to ensure that an operator meets all the rules, the most important information on cost accounting and separated accounts systems should be documented and contain the following:

- Description of accounting policies used;
- Definition of business units for which regulatory statements are to be prepared;
- Process applied to identify revenues and measure mail volumes at the product/service level.
- Methods for attributing costs, revenues, assets* and liabilities* to the business units and universal service areas;
- Description of the applied approach to cost accounting (specification of the methodology);
- Internal transfers (if applicable);
- Description of format of prepared statements;
- Indication of the methodology used to calculate costs;
- Step-by step description of how the costs of different services are computed;
- Details of sampling processes.

3.2.1 Description of accounting policies

These policies are those that reflect the basis used for the preparation of standard statutory accounts and should include, for example, details of fixed asset* depreciation* periods and the treatment of research and development costs. Where the regulatory accounts* are prepared on a current cost basis then the basis on which assets* are valued will be included with the accounting policies. Moreover the policies should also establish the key doctrines to be applied in the preparation of regulatory accounting information. They should include, inter alia, the principles of cost causality*, objectivity, transparency and consistency*.

3.2.2 Definition of business units for regulatory statements

The objective of separated regulatory accounts* is to measure the performance of individual parts of a postal operator’s business as if it had operated like a vertically disaggregated company. The parts of an operator’s business are usually referred to as business units and the performance can be measured in terms of contribution, profit margin or Return On Capital Employed (ROCE)*, etc. The measurement of ROCE* requires that the notified operator determines the revenues, costs and capital employed of each business unit. Business unit can be defined in various ways. The most disaggregated businesses are simple services provided by an operator.

3.2.3 Methods for attributing costs, revenues, assets and liabilities

Allocation of costs, revenues and capital employed to each of the business units, services and products is not a straight forward exercise. In many cases it is difficult to directly assign capital employed to the separate business units. Therefore the key to allocate capital employed is to identify and allocate assets* to each business unit based on usage. The allocated assets* will represent the amount of capital employed attributable to each business unit.

Book ledgers, kept for statutory accounting purposes, do not provide all the data (in the required level of detail) for the preparation of separated accounts. Correct and transparent attribution of costs, revenues, assets* and liabilities* to each of the defined business units, services and products has a critical influence on the determination of the associated profitability. Depending on the choice of allocation methods and relevant cost drivers*, the results for the business units, services and products can be very different.

Identifying different types of costs and attributing these costs to individual business units, services and products is an essential and complex issue. It is believed that allocations should be based on cost causality*, objectivity, consistency* and transparency.

The principle of causality* implies that costs and revenues are allocated once and only once, directly or indirectly, to the services that “cause” the costs to be incurred (and revenues to arise). This requires the implementation of appropriate and detailed cost allocation methodologies. In practice this requires that operators:

- Review and justify each item of cost, capital employed and revenue;
- Establish the driver that caused each item to arise; and
- Use the driver as a basis to apportion each item to the business units, services and products.

It is recalled (see supra section 2. “Common approaches”) that the non-attributable common costs* should be allocated on the basis of a general allocator.

Details of all the cost/revenue drivers used should be documented. In the case of revenues, it is anticipated that most of them can be thoroughly allocated directly to those business units, products/services to which they relate. This is not the case for costs, however, because a relatively high proportion of the costs of operators are shared between different services. Several approaches can be followed to allocate costs.

Attribution of each category of revenues, costs, assets* and liabilities* to defined business units or products/services should be described together with applied method of attribution. The attribution seems to be the most illustrative when presented in a tabular form.

3.2.4 Description of the applied approach to cost accounting

In order to prove to what extent the existing accounting system meets the regulatory requirements, the USP* shall specify the approach used to reflect costs in calculations and separated accounts statements. The two alternative approaches are Historical Cost Accounting System (HCA) and Current Cost Accounting System (CCA).

HCA is based on recording transaction at their original historical monetary cost.

CCA is a convention devised for financial reporting in an environment of rapidly changing prices, where traditional HCA may be considered inadequate. CCA, contrary to traditional HCA takes into account the impact made by inflationary tendencies on shareholders' interests.

HCA is far easier to implement since it does not result in any additional and complicated revaluations. CCA results in unavoidable revaluation which on one hand can better reflect costs of the operator from current perspective and on the other implies a reconciliation of accounting separation statements with the company (and its audited) accounts.

Whenever CCA is applied, specific issues concerning revaluation of costs should be documented. Crucial meaning in revaluation can be arrogated to methods according to which the revaluation is to be performed. The most common methods are Detailed Revaluation Method (DAR) and Indexation method – in terms of revaluation of assets* also called Specific Asset Price Indexation (SAPI). The documentation should reflect what methods were used to revalue each group of assets* (and as a consequence their costs like e.g. depreciation*) and operating costs.

Basing on the documentation, the NRA* should be able to assess the correctness of applied method. In order to achieve this, the submitted documentation should describe the sources of used data for both methods and the determination of applied indices for the indexation method.

In the postal sector the level of capital investment is relatively low compared to other industries such as telecom. In addition, asset* lives and residual values are more predicable. Therefore in most cases the work involved in introducing a CCA is not normally appropriate. Nevertheless it is important to bear in mind that the continuing use of obsolescent sorting machinery and processes may give raise to significantly higher labour cost compared with the use of modern ones.

3.2.5 Internal transfers

Internal transfers represent virtual streams of internal transactions that would be completed between business units if they operated as separated entities. The disclosure of internal transfers and the determination of the associated charge are highly dependent on the way the business units are defined. The NRA* needs assurance that all inter/intra- unit transactions are cost oriented and non discriminatory (i.e. between internal charges and the payment expected from an external transaction) and do not result in unfair cross-subsidizing practices.

The documentation should disclose details of all internal transfers between the business units and provide details as to the calculation of the associated charges.

3.2.6 Description of format of prepared statements

By preparing separated accounts, ROCE* for each of separated business unit can be computed. Two components of ROCE*: return and capital employed, should be clearly disclosed so that the calculation can be re-performed by any user of the separated accounts.

This re-performance can be made through preparation of three “basic” reporting formats for each of Business Unit/Service:

- Profit and loss account;
- Statement of capital employed;
- Calculation of ROCE*.

The separated accounts should include reconciliation with the published audited financial statements of the operator.

The requirement for reconciliation to the statutory financial accounts is fulfilled in two ways:

- Basic separated reports (profit and loss account, statement of capital employed) should wherever possible enable to reconcile main positions of balance sheet and profit and loss to the statutory financial accounts;
- Notes to accounting separation reports should further facilitate final reconciliation.

There shall be consistency* of accounting treatment from year to year. Where there are material changes to the accounting principles, the attribution methods, or the presentation of items that have an effect on the information reported in the Financial Statements of the business units, services and products, the relevant sections of the previous year’s financial statements affected by the changes shall be restated. This is why all separated accounts should present current year information and comparative previous year figures. If, for some reason, the current year figures are not comparable to previous year figures and the restatement couldn’t be made, it should be clearly disclosed in the separated accounts.

Further, all adjustments made to statutory financial reports of operators must be clearly and separately disclosed. Especially, all internal transfers must be explicitly presented separately in costs and revenue. Furthermore, current cost adjustments should be separately disclosed.

The transparency between adjustments made explicit for the purpose of accounting separation and items included in statutory accounts should be achieved.

3.2.7 Step-by-step description (computing of costs of products/services)

One of the aims of documenting cost accounting/separated accounts systems is to agree with the NRA* the important aspects of the preparation of the statements. In order to achieve this, the NRA* should be able to get an understanding of how the costs of different products/services are calculated.

The Fully Distributed* Cost (FDC) approach allocates costs that are directly and not directly attributed to services or products according to measures such as ABC*, samples and surveys, revenues or price-proportional mark-ups, in a way so that no costs are left unallocated.

The Long Run Incremental Cost (LRIC) approach allocates incremental costs that are attributed to products/services using cost volume relationships.

Both methodologies can be backed up by ABC* that allows the establishment of stronger causal relations between costs and products/services. ABC* views the services and products as a series of activities, each of which consumes resources and therefore generates costs. This methodology, based on the cause of costs (cost drivers*), traces and allocates costs through the activities performed and establishes a clear cause-and-effect relationship between activities, their associated costs and the resulting output from those activities.

The most significant areas in terms of importance of information that should be documented are:

- list of products/services subject to calculation;
- description of groups of resources (cost categories) and activities or network elements defined;
- presentation of relations between all of cost model elements (cost allocation process);
- identification of:
    - direct costs*;
    - indirect costs*;
    - non-attributable common costs*.
- treatment/apportionment of non-attributable common costs*
- cost driver* definitions and calculations and the methodology used for survey and sampling techniques (e.g. volumes of services sold);
- methodology of calculation of depreciation* cost

3.3 Data source for accounts

It is important that any sampling process used is appropriate and continues to remain relevant and representative of the entire network. This will help to reduce bias in the sampling process and therefore increase the level of confidence in the reliability of its results.

The use of statistical sampling is particularly relevant when volumes/revenues/costs cannot be directly allocated to specific products/services. The following needs to be determined:

- Level of confidence
- Degree of precision
- Sample size
- Location of sample (ensure that it is representative).

With regard to the input data for analytical cost accounting, particularly statistics, random checks, time-and-motion studies, etc., it is useful to verify to what extent these aspects are internally consistent and can be verified.

The regulated statements should be prepared by disaggregating the balances which have been recorded in the general ledger of the company. It is of vital importance that such regulatory accounts* are reconciled with the statutory financial accounts of the company.

An inherent feature of the postal industry involves the use of common resources to provide products and services.

The basis of allocation and apportionment should be based on a set of principles, the main ones being:

- Cost causality* – revenues and costs should be attributed in accordance with the activities which cause the revenue to be earned and the costs to be incurred.
- Objectivity – all allocation and apportionment bases should be performed on an objective starting point and should not be intended to unduly benefit the USP*.
- Consistency* – practically all allocation and apportionment bases should be consistently applied from one year to the next one.
- Transparency – methods of allocation should be transparent and the revenues and costs should be clearly distinguishable from each other.

Costs and revenues should therefore be directly allocated to products/services as far as is practicable – costs should ideally be assigned to products/services using ABC* methods – revenues should be directly assigned if possible.

