
Review of regulatory financial reporting for Royal Mail

Cost allocation and transfer pricing consultation

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CONSULTATION:

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About this document

On 18 December 2017, we published a statement setting out our decisions following the Phase I of our review of the regulatory financial reporting requirements for Royal Mail. In that document, we set out our modifications to the Universal Service Provider Accounting Condition (USPAC) and the Regulatory Accounting Guidelines (RAG). These modifications related mainly to the contents, disclosure, frequency, deadlines and audit requirements of the required regulatory financial reports. We also said in that document that in Phase II we would review some of our costing rules in the RAG, and if necessary, we would propose updates to those rules to ensure they remain fit for purpose. This document sets out our proposed amendments to those costing rules for consultation.

The first three Sections of this consultation provide an overview of our duties, our regulatory objectives, our regulatory financial reporting requirements for Royal Mail and how we use the information they provide. We expect these Sections to be of interest to a wide range of stakeholders that have an interest in the postal sector. The more technical parts within the consultation are set out mainly in Sections 4 and 5, in which we explain some of the changes Royal Mail has made to its costing methodology and the work we have done to assess the impact of those changes including the proposals we have as a result. These parts are likely to be of interest primarily to Royal Mail and other stakeholders with an interest in the technical details of our regulatory financial reporting requirements.

This consultation will close on 27 February 2019.

Contents

Section

1. Executive summary	1
2. Introduction	4
3. Our requirements for costing data and Phase II review	11
4. Royal Mail's costing approach and its changes	19
5. Our proposed changes to our costing rules	24

Annex

A1. Responding to this consultation	49
A2. Ofcom's consultation principles	52
A3. Consultation coversheet	53
A4. Consultation questions	54
A5. Legal instruments	55

1. Executive summary

Background

- 1.1 In March 2012, we put in place a new regulatory framework for post which gave Royal Mail more commercial freedom and operational flexibility. We also put in place regulatory safeguards to protect consumers and, where appropriate, promote effective competition. One such safeguard was a comprehensive monitoring regime.
- 1.2 The monitoring regime enables us to assess how well the regulatory framework is working to meet our regulatory objectives of securing the provision of the universal service, incentivising efficiency improvements, maintaining quality of service standards and ensuring universal services remain affordable. The monitoring regime also helps us consider the impact of any changes on the regulatory framework and assess whether there is a need to intervene to protect the universal service, customers and competition.
- 1.3 The monitoring regime relies on our regulatory financial reporting requirements for Royal Mail to provide us with relevant financial information. These requirements are set out in the USP Accounting Condition ("**USPAC**"), as supplemented by the Regulatory Accounting Guidelines ("**RAG**").
- 1.4 The detailed requirements in the RAG include, among other things, costing rules that explain how Royal Mail must calculate and allocate national average Fully Allocated Costs ("**FAC**") data.
- 1.5 The national average FAC data provides a good first-order view of Royal Mail's product costs and how they change over time. These product costs are a key input in the broad indicators we use to monitor competition and consumer issues. FAC is also a key input in monitoring the financial sustainability and efficiency of the provision of the universal service where there is a need to have full view of all costs incurred. FAC is also currently used in our ex ante margin squeeze control.
- 1.6 In 2013/14 and 2016/17, Royal Mail made a series of changes to its cost allocation methods which affected the way the national average FAC was allocated to products (see Section 4). According to Royal Mail, the key reason for these changes was to ensure the costing reflected the new operational reality on the ground including the introduction of new delivery methods.
- 1.7 The effect of these changes was broadly to allocate more costs to letters by moving costs out of parcels; and more costs to USO parcel products by moving costs out of non-USO parcel products.

The purpose of this consultation

- 1.8 In 2016/17 we carried out a review of our regulatory framework for post. In our March 2017 Statement on the Regulation of Royal Mail¹, we concluded that our overall approach to regulating the postal market remained appropriate and reiterated that on-going monitoring of the postal market remains a key component of the regulatory framework but explained that we would review whether the reporting requirements remain fit-for-purpose.
- 1.9 In our March 2017 Consultation on the Review of Regulatory Reporting for Royal Mail², we explained that we were approaching the review in two stages: Phase I would focus on the form and content of the regulatory financial reporting we require from Royal Mail; Phase II would focus on some of the costing and accounting rules which are applied by Royal Mail in preparing its regulatory financial reports.
- 1.10 Our findings from Phase I of regulatory financial reporting for Royal Mail were set out in our December 2017 and November 2018 statements.³ This consultation is Phase II of our review. In this document, we set out the findings of our review of the changes to the cost allocation methods made by Royal Mail in 2013/14 and 2016/17. We then set out our proposals to amend some of our costing rules in light of those changes.

Our findings and proposals

- 1.11 We have reviewed Royal Mail's changes in detail and consider that they are consistent with the RAG and fit for our monitoring purposes. As explained in Section 5, we consider that the new allocation methods better reflect the operational reality of the new delivery methods than the previous allocation methods.
- 1.12 However, to ensure the FAC data provided remains robust and fit for our monitoring purposes in the future and in light of Royal Mail's changes, we have identified the need for some changes to our costing rules in the RAG. We also propose some minor changes to transfer pricing rules in the RAG. Our proposed changes are set out in Section 5.
- 1.13 We consider that Royal Mail's FAC data, prepared in accordance with the USPAC and the RAG, is a key input in the broad indicators we use in our monitoring regime, and that it will provide a useful starting point for future analysis for specific regulatory questions.

¹ Ofcom, Review of the Regulation of Royal Mail, statement, 1 March 2017, <https://www.ofcom.org.uk/consultations-and-statements/category-1/royal-mail-review2016>

² Ofcom, Review of Regulatory Financial Reporting for Royal Mail, consultation, 31 March 2017, https://www.ofcom.org.uk/_data/assets/pdf_file/0038/99785/Consultation-Review-of-Regulatory-Financial-Reporting.pdf

³ Ofcom, Regulatory financial reporting for Royal Mail, Statement, dated 18 December 2017, https://www.ofcom.org.uk/_data/assets/pdf_file/0032/108869/financial-reporting-Royal-Mail.pdf; and Ofcom, Amendments to the Universal Service Provider Access Condition in relation to the margin squeeze control, Statement dated 8 November 2018, https://www.ofcom.org.uk/_data/assets/pdf_file/0021/125922/Margin-squeeze-2018-statement.pdf

- 1.14 However, we recognise that the FAC data will not necessarily provide an appropriate measure of costs for all the regulatory questions we may need to answer in future.
- 1.15 Depending on the nature of any specific regulatory concerns, we may need to adjust Royal Mail's FAC and its cost allocations, or apply different cost allocation methods, or use cost standards other than national average FAC. For example: for a detailed and comprehensive view of the sustainability of the USO, we may need to calculate the net cost of the universal service, which could involve modelling a hypothetical network and applying different cost allocation methods; for questions relating to cross-subsidisation and associated predatory pricing issues, it may instead be more appropriate to use long-run incremental costs or average avoidable costs.
- 1.16 Therefore, our findings and proposals set out in this consultation should not be interpreted as an endorsement of Royal Mail's cost allocation methods as the basis for all future regulatory decisions.

Next steps

- 1.17 Royal Mail is currently in the process of conducting a review of its UK network "to develop the blueprint for a modern, optimised, efficient network to deliver letters, parcels and new products"⁴. Royal Mail's review could result in changes to its universal service network. These changes may in turn lead Royal Mail to make changes to its cost allocation methods. We will review those cost allocation changes, and if necessary, our costing rules to ensure the cost allocations in Royal Mail's FAC data remain fit for our monitoring purposes.
- 1.18 We are in the process of building our own costing model to help develop further our view of the costs of Royal Mail's delivery operations and other key areas of its network and how these might change over time under different scenarios. We expect this costing model to further inform and support our views on the issues we discuss above, including financial sustainability and efficiency of Royal Mail's provision of the universal service, as well as our consideration of competition issues.

Responding to this consultation

- 1.19 We welcome comments on the proposals set out in this document. The deadline for responses is 27 February 2019.

⁴ Royal Mail Plc, Results for the Half Year ended 23 September 2018, page 4.
<https://www.royalmailgroup.com/media/10493/royal-mail-plc-financial-report-for-the-half-year-ended-23-september-2018.pdf>

2. Introduction

Structure of this consultation document

- 2.1 This consultation sets out some specific and detailed proposals to amend our sectoral rules imposed on Royal Mail in relation to its regulatory financial reporting. Our proposals are discussed in Section 5 of this consultation document. They accompany our proposed modifications to the relevant sectoral rules, which are published in the statutory notification at Annex 5.
- 2.2 These proposals arise from Phase II of our review of regulatory financial reporting for Royal Mail, having concluded Phase I in the statements we published in December 2017 and November 2018⁵. Phase I updated mainly the contents, disclosure, frequency, deadlines and audit requirements of the required regulatory financial reports, as well as the margin squeeze control (which is an ex-ante control designed to allow efficient upstream competition between Royal Mail and access operators⁶). Phase II focuses on some of our costing rules. We explain in Sections 3 and 4 the background and the reasons for carrying out this Phase II review.
- 2.3 In this Section, we deal with the following matters to provide relevant legal context and policy background for our above-mentioned proposals:
- first, we summarise our powers and duties relevant to the sectoral rules we are proposing to modify in this consultation;
 - second, we give a broad summary of the current sectoral rules relevant in this context;
 - third, we set out our broader policy objectives for these sectoral rules and this Phase II review;
 - fourth, we introduce our impact assessment for our proposals;
 - fifth, we set out our equality impact assessment; and
 - finally, we explain our next steps for stakeholders.

