



An Post

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Belgium

18<sup>th</sup> January 2012

CC : Mr Goran Marby – Chairman ERGP

**Ref: Draft ERGP Report on Common Costs Allocation- For Public Consultation**

Dear Ms Kemileva

I attach a response from An Post to the above public consultation.

Please do not hesitate to contact me if you require any clarification on our response.

Yours sincerely,

A handwritten signature in black ink that reads "Brian Fay".

Brian Fay  
Head of Regulatory Affairs

## **Response to Consultation on Draft ERGP Report on Common Costs Allocation**

### **Overview of An Post**

An Post is the national postal operator for Ireland providing a wide range of services which encompass postal, communication, retail, money transmission services and mobile telephony services. It is one of Ireland's largest companies directly employing 9,500 people through its national network of retail, processing and delivery points. Annually, An Post staff delivers over circa 750 million items of mail to 2.1 million homes.

### **Executive Summary**

In relation to traffic measurement, An Post considers that revenue based traffic are a more accurate representation of underlying volumes. This view was also shared by OFCOM in a recent consultation<sup>1</sup> which required Royal Mail should use the revenue derived traffic basis as the sole basis for traffic measurement used in supporting regulatory financial reporting from 2012-13.

An Post considers that the "Top Down" methodology is the best method of cost allocation and in the production of regulatory accounts as it captures the total costs associated to the provision of the different services and can easily be reconciled with financial statements and verified and audited. In contrast, Bottom Up models reflect a hypothetical scenario and do not reflect the actual position. They are subjective and are unlikely to capture every detail of the operation. Absolute clarity of every process no matter how small needs to be considered and this is a substantial piece of work. Even if all this is undertaken, no definitive conclusions can be drawn. Therefore bottom up models cannot replace traditional top down models in regulatory reporting.

In terms of priorities of issues to be addressed in the future by ERGP, An Post considers that the assessment of traffic measures should be prioritised.

An Post welcomes any clarification provided by ERGP in this consultation paper on issues such as joint costs and common overheads. Given that these are complex and challenging topics, An Post considers that further consideration should be provided in the decision to this consultation and indeed possibly by a further consultation.

### **Response to Public Consultation Questions**

**Question 1: Please provide comment on the ERGP observation regarding the widespread use of HCA System and Top-Down ABC methodology in regulatory accounting systems in the postal sector.**

An Post agrees with the observations set out above and indeed An Post prepares annual Regulatory Accounts for submission to the NRA on a HCA Basis using a top down ABC Methodology.

**Question 2: Please provide comment on the ERGP observation about the need to ensure that the scope of regulatory accounts extends to all activities shared by both**

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<sup>1</sup> OFCOM Consultation – Securing the Universal Postal Service- Annex 6 Regulatory Financial Reporting to

**USO and non-USO products/services, as provided for by article 14 of the Postal Services Directive.**

An Post does not have any objection to extending the scope of the regulatory accounts to include activities shared by USO and non USO products/services but only insofar as it allows the NRA to ensure that consistent principles are applied between USO & Non USO services only. It should be noted that these non USO products are not subject to regulation.

An Post includes details of non USO products in its Regulatory Accounts.

**Question 3: Please provide comment on the ERGP analysis about the importance of ensuring that consistently applied and objectively justifiable cost accounting principles are enforced in regulatory accounting systems, when applied to USO and non-USO products/services, as requested by article 14 of the Postal Services Directive.**

An Post agrees that consistently applied principles should be applied to USO and Non USO product/services.

**Question 4: Please provide comment on the definitions set out in Part 3 above.**

An Post welcomes any effort by ERGP to provide clarity on the definitions of cost types. The classification of cost can be subjective and any further guidance provided by ERGP is welcome. However An Post considers that definitions provided in the consultation are not sufficiently clear and further clarification is required. Specific examples of each type of cost would be useful. The demarcation/overlap between each types of cost should be fully explained. The consultation raised a number of issues which need to be explored and examined further (i.e. nested overheads, distinction between joint and common costs).

**Question 5: Please provide comment on the definition of joint costs set out above and the distinction between the fixed and variable component (in a short run perspective) of costs.**

The treatment of joint costs and the distinction between the fixed and variable component is both complex and challenging. The examples provided in the consultation are both academic and theoretical and may not reflect reality. An Post considers that further discussion is required on this topic.