Where the stamped and meter revenue cannot be directly assigned, the revenue attributable to each product / service (paid for by stamps and meter) should be obtained using discrete measurement systems or a mix of traffic counting and sampling processes. It is important however that the total income reconciles with the financial ledger and P&L account.

Costs and revenues that relate to groups of products/services and which cannot be directly assigned should be apportioned across all products on the basis of an indirect linkage (cost driver*) or a general allocator (see supra section 2. “Common approaches”).

The devised sample should be conducted throughout the accounting period and it should be (for instance, of sufficient size as to be) representative of the entire population.

3.4 Volumes

With the exception of account volumes, where figures are available but need verification (e.g. franking machines), no data on the volume of mail handled by a USP* can be ascertained from normal accounting records.

In such circumstances, operational traffic methodology, if available and reliable, should be used as the basis of measuring volumes – this involves the determination of traffic by machine counting or by counting numbers of containers and applying statistical techniques. A distinction should nevertheless be made between items that are handled differently (i.e. letters, flats and packets) and if weight is a driving factor, a distinction should be made on that basis.

The remuneration paid by a mail service division to the post office division, for example, should be determined by actual mail volumes handled by post offices. If this solution is impracticable, a mechanism of correction will have to be introduced at the end of the financial year and which takes the actual volumes into account.

Where traffic volumes are determined by applying a statistically derived number of items per kilogram to the weight of mail carried, there is no reason in theory why the operational traffic methodology identified above can’t be applied as a basis for measuring volumes.

In some instances it may be more appropriate to use an “equivalent volume” rather than pure volumes. This concept is based on the premise that pure volumes are not entirely reflective of costs but need to be adjusted to take account of specific operational characteristics e.g. it takes more time to process a flat than a P.O.P. (Post Office Preferred) envelope and therefore the processing costs should be apportioned accordingly.

3.5 Statutory financial vs. regulatory accounts

In order to crosscheck the interrelationship between statutory and regulatory accounts* it is necessary to have rules for structuring and reconciling. The requirements of IFRS 8 (see infra section 3.5.1. “Comparative accounting information”) should also to be taken into account.

The Fourth Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies with limited liability obligates EU Member States to apply prescriptions relating to the presentation and content of annual accounts and annual reports, the valuation methods used therein and their publication, for the protection of members and third parties. Article 2 provides that “The annual accounts shall comprise the balance sheet, the profit and loss account and the notes on the accounts” and “shall give a true and fair view of the company’s assets*, liabilities*, financial position and profit or loss”.

The profit and loss account differs significantly from the balance sheet in that it is a record of the company's activities over a period of time whereas the balance sheet is a snapshot of the financial position at a moment in time (i.e. financial year end).

Article 15 of Directive 97/67/EC requires that the financial accounts of all Universal Service Providers* shall be drawn up, submitted to audit by an independent auditor and published in accordance with the relevant European and national legislation to commercial undertakings.

3.5.1 Comparative accounting information

Article 4 of the Fourth Council Directive 78/660/EEC requires from EU Member States that "In respect of each balance sheet and profit and loss account item the figure relating to the corresponding item for the preceding financial year must be shown. The Member States may provide that, where these figures are not comparable, the figure for the preceding financial year must be adjusted. In any case, non-comparability and any adjustment of the figures must be disclosed in the notes on the accounts, with relevant comments". This will enable an assessment to be made regarding the existing trends from which judgements can be made about the future. An analysis in unit cost terms can also be useful – total costs may be increasing but unit costs falling e.g. due to volume increases and the effects of economies of scale.

Regulation 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards* requires all publicly traded companies governed by the law of a UE Member State to prepare their consolidated accounts in conformity with the International Accounting Standards (IAS)*, renamed as International Financial Reporting Standards (IFRS)*, for each financial year starting on or after 1 January 2005, and encourages their use by non publicly traded companies and/or for the preparation of annual accounts.

IAS 1 *Presentation of Financial Statements* describes financial statements as a structured financial representation of the financial position of and the transactions undertaken by an entity. The objective of the financial statements is therefore to provide information about financial position and performance that is useful to a wide range of users in making economic decisions. IAS 1 requires financial statements to be prepared annually. Consistency* of accounting treatment is of vital importance. IAS 14 *Segment Reporting* (replaced by IFRS 8 *Operating Segments* effective for annual periods beginning 1 January 2009) establishes principles for reporting financial information by line of business (and by geographical area).

3.5.2 Regulatory accounts

Directive 97/67/EC as amended by Directive 2008/6/EC requires (art. 14 §2) that "The Universal Service Provider(s)* shall keep separate accounts within their internal accounting systems in order to clearly distinguish between each of the services and products which are part of the universal service and those which are not".

Regulatory accounts* are prepared to provide financial information about regulated businesses for use by the NRA*. They provide information that is more focused and detailed than that contained in the published financial accounts.

3.5.3 Structuring

- Consistency

In preparation of the regulatory accounts*, consistency* is of vital importance in terms of cost allocation and inter-company charges. This will help to ensure that there is no inappropriate cross subsidies between business segments*.

- Transparency

All methods used in cost allocation and inter company transactions should be transparent. The revenues and costs should be separately distinguishable from each other.

- Segment Reporting*

The standard IFRS 8 will enable a complete assessment be made of management's operating and financial strategies with regard to all segments* of the business.

3.5.4 Format and content of regulatory (separated) accounts

The hierarchy of costs to be applied to each service should be decided upon in order to achieve greater consistency* and comparability between operators.

Separate accounts for reserved services and non-reserved services within the universal service area are needed, where applicable.

The USP* shall provide to the NRA* regulatory accounts*, disaggregated to the level of products/services, within a specified reasonable time from the end of each financial year.

The regulatory accounts* should contain:

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

- 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.

(b) 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*. This shall include, inter alia, details of the USP*'s income recognition policy, depreciation* policy, capitalization policy, and its approach to dealing with issues such as cost allocation, prior year adjustments and changes in accounting policy.

Where a calculated cost of capital* is substituted for the actual costs incurred, details of the Weighted Average Cost of Capital* (WACC) should be disclosed with an explanation including the linkage of assets*/products to product groups. If the universal postal service provider or the concession-holder postal service provider applies settlement transfer prices* for the internal services between or within its business units it shall submit to the NRA* a list of internal services (transfers) and explanation of their content, a transfer matrix, including statement on the different transfer prices* and transfers, and the methodology used.

The methodology of evaluating the avoided costs*, forming the basis for the tariff discounts granted to the customers for a larger volume of postal items, as well as the method of presenting and justifying these costs within the separated financial statements shall be explained. Within the income statement, the revenues shall be shown as net values, i.e. by deducting the tariff discounts granted, while in the explanatory memoranda accompanying the separated financial statements, these tariff discounts shall be distinctly highlighted and shall be separated by customer categories, depending on the correspondence volumes generated by each customer category.

(c) Income statements and balance sheets for each business segment* as defined in IFRS 8 or as agreed by the NRA*, and prepared in accordance with IFRS 8. Accounts shall show data for the USP*'s last complete financial year as well as the previous financial year and where these figures are not comparable, the figure for the preceding financial year must be adjusted.

(d) Income statements for the business segments* providing services within the scope of universal service as defined in the regulations, distinguishing (where applicable) between services wholly or partly within the reserved sector and those wholly within the non-reserved sector. These accounts shall also include income statements for each service. They are also required to be fully reconciled to the published financial accounts of the USP*, identifying all items not relevant to the accounting period that have been excluded from the regulatory accounts*.

(e) 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* at least on an annual basis following discussion with the USP*.

(f) 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.

(g) 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.

(h) 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.

(i) 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.

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

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

3.5.5 Reconciling

A complete reconciliation should be made available between information in the regulatory accounts* and the information in the published statutory financial accounts. This will include providing information on competitive services, and on services other than postal services*, which are provided by the legal entity providing the regulated service(s). Failure to undertake this reconciliation might mean that some important element of revenue or costs is omitted or double counted.

3.5.6 Publication

The requirements in the Postal Directive* to keep confidential detailed accounting information provided to the NRA* or to the European Commission could create two problems:

1. There can be occasions when the NRA* needs to refer to some data that is in the public domain in terms of price control/approval investigations.
2. The USP*(s) may selectively (publicly) disclose only part of the information.

If a USP* decides to publish (put into the public domain) any information from its regulatory accounts*, specific rules should be established e.g.:

- Regulated accounts must be fully reconciled to the statutory financial accounts; partial or incomplete data should never be published.
- Segment reporting* (see supra section 3.5.1. "Comparative accounting information") by line of business and by geographical area is of great importance as the universal postal sector represents only a proportion of the total business of a USP*; it would enable the regulators (and other stakeholders) to get a more complete picture of the regulated activities.
- Must be made freely available.

3.5.7 Comparisons

1. Yearly

The date of emergence of costs may sometimes differ from the date of value creation.

The common principle of comparing the current annual results with the figures for the preceding financial year is needed.

The “matching principle” requires that all costs incurred in generating revenue be recognised in the same accounting period as the associated revenues are recognised.

The general approach is first to attempt to match costs and revenues. Next, a method of systematic and rational allocation should be attempted. If neither of these measurement principles is appropriate, the cost should be immediately expensed.

2. Change of size of universal or reserved area

Changes in postal legislation lead to the reduction or elimination of the reserved areas and there may also be changes in the national level of “universal service”. This will necessitate changes in cost accounting segments. Therefore a method to compare those annual results is needed.

With the gradual liberalisation and opening up of the market, the changes in the reserved/non reserved areas will become a major accounting issue in the preparation of the regulatory accounts*. There is need to look at the big picture and then analyse it into reserved area and non-reserved services within the universal service area.

IAS 1 (see supra section 3.5.1. “Comparative accounting information”) identifies a number of considerations that needs to be borne in mind in the preparation of financial accounts. The need for comparable accounts is just one of these. If this is also applied to the regulatory accounts*, it will mean that the prior year accounts will need to be restated so as to reflect the current conditions.

Changes in the Domestic tariff may also lead to changes in the reserved/non reserved splits. If such changes take place mid year, there is a need for an apportionment of revenue/costs. This can introduce complexities as the prior year accounts will also have to be prepared accordingly. In practice, therefore, it may be more appropriate to look at the position at the year end and restate the prior year accordingly.