⁵ Ofcom, Regulatory financial reporting for Royal Mail, Statement, dated 18 December 2017, https://www.ofcom.org.uk/_data/assets/pdf_file/0032/108869/financial-reporting-Royal-Mail.pdf; and Ofcom, Amendments to the Universal Service Provider Access Condition in relation to the margin squeeze control, Statement dated 8 November 2018, https://www.ofcom.org.uk/_data/assets/pdf_file/0021/125922/Margin-squeeze-2018-statement.pdf

⁶ The margin squeeze control is intended to ensure that the difference between Royal Mail's access prices and the equivalent retail prices are consistent with principles that allow efficient competition and thus prevent margin squeeze from happening.

Our powers and specific duties relevant to our proposals

Our powers to impose or modify the sectoral rules

- 2.4 The legal framework relating to the regulation of postal services is set out in the Postal Services Act 2011 (the “**PSA 2011**”), which transposes the EU Postal Services Directive⁷ into UK legislation.
- 2.5 We have the power under section 39 of the PSA 2011 to impose a USP accounting condition (known as the “**USPAC**”) on Royal Mail as the universal service provider requiring it:
- to maintain a separation for accounting purposes between such different matters as we may direct for such purposes as we may direct, including separation in relation to different services, facilities or products or in relation to services, facilities or products provided in different areas as well as the accounting methods to be used in maintaining the separation;
 - to comply with rules made by us in relation to those matters about the identification of costs and cost orientation, including the application of presumptions in the fixing and determination of costs and charges for any purpose as well as the publication of such accounts and other information relating to anything required to be done by us in this regard;
 - to comply with rules made by Ofcom about the use of cost accounting systems in relation to those matters, including the application of presumptions in the fixing and determination of costs and charges for any purpose as well as the publication of such accounts and other information relating to anything required to be done by Ofcom in this regard; and
 - to secure that the universal service provider’s compliance with those systems is audited annually by a qualified independent auditor, including an obligation to meet the costs of the audit.
- 2.6 Our powers to impose a regulatory condition, like the USPAC, include powers to impose obligations also requiring the universal service provider to comply with directions with respect to the matters to which the condition relates, and also powers to impose obligations with respect to those matters framed by reference to, or conditional on, our consent, approval or recommendation.⁸ The process for giving, modifying or withdrawing such directions is similar to the statutory process for imposing, modifying or revoking regulatory conditions, including to consult for a minimum of one month prior to making our decision.

⁷ 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 in particular by Directive 2002/39/EC and Directive 2008/6/EC. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:01997L0067-20080227&from=EN>

⁸ Paragraph 2 of Schedule 6 to the PSA 2011.

- 2.7 We may, however, impose or modify a regulatory condition only if we are satisfied that the general test set out in paragraph 1 of Schedule 6 to the PSA 2011 is met. According to this test, Ofcom must be satisfied that the condition is objectively justifiable, does not discriminate unduly against particular persons or a particular description of persons, is proportionate to what it is intended to achieve and is transparent in relation to what it is intended to achieve. A similar test also applies in giving, modifying or revoking directions imposing more detailed requirements and rules under the USPAC, such as our Regulatory Accounting Guidelines (the “RAG”).⁹

Our statutory duties

- 2.8 In carrying out our functions, such as exercising our above-mentioned powers (including to modify the RAG), Ofcom’s principal duty under the Communications Act 2003 (the “CA 2003”) is to further the interests of citizens and of consumers, where appropriate, by promoting competition. For postal services, we also have a duty under the PSA 2011 to secure the provision of the universal postal service, to which we must give priority if we consider that there is any conflict with our principal duty. We explain in more detail below how these duties fit together.
- 2.9 Section 29(1) of the PSA 2011 provides that Ofcom must carry out its functions in relation to postal services in a way that it considers will secure the provision of a universal postal service. Section 29(2) of the PSA 2011 provides that Ofcom’s power to impose access or other regulatory conditions, like the USPAC, is subject to the duty imposed by section 29(1) of the PSA 2011.
- 2.10 Section 29(3) of the PSA 2011 provides that, in performing our duty under section 29(1), we must have regard to the need for the provision of a universal postal service to be:
- financially sustainable; and
 - efficient before the end of a reasonable period and for its provision to continue to be efficient at all subsequent times.
- 2.11 Section 29(4) of the PSA 2011 states that ‘financially sustainable’ includes the need for a reasonable commercial rate of return for any universal service provider on any expenditure incurred by it for the purpose of, or in connection with, the provision by it of a universal postal service.
- 2.12 Section 29 of the PSA 2011 does not require that Ofcom gives more weight to one of those considerations over the other. We must take them both into account in arriving at a judgment as to how we ought to carry out our functions, including when considering imposing or modifying regulatory conditions.
- 2.13 Section 3(6A) of the CA 2003 provides that the duty in section 29(1) of the PSA 2011 takes priority over Ofcom’s general duties in the CA 2003 in the case of conflict between the two where Ofcom is carrying out its functions in relation to postal services. However, if we

⁹ Paragraph 4(2) of Schedule 6 to PSA 2011.

consider that no conflict arises, Ofcom must carry out our functions in accordance with these general duties and so must further the interests of citizens and of consumers, where appropriate by promoting competition.

- 2.14 Ofcom does not consider that there is any conflict between its duty to secure the provision of the universal postal service and its general duties in respect of our proposals in this consultation.
- 2.15 In performing its general duties, Ofcom is also required under section 3(4) of the CA 2003 to have regard to a range of other considerations, which appear to Ofcom to be relevant in the circumstances. In relation to our proposals in this consultation, we consider that the following considerations appear particularly relevant:
- the desirability of promoting competition in relevant markets; and
 - the desirability of encouraging investment and innovation in relevant markets.
- 2.16 Section 3(5) of the CA 2003 provides that, in performing its duty to further the interests of consumers, Ofcom must have regard, in particular, to the interests of those consumers in respect of choice, price, quality of service and value for money.
- 2.17 Additionally, pursuant to section 3(3) of the CA 2003, in performing its general duties, Ofcom must have regard, in all cases, to the principles under which regulatory activities should be transparent, accountable, proportionate, consistent, and targeted only at cases in which action is needed, and any other principles appearing to us to represent the best regulatory practice. In this regard, we also note Ofcom's general regulatory principles.¹⁰
- 2.18 Finally, we have an on-going duty under section 6 of the CA 2003 to keep the carrying out of our functions under review with a view to ensuring that regulation by Ofcom does not involve the imposition of burdens which are unnecessary or the maintenance of burdens which have become unnecessary.

Our current sectoral rules relevant in this context

- 2.19 On 27 March 2012, we published our Statement *Securing the Universal Postal Service: Decision on the new regulatory framework* (the "**March 2012 Statement**").¹¹ This set out our decision on the new regulatory framework for the postal sector, which gave Royal Mail more commercial freedom and operational flexibility (particularly in relation to setting its prices). Regulatory safeguards were however implemented to protect consumers and, where appropriate, promote effective competition.
- 2.20 One such safeguard was an effective and comprehensive monitoring regime. In our March 2012 Statement, we noted that establishing a comprehensive monitoring was essential to ensure that Royal Mail's commercial and operational flexibility was used in a way that accords with our regulatory objectives in respect of the universal service.

¹⁰ See <https://www.ofcom.org.uk/about-ofcom/what-is-ofcom>

¹¹ Ofcom, 2012. *Securing the Universal Postal Service: Decision on the new regulatory framework*, 27 March 2012. <http://stakeholders.ofcom.org.uk/binaries/Consultations/review-of-regulatory-conditions/Statement/Statement.pdf>

- 2.21 The monitoring regime relies on our regulatory financial reporting requirements for Royal Mail to provide us with relevant financial information. These requirements are imposed on Royal Mail in the USPAC, as supplemented by our more detailed requirements in the RAG. One specific set of detailed requirements contained in the RAG are our rules that govern the so-called National Costing Methodology that Royal Mail applies to calculate national average Fully Allocated Costs (“**FAC**”) data. These specific rules are known as the National Costing Rules (“**NCRs**”), which are the main subject of our proposals in this consultation. We therefore discuss the detail of the relevant NCRs affected by our proposals in Section 5.
- 2.22 The main purposes of the USPAC (as well as the related RAG) is to provide assurance that we can rely on the financial information reported by Royal Mail for regulatory purposes. In that regard, the USPAC also sets the high-level regulatory accounting principles (the “**Guiding Principles**”), as well as the types of information Royal Mail must provide and/or publish, including the deadlines and frequency. The RAG contains, in particular, the detailed regulatory accounting rules (including costing rules such as the NCRs) which may change over time to adapt to Royal Mail’s operational changes and our regulatory needs and priorities.
- 2.23 In Section 3, we explain how Royal Mail’s FAC data is prepared and how we use that data for our regulatory purposes. We also explain in further detail the role that the Guiding Principles and the NCRs play in the preparation of FAC.

Our broader policy objectives in this context

- 2.24 As part of Phase I of our review, we adopted revised objectives for the regulatory financial reporting requirements to assess whether the existing regulatory financial reporting continued to provide us with the information appropriate to enable us to meet our above-mentioned duties, for the purposes of the overall regulatory framework, in light of the changes in the postal market. Those objectives were:
- a) monitoring the financial sustainability of the universal service provision;
 - b) monitoring the efficiency of universal service provision;
 - c) monitoring competition in the postal market; and
 - d) protecting the interests of consumers.
- 2.25 We consider that those four objectives remain relevant to this Phase II of our review, including our proposals in this consultation. In Section 3, we explain how the FAC data helps us in achieving these objectives and how our Phase II review in this consultation is guided by these objectives.
- 2.26 The financial regulatory reporting requirements, together with the information we obtain from other operators, provide us with the information necessary for our monitoring regime. The monitoring regime allows us to assess how well the regulatory framework, as a whole, is working to meet our regulatory objectives which include securing the provision of the universal service, incentivising efficiency improvements, maintaining quality of service standards and ensuring universal services remain affordable. The monitoring regime helps

us consider the impact of any changes on the regulatory framework and assess whether there is a need to intervene to protect the universal service, customers and competition.