An Post does not agree that the top down model is not able to identify the fixed element of joint costs.

**Question 6: Please provide comment on the distinction made between general overheads and nested overheads, as two sub-categories of common costs, and the nested and non-nested approach.**

An Post considers that further discussion is required on this topic and in particular on the topic of nested overheads. Further guidance would be useful on the classification of costs into the nested and non nested categories and on the hierarchy for the application of the types of overheads.

**Question 7: Please provide comment on the description of cost allocation.**



As we have stated in Question 5 & 6 above, further discussion and clarification is required.

**Question 8: Please provide comment on the need for NRAs to have a detailed view of the postal activities and of the associated costs.**

An Post agrees with the need for a comprehensive and detailed view of postal activities and their associated costs. These should be provided by the postal operator who has intimate knowledge of the industry and the duty of the NRA is to review these activities.

**Question 9: Please provide comment on the generic description of postal activities as provided for in Appendix 2.**

An Post welcomes any effort by ERGP to provide clarity, however the descriptions provided in appendix 2 would need to be more comprehensive as they exclude activities relating to revenue collection, inward or outward sortation activities.

**Question 10: Please provide comment on the ERGP analysis that the identification of the fixed component (in a short run perspective) of joint costs is a key issue to address.**

An Post is amenable to researching and exploring this issue further. One option would be to analyse the relevant cost categories to isolate the fixed and variable component. In advance of this we would welcome further comprehensive discussion and guidance from ERGP on this issue.

**Question 11: Please provide comment on the ERGP analysis that the identification of “overheads” and “nested” common costs within the total cost is necessary for the assessment of common costs in regulatory accounting systems.**

As per our response to Question 6 above, An Post would welcome any further clarification on the treatment of “nested” overheads before it can provide a comprehensive response.

**Question 12: Please provide comment on the ERGP analysis that the identification of cost drivers for elementary activities is a primary objective for each NRA for cost allocation purposes.**

An Post considers that the identification of cost drivers should be prepared by the postal operator. The NRA could then review these.

**Question 13: Please provide comment on the possibility that a Bottom-Up model would be a relevant way to complement, verify, or replace traditional Top-Down analysis, especially when the data or the results from the USP accounting system are not sufficiently reliable, transparent or justifiable.**

An Post considers that Top Down models are preferable as they capture the total costs associated to the provision of the different services and a well designed model can aggregate production processes and activity to a high degree of granularity. Top Down models can easily be reconciled with financial statements and are verified and audited in An Posts case by a reputable auditing firm. Top down models reflect reality the business

realities of the post industry. They are not theoretical and do not rely or includes assumptions or benchmarks.

Bottom Up models reflect a hypothetical scenario and do not reflect the actual position. Absolute clarity of every activity is required for bottom up models to be accurate.

Activities and products ranges are aggregated to a level which can make the results meaningless. The data needed for the model may not exist and therefore reliance is placed on assumptions and benchmarks, which are subjective and open to contradiction. The design of bottom up models is a time-consuming and expensive process.

An Post considers that bottom up models should not replace traditional top-down analysis as a regulatory tools.

**Question 14: Please provide comment on the ERGP view that checking and validation of traffic measures are necessary to avoid costing distortions.**

An Post used revenue derived volumes in the production of its Regulatory Accounts. Statistical sampling is used to determine the level of stamped and metered mail and An Post employs an expert consultancy firm to ensure that the data used in statistical sampling is accurate and within acceptable confidence levels. These figures are then audited as part of the annual audit of the Regulatory Accounts.

An Post also undertakes operational counts of mail at it mail centres. These counts are undertaken for planning purposes at the mail centres and are not audited or validated to ensure that they are within accuracy levels. Operational volumes are not part of the Financial systems of the company, and were only ever intended to provide indicative numbers to operational staff to assist in production planning. Regulators should never have relied or sought to rely on these particularly where sampling systems are designed and implemented to provide very accurate volume details.

An Post considers that revenue based methods are the best method to measure traffic for the reasons set out above. An Post would welcome further discussion on this issue.

**Question 15: Between the use of bottom-up model and the assessment of traffic measure, which item should be analysed first by the ERGP?**

An Post considers that priority should be given to traffic measurement