The procedure required by the NRA* must be clearly communicated to the USP* in a timely fashion so the necessary procedures can be put in place to ensure compliance.

4 Basics

4.1 Depreciation

Operators have to respect the general accounting principles and those specifically set by the legislation or the NRA* regarding the issue of depreciation*.

The following two key elements need to be distinguished:

- normal depreciation* (e.g. sorting facilities);
- exceptional depreciation* (e.g. written-off assets*).

Depreciation* is required to be charged in the profit and loss account, based on the carrying amount of the asset in the balance sheet, whether at historical cost* or the revalued amount. The following principles should be applied in determining the appropriate depreciation*: the measure of the wearing out, consumption or other reduction in the useful economic life of a fixed asset whether arising from use, effluxion of time or obsolescence through technological or market changes.

The financial transactions of an exceptional and non-recurring nature should be accounted for in accordance with their exceptionality. The cost accounting systems should respect this and should be reconciled with the financial accounts.

4.2 Asset valuation

As far as asset valuation is concerned, the postal sector has always been considered as labour intensive. Nowadays more and more postal operators are investing in tangible assets* such as infrastructure, vehicles and machinery. For that reason it may be useful to analyse how the historical, current and new assets* should be valued in their accounts. Assets* of the historical postal operator may have a low book value but the market/replacement value could be very high e.g. premises, post offices, etc. This could for example influence the remuneration of capital, the separate accounts within their internal accounting system, namely the reserved universal service, the non-reserved universal services and other services, etc.

There may also be a need to identify or revalue specific assets* (e.g. infrastructure) in the provision of a postal service*.

4.3 Internal transfer pricing

When products/services which fall outside the scope of the universal service are transferred between different divisions of the postal operator e.g. between parent operator and majority-owned subsidiaries or between the postal operator and affiliated or associated companies, transfer pricing should be applied on an “arm’s length” basis, consistent with the pricing and conditions that would be applied to a third party (the customer).

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. For example, the fixed costs* of the infrastructure (especially, of the post offices) must be supported by all products according to the infrastructure’s utilization and therefore cost/cost-plus basis may be applied.

Internal revenues which result from payment of internal transfer pricing on cost-plus basis should be reasonable, as they could have a material impact on the financial performance of the three regulatory areas (i.e. reserved, non-reserved universal service, and non-universal service).

4.3.1 Principle of arm’s length standards

4.3.1.1 History and discussion of the general concept

Within multidivisional companies a centralized management cannot supervise and control all operations of its subunits. For that reason these enterprises are usually separated into autonomous units where managers have the freedom to take the necessary actions. Transfer prices* used within these multidivisional companies govern transactions among divisions of a firm or company and serve the purpose of tracking internal transactions and of evaluating the performance of each subunit as well as of measuring the contribution of each division to the total costs and profit of the organization. Transfer prices* are also usually used to set prices for intermediate products and services which are transferred from one subunit to another.

Transfer prices* which will be used to place a value on the transaction between the two divisions, tend not to differ much from the price in the market because one of the entities in such a transaction will lose out: they will either be buying for more than the prevailing market price or selling below the market price, and this will affect their profitability or performance. Transfer prices* also enable the USP* to allocate costs to different inter-company activities and so create incentives to divisional managers.

4.3.1.2 Recommendation of the OECD

Most countries enforce tax legislation based on the arm's length standard as defined in the OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (first issued in 1979, extensively updated in 1995 and periodically revised).

These guidelines maintain the arm's length principle of treating related enterprises within a group and affirm traditional transaction methods as the preferred way of implementing the principle. .

The computation of the transfer price* for the relevant transactions might be a simple matter while determining comparable prices from non-related party transactions, i.e. transactions involving proprietary goods and services and intangibles, deriving from the arm's length approach can be more sophisticated. The definition itself raises two sub-questions:

- What is a related party?
- The OECD guidelines focus on the de facto control of the parties rather than mere legal control. Thus any control, even control by one entity over another that is not legally enforceable, will satisfy the definition of a related party.

4.3.1.3 Selection of methods in line with the arm's length principle

There is the choice of the following methods:

- The Comparable Uncontrolled Price (CUP)
  The CUP method directly compares the price of the controlled transaction with the price of the uncontrolled transaction. This method combines the resale price and cost plus methods thus focusing on a single price. The CUP presumes that

the relevant transactions, products and circumstances are reasonably comparable.

- The Resale Price Method (RPM)
  The resale price method refers to the gross margin to be charged by the distributor. The gross margin can be characterized as the selling price of the service reduced by the operating cost incurred. The arm's length margin can be determined by comparing the controlled gross margin with an independent distributor performing comparable functions as the related distributor.

  RPM is generally considered to be applied where the USP* sells services (e.g. information on address changes) to a related affiliate primarily acting as a distributor reselling to an uncontrolled market (e.g. market of direct-marketing services as an example for a non-universal service) and adds little additional value to the product (e.g. optimizing of this address information by connecting with marketing data).
- The Cost Plus Method (CPM)
  The cost plus method should preferably be used where a manufacturer sells services to a related distributor who resells to an uncontrolled market and adds substantial additional value to the product. The method focuses on the manufacturer's gross mark-up with the related manufacturer's costs being determined and, an appropriate gross profit mark-up applied to arrive at the deemed sales price.
  Application of CPM is effected by adding to the controlled sellers cost of the value chain a surcharge for the appropriate gross profit – the appropriate gross profit percentage shall reflect and correspond to the gross profit percentage charged on the uncontrolled transaction(s) most comparable to the related parties' transaction. Comparability may be determined by considering the same factors discussed under the resale price method. Under CPM, adjustments as with the other methods may be made where there are differences in the controlled and uncontrolled models which have a reasonably ascertainable effect on the price.

Conclusion:

Although there is technically no hierarchy of methods, CUP as the purest method should be preferred where comparable uncontrolled prices on the relevant market exist. However, other methods may be used where the results are more accurate.

4.3.1.4 How do related parties determine the arm's length price?

The application of the above mentioned arm's length price methods requires a thorough examination of the enterprises in question and its structure. The method to be used depends on the availability of data and comparable transactions. It should be considered that comparable transactions need not be identical. Identical or similar transactions may be the exceptional scenario.

Nevertheless parameters and factors should be identified to evaluate the sufficiency of comparability between controlled and uncontrolled parties' transactions. In this context risks, contract terms, economic conditions and the nature of property and services should be considered. To find comparables for intra-company transactions the USP* has various possibilities for obtaining the relevant data. These comprise sources of information within the company or the group, as well as external comparables derived from a variety of database-sources when latter comply with the comparability requirements.

4.3.1.5 Reporting requirements

To enhance transparency and consistency*, special attention should be paid to standardized transfer pricing documentation. At a minimum the documentation shall contain a general description of the USP*'s organizational, legal and operational structure (including an organizational chart), an identification of the associated enterprises engaged in controlled transactions and the characteristics of the inter-company transactions as well as flows of transactions and the amounts of transaction flows. Therefore for each relevant transaction affecting the universal service segment, the USP*'s transfer pricing policy and the methodology of the applied arm's length scheme must be comprehensively documented as well as the advantages for the preferably applied methods. Particularly it must be reported which transactions (i.e. postal services*, IT-services, legal advice and accounting services) are provided by the parent or the affiliate. In this way the NRA* can see which affiliates might benefit from those transactions and if they are cross subsidizing the competitive part of the value chain. Those relevant transactions affecting the universal services should be published and revealed to the NRA*. Publication of tariffs is necessary as it enlarges the audience (for example potential service providers who are able to service the network company at lower cost) and thereby valuable information might be brought to the attention of the NRA*.

For that reason the USP* shall be required to disclose all transfer charges for the transactions with affiliated companies in their regulatory accounting statements.

The published documents provided to the NRA* should be in line with IAS 24 *Related Party Disclosures* and contain information on transactions such as:

- purchases of products/services and their value (description of these transactions, including information on whether tendering procedure was used);
- sales of products/services and their value (description of the relevant sale transaction including information on performance in tendering procedures);
- purchases and sales of property and other assets*;
- transfers of research and development services;
- leases;
- financing costs (including dividends paid to affiliated companies, derivatives etc).

The disclosure required shall be made separately for each of the following categories:

- the parent entities with joint control or significant influence over the entity;
- subsidiaries;
- associates;
- key management personnel of the entity or its parent;
- other related parties.

5 Valuation

5.1 Cost of capital

An equitable ROCE* by the USP* may be added to the costs.

The most appropriate way to calculate the cost of capital* is by means of a “WACC-RAB” approach, a method which is already widely used in other sectors and which are totally or partially liberalized but nevertheless regulated (e.g. telecommunications, electricity, gas etc).

The allocation of assets*, including receivables and cash, to individual services and products is a key determinant in the calculation of the capital employed, due to the nature of network activity and capacity utilization. The allocation rules should be reviewed and agreed with the NRA*.

According to the “WACC-RAB” approach, the cost of capital* equals the Regulatory Asset Base (RAB) value multiplied by the return authorized on these assets*. The most wide spread and accepted method in order to determine the return authorized is the Weighted Average Cost of Capital* (WACC).

5.1.1 Regulatory Asset Base

The RAB is the value of the regulated assets*. The term “regulated” refers to the calculation of the universal service cost based on the share of the assets* used for providing the universal service (reserved or non-reserved).

Several methods exist allowing for quantifying and valuing the capital to be remunerated. These methods can be technical or economic or mixed. The technical evaluation is based on the technical value of the different asset elements whereas the economic evaluation refers to the revenues generated by the assets*.

The advantage of the technical valuation methods is their simplicity. These methods facilitate the use of relatively well-defined concepts as a basis, such as the book value or the replacement value of fixed assets*.

The most widely used methods are:

- Depreciated Actual Cost (DAC)

  Tangible assets* are valued at their purchase price reduced by the depreciations* posted, i.e. net book value. This is a simple and objective method and the application of which is not expensive.