General impact assessment

- 2.27 The analysis presented in this consultation document represents in its entirety an impact assessment, as defined in section 7 of the CA 2003.
- 2.28 Impact assessments provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policy making. This is reflected in section 7 of the CA 2003, which means that generally Ofcom has to carry out impact assessments where its proposals would be likely to have a significant effect on businesses or the general public, or when there is a major change in Ofcom's activities. However, as a matter of policy Ofcom is committed to carrying out and publishing impact assessments in relation to the great majority of its policy decisions. For further information about Ofcom's approach to impact assessments, see our guidelines, *Better Policy Making: Ofcom's approach to Impact Assessment*.¹²
- 2.29 Specifically, pursuant to section 7, an impact assessment must set out how, in our opinion, the performance of our general duties (within the meaning of section 3 of the CA 2003) is secured or furthered by or in relation to what we propose.

Equality impact assessment

- 2.30 In carrying out our functions, we are also under a general duty under the Equality Act 2010 to have due regard to the need to:
- eliminate unlawful discrimination, harassment and victimisation;
 - advance equality of opportunity between different groups; and
 - foster good relations between different groups
- in relation to the following protected characteristics: age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex and sexual orientation.
- 2.31 Such equality impact assessments also assist us in making sure that we are meeting our principal duty under section 3 of the CA 2003 mentioned above.
- 2.32 We have therefore considered what (if any) impact the proposals in this consultation may have on equality. Having carried out this assessment, we are satisfied that our proposals are not detrimental to any group defined by the protected characteristics set out in paragraph 2.30 above.

¹² Ofcom, 2005. *Better Policy Making: Ofcom's Approach to Impact Assessment*. For further information see our website: <https://www.ofcom.org.uk/consultations-and-statements/better-policy-making-ofcoms-approach-to-impact-assessment>

Next steps

- 2.33 We invite responses to this consultation, to reach us by no later than 27 February 2019. The period for this consultation is therefore 10 weeks. We consider that this period is consistent with Ofcom's consultation principles. In particular, we consider that it is appropriate given the technical nature and the limited impact of our proposals to stakeholders generally, but also to allow sufficient time for any stakeholder to provide a considered response as our consultation spans all of the Christmas holiday period.
- 2.34 Subject to the responses we receive to this consultation, we expect to publish our statement on these proposals in the first half of the 2019/20 financial year.

3. Our requirements for costing data and Phase II review

Introduction

- 3.1 In this Section, we outline our requirements for costing data produced by Royal Mail as part of our regulatory financial reporting framework. We also set out an outline of the principles and rules which we impose on Royal Mail as part of that framework to ensure the costing data is fit for purpose. We then explain how we use the costing data in achieving our regulatory objectives. At the end of this Section, we explain the aims and the scope of our Phase II review which is the subject of this consultation.

Our regulatory financial reporting framework

- 3.2 On 27 March 2012, we published our Statement *Securing the Universal Postal Service: Decision on the new regulatory framework* (the “**March 2012 Statement**”).¹³ This set out our decision on the new regulatory framework for the postal sector, which gave Royal Mail more commercial and operational flexibility (particularly in relation to setting its prices). Regulatory safeguards were however implemented to protect consumers and, where appropriate, promote effective competition.
- 3.3 One such safeguard was an effective and comprehensive monitoring regime,¹⁴ which relies on our regulatory financial reporting requirements for Royal Mail to provide us with relevant financial information. As explained in Section 2, these requirements are imposed on Royal Mail in the USPAC, as supplemented by our more detailed requirements in the RAG. We explain later in this Section the objectives of the monitoring regime and how the costing data helps us in achieving those objectives.
- 3.4 Our regulatory financial reporting framework requires Royal Mail to produce national average Fully Allocated Costs (“**FAC**”) data¹⁵ which underpins many of the financial regulatory reports it is required to provide to us. There is also a set of detailed requirements contained in the RAG that govern the so-called National Costing Methodology that Royal Mail applies to calculate national average FAC data. These specific rules are known as the National Costing Rules (“**NCRs**”), which are the main subject of our proposals in this consultation (we discuss the NCRs in further detail later in this Section and in Section 5 we set out our proposed changes to certain NCRs).

¹³ Ofcom, 2012. Securing the Universal Postal Service: Decision on the new regulatory framework, 27 March 2012. <http://stakeholders.ofcom.org.uk/binaries/Consultations/review-of-regulatory-conditions/Statement/Statement.pdf>

¹⁴ In our March 2012 Statement, we noted that establishing a comprehensive monitoring was essential to ensure that Royal Mail’s commercial and operational flexibility was used in a way that accords with our regulatory objectives in respect of the universal service.

¹⁵ Royal Mail also produces zonal costing data which is not the subject of this consultation.

The USPAC and the RAG

- 3.5 One of the main purposes of the USPAC and the RAG is to provide assurance that we can rely on the financial information reported by Royal Mail for regulatory purposes. In that regard, the USPAC also sets the high-level regulatory accounting principles (the “**Guiding Principles**”). The USPAC also sets out the types of information Royal Mail must provide and/or publish, including the publication and audit requirements, deadlines and frequency.
- 3.6 The RAG contains detailed regulatory accounting rules, including costing rules such as the NCRs, which may change over time to adapt to Royal Mail’s operational changes and our regulatory needs and priorities.
- 3.7 The USPAC and RAG provide a framework within which Royal Mail can choose methods to allocate its costs.

Guiding Principles

- 3.8 USPAC 1.7 outlines the obligation to comply with the Guiding Principles and provides details of those principles.
- 3.9 There are eight principles which provide Royal Mail with the broad framework for the allocation of costs. They are:
- a) Completeness;
 - b) Equivalence;
 - c) Causality;
 - d) Objectivity;
 - e) Accuracy;
 - f) Compliance with the statutory accounting standards;
 - g) Consistency; and
 - h) Materiality.
- 3.10 When there is a conflict between the Guiding Principles in a particular case, the conflict must be resolved using the hierarchy as listed in USPAC 1.7.1 (and as listed above). Put broadly, if there are relevant specific rules in the RAG for a case in hand, then those more detailed specific rules must be applied obviating the need to appeal to the Guiding Principles.

National Costing Rules (“NCRs”)

- 3.11 Section 8 of the RAG contains, among other things, the National Costing Rules. These rules provide Royal Mail with additional guidance and more detail of how to calculate and allocate national average FAC. They aim to provide Royal Mail with clear limits, while still allowing it a significant degree of freedom when choosing the cost allocation methods.

- 3.12 There is no specified order in which to apply the rules and all rules will not necessarily apply to all cost and products. However, we expect Royal Mail to demonstrate compliance with all the relevant rules for each item of cost.
- 3.13 Where conflict between the rules arise, we expect Royal Mail to identify the nature of the conflict and document the manner in which Royal Mail has chosen to resolve it. In doing so Royal Mail should explain which rules have been disregarded and why that is deemed appropriate.

Granular FAC data

- 3.14 Section 6 of the RAG requires Royal Mail to produce a Costing Manual which provides a comprehensive level of detail of the National Costing Methodology to demonstrate compliance with the National Costing Rules (as well as the Zonal Costing Rules). The Costing Manual contains, among other things, granular FAC data (in the Technical Appendices), which we use to build our own static costing model, Cost Allocation Model (“CAM”). The CAM is a static model which simulates parts of Royal Mail’s costing system. We use the CAM to understand how costs are calculated and allocated at the most granular level. Royal Mail updates the Costing manual quarterly.

Change control

- 3.15 The USPAC and the RAG set out the details Royal Mail needs to submit to us when it makes any changes to its costing methodologies. Specifically, USPAC 1.6.3 requires Royal Mail to notify us in writing of any material changes within 7 days of making those changes. This requirement is referred to as the ‘Change control’. This allows us to ensure that Royal Mail’s methods continue to produce cost data which adheres to the Guiding Principles and costing rules in the RAG including the NCRs where relevant.
- 3.16 Section 2 of the RAG (2.1 (f)) defines a material change. Appendix 3 of the RAG also provides the pro-formas and the information Royal Mail must disclose when informing us of any material change.
- 3.17 While Royal Mail is permitted to make changes to its costing methodologies subject to the above requirements, we may, however, give directions pursuant to USPAC 1.2.2 b) and c) to Royal Mail in relation to its compliance with the rules in relation to the identification of costs, charges and the use of accounting systems. Therefore, following a consultation, we could direct Royal Mail to reverse changes, were we to consider that they do not align with our objectives.

How we use FAC

Our monitoring regime

- 3.18 As we explained in Section 2, we have a comprehensive monitoring regime which is essential to ensure that Royal Mail’s commercial and operational flexibility is used in a way that accords with our regulatory objectives in respect of the universal service. The

monitoring regime enables us to assess how well the regulatory framework, as a whole, is working to meet our regulatory objectives which include securing the provision of the universal service, incentivising efficiency improvements, maintaining quality of service standards and ensuring universal services remain affordable. The monitoring regime also helps us consider the impact of any changes on the regulatory framework and assess whether there is a need to intervene to protect the universal service, customers and competition.

3.19 We also explained in Section 2 that our regulatory financial reporting requirements are set up in order to inform our monitoring regime. In Phase I of our review, we updated our objectives for the regulatory financial reporting requirements to ensure the requirements continue to inform our monitoring regime effectively. These objectives are:

- a) monitoring the financial sustainability of the universal service provision;
- b) monitoring the efficiency of universal service provision;
- c) monitoring competition in the postal market; and
- d) protecting the interests of consumers.