- Depreciated Replacement Cost (DRC)

  Tangible assets* are valued at the replacement cost of the assets* minus the depreciations*. The replacement assets* although not necessarily identical provide the same services and the same capacity. This method offers the advantage of a valuation at current cost. As far as objectivity is concerned, however, this method is less effective because estimations and judgments are necessary, which can lead to disagreements between experts.

- Optimized Depreciated Replacement Cost (ODRC)

  A variant of the previous method, whereby the price of the most effective alternative is calculated in order to provide the same services and the same capacity.

5.1.2 Weighted Average Cost of Capital

The WACC is the weighted average cost of capital*. A distinction between a post-tax and a pre-tax WACC can be made as follows:

- Post-tax WACC is calculated in accordance with the following formula:

$$WACC_{post-tax} = (r_e \times \frac{E}{E+D}) + \left[r_d (1-t_c) \times \frac{D}{E+D} \right]$$

- Pre-tax WACC is calculated in accordance with the following formula:

$$WACC_{pre-tax} = (\frac{r_e}{1-t_c} \times \frac{E}{E+D}) + (r_d \times \frac{D}{E+D})$$

where:

r_e	:	the cost (or rate of return required) of equity* (after taxes),
r_d	:	the cost (or rate of return required) of debt (before taxes),
t_c	:	tax rate,
E	:	the market value (possibly normative) of equity*,
D	:	the market value (possibly normative) of debt.

The tax rate used in the WACC calculation should be the effective tax rate (estimated by dividing the taxes due by the taxable profit over the considered period).

The cost of capital* takes into account the cost of equity* by means of the r_e coefficient and the cost of debt by means of the r_d coefficient. The WACC is the weighted average cost of those two components. In order to take into account the respective weight of each component, the relative market value of equity* and debt should be considered.

The calculation of the cost of equity* is based on the Capital Asset Pricing Model (CAPM), which is the most wide-spread and recognized methods used to calculate the rate of return required by investors/ shareholders. The CAPM calculates this rate taking into account the opportunity cost of investing in the market, the volatility of the market and the company's systematic risk.

The r_e value is determined in accordance with the following formula:

$$r_e = r_f + \beta_{equity} * [\, E(r_m)-r_f \,]$$

where:

r_f	:	risk-free interest rate,

$E(r_m)$: expected return/profitability of a highly diversified market portfolio,

$E(r_m)-r_f$: market risk premium,

β_{equity} : the systematic risk of the share of the postal service provider studied, i.e. the risk that cannot be eliminated by diversifying the portfolio. It reflects the proportion in which the rate and the revenues associated with the company studied vary according to the evolution of the market as a whole.

The β is therefore a factor that describes the correlation between the expected return of a stock or a portfolio and the stock market's return. When the USP* isn't stock listed this correlation cannot be observed and is necessary to use proxies for the β's estimation. A possible solution could be the calculation of this coefficient using as benchmark the β of companies that are comparable with the USP* – e.g. postal companies, utilities companies, companies of other regulated activities. Each β of these comparable companies (***levered*** β) should be corrected ***(unlevered)*** of its specific structure of capital (the unlevered β is the β of a company without any debt; unlevering β removes the financial effects from leverage), and subsequently adjusted (***relevered***) considering the particular capital structure of the USP*. The unlevered β is calculated by dividing the levered β by $[1 + (1 - t_c) * D/E]$. The formula to calculate the relevered β is: $\beta_{relevered} = \beta_{unlevered} * [1 + (1 - t_c) * D/E]$.

The cost of debt is calculated via the following formula giving the r_d value:

$$r_d = r_f + p$$

where:

r_f : risk-free interest rate,

p : the risk premium of the debt depending on the company's rating and classification (AA, …).

Determining the WACC parameters, and in particular the risk premium of the shares of the company being studied seems very simple but raises many questions concerning the hypotheses to be withheld and the ways to evaluate them. Moreover, the regulatory system can have an impact on a company's risk level. This factor, difficult to quantify, especially for companies with additional activities outside the postal area, is nevertheless not inconsiderable.

The pre-tax WACC calculates the cost of capital* before corporation tax. The WACC post-tax calculates the return on capital after corporation tax.

The pre-tax WACC calculates the cost of capital* used, including the cost of the taxes paid. By means of a WACC pre-tax approach the cost of equity* is calculated taking into account the taxes to be paid on the taxable profit, and the cost of debt on the basis of the interest rate negotiated with the creditors.

The post-tax WACC, on the contrary, calculates the cost of capital* used excluding the cost of taxes paid. The impact of taxes paid on the cost of equity* is consequently not taken into consideration, and reduces the costs of debt by the tax relief that the payment of interests entails.

It has to be noted that a post-tax WACC approach, resulting in a lesser value than a pre-tax WACC, requires the incorporation of the tax cost on the level of cost allocation per product.

It is important to note however that the application of this method to the postal sector can be difficult due, for example, to the following characteristics of the USP*:

- negative working capital
- negative equity*
- no equity* (except retained earnings*)

5.2 Retained earnings

Retained earnings* (also called accumulated earnings, accumulated profit, accumulated income, undistributed earnings, etc.) are profits generated by a firm that are not distributed (to shareholders) as dividends but are either reinvested in the business or kept as a reserve for specific objectives (such as to pay off a debt or purchase a capital asset). Balance sheet figure shown under the heading retained earnings* is the sum of all profits retained since the company’s inception. Retained earnings* are reduced by losses.

In principle retained earnings* are part of the shareholders’ equity* and should therefore be treated in exactly the same way as share capital. However, most, but not all, USP*s are government owned. When calculating the cost of capital* it should therefore be borne in mind that in such instances the users of services within the reserved area have already contributed to the actual capital.

5.3 Interest receivable

Interest receivable can be a material part of the income to an operator in the postal sector. This reflects the fact that USP*s are cash businesses who receive payments mainly in advance of the postal transaction and revenue recognition point-due for example to the actual mailer’s purchase of stamps, and the SME companies’ pre-payment of meters. This means that revenue prepayments for postage stamps and franking machines can be quite a number of days.

This is accounted for as a prepayment in accordance with Generally Accepted Accounting Principles (GAAP)*. Many postal operators also enjoy positive working capital unlike many manufacturers who need to fund inventories and finished goods as well as receivables.

There may be an element of subsidisation between those customers who are pre-paying and the larger customers who are receiving credit. For example credit terms may be 7 days, but in reality the average credit length can be of the order of 35 days by the time invoices are raised and payment is received by the Universal Service Provider*.

A number of issues arise:

1. Most, but not all, USP*s are government owned which historically have had a monopoly. Their accounting has been on a cash basis rather than on a GAAP* accrual basis* because of the accounting process used by Governments, Treasuries and Finance Ministries.
2. This issue becomes more crucial in payment terms between countries through terminal dues* agreements, which have commonly led to delayed settlements and sometimes bad debt write-offs.
3. This in turn gives rise to a need to establish the appropriate level of “income earned (or paid)” by postal services* in the reserved sector, and how this should be allocated between types of mailers.

The regulatory accounts* and statements should establish the physical volume metrics, revenue distribution from sampling methods, and compute/reconcile segmented cash flows to the revenue streams relating to each of the business and/or regulatory segments* in order to attribute and allocate interest earned.

6 Allocation

6.1 Common allocation approach

As stated above (see supra section 3.3. “Data source for accounts”), costs and revenues should be directly allocated to products/services as far as is practicable.

Those costs that cannot be assigned to a single product but to a group of products shall be regarded as indirect costs* for this group of products. The allocation based on the causality* principle is thus very important. The total costs have to be apportioned to the individual products using appropriate cost drivers*.

Those costs that cannot be allocated to any product/service or group of products/services must be regarded as non-attributable common costs* and allocated using a general allocator (see supra section 2. “Common approaches”). In the postal sector these costs often are a significant part of the total costs.

The allocation of indirect costs* amongst business segments* both within the universal and non-universal areas, is achieved on the basis of cost drivers* (e.g. some physical quantity). The complexity of the allocation process of course depends on the scope of information of the cost drivers*.

For example, the manpower and payroll records need to be classified and sorted to determine the heads and hours paid, together with associated costs of employment such as social security, payroll taxes, and pension plans. The payroll records might be sorted to produce these statements by the major chart of accounts cost categories of:

- Marketing and Sales,
- Administration and Finance,
- Overheads*,

whereas regulatory accounting should always aim at ensuring transparency by having accounting separation as detailed as possible.

The allocation process should take into account the following ratios per product/service:

a. Personal i.e. labour costs (increased salary because of special skills needed by employees – e.g. cross-border parcels – should be allocated to those services only, where the special skills are needed);

b. Equipment (special equipment for special services – e.g. specialized computer programmes – should be allocated to those services only, where the equipment is needed);

c. Space (increased space for special services – e.g. voluminous items – should be allocated to those services only, where the space is needed);

d. Sub-contracted services;

e. Miscellaneous operating costs (maintenance of infrastructure in case of externalisation, outsourcing etc.).

The regulatory accounts* and statements should be prepared in order to establish the volumes, revenues, and costs for each of the regulatory areas (reserved services, non-reserved services and area outside universal service) and by the major cost accounting categories (Sales and Marketing, Overheads*, Administration and Finance, etc).

Given the high levels of indirect costs* and non-attributable common costs* (combined), and the potential implications for unit cost calculations, there is a need for all NRA*s to review and approve the USP*'s system of cost allocation (see supra section 2. "Common approaches").

6.2 Cost drivers (appropriate scenarios)

The use of cost drivers* has an increasing importance in the allocation of indirect costs*. A cost driver* is an event or a factor that has a systematic relationship to a particular type of cost and which causes that cost to be incurred.

The costing methods applied are techniques used to allocate the operator's costs in a relevant way, in other words resources to activities and activities to cost objects. This allocation takes place with cost drivers*. In practice, a driver is a distribution key to share out the costs in an objective and quantifiable way. The choice of the exact resources and activity drivers and also the cost objects are crucial in the ABC* approach.

A well defined cost-allocation system should enable a high percentage of the costs to be allocated on the basis of cost causation.

It is important:

- To identify all activities of postal value chain;
- To allocate appropriate cost drivers* to activities:
  - 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,

    - consolidation of partial processes/activities to main process/activity;
- To take into account:
    - the fixed/variable costs* classification,
    - the impact of the accepted cost drivers* on the contribution/gross margin at the service/product level,
    - the justification of causalities and cost drivers* in case calculated expenses clearly differ from (estimated) actual costs.

The choice and validity of cost drivers* should be provided to the NRA* (for its approval). Examples of possible cost drivers* (indicating dominant cost drivers*) are listed infra in section 6.5. “Most appropriate cost drivers”).

6.3 Allocation by process

6.3.1 Counter

In many cases additional non-postal services, e.g. payment of social welfare pensions/allowances, provision of Financial Services etc, are also undertaken at post office counters.

As a minimum there is a need to

- separate postal services* from financial and other non-postal services,
- identify the direct costs*,
- allocate indirect costs* by cost drivers* where possible,
- apportion unallocated (non-attributable common) costs* by a general allocator,

by taking into account for example the following possible activities:

- philately,
- packaging,
- moneys orders,
- banking and insurance,
- envelopes, printed, phone cards, etc.,
- work on behalf of local or regional authorities.

In some instances (for example, where non-postal services are in the majority), it may be preferable to treat counter services as a separate (non-postal) business.

The following table shows recommendations for cost accounting depending on the area concerned.

Subject	Area concerned	Critical aspect	Recommendation for cost accounting rule
Counter	Access – Full postal Services*	Postal services* offered at counter often are not separated between reserved area (RA) – universal outside RA – non-universal	Distribution ratios/product: a) Personal = Labour costs (increased salary because of special skills needed by employees – e.g. cross-border parcels – should be allocated to those services only, where the special skills are needed) b) Equipment (special equipment for special services – e.g. parcels – should be allocated to those services only, where equipment is needed for) c) Space (increased space for special services – e.g. parcels – should be allocated to those services only, where the space is needed) d) Sub-contracted services e) Miscellaneous operating costs (maintenance of infrastructure in case of externalisation, outsourcing etc.).
Counter	Access – Financial and other Non-Postal Services	Financial and other non-postal services offered at counter often are not separated from postal services*	Distribution ratios/product: a) Personal = Labour costs (increased salary because of special skills needed by employees – e.g. insurance services – should be allocated to those services only, where the special skills are needed) b) Equipment (special equipment for special services – e.g. giro services – should be allocated to those services only, where the equipment is needed) c) Space (increased space for special services – e.g. packages – should be allocated to those services only, where the space is needed) d) Sub-contracted services e) Miscellaneous operating costs (maintenance of infrastructure in case of externalisation, outsourcing etc.).

Subject	Area concerned	Critical aspect	Recommendation for cost accounting rule
Counter	Delivery – Full Postal Services*	Postal items delivered at counter are not separated between RA – universal outside RA – non-universal	Distribution ratios/product: a) Personal = Labour costs (increased salary because of special skills needed by employees – e.g. delivery of insured items – should be allocated to those services only, where special skills are needed) b) Equipment (special equipment for special services – e.g. parcels – should be allocated to those services only, where equipment is needed) c) Space (increased space for special services – e.g. parcels – should be allocated to those services only, where the space is needed) d) Sub-contracted services e) Miscellaneous operating costs (maintenance of infrastructure in case of externalisation, outsourcing etc.).
Counter	Delivery – Financial and other Non-Postal Services	Payments and other non postal services “delivered” at counter often are not separated from postal services*	Distribution ratios/product: a) Personal = Labour costs (increased salary because of special skills needed by employees – e.g. payment of social welfares – should be allocated to those services only, where the special skills are needed) b) Equipment (special equipment for special services – e.g. giro services – should be allocated to those services only, where equipment is needed) c) Space (increased space for special services – e.g. telephone books – should be allocated to those services only, where the space is needed) d) Sub-contracted services e) Miscellaneous operating costs (maintenance of infrastructure in case of externalisation, outsourcing etc.).

6.3.2 Collection

The following table shows recommendations for cost accounting depending on the area concerned:

Subject	**Area concerned**	**Critical aspect**	**Recommendation for cost accounting rule**
Collection	Post boxes	a) Items collected at post boxes are not separated between RA – universal outside RA – non-universal b) Cost savings by third party production	Distribution ratios/product: a) Personal = Labour costs b) Equipment (special equipment for special services - e.g. voluminous items – should be allocated to those services only, where equipment is needed) c) Space (increased space for special services – e.g. voluminous items – should be allocated to those services only, where the space is needed) d) Sub-contracted services e) Miscellaneous operating costs (maintenance of infrastructure in case of externalization, outsourcing etc.).
Collection	Rural postman*	Items collected by rural postman* are not separated between RA – universal outside RA – non-universal. Furthermore rural postman* may offer financial services	Distribution ratios/product: a) Personal = Labour costs (increased salary because of special skills needed by employees – e.g. insured items – should be allocated to those services only, where the special skills are needed) b) Equipment (special equipment for special services – e.g. voluminous items – should be allocated to those services only, where the equipment is needed) c) Space (increased space for special services – e.g. voluminous items – should be allocated to those services only, where the space is needed) d) Sub-contracted services e) Miscellaneous operating costs (maintenance of infrastructure in case of externalization, outsourcing etc.).

Subject	Area concerned	Critical aspect	Recommendation for cost accounting rule
Collection	From Customer	a) Items collected from customer are not separated between RA – universal outside RA – non-universal b) Cost savings by third party production	Distribution ratios/product: a) Personal = Labour costs b) Equipment (special equipment for special services – e.g. voluminous items – should be allocated to those services only, where equipment is needed) c) Space(increased space for special services – e.g. voluminous items – should be allocated to those services only, where the space is needed) d) Sub-contracted services e) Miscellaneous operating costs (maintenance of infrastructure in case of externalization, outsourcing etc.).

6.3.3 Transport

The following table shows recommendations for cost accounting depending on the area concerned:

Subject	Area concerned	Critical aspect	Recommendation for cost accounting rule
Transport	After Access (to sorting centre, responsible for the region of origin)	Transport may combine items of RA – universal outside RA – non-universal	Distribution ratios/product: a) Personal = Labour costs (increased salary because of special skills needed by employees – e.g. special driving license for trucks – should be allocated to those services only, where the special skills are needed) b) Equipment (special equipment for special services – e.g. voluminous or heavy weight items – should be allocated to those services only, where the equipment is needed) c) Space (increased space for special services – e.g. voluminous or heavy weight items – should be allocated to those services only, where the space is needed) d) Sub-contracted services e) Miscellaneous operating costs (maintenance of infrastructure in case of externalization, outsourcing etc.).

Subject	**Area concerned**	**Critical aspect**	**Recommendation for cost accounting rule**
Transport	After Sorting (between sorting centres)	Transport may combine items of RA – universal outside RA – non-universal	Distribution ratios/product: a) Personal = Labour costs (increased salary because of special skills needed by employees – e.g. special driving license for trucks – should be allocated to those services only, where the special skills are needed) b) Equipment (special equipment for special services – e.g. voluminous or heavy weight items – should be allocated to those services only, where the equipment is needed) c) Space (increased space for special services – e.g. voluminous or heavy weight items – should be allocated to those services only, where the space is needed) d) Sub-contracted services e) Miscellaneous operating costs (maintenance of infrastructure in case of externalization, outsourcing etc.).
Transport	Prior Delivery (from the sorting centre responsible for the region of destination)	Transport may combine items of RA – universal outside RA – non-universal	Distribution ratios/product: a) Personal = Labour costs (increased salary because of special skills needed by employees – e.g. special driving license for trucks – should be allocated to those services only, where the special skills are needed) b) Equipment (special equipment for special services – e.g. voluminous or heavy weight items – should be allocated to those services only, where the equipment is needed) c) Space (increased space for special services – e.g. voluminous or heavy weight items – should be allocated to those services only, where the space is needed) d) Sub-contracted services e) Miscellaneous operating costs (maintenance of infrastructure in case of externalization, outsourcing etc.).

6.3.4 Sorting

The following table shows recommendations for cost accounting depending on the area concerned:

Subject	**Area concerned**	**Critical aspect**	**Recommendation for cost accounting rule**
Sorting	In the Sorting Centre responsible for the Region of Origin	a) The sorting of postal items for delivery often is not separated RA – universal outside RA – non-universal b) Cost savings by third party production	Distribution ratios/product: a) Personal = Labour costs (increased salary because of special skills needed by employees – e.g. hand sorting of flats – should be allocated to those services only, where the special skills are needed) b) Equipment (special equipment for special services – e.g. voluminous items – should be allocated to those services only, where the equipment is needed) c) Space (increased space for special services – e.g. voluminous items – should be allocated to those services only, where the space is needed) d) Sub-contracted services e) Miscellaneous operating costs (maintenance of infrastructure in case of externalization, outsourcing etc.).
Sorting	In the Sorting Centre responsible for the Region of Destination	a) The sorting of postal items for delivery often is not separated RA – universal outside RA – non-universal b) Cost savings by third party production	Distribution ratios/product: a) Personal = Labour costs (increased salary because of special skills needed by employees – e.g. hand sorting of flats – should be allocated to those services only, where the special skills are needed) b) Equipment (special equipment for special services – e.g. voluminous items – should be allocated to those services only, where the equipment is needed) c) Space (increased space for special services – e.g. voluminous items – should be allocated to those services only, where the space is needed) d) Sub-contracted services e) Miscellaneous operating costs (maintenance of infrastructure in case of externalisation, outsourcing etc.).

6.3.5 Delivery

Preliminary remark: according to the country, the process “delivery” may include a sub-process final sorting and preparation / sequencing. These should be treated in the same manner as in section 6.3.4.

Routing time and travelling time between the delivery office and the start of the route is dealt with separately at the end of this section.

The following table shows recommendations for cost accounting depending on the area concerned:

Subject	Area concerned	Critical aspect	Recommendation for cost accounting rule
Delivery	To the Addressee – Normal Procedure (by postman)	Postal items delivered to the addressee are not separated between RA – universal outside RA – non-universal	Distribution ratios/product: a) Personal = Labour costs (increased salary because of special skills needed by employees – e.g. delivery of insured items – should be allocated to those services only, where the special skills are needed) b) Equipment (special equipment for special services – e.g. parcels – should be allocated to those services only, where the equipment is needed) c) Space (increased space for special services – e.g. parcels – should be allocated to those services only, where the space is needed) d) Sub-contracted services e) Miscellaneous operating costs (maintenance of infrastructure in case of externalisation, outsourcing etc.).