3.20 These objectives remain relevant to this Phase II of our review, including our proposals in this consultation.

FAC data and Royal Mail's changes

3.21 As explained above, we require Royal Mail to produce national average FAC. FAC provides a good first-order view of Royal Mail's product costs and how they change over time. These product costs are a key input in the broad indicators we use to monitor competition and consumer issues. FAC is also a key input in monitoring the financial sustainability and efficiency of the provision of the universal service where there is a need to have full view of all costs incurred. FAC is also currently used in our ex ante margin squeeze control¹⁶.

3.22 As we explained above, Royal Mail is permitted to make changes to its costing methodologies, including the way it calculates and allocates national average FAC. These changes are however subject to Change control requirements as we explained above, and we can consult to reverse any changes which we may consider are not aligned with our needs and applications of FAC data.

3.23 Royal Mail made a series of significant changes to its national average FAC allocation methods related to the outdoor delivery part of its network in 2013/14 and 2016/17. We explain these changes in Section 4. These changes had the broad net impact of moving

¹⁶ The margin squeeze control is intended to ensure that the difference between Royal Mail's access prices and the equivalent retail prices are consistent with principles that allow efficient competition and thus prevent margin squeeze from happening. As explained in our recent Statement relating to technical changes to the margin squeeze control (November 2018 Statement), assessing margin squeeze by reference to LRIC is likely to be the most appropriate approach in the longer-term, subject to appropriate LRIC data being available. However, robust LRIC information is not currently available. Instead, we currently use 50% of FAC in the absence of robust LRIC data. See Paragraphs 3.6-3.11, https://www.ofcom.org.uk/_data/assets/pdf_file/0021/125922/Margin-squeeze-2018-statement.pdf

costs from parcels to letters, making parcels less costly and letters more costly under the new allocation methods. The changes also allocated more costs to USO parcel products by moving them out of non-USO parcel products. As we explain in Section 4, Royal Mail's main justification for these changes were the introduction of new delivery methods and the significant changes in the operational reality on the ground.

Implications of Royal Mail's changes

- 3.24 We recognise that Royal Mail may have incentives to allocate its costs in certain ways which helps it achieve its own objectives, including:
- a) Allocating less costs to competitive products to help justify lower prices; and
 - b) Allocating more costs to the USO products which has the effect of making the USO appear more costly to provide (or to help justify raising prices for USO products).
- 3.25 Royal Mail's cost allocation changes, which we described above, appear to broadly align with these incentives.
- 3.26 Some stakeholders raised concerns regarding these cost allocation changes. One respondent, in response to our 2015 discussion document¹⁷, requested that Ofcom review the allocation of Royal Mail's costs, pricing and margins. It was concerned that Royal Mail might be able to engage in predatory pricing through inappropriate cost allocations where it faces competition, which would disadvantage its competitors, increasing Royal Mail's market share and potentially driving competitors out of the market.¹⁸
- 3.27 In our consultation in May Consultation 2016¹⁹ (the "**May 2016 Consultation**"), we recognised these concerns and indicated our intention to review Royal Mail's changes and our costing rules. We stated that, as part of the review, 'we intend to consider whether there are ways to better ensure that Royal Mail is appropriately allocating costs between parcels and letters'.²⁰

Limitations of FAC data

- 3.28 As explained above, we consider that the national average FAC provides a good first-order view of Royal Mail's product costs and how they change over time. This information is a key input in the broad indicators we use in our monitoring regime, for monitoring the financial sustainability and efficiency of the provision of the universal service, and particularly for monitoring competition and consumer issues.

¹⁷ Ofcom, Review of the regulation of Royal Mail, Discussion paper, 17 July 2015, https://www.ofcom.org.uk/data/assets/pdf_file/0023/79430/review_of_rm_regulation.pdf

¹⁸ CONFIDENTIAL [X]

¹⁹ Ofcom, Review of the Regulation of Royal Mail Consultation, 25 May 2016, https://www.ofcom.org.uk/data/assets/pdf_file/0028/78184/review-of-royal-mail-regulation.pdf

²⁰ Ofcom, Review of the Regulation of Royal Mail Consultation, 25 May 2016, paragraph 5.36, https://www.ofcom.org.uk/data/assets/pdf_file/0028/78184/review-of-royal-mail-regulation.pdf

- 3.29 For in-depth analysis of specific regulatory concerns, we may need to adjust Royal Mail's FAC and its cost allocations, or apply different cost allocation methods, or use cost standards other than national average FAC. For example, for a detailed and comprehensive view of the sustainability of the USO, we may need to calculate the net cost of the universal service²¹, which could involve modelling a hypothetical network and applying different cost allocation methods.
- 3.30 In connection with cross-subsidisation and associated predatory pricing issues, it may instead be more appropriate to use long-run incremental costs ("**LRIC**") or average avoidable costs.
- 3.31 For example, in considering the allocation of cost between letters and parcels, one method may be to take the total costs of the business and subtract the standalone cost of letters to estimate the incremental cost of parcels. Alternatively, the avoidable cost of parcels could be calculated, which puts the onus on calculating the incremental cost of parcels directly rather than approaching it indirectly.
- 3.32 As a minimum, in response to an investigation into anti-competitive behaviour, Royal Mail would be expected to demonstrate that the FAC of the products in question is calculated free of inappropriate cross subsidisation. This would as a minimum entail that:
- a) the FAC of the products in question is greater than the LRIC of those products, and thus the products in question are not incrementally loss-making to the business; and
 - b) the FAC of the products in question is less than standalone costs ("**SAC**") of those products, which is the cost of providing the products plus all other fixed and common costs of the business and would be the maximum cost that could reasonably be allocated to the products in question.
- 3.33 In its response to the May 2016 Consultation, Royal Mail referred to a report it commissioned to be prepared by FTI Consulting²² which noted that "the economic literature considers the use of FAC (or Fully Distributed Cost) inappropriate as part of a test for cross-subsidies. This is due to the arbitrary methods used to allocate common costs, and the lack of a direct relationship between FAC and marginal cost. On economic efficiency grounds, there is no basis for FAC pricing. It is particularly inappropriate when a large proportion of the costs are fixed and common, which they are for Royal Mail". FTI Consulting concluded that the correct cost standards to assess cross-subsidy are incremental cost and SAC.
- 3.34 As explained above, we recognise that FAC data produced by Royal Mail will not necessarily provide an appropriate measure of costs for all the regulatory questions we may need to answer in future. Changes to Royal Mail's cost allocation methods will not change that. However, we remain of the view that robust FAC data provides a key input in

²¹ Section 44 of the Postal Services Act 2011, <http://www.legislation.gov.uk/ukpga/2011/5/section/44/enacted>

²² FTI on behalf of Royal Mail, https://www.ofcom.org.uk/data/assets/pdf_file/0024/90780/FTI-Report-on-Testing-for-Cross-Subsidisation.pdf

the broad indicators we use in our monitoring regime, and also a useful starting point for future analysis for specific regulatory questions.

- 3.35 We therefore consider that Royal Mail must continue to prepare and provide FAC data using a coherent and transparent set of allocation methods and in accordance with the USPAC and the RAG.

Scope of Phase II review

- 3.36 This consultation, which is Phase II of our review of the regulatory financial requirements, is intended to review Royal Mail's cost allocation changes and our costing rules as indicated in the May Consultation 2016. It is also intended to address the concerns we have and the concerns raised by the stakeholders about Royal Mail changes to its outdoor delivery cost allocation methods.
- 3.37 As we explain in detail in Section 5, we have developed proposals to revise certain NCRs in the RAG to ensure the national average FAC that Royal Mail produces remains fit for the purposes of our monitoring regime. These revisions are necessary in light of the changes Royal Mail has made to its cost allocation methods.
- 3.38 We do not expect our proposals to result in fundamental changes to the National Costing Methodology, which Royal Mail uses to produce national average FAC. We also do not expect these changes to have a significant impact on Royal Mail's cost allocations. As we explained above, national average FAC continues to be a key input in the broad indicators we use in our monitoring regime, particularly in monitoring competition and consumer issues.
- 3.39 However, as we explained above, the findings of our Phase II review and our proposals should not be interpreted as an endorsement of Royal Mail's cost allocation methods to be used for all our regulatory purposes. In considering specific regulatory questions, such as cross-subsidisation, we may not consider Royal Mail's current choice of allocation methods to be appropriate.
- 3.40 Royal Mail is currently in the process of conducting a review of its UK network "to develop the blueprint for a modern, optimised, efficient network to deliver letters, parcels and new products"²³. Royal Mail's review could result in changes to its universal service network. These changes may in turn lead Royal Mail to make changes to its cost allocation methods. We will review those cost allocation changes, and if necessary, our costing rules to ensure the cost allocations in Royal Mail's FAC data remain fit for our monitoring purposes.
- 3.41 Additionally, in order to help develop further our own view of the costs of Royal Mail's delivery operations and other key areas of its network and how these might change over time under different scenarios, we are now in the process of building our own costing

²³ Royal Mail Plc, Results for the Half Year ended 23 September 2018, page 4.
<https://www.royalmailgroup.com/media/10493/royal-mail-plc-financial-report-for-the-half-year-ended-23-september-2018.pdf>

model²⁴. We expect this costing model, when completed, to further inform and support our views on the issues we discuss above including financial sustainability and efficiency of Royal Mail's provision of the universal service, as well as our consideration of competition issues.

²⁴ This model differs fundamentally in its scope, design and functionalities from the CAM which is a static representation of parts of Royal Mail's ABC costing system.

4. Royal Mail's costing approach and its changes

Introduction

- 4.1 In this Section, we outline how Royal Mail calculates and allocates its costs to its products. We also explain a series of changes Royal Mail has introduced to its cost allocation methods in recent years.