Subject	Area concerned	Critical aspect	Recommendation for cost accounting rule
Delivery	To the addressee – Special Procedure (by vehicle - large volumes of mail)	Postal items delivered to the addressee are not separated between RA – universal outside RA – non-universal	Distribution ratios/product: a) Personal = Labour costs (increased salary because of special skills needed by employees – e.g. delivery of insured items – should be allocated to those services only, where the special skills are needed) b) Equipment (special equipment for special services – e.g. parcels – should be allocated to those services only, where the equipment is needed) c) Space (increased space for special services – e.g. parcels – should be allocated to those services only, where the space is needed) d) Sub-contracted services e) Miscellaneous operating costs (maintenance of infrastructure in case of externalisation, outsourcing etc.).
Delivery	To Letter Boxes – Normal Procedure (through Letter boxes)	a) Postal items delivered to the addressee are not separated between RA – universal outside RA – non-universal b) Access prices for third party induction	Distribution ratios/product: a) Personal = Labour costs (increased salary because of special skills needed by employees – e.g. delivery of insured items – should be allocated to those services only, where the special skills are needed) b) Equipment (special equipment for special services – e.g. voluminous items – should be allocated to those services only, where the equipment is needed) c) Space (increased space for special services – e.g. voluminous items – should be allocated to those services only, where the space is needed) d) Sub-contracted services e) Miscellaneous operating costs (maintenance of infrastructure in case of externalisation, outsourcing etc.).

Subject	Area concerned	Critical aspect	Recommendation for cost accounting rule
Delivery	To Letter Boxes – Special Procedure (at counter -large volumes of mail)	a) Postal items delivered to the addressee are not separated between RA – universal outside RA – non-universal b) Access prices for third party induction	Distribution ratios/product: a) Personal = Labour costs (increased salary because of special skills needed by employees – e.g. delivery of insured items – should be allocated to those services only, where the special skills are needed) b) Equipment (special equipment for special services – e.g. voluminous items – should be allocated to those services only, where the equipment is needed) c) Space (increased space for special services – e.g. voluminous items – should be allocated to those services only, where the space is needed) d) Sub-contracted services e) Miscellaneous operating costs (maintenance of infrastructure in case of externalisation, outsourcing etc.).
Delivery	Special Delivery Arrange-ments	Postal items delivered to the addressee are not separated between RA – universal outside RA – non-universal	Distribution ratios/product: a) Personal = Labour costs (increased salary because of special skills needed by employees – e.g. delivery of insured items – should be allocated to those services only, where the special skills are needed) b) Equipment (special equipment for special services – e.g. voluminous items – should be allocated to those services only, where the equipment is needed) c) Space (increased space for special services – e.g. voluminous items – should be allocated to those services only, where the space is needed) d) Sub-contracted services e) Miscellaneous operating costs (maintenance of infrastructure in case of externalisation, outsourcing etc.).

Subject	**Area concerned**	**Critical aspect**	**Recommendation for cost accounting rule**
Routing time and travelling time between the delivery office and the start of the route	To the addressee	When it is suggested that routing costs should be combined with other delivery processes or treated as indirect costs~~,~~ it is important that the NRAs must be fully satisfied that all such costs are driven by the volumes or the number and/or characteristics of services/products carried by the delivery person.	Depending on the answer to this question, countries may decide to use a “general allocator” or to use appropriate cost drivers reflecting the causality principle.

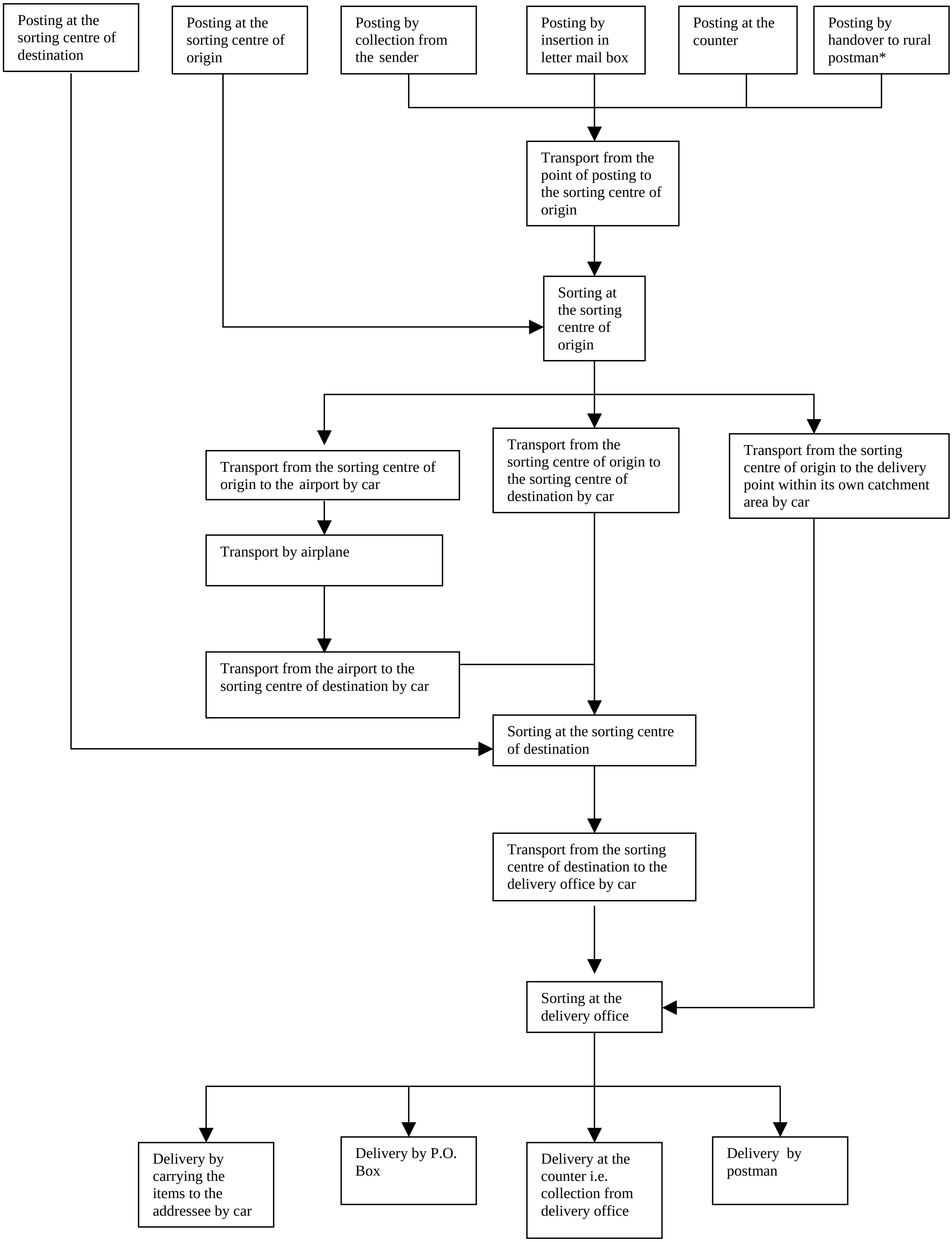
6.3.6 Additional allocation issues

The following table shows other areas that need to be considered:

Subject	Area concerned	Critical aspect	Recommendation for cost accounting rule
Costs exceeding the cost of efficient service provision * (if required by national legis-lation)	Based on or caused by legislation	Distribution and handling of costs exceeding the costs of efficient service provision*, (e.g.: whether and to which extent they are to be accepted; whether infrastructure costs, that have already been considered in past financial statements can be postponed into future years)	Where costs exceeding the costs of efficient service provision* caused by legislation are identified (this identification may be a crucial issue), these should be separately allocated (and be identifiable) according to the principle of causation, where reasonable.
Costs exceeding the cost of efficient service provision * (if required by national legis-lation)	Based on or caused by history	Inefficiency inherited from the past (e.g.: purchase of expensive vehicles, although there are on easy terms)	Where costs exceeding the costs of efficient service provision* caused by history are identified, these may only be accepted for an interim period, to be defined by national regulator, and should be abolished in the long run.
Surplus capacity	Seasonal	Capacity kept available for peak loads	Correctly assign the operating costs to products (e.g. allocate to services for which they are used).

Subject	**Area concerned**	**Critical aspect**	**Recommendation for cost accounting rule**
Surplus capacity	Long run	Stranded assets* (excluding universal service standards)	Surplus capacity may only be accepted for an interim period, to be defined by national regulator, and should be abolished in the long run.

6.4 Example for processes "Conveyance of letter post item"



6.5 Most appropriate cost drivers

Cost drivers	**Collection**	**Transport**	**Sorting**	**Distribution**
Weight				
Degree of pre-sortation				
Postage mode (stamped, post paid impression, franking machine)				
Stops (Place of posting)				
Numbers of items per batch				
Quantity				
Format				
Service standard (speed)				
Distance				
Type of mail (single piece/bulk)				
Work plan				
Opening hours				
Level of preparation (e.g. barcoding)				
Transport mode				
Address quality				
Readability of address				
Wrapping quality				
Number of sorting processes				
Frequency				
Share of redirected items				
Share of P.O. Boxes				
Number of items per delivery				
Type of sorting				
Level of registration on tracking				
Mode of delivery				
Time per item				
Number of delivery points				
Probability of successful delivery (in %)				

= Most appropriate cost drivers

7 Presentation and disclosure

7.1 Level of detail in cost accounts

In order to aid understanding of the regulatory accounts*, it is recommended that there should be full disclosure in the cost accounts and in the supporting documentation of:

- the basis of preparation (including accounting principles and principles of revenue and cost identification and volume measurement);
- the determination of the value of the regulatory asset base;
- the system used for allocation of assets*, liabilities*, cost and revenue;
- the return;
- where appropriate the return on a price control basis and other performance indicators;
- the internal transfer prices* and key of repartitions to the cost accounts;
- commentary on USP*'s performance (including trends, year on year movements, adjustments etc.).

The information in the cost accounts should be useful for the regulator and other stakeholders.