Activity Based Costing ("ABC")

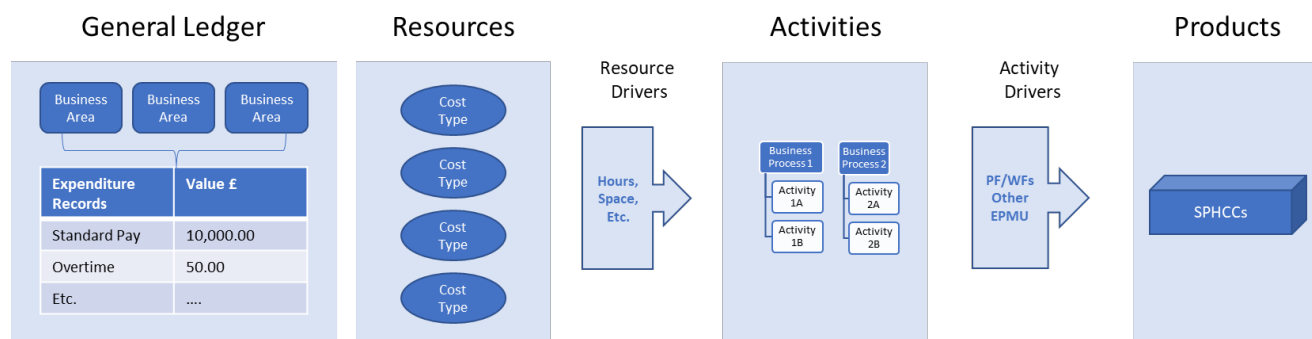
- 4.2 As we explained in Section 3, Royal Mail is required to produce national average FAC data²⁵ which underpins many of the financial regulatory reports it is required to provide to us.
- 4.3 The NCRs in the RAG require Royal Mail to calculate the national average FAC using Activity Based Costing ("**ABC**"). Royal Mail's ABC costing system produces national average FAC by allocating all direct costs as well as a share of common costs to each product.
- 4.4 The ABC approach identifies and allocates costs to Activities, based on the resources consumed by those Activities. Then it allocates the resulting Activity Costs to products based on the contributions of the relevant Activities to those products.
- 4.5 The main components and allocation steps in Royal Mail's ABC approach are (also see Figure 4.1 below):
- a) all costs of the Reported Business²⁶ which have been recorded in the General Ledgers of Royal Mail's accounting systems are grouped into Cost Types;
 - b) Business Processes, which are largely the same as the elements of Royal Mail's network (e.g. processing and indoor and outdoor delivery) are divided into Activities, which are various tasks or work (whether operational or non-operational) required to complete a Business Process;
 - c) Activities are costed by allocating Cost Types to them using Resource Drivers which determine what proportion of each Cost Type must be allocated to each relevant Activity; and
 - d) Activity Costs are then allocated, using Activity Drivers to Sales Product Handling Characteristic Combinations ("**SPHCCs**") which are commercial products and services

²⁵ Royal Mail also produces zonal costing data which is not the subject of this consultation.

²⁶ Ofcom, USP Accounting Condition, Schedule dated 18 December 2017, USPAC 1.1.2 Definitions, (s) "Reported Business" means the part of Royal Mail's business that undertakes activities for the purpose of, or in connection with, the provision of USO and non-USO (including, but not limited to, non-Mails), the fully allocated costs of which are derived by the National Costing Methodology and Zonal Costing Methodology as described in the Costing Manual. For the avoidance of doubt, those activities shall be treated to include all the activities, products and/or services which fall within the scope of the Costing Manual from time to time. The reference to fully allocated costs is a reference to a costing methodology in which all costs are allocated to the outputs of the business.

broken down further to allow more accurate and causal cost allocation. Activity Drivers represent the relative contribution of each Activity to the relevant SPHCCs.

Figure 4.1: Illustrative example of Royal Mail's costing system



Royal Mail's changes to its cost allocation methods

- 4.6 Since March 2012, Royal Mail has made various changes to its costing methodology. Some of these changes, which were made mainly to the allocation of costs of outdoor delivery, have been significant in their scope and impact.
- 4.7 These changes are the subject of our Phase II review. Apart from the scope and the impact of these changes, the changes are also relevant to the concerns relating to the allocation of letters and parcels costs which we explained in Section 3. The reason is that the net effect of these changes has broadly been to move costs from parcels to letters and from Non-USO parcels to USO parcels. We therefore considered it was important for us to review these changes and assess whether the resulting costing data still met our needs. We also considered it important to assess whether the NCRs continue to be fit for purpose in light of these significant changes.

Royal Mail's reasons for the cost allocations changes

- 4.8 In 2010, Royal Mail began to introduce new delivery methods and implement a programme designed to put in place delivery best practice, such as the removal of bicycles as a method of delivery, the introduction of High Capacity Trolleys (HCTs) and the use of Shared Vans.
- 4.9 Royal Mail has informed us that the new delivery methods were introduced to:
- take account of the change in mix of Parcels and Letters, including the growth in the absolute range and size of parcels;
 - take weight off the shoulder and stop delivery by bicycle, due to health and safety concerns; and
 - allow route lengths to be increased so post men and women spend more time outdoors, to take account of short hours indoors following the automation of sortation.

- 4.10 As a result of these operational changes, Royal Mail also introduced a series of changes to its cost allocation methods in its ABC system. Royal Mail informed us that these changes were predominantly intended to reflect the new operational reality.

Royal Mail's changes in 2013/14

- 4.11 In 2013/14, once the critical mass of the adoption of the new delivery methods had been achieved²⁷, Royal Mail made changes to its costing system to reflect the new operational reality. Royal Mail made two main changes:
- a) changing the Activities used by each format; and
 - b) updating the relative effort that it takes to deliver each format by updating the Weighting Factors (which are a type of Activity Driver and represent the relative proportions of effort that units of each SPHCC require from each related Activity).
- 4.12 Royal Mail updated its costing system to reflect changing the actual method of delivery from foot or cycle to new delivery methods²⁸. The updates included changing how the Activities, particularly Shared Van, Rural, Van and Firm Van, are costed and are then allocated to products.

Impact of changes

- 4.13 The combined impact of these 2013/14 cost allocation changes²⁹ was broadly to increase the costs of letters, mainly in outdoor delivery, and reduce the same costs for parcels:

Table 4.1: The impact of Royal Mail's 2013/14 cost allocation changes (rounded to whole numbers)

Movement in Cost (£m)	Letters	Parcels	Total Difference	% difference
USO products	[X]	[X]	[X]	0%
Access products	[X]	[X]	[X]	8%
non-USO (remainder)	[X]	[X]	[X]	-3%
Total	[X]	[X]	0	
% difference	5%	-5%		

Royal Mail's changes in 2016/17

- 4.14 In 2016/17, Royal Mail made further changes to its costing system. Royal Mail has explained that these changes were needed to reflect the following developments:
- a) parcels have got larger and heavier (referred to as “**Volumetrics Effects**”);

²⁷ Royal Mail, Presentation to Ofcom on 14 April 2014, “Deployment of Delivery methods is at an advance stage, therefore the “critical mass” of change has been achieved (1000 offices early Dec out 1400)”.

²⁸ Royal Mail delivery methods are now Un-motorised High Capacity Trolley (HCT) (which can take Letters, Large Letters and Format 1 & 2 parcels), Motorised Shared Van, Motorised Rural Van, Motorised Town Van, Motorised Firm Van and Motorised Van Diversions (which mainly take Format 3 & 4 mail as well as Special delivery pre 9am items).

²⁹ Royal Mail, Royal Mail Group Limited Regulatory Financial Statements 2013-14, dated December 2005, Delivery Methods page 5 & 6, <https://www.royalmailgroup.com/en/about-us/regulation/regulatory-financial-statements/>

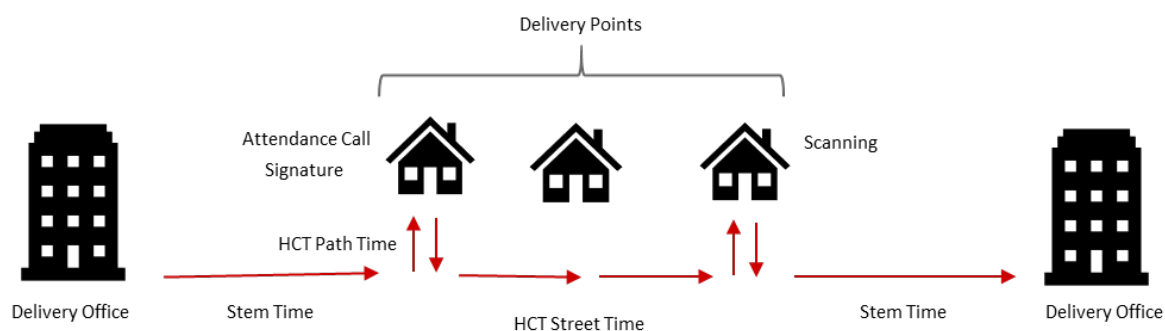
- b) final roll-out of the new delivery methods (referred to as “**Delivery Methods 2017**”); and
- c) allocating costs of the collection office to products which use it (i.e. the “**Callers Office**”).

Volumetrics Effects

- 4.15 Parcels are currently classified by Royal Mail into four Formats which determine the method by which they are to be delivered. Format 1 and 2 parcels are foot deliverable and Format 3 and 4 parcels are non-foot deliverable.
- 4.16 In the past, Royal Mail made a simplifying assumption of one-to-one mapping of parcel products to parcel formats. For example, a small parcel weighing 0-100g was categorised as Format 1, and a medium parcel weighing over 2kg would be Format 4.
- 4.17 Since 2016/17, Royal Mail updated the costing system to use the dimensions of the parcels as well as their weight. Using this volumetric data, Royal Mail calculates what proportion of parcels fits into each Format 1 to 4, which Royal Mail considers better reflects operational reality. The dimension of a parcel is therefore determined by both its size and weight.
- 4.18 The results of using the volumetric data have shown that USO parcels have increased in cost and reduce the costs for the non-USO parcels. This is due to approximately [X]% more USO parcels being categorised as Format 3 and 4 which are delivered using a motorised delivery method and therefore are more costly to deliver. These products now take a larger share of the total cost of outdoor delivery.

Delivery Methods

- 4.19 In 2016/17, Royal Mail also made the following further changes to reflect the completed implementation of the new delivery methods which started in 2010:
 - a) Outdoor delivery operations were disaggregated further into Activities such as Stem Time, Path and Street time for each delivery method (HCT, Shared Van, Town Van, Rural Van, Firm Van and Van Diversion), Delivery Outdoor Signature, Delivery Outdoor Scanning time and Delivery attendance call (see Figure 4.2, for example of the HCT delivery method).
 - b) As a result, Royal Mail needed to calculate more detailed Weighting Factors for each of the new Activities (Weighting Factors are a type of Activity Driver and represent the relative proportions of effort that units of each SPHCC require from each related Activity).
 - c) Royal Mail stopped using Resource Control System (RCS) hours as the basis for allocating costs to Activities (using Resource Drivers). Royal Mail continued to use these actual hours to split total costs between the indoor and outdoor delivery.

Figure 4.2: An example of the new outdoor delivery Activities - HCT delivery method

Callers Office

4.20 In 2016/17, Royal Mail also made changes to how Callers Office (Collection Office) costs are allocated. These costs are now being shared across products which use the service, taking into account how frequently they would pass via the Callers Office. This is instead of being allocated across products that could pass via the Callers Office (as before).

Impact of changes

4.21 The combined impact of these 2016/17 cost allocation changes was broadly to increase the costs of the USO parcels and reduce the same costs for the non-USO parcels (Table 4.2).

4.22 The main reason for this impact is due to the reassessment of parcel sizes which indicated that USO parcels are larger than what was assumed in the previous allocations (see Volumetrics Effects explained in paragraphs 4.15 to 4.18).

Table 4.2: Table showing the impact of Royal Mail's 2016/17 cost allocation changes (rounded to whole numbers)

Movement in Cost (£m)	Letters	Parcels	Total Difference	% difference
USO Products	[X]	[X]	[X]	6%
Access Products	[X]	[X]	[X]	2%
Non-USO (remainder)	[X]	[X]	[X]	5%
Total	[X]	[X]	(0)	
% difference	-1%	1%		

4.23 The changes also affected, albeit to a lesser extent, the costs of letters and parcels. The changes reduced the costs of letter and increase the same costs for parcels (Table 4.2)

5. Our proposed changes to our costing rules

Introduction

- 5.1 In this Section, we explain the findings of our Phase II review and then we set out our proposed changes to some of our regulatory accounting rules in the RAG.
- 5.2 Our proposals mainly concern changes to some of the NCRs³⁰. We also propose in this Section some minor changes to transfer pricing rules in the RAG³¹ and provide further clarifications in relation to the NCR 2 – Operational Reality and how it must be applied in conjunction with other NCRs.

Our findings

- 5.3 As we explain in Section 4, in 2013/14 and 2016/17 Royal Mail made a series of significant changes to its cost allocation methods, particularly in outdoor delivery, following the introduction of new delivery methods.
- 5.4 Royal Mail informed us of these changes and their impact as part of our change control requirements (see Section 3). We requested further information regarding the details, the reasons and the impact of these changes. As part of our Phase II review, we reviewed Royal Mail's changes in detail. We engaged with Royal Mail - through a series of meetings and further detailed information requests - to ensure we fully understand these changes.
- 5.5 We summarise our understanding of these changes in Section 4. In this Section, we set out further details and our views about these changes.
- 5.6 As a result of our work, we found that Royal Mail's changes are consistent with the NCRs in the RAG. In particular, we found that the new allocation methods better reflect the operation reality of the new delivery methods.
- 5.7 As a result of our review, we have identified that we need to revise some of the NCRs in the RAG in light of Royal Mail's changes to ensure the FAC data provided remains robust and fit for our monitoring purposes in the future.
- 5.8 Our proposed revisions to the NCRs reflect two themes which we identified with Royal Mail's changes:
- a) Defining new Activities to reflect the new operational reality better and how we can make sure the Causality Guiding Principle is considered in those definitions in a more appropriate manner (NCR 5 – Activities, NCR 8 – Activity Costs and NCR 10 – Weighted Activity Drivers); and

³⁰ Paragraphs 8.12-8.43, https://www.ofcom.org.uk/data/assets/pdf_file/0025/108871/Annex-2.-New-RAG.pdf

³¹ Paragraphs 8.72 to 8.76 and 9.8 to 9.13, https://www.ofcom.org.uk/data/assets/pdf_file/0025/108871/Annex-2.-New-RAG.pdf

- b) Use of theoretical or modelled data instead of actual data to calculate certain cost drivers and how we can make sure that is done appropriately (NCR 6 – Resource Drivers, NCR 11 – Other Drivers, NCR 14 - Operational data and sampling and NCR 15 - Data Integrity).
- 5.9 We set out later in this Section our proposed changes to the following NCRs under the above two themes.
- 5.10 There are areas in which we expect Royal Mail to make adjustments to some of its allocation methods as a result of our findings and to comply with our proposed revisions to the NCRs (see proposals on NCR 5). As we explain below, we do not expect these changes to have a significant impact on Royal Mail's costing data.
- 5.11 We also propose some further reporting of supporting data by Royal Mail to us to ensure adequate transparency over some of the new allocation methods (see proposals on NCR 6).

New Activities and causality

Changes to NCR 5: Activities

The current position

- 5.12 When postmen and postwomen deliver mail they have to get to the first point on their route, walk between each door, deliver to each door and return to the delivery office. Each of these tasks takes a different amount of effort and are done a different number of times for each route and for each SPHCC.
- 5.13 Each task is an Activity in the Royal Mail costing system and must be allocated costs based on the resources that Activity requires.
- 5.14 The RAG defines Activities as tasks or work (whether Operational or Non-operational), which are required to be carried out in order to complete a Business Process. NCR 5 which provides guidance on Activities currently states:

8.19 Where appropriate (and to the extent possible), Business Processes shall be divided into Activities.

Our analysis

- 5.15 In 2016/17, Royal Mail changed the Activities in the Business Process known as outdoor delivery to take account of the introduction of its new delivery methods (see Section 4). This included introducing a new Activity called Stem Time.
- 5.16 Stem Time is the time taken to get from the Delivery Office (DO) to the first Delivery Point (DP) on a route and then from the last DP back to the DO again (see Figure 4.2).
- 5.17 Prior to 2016/17, there was no individual Stem Time Activity. Instead, Royal Mail included this Activity under a wider Activity, for example Delivery Rural Motorised, which accounted

for the total time for each delivery method. The total time for the Delivery Rural Motorised Activity was then used to calculate the weighting factors which were used to attribute costs of each delivery method to the SPHCCs.

- 5.18 The Cost Types allocated to the Stem Time Activity are vehicle, fuel and people costs. The Stem Time activity costs are then allocated to SPHCCs.
- 5.19 However, the Stem Time Activity includes costs for all types of delivery method; HCT, Shared Van, Rural Van etc. Furthermore, the SPHCCs, which the Stem Time activity costs are attributed to, are not always delivered by all these delivery methods, specifically parcel formats 3 and 4 are not delivered on an HCT.
- 5.20 The way the Stem Time Activity is defined may result in some costs being allocated to SPHCCs which do not cause those costs to be incurred. For example, it is possible that fuel costs are allocated to SPHCCs delivered by HCT routes.

Our proposal

- 5.21 We propose that NCR 5 should be changed to include an explicit requirement to consider the Guiding Principle of Causality. This is to ensure the Business Processes are divided into Activities in a manner which allows the best fit with causality considerations.
- 5.22 We therefore propose the new rule to be amended as follows (amendments are in bold letters):

8.19 Where appropriate (and to the extent possible), Business Processes shall be divided into Activities. **When identifying an Activity, consideration must be given to the Cost Types used by that Activity to ensure those Cost Types are caused, in accordance with the Guiding Principle of Causality, by the SPHCCs to which the Activity Cost is allocated.**

- 5.23 As a result of this change, we expect Royal Mail to create at least two Stem Time Activities, one for the stem time of unmotorised delivery routes and another for stem time for motorised delivery routes.
- 5.24 If Royal Mail were to decide to create Stem Time Activities for each delivery method, we would expect the Activity Drivers used, to allocate those Stem Time Activities to the SPHCCs, to be consistent with those of Path Time and Street Time Activities as discussed in NCR 10, paragraphs 5.32 to 5.52.
- 5.25 Based on analysis carried out by Royal Mail, we estimate that as a result of our proposal, namely the introduction of at least two Stem Time Activities (see 5.23), there will be an increase in the total cost of letters by approximately [X £1m to £2m] with the equal and opposite effect on total parcel costs.

Changes to NCR 8: Activity Costs

Current position

- 5.26 As explained in paragraph 4.5, Activity Costs are allocated to SPHCCs using Activity Drivers. NCR 8 defines categories of Activity Costs and NCR 9 sets out how Activity Drivers must be determined and applied to each category of Activity Cost. In particular, NCR 8 defines Overheads as one of the categories of Activity Costs as follows:

The National Costing Methodology shall assign an appropriate share of each Activity Cost to each of the relevant SPHCCs as set out below. To determine how an Activity Cost shall be assigned to the relevant SPHCCs, it shall first be determined into which one of the following categories the Activity Cost falls:

[...]

d) Overheads, which shall be classed either—

- i) if the Activity Costs relate to one or more Operational Business Processes which do not have a direct causal link to any of the SPHCCs being processed, as Pipeline Overheads; or
- ii) if the Activity Costs relate to Non-operational Business Processes, as General Overheads.