The accounting principles should disclose the cost base used. If the current costs are significantly different from the historical cost this information should also be disclosed.

The value of the regulatory asset base is required. If the assets* are used by regulated and non-regulated activities, disclosure is required on the method used to allocate the cost of such to each activity.

If activity based costing is used, the cost accounts should give a full disclosure of the cost drivers* which are used. Information is also required on the method used to determine the value of the cost drivers*.

If a price control system is used (based on indexes) information regarding the way the price control system is used is required. The methodology of the system should also be disclosed. A comparison of the actual results with the assumptions made in setting price controls is required.

In general an explanation of the variances between actual results and the results of the previous year and plans is required.

Reconciliation between the regulatory accounts* and the statutory accounts should be made. Preferably both the statutory accounts and the regulatory accounts* should be published at the same time.

7.2 Audit

An independent auditor should audit the regulatory accounts*. The purpose of the audit is to enhance the quality, objectivity and credibility of the accounts. The following should therefore be considered; the scope of the audit, the skills required from the auditor, duty of care, letter of engagement, conformity and publication of the audit opinion.

The engagement letter should clearly identify the duty of care expected from the auditor.

The auditor should state whether the work has been performed in accordance with Generally Accepted Auditing Standards (GAAS)*, the applicable legislation and NRA* determinations and recommendations.

If the audit work has not been performed in accordance with GAAS*, the deviations should be disclosed. The reasons for not using GAAS* should also be disclosed.

Availability of the audit opinion on the compliance with the cost accounting requirements (as set by the NRA* or by the legislator) should be properly published.

7.2.1 Selection of the auditor

The auditor should have both audit and legal skills to perform the audit at a high level. 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.

Regarding the specific skills: the auditor should have a good knowledge of the following:

- analytical accounting;
- experience in similar industries;
- knowledge of regulated industries.

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.

The auditing may be performed by

- a certified auditor;
- an auditor from the state audit office;
- an external chartered accountant;
- the NRA* itself;
- an external consultant.

Best practice should be to select an expert with an appropriate professional qualification, or a certified auditor or an external accountant belonging to a regulated profession. Another option may be an auditor from the state audit office (where this office exists). The auditor may be selected by the NRA* or the USP*; in the latter case, the choice must be approved by the NRA*. In any case, the auditor has to accept a duty of care to the NRA*.

7.2.2 Type of audit

Different types of audit are performed, as there are

- Financial audit;
- Methodology audit;
- Compliance audit;
- Special audit.

Best practice for regulatory purposes should be a financial audit combined with a compliance audit, because the task consists of the following elements:

- Check the analytical accounts, namely the allocation of costs, revenues and volumes to the different business units, products and services, and verify if this allocation is correct;
- Check in detail the logic and consistency* of the allocation;
- Check that the regulatory accounts* are consistent with the specific postal regulation requirements;
- Check the reconciliation of the regulatory accounts* with the financial accounts.

In reality it is a combination of the financial audit and the compliance audit, namely check the analytical accounts, verify the allocation, reconcile with the financial accounts and examine compliance with the specific postal accounting regulation rules.

The auditor should examine compliance with the following basic principles regarding cost accounting, namely,

- the principle of causality*;
- the principle of objectivity;
- the principle of consistency*;
- the principle of transparency.

In addition, the information used in the accounting system should meet the following criteria:

- pertinent;
- accurate
- reliable;
- comparable;
- material;

- verifiable.

7.2.3 Costs of audit

The ideal situation is for the NRA* to pay for the audit as this guarantees the auditor's full independency.

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*

7.3 Allocation of services to market segments

The postal operator is providing:

- reserved services,
- non reserved postal services* which are part of the universal service:
  - without actual competition,
  - with working competition,
- services outside the universal service:
  - without actual competition,
  - with working competition.

It is important to have a full list of business segments* to which products/services will have to be allocated (and agreed by the regulator) and to have costs, revenues and volumes for each product on the list. Finally, the knowledge of internal transfer prices* and key of repartitions are necessary too.

7.3.1 Reserved, universal non-reserved and non-universal services

Detailed information as to the reserved services of the USP* should be made available in addition to details of its universal service obligation.

Other operators are not allowed to provide these reserved services; therefore it is important to have detailed information of these services.

The other services which are not reserved, but still part of the universal service obligation, should also be listed. Information regarding the profitability of both areas is required.

In order to be able to detect or avoid cross subsidisation the regulator must also obtain information from the USP* regarding sales, cost and profit or loss of the non-universal services of the postal operator.

7.3.2 Business (bulk) vs. private (single piece)

The issue regarding business and private items relates to the different regulatory regimes in the various countries. These items may therefore be classified as reserved or non-reserved or as part of, or outside, the universal service.

The classification may have consequences for pricing. Bulk mail may be cheaper to process, so that the prices should be based on costs and the discounts given should be based on the avoided cost.

7.3.3 Identification of reserved items

Only items of correspondence within certain limits may be reserved. A system should be in place to determine which postal items are parts of the reserved area and which are not.

7.4 Performance indicators

The performance of the postal operator should be measured. Since tariffs should be cost orientated, the return should be reasonable. Profits should not be excessive. The performance indicator should be in line with the structure of the company. Possible indicators are return on assets* (based on the weighted average cost of capital*). The return on assets* is a common indicator for companies which are listed on the Stock exchange. Return on sales is commonly used for companies, which are labour intensive.

The postal operator should earn a reasonable return in order to attract investors. The postal operator may choose to report return on assets* as a performance indicator.

Return on Sales, as an indicator is particularly useful if the outcome can be compared with other companies.

8 Further subjects to be considered

8.1 Goodwill

The goodwill* is the difference between the (acquisition-date) fair value of a business and the net of the (acquisition-date) amounts value of its identifiable assets* and liabilities*. It can be positive or negative. Positive purchased goodwill* is capitalised and classified as an (intangible) asset on the balance sheet. Widely accepted position (e.g. IFRS 3) is that non-purchased goodwill* (i.e. internally generated) is never recognised.

Since internally generated goodwill* is never recognised, it can not be considered an issue when the reserved area or the universal service is affected by a change of legislation, e.g. when activities are transferred from the reserved area to the non-reserved area.

8.2 Unit costs

Postal services* benefit from considerable economies of scale and economies of scope. A consequence of this is that unit costs fall as volume increases and rise as volumes fall. The production of unit cost data is therefore of considerable importance to the evaluation of cost accounts. Detailed rules need to be followed in calculating unit costs.

A unit cost is a “cost per item” – this may be divided into a marginal cost (direct costs* only) or a fully distributed* cost (direct and indirect costs* and a share of non-attributable common costs*). Due to economies of scale in the short run the cost per unit will fall as volume increases and rise as volume decreases.

Calculating and knowing the actual unit cost per output is an essential element of managing the business.

Unit costs also provide a base for the comparison of the efficiency for companies or the development of efficiency of one company over a period of time.

An analysis of unit costs is very important for the proper control of any business. For example an apparent small increase in total costs for a particular activity where volume has decreased can in fact conceal quite a large (and possibly unjustified) increase in unit costs.

Unit costs also provide a means of ensuring that costs have been attributed to the different products using a specific part of the postal network* on a fair and equitable basis. Therefore unit cost information is important for regulators’ to assist in controlling abusive practices. Transparency in unit costs helps to audit single products prices and identify areas of possible cross subsidization.

Clear guidelines are needed as to the basis of calculation of the unit cost. Above all exact rules of the non-attributable common costs*’ apportionment are needed. Allocation of indirect costs* in accordance with the principle of causation requires detailed information on cost drivers*. Therefore the issue of “cost drivers*” needs to be considered.

It is important that the correct basis of cost allocation between business segments* or product/service streams is used otherwise the costs/tariffs will not be truly representative.

Annex: Glossary

Glossary of Terms

Term	Definition	Source
Access Points	Physical facilities, including letter boxes provided for the public either on the public highway or at the premises of the postal service provider(s), where postal items may be deposited with the postal network by senders.	Postal Directive
Accounting standards	Definitive rules prescribed by competent authorities (national or international) for reporting of accounting data in financial statements. These rules must be applied to all financial statements in order to provide a true and fair view of the firm's financial position, and a standardized method of comparison with financial statements of the other firms.	CERP Project Team Cost/Price
Accrual basis accounting	System of accounting based on "accrual principle" under which revenue is recognized (recorded) when earned, and expenses are recognized (recorded) when incurred. Totals of revenues and expenses are shown in the financial statements (prepared at the end of an accounting period), whether or not cash was received or paid out in that period. Accruals basis accounting conforms to the provisions of Generally Accepted Accounting Principles (GAAP)* in preparing financial statements for external users, and is employed by all firms except the ones which use cash basis accounting.	CERP Project Team Cost/Price
Activity Based Costing (ABC)	Cost accounting approach concerned with matching costs with activities that cause those costs. ABC states that (1) products consume activities, (2) activities (and not products) consume resources, and (3) activities are not necessarily based on the volume of production. Instead of allocating costs to cost centres (such as manufacturing, marketing, finance), ABC allocates direct and indirect costs to activities. ABC enables management to better understand (a) how and where the firm makes a profit, (b) where money is being spent and (c) which areas have the greatest potential for cost reduction.	CERP Project Team Cost/Price

Glossary of Terms

Term	Definition	Source
Assets	Value that an entity has acquired or purchased, and has use of, in generating income. An asset can be (1) something physical, such as machinery, inventory, land, building…, (2) an enforceable claim against others, such as accounts receivable, (3) a right, such as copyright, trademark…, or (4) an assumption, such as goodwill*.	CERP Project Team Cost/Price
Attributable common costs	See Indirect costs.	
Avoided costs	Costs that a producer escapes by not producing a product or service instead of producing it. Costs that do not emerge, as the service has been provided different then before or in parts only, because, for example, (1) of changes to the service itself (change of quality specifications, change in logistics), (2) parts of the service have been provided by third parties (downstream access, multiple operator case), special contractual agreements with the customer that allows variable conditions.	CERP Project Team Cost/Price
Business segment	Identifiable component of a business. The segment may be identified by product line, geographic region, division, or other divisible part of the firm. See Operating segment, Reportable segment.	CERP Project Team Cost/Price
Causality principle	Principle of cost accounting that implies cost allocation, directly or indirectly, to the products or services where the costs originally occur, through the identification of cause-effect relations between the costs and the activities necessary to their provision.	CERP Project Team Cost/Price
Clearance	The operation of collecting postal items by a postal service provider.	Postal Directive
Collection	See Clearance.	
Common costs	Costs that are common to a number of products or services but cannot be assigned to them directly and individually. In the Postal Directive*, common costs include what accountants normally call indirect costs* and non-attributable common costs*.	CERP Project Team Cost/Price
Consistency principle	Basic accounting concept that establishes that once an accounting method is adopted, it should be followed consistently from one accounting period to the next. If, for any reason, the accounting method is changed, a full disclosure of the change and an explanation of its effects on the items of the financial statements in prior years must be given in the accompanying notes.	CERP Project Team Cost/Price

Glossary of Terms

Term	Definition	Source
Cost driver	A factor that has a systematic relation to a particular type of cost and which causes that cost to be incurred.	CERP Project Team Cost/Price
Cost of capital	The cost of capital is usually measured as the Weighted Average Cost of Capital (WACC) considering the cost of equity and the cost of debt, and their relative weights. The cost of equity is usually the rate of return required by the investors/shareholders, and is measured by taking into account the risk-free rate of return, the risk of investing in the stock market as a whole (because of the volatility of returns), and the extra (or lower) risk of investing in stocks of the specific company. This so-called systematic risk is measured by the level of correlation between the returns of the company and the stock market as a whole. The cost of debt is calculated taking into account the risk-free rate of return and the specific company debt risk premium.	CERP Project Team Cost/Price
Costs of efficient service provision	Cost of service provision without any surcharges prevailing solely as a result of the provider's position (inefficiency inherited from the past, surplus capacity…) and without any discounts prejudicing the competitive opportunities of other firms (predatory pricing, dumping or price-cost squeeze).	CERP Project Team Cost/Price
Delivery	See Distribution.	
Depreciation	Conversion of the cost of a fixed asset* into an operational expense. The objectives of computing depreciation are to (1) reflect reduction in the value of the asset* due to obsolescence (functional depreciation) and wear (physical depreciation) over the asset's estimated useful life, (2) spread a large expenditure (purchase price of the asset) proportionately over a fixed period to match revenue received from it, and (3) reduce the taxable income by charging the amount of depreciation against the firm's total income. Depreciation is computed at the end of an accounting period and the method best-fitting the usage profile of the asset is chosen. Some other method dictated by the tax laws may also be appropriate. When applied to intangible assets, the preferred term is amortization.	CERP Project Team Cost/Price
Distribution	The process from sorting at the distribution centre to delivery of postal items to their addressees.	Postal Directive

Glossary of Terms

Term	Definition	Source
Direct costs	Costs that can be traced directly to a specific cost object such as a particular service or a product.	CERP Project Team Cost/Price
Equity	Ownership interest or claim of a holder of shares of a firm. On a balance sheet, equity represents funds contributed by the owners (shareholders) plus retained earnings and minus the accumulated losses. In case of state-owned enterprises, equity represents the state's investment plus retained earnings and minus losses.	CERP Project Team Cost/Price
Fixed assets	Assets* that are not consumed or sold during the normal course of a business but used to carry on the productive operations. On a balance sheet, these assets are shown at their book value (taking into account depreciation and possibly revaluation).	CERP Project Team Cost/Price
Fixed costs	Costs that remain unchanged irrespective of the output level or sales revenue of a firm. In practice, no cost is purely fixed but the concept of fixed costs is used in short-term cost accounting.	CERP Project Team Cost/Price
Fully Distributed Costing	Method in which the cost of a product is determined by allocating to it direct costs*, indirect costs* and non-attributable common costs*, so that no costs are left unallocated.	CERP Project Team Cost/Price
General allocator	The ratio used to allocate non-attributable common costs when EPMU (equi-proprtional mark up) is used / mandated.; costs are allocated using a general measure such as the ratio of direct and indirect cost already allocated.	CERP Project Team Cost/Price
Generally Accepted Accounting Principles (GAAP)	Authoritative rules, practices, and conventions meant to provide both broad guidelines and detailed procedures for preparing financial statements and handling specific accounting situations. They provide objective standards for presenting and comparing financial data. Most large countries have their own GAAP which may differ from those of others in minor or major details.	CERP Project Team Cost/Price
Generally Accepted Auditing Standards (GAAS)	Rules that govern auditing measurements and standards of presentation of audited accounts and audit reports. Most large countries have their own GAAS which may differ from those of others in minor or major details.	CERP Project Team Cost/Price

Glossary of Terms

Term	Definition	Source
Goodwill	Difference between: (1) the aggregate of (a) the acquisition-date fair value of the consideration transferred, (b) the amount of any non-controlling interests, and (c) in a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously-held equity* interest in the acquiree; and (2) the net of the acquisition-date amounts of the identifiable assets* acquired and the liabilities* assumed. If the difference above is negative, the resulting gain is recognised as a bargain purchase in profit or loss.	IFRS 3
Historical cost	Actual amount that was (or is assumed to have been) spent, on a purchase or an operation of a firm. Historical cost does not take the effects of inflation into account, and ignores the replacement cost of the resources consumed. Although (in inflationary times) historical costing can lead to inadequate allocation for replacement of assets*, it is a very useful concept by virtue of being based on fact.	CERP Project Team Cost/Price
Indirect costs	Costs incurred in joint usage and, therefore, difficult to assign to or identify with a specific cost object or cost centre.	CERP Project Team Cost/Price
International Accounting Standards (IAS)	Standards for the preparation and presentation of financial statements created by the International Accounting Standards Committee (IASC). They were first written in 1973, and stopped when the International Accounting Standards Board (IASB) took over their creation in 2001.	CERP Project Team Cost/Price
International Financial Reporting Standards (IFRS)	Guidelines and rules set by the International Accounting Standards Board (IASB) that companies and organizations can follow when compiling financial statements. The creation of international standards allows investors, organizations and governments to compare more easily the financial statements with greater ease. Many countries currently require or permit companies to comply with IFRS standards. The International Financial Reporting Standards were previously called the International Accounting Standards (IAS)* – See International Accounting Standards (IAS).	CERP Project Team Cost/Price

Glossary of Terms

Term	Definition	Source
Liability	Claim against the assets, or legal obligations of a firm, arising out of past or current transactions or actions (such as accounts and wages payable, accrued rent and taxes, trade debt, and short and long-term loans). Owners' equity* also is termed a liability because it is an obligation of the firm to its owners.	CERP Project Team Cost/Price
National Regulatory Authority (NRA)	Body legally separate from and operationally independent of the postal operators with the particular task of ensuring compliance with legal obligations arising from national legislation. It may also be charged with ensuring compliance with competition rules in the postal sector.	CERP Project Team Cost/Price
Non-attributable common costs	Costs a firm incurs as a whole, and which cannot be assigned directly or indirectly to any specific cost object (product or service) or cost centre. Non-attributable common costs are generally allocated on the basis of a general allocator.	CERP Project Team Cost/Price
Operating segment	Component of an entity: (1) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity), (2) whose operating results are reviewed regularly by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and (3) for which discrete financial information is available.	IFRS 8
Overheads	Costs that (1) relate to a firm as a whole, (2) do not become an integral part of a product or service, and (3) cannot be applied or traced to any specific unit of output.	CERP Project Team Cost/Price
Postal Directive	Directive 97/67/EC of the European Parliament and of the Council of 15 December 1997 on common rules for the development of the internal market of Community postal services and the improvement of quality of service, as amended by the Directive 2002/39/EC of 10 July 2002 and by the Directive 2008/6/EC of 20 February 2008.	CERP Project Team Cost/Price
Postal services	Services involving the clearance, sorting, transport and distribution of items.	Postal Directive

Glossary of Terms

Term	Definition	Source
Postal network	System of organization and resources of all kinds used by the universal service provider(s)* for the purposes in particular of: (1) the clearance of postal items covered by a universal service obligation from access points throughout the territory, (2) the routing and handling of those items from the access point to the distribution centre, (3) the distribution to the addresses shown on items.	Postal Directive
Regulatory accounts	Accounts prepared specifically by companies operating in the postal sector to comply with the requirements of a National Regulatory Authority*.	CERP Project Team Cost/Price
Reportable segment	Operating segment* or aggregations of operating segments that meet specified criteria: (1) its reported revenue, from both external customers and inter-segment sales or transfers, is 10 % or more of the combined revenue, internal and external, of all operating segments; or (2) the absolute measure of its reported profit or loss is 10 % or more of the greater, in absolute amount, of (a) the combined reported profit of all operating segments that did not report a loss and (b) the combined reported loss of all operating segments that reported a loss; or (3) its assets are 10 % or more of the combined assets of all operating segments. If the total external revenue reported by operating segments constitutes less than 75 % of the entity's revenue, additional operating segments must be identified as reportable segments (even if they do not meet the quantitative thresholds set out above) until at least 75 % of the entity's revenue is included in reportable segments.	IFRS 8
Retained earnings	Profits generated by a firm that are not distributed as dividends but are either reinvested in the business or kept as a reserve for specific objectives. Retained earnings are reduced by losses.	CERP Project Team Cost/Price
Return on Capital Employed (ROCE)	Ratio measuring the operating profit of a firm or a business unit expressed as a percentage of funds acquired from investors and lenders (equity* plus long-term debt).	CERP Project Team Cost/Price
Rural postman	Postman not only delivering postal items but also offering services such as the acceptance of postal items, sale of stamps and other products, financial services. The question of whether or not such additional services are offered, and to what degree, differs from country to country.	CERP Project Team Cost/Price

Glossary of Terms

Term	Definition	Source
Terminal dues	Remuneration of universal service providers* for the distribution of incoming cross-border mail.	Postal Directive
Transfer prices	The price charged for the provision of services by one business segment to another.	CERP Project Team Cost/Price
Universal Service Provider (USP)	Public or private postal service provider providing a universal postal service* or parts thereof within a Member State.	Postal Directive
Variable costs	Costs that vary with changes in the output or the sales of a firm.	CERP Project Team Cost/Price