Our analysis

- 5.27 The definition of General overheads in NCR 8, paragraph 8.24(d)(ii), categorises any Activity Cost related to Non-operational Business Processes as General Overheads. NCR 9 prescribes Equi-Proportional Mark Up (EPMU) as the appropriate Activity Driver for General Overheads. Using the EPMU, General Overheads are allocated based on the relative proportions of costs already allocated to SPHCCs (having used other Activity Drivers). It follows that all Activity Cost related to Non-operational Business Processes must be allocated using EPMU.
- 5.28 Most Non-operational Business Processes—which include commercial, support, wholesale and business sustaining, management, marketing and financing activities—do not have a direct causal link to any of the SPHCCs.
- 5.29 However, if there is an Activity Cost within a Non-operational Business Process which has a direct causal link to specific SPHCCs, then it would not be appropriate to categorise it as General Overheads and use EPMU to allocate that Activity Cost. The Activity Cost in question must be categorised as an Attributable Non-operational Cost (as defined in NCR 8, paragraph 8.24(b)) and a causal Activity Driver (as defined in NCR 9) must be used to allocate it to the relevant SPHCCs (a Weighted Volume Drivers or an Other Driver). This will ensure consistency with the Causality Guiding Principle³².

³² Ofcom, USP Accounting condition, USPAC 1.7. (c), dated 18 December 2017, https://www.ofcom.org.uk/_data/assets/pdf_file/0024/108870/Annex-1.-New-USPAC.pdf

Our proposal

5.30 We therefore propose to amend NCR 8 as follows (amendments are in bold letters):

The National Costing Methodology shall assign an appropriate share of each Activity Cost to each of the relevant SPHCCs as set out below. To determine how an Activity Cost shall be assigned to the relevant SPHCCs, it shall first be determined into which one of the following categories the Activity Cost falls:

[...]

d) Overheads, which shall be classed either—

i) if the Activity Costs relate to one or more Operational Business Processes which do not have a direct causal link to any of the SPHCCs being processed, as Pipeline Overheads; or

ii) if the Activity Costs relate to Non-operational Business Processes **which do not have a direct causal link to any of the SPHCCs being processed**, as General Overheads.

5.31 As a result of our proposed changes, we expect Royal Mail to review the Activity Costs of the Non-operational Business Processes to ensure they are treated and allocated in accordance with the amended NCR 8.

Changes to NCR 10: Weighted Volume Drivers

Current position

5.32 According to NCRs 8 and 9, if an Activity Cost has a direct causal link to the processing of some or all of the SPHCCs, then it must be categorised as an Attributable Operational or Non-operational Cost, and it must be allocated to the SPHCCs in question using either a Weighted Volume Driver or an Other Driver.

5.33 NCR 10 sets out how Weighted Volume Drivers are to be calculated as follows:

8.28 Weighted Volume Drivers shall incorporate two types of factors for each relevant attributable Activity Cost, namely—

- a) Proportional Factors, which represent the proportion of the total volume of each SPHCC which uses the related Activity; and
- b) Weighting Factors, which represent the relative proportions of work that units of each SPHCC require from the related Activity.

8.29 Proportional Factors referred to in §8.28(a) shall be based on operational data collected using representative measurements of total volumes (including statistical sampling techniques where necessary).

8.30 Depending on the nature of the Activity, one or more of the following variables may be used as a determinant of the work to calculate the Weighting Factors—

- a) time (needed to carry out the Activity): where appropriate, industrial engineering studies must be carried out in accordance with relevant ISO standards;
- b) weight: appropriate operational data must be used; and
- c) size: appropriate operational data must be used.

8.31 Royal Mail must carry out for each Financial Year a review to ascertain which Proportional Factors and Weighting Factors need to be reviewed and, if necessary, must update them to ensure that they continue to reflect operational reality accurately.

8.32 To identify the Proportional Factors and the Weighting Factors which may need adjusting referred to in §8.31, Royal Mail must consider what (if any) changes have occurred during the Financial Year in question in the following areas—

- a) working practices;
- b) technology; and
- c) SPHCCs mix (relative volumes).

8.33 Royal Mail may carry out ad hoc event-driven reviews and updates if necessary.

- 5.34 As an illustrative example, if half the parcels were to be delivered using a Van route and the other half via other routes, then the Proportional Factor for the parcels relating to Van route would be 50%. And if an Activity takes on average five times more effort to carry out for a parcel than a letter, then the Weighting Factor for the parcels on that Activity would be 5 compared with the Weighting Factor of 1 for a letter.

Our analysis

- 5.35 In 2013/14, Royal Mail changed the Weighting Factors related to outdoor delivery (see paragraphs 4.11 to 4.12). As a result of these changes, in some instances the Weighting Factor for parcels was reduced from 40 to 12 compared with the Weighting Factor of 1 for a letter.

- 5.36 This change in Weighting Factors was one of the key reasons why Royal Mail's changes to its cost allocations in 2013/14 resulted in less cost being allocated to parcels and more cost to letters³³.
- 5.37 In 2016/17, Royal Mail made further changes to the Activities and Weighting Factors. As a result of these changes, new Street and Path Activities were introduced to reflect the way mail is conveyed along the street or the path to the recipient's door in a Shared Van, on foot or in an HCT.
- 5.38 Royal Mail considers that, while letters and parcels are en route, for example while they are being transported on a Shared Van or an HCT, the relative effort of conveying them is the same. Royal Mail therefore sets the Weighting Factors for letters and parcels for those Activities as equal. Royal Mail has informed us that this assumption underpinned also the previous cost allocation methods, although it was not explicitly stated in the Costing Manual.
- 5.39 Royal Mail argues that, while letters and parcels are en route, the cost drivers depend only on the distance and the time taken, which is independent of the format, weight or size of the mail items being conveyed. Instead, the format affects the new cost allocation methods by determining the proportions of various SPHCCs going through different delivery methods.
- 5.40 For example, parcel SPHCCs are classified into four formats which determine the method by which they are to be delivered. Format 1 and 2 parcels which are smaller and lighter and most letters are foot deliverable (including Shared Van and HCT delivery methods). Format 3 and 4 parcels which are larger and heavier parcels are delivered using motorised delivery methods (including dedicated vans). These formats are therefore allocated the Activity Costs of motorised delivery methods, as a result of which the delivery costs allocated to larger and heavier parcels are generally higher.
- 5.41 We consider Royal Mail's assumption relating to the equal effort of conveyance for letters and parcels to be consistent with the NCRs and also appropriate for our monitoring purposes. However, Royal Mail has not explained and justified this assumption in its published Costing Manual³⁴.
- 5.42 Also, the way Royal Mail has set up its calculations, some of which are reflected in its published Costing Manual³⁵, is not consistent with the terminology defined in the NCRs. For example, we note that some of Royal Mail's conflate the function of a Weighting Factor and a Proportional Factor. In other words, Royal Mail uses the Weighting Factors to also reflect the proportion of the parcel SPHCCs between foot deliverable and non-foot

³³ Royal Mail, Royal Mail Group Limited Regulatory Financial Statements 2013-14, dated December 2005, Delivery Methods page 5 & 6, <https://www.royalmailgroup.com/en/about-us/regulation/regulatory-financial-statements/>

³⁴ Royal Mail, ABC Costing Manual Technical Appendices, 2016-17.

³⁵ Royal Mail, ABC Costing Manual Technical Appendices, 2016-17, Appendix 5.1.1.7: Derivation of Delivery Outdoor SPHCC Weightings.

deliverable, which we consider to be the function of Proportional Factors as required by NCR 10 (paragraph 8.28 (a)).³⁶

- 5.43 Royal Mail has informed us that the Weighting Factors have been used in this way as it was the most practical means of updating cost allocation calculations and was deemed to be the simplest and easier to maintain and control.
- 5.44 While we understand Royal Mail's reasons, we expect Royal Mail to explain its approach more clearly in its published Costing Manual and other relevant submissions and ensure those explanations use a terminology that is consistent with the RAG. If the functions of Weighting Factors and Proportional Factors are combined in a single set of numbers, this must be explained clearly. Royal Mail must also ensure that it has the ability to break down, if needed, the single set of numbers into separate Weighting Factors and Proportional Factors.
- 5.45 In addition, many of the Activity Drivers used by Royal Mail are based on Planning Values and industrial engineering measurements, because actual data could not be reasonably and cost-effectively recorded at the required level of granularity. We therefore propose the need to set out further guidance regarding the use of theoretical or modelled data in NCR 10 (similar to the further guidance we propose to give on NCR 6 – see paragraph 5.62).
- 5.46 We consider that the Guiding Principle of Objectivity and the NCR 2 on Operational reality require Royal Mail to use actual data where there is reliable and relevant data recorded. Theoretical or modelled data must be used only where this is not the case, because we consider there is more risk of bias when data is not grounded in actual operations and actual work done.
- 5.47 Furthermore, we consider that any use of theoretical or modelled data must be done in accordance with the NCR 14 and 15 which address the use of operational data and data integrity.

Our proposal

- 5.48 To ensure the definition of Weighting Factors is sufficiently clear, we propose to amend NCR 10 as follows (amendments are in bold letters):

³⁶ As an illustrative example, if 20% of all parcels are delivered using an HCT route, and 94% of the parcels which weigh between 0 – 100g are Format 1 and 2 which makes them foot deliverable (the remaining 16% being Format 3 and 4, which makes them deliverable using a motorised method); then Royal Mail states in the Costing Manual that the Proportional Factor is 20% and the Weighting Factor is 0.94. Whereas, if the definitions in line with RAG are applied appropriately, the Proportional Factors for Format 1 and 2 parcels would be 18.8% (20% x 0.94) and the Weighting Factors for those parcels would be 1 (equal to letters' Weighting factor of 1).

8.28 Weighted Volume Drivers shall incorporate two types of factors for each relevant attributable Activity Cost, namely—

- a) Proportional Factors, which represent the proportion of the total number of revenue derived volumes of each SPHCC which uses the related Activity; and
- b) Weighting Factors, which represent the relative proportions of amount of work that units of each SPHCC require from the related Activity, **when compared to a different SPHCC using the same Activity.**

- 5.49 We expect Royal Mail to review its use of the terminology related to the Weighting Factors and Proportional Factors in its published Costing Manual and its submissions to us to ensure that they are consistent with the amended NCR 10. We also expect Royal Mail to explain its reasons clearly for all its assumption in determining the Weighting Factors including where it assumes parcels and letters to have equal Weighting Factors.
- 5.50 To provide further guidance on the use of theoretical or modelled data and clarify other related aspects of the rules, we propose the NCR 10 to be amended as follows (amendments are in bold and strike-through letters):

8.29 Proportional Factors referred to in §8.28(a) shall be based on operational data collected using representative measurements of total volumes (including statistical sampling techniques where necessary, **see National Costing Rule 14**).

8.30 Depending on the nature of the Activity, one or more of the following variables may be used as a determinant of the amount of work to calculate the Weighting Factors—

- (a) time (needed to carry out the Activity): ~~where appropriate, industrial engineering studies must be carried out in accordance with relevant ISO standards;~~
- (b) weight (of an item): ~~appropriate operational data must be used; and~~
- (c) size (or physical dimensions of an item): ~~appropriate operational data must be used.,~~

provided that each variable used by Royal Mail to calculate each Weighting Factor is quantified based on appropriate operational data using actual data containing the necessary granularity.

Only where such actual data is unavailable or lacks sufficient granularity, Royal Mail may use modelled or theoretical data, provided that this data is—

- (d) based on sampling or industrial engineering studies; and
- (e) prepared in accordance with relevant statistical sampling techniques and ISO standards (see **National Costing Rule 14**).

For the avoidance of doubt, where Royal Mail uses either actual, modelled or theoretical data under this §8.30, Royal Mail must ensure the integrity of the data in accordance with National Costing Rule 15.

8.31 Royal Mail must carry out for each Financial Year a review to ascertain which Proportional Factors and Weighting Factors need to be reviewed and, if necessary, must update them to ensure that they continue to reflect operational reality accurately.

8.32 To identify the Proportional Factors and the Weighting Factors which may need adjusting referred to in §8.31, Royal Mail must consider what (if any) changes have occurred during the Financial Year in question in the following areas—

- a) working practices;
- b) technology; and
- c) SPHCCs mix (relative volumes).

8.33 Royal Mail may carry out ad hoc event-driven reviews and updates if necessary.

- 5.51 We do not anticipate changes in the costs as a result of the proposed changes to NCR 10. However, we expect Royal Mail to revise its published Costing Manual and its relevant Technical Appendices to address the issues we have identified in paragraphs 5.39 to 5.44.

Use of theoretical or modelled data

Changes to NCR 6: Resource Drivers

Current position

5.52 NCR 6 sets out the rule for calculating and applying Resource Drivers, namely:

8.20 All costs aggregated into Cost Types shall be attributed to the Activities which cause those costs to be incurred. Where a Cost Type is incurred as a result of more than one Activity, Resource Drivers shall be used to attribute an appropriate share of the Cost Type to each Activity.

8.21 The Resource Driver for each Cost Type shall be—

a) based on the resource consumption giving rise to the Cost Type (e.g. staff hours, machine hours, accommodation footprint, vehicle hours); and

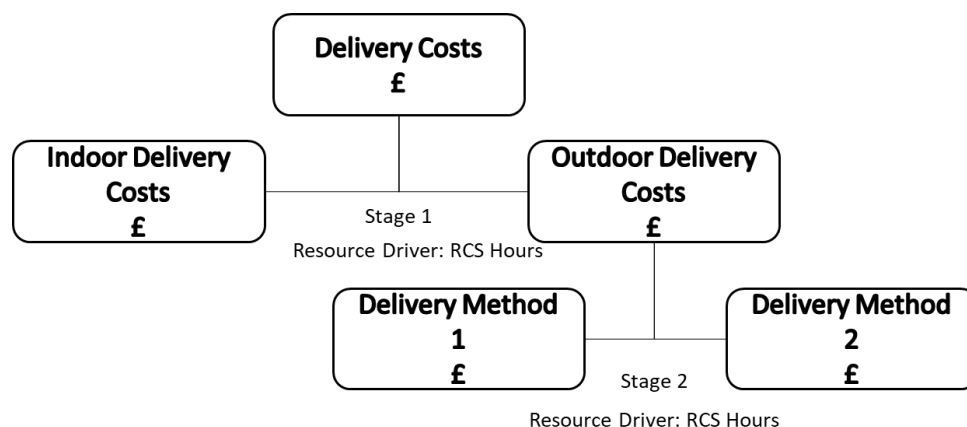
b) quantified based on appropriate operational and financial data.

5.53 NCR 6 means, for example, that staff costs could be allocated to Activities based on the number of hours booked to a timesheet system or taken from shift pattern information.

Our analysis

5.54 Actual outdoor delivery hours are recorded by staff in Royal Mail's Resource Control System ("RCS") against a series of defined tasks. Prior to 2016/17, these recorded hours were used as the basis of the Resource Drivers to allocate both staff and non-staff Cost Types to the relevant outdoor delivery Activities (See Figure 5.1).

Figure 5.1: Illustrative example of the use of RCS Hours as a Resource Driver



5.55 In 2016/17, Royal Mail stopped using RCS hours as the basis of calculating Resource Drivers and splitting costs between different Delivery Methods (stage 2, Figure 5.1), but it continued to use these actual hours to split total costs between indoor and outdoor

delivery Methods (stage 1, Figure 5.1). Royal Mail instead began using Planning Values³⁷, namely theoretical or modelled hours as the basis of the Resource Drivers. The Planning Values are assessed by industrial engineering methods and represent standard hours or hours that each task should take, and not the actual hours.

- 5.56 Royal Mail has informed us that it does not currently have sufficiently reliable and granular data to calculate the Resource Drivers for the Activities, which relate to the new delivery methods. As explained in paragraph 4.12, the new Activities were introduced in to the costing system to reflect the new delivery methods.
- 5.57 Royal Mail has also informed us that Postal Digital Assistant (PDA) Outdoor actuals, alongside the ongoing trials of Automated Hours Data Capture (AHDC) and Resource scheduler are being used to align hours worked with workload and fairness in processing, logistics and delivery. This is a potential new source of outdoor actual hours. However, Royal Mail has informed us that currently the Planning Values (i.e. theoretical data) are a more reliable basis for the calculation of Resource Drivers than actual hours recorded in the RCS.
- 5.58 NCR 6 only refers to the use of operational and financial data and does not refer explicitly to the use of theoretical or modelled data. We recognise that the use of theoretical or modelled data may be the most proportionate way to get suitably detailed information for cost allocations in some circumstances. Many of the Activity Drivers used by Royal Mail to allocate Activity Costs to the SPHCCs are based on Planning Values, because actual data could not be reasonably and cost-effectively recorded at the required level of granularity.
- 5.59 For example, updating the recorded data to reflect the new Activities would require each postmen and postwomen to record how much time they spent on each part of their delivery route; paths to front doors, on the street between paths, waiting at a front door etc. This might not provide a reliable source of data, as postmen and postwomen might not all record the information in the same way, and they each have to remember to record possibly hundreds of data points for each route.
- 5.60 However, we consider that our Guiding Principle of Objectivity and NCR 2 on Operational reality require Royal Mail to use actual data where there is reliable and relevant data recorded. Theoretical or modelled data should be used only where this is not the case, because we consider there is more risk of bias when data is not grounded in actual operations and actual work done.
- 5.61 Additionally, we consider that any use of theoretical or modelled data must be done in accordance with the NCR 14 and 15 which address the use of operational data and data integrity. We also propose changes to NCR 14 and 15, as explained further below (see paragraphs 5.75 to 5.97), to ensure all types of data and all aspects of data integrity.

³⁷ Planning Values (PVs) express the expected time to undertake a wide variety of tasks within operational processes. PVs are obtained from standard Industrial Engineering work measurement exercises undertaken over a number of years. A task is observed, the specific actions involved in the task are recorded, and the relevant time standards are applied to arrive at the time it should take to undertake the activity at a given rate of working.

Our proposal

- 5.62 For those reasons, we propose NCR 6 to be amended as follows (amendments are in bold letters):

8.20 All costs aggregated into Cost Types shall be attributed to the Activities which cause those costs to be incurred. Where a Cost Type is incurred as a result of more than one Activity, Resource Drivers shall be used to attribute an appropriate share of the Cost Type to each Activity.

8.21 The Resource Driver for each Cost Type shall be—

- a) based on the resource consumption giving rise to the Cost Type (e.g. staff hours, machine hours, accommodation footprint, vehicle hours);
- b) quantified based on appropriate operational and financial data **using actual data containing the necessary granularity.**

Only where such actual data is unavailable or lacks sufficient granularity, Royal Mail may use modelled or theoretical data, provided that this data is—

- (c) based on sampling or industrial engineering studies; and
- (d) prepared in accordance with relevant statistical sampling techniques and ISO standards (see National Costing Rule 14).

For the avoidance of doubt, where Royal Mail uses either actual, modelled or theoretical data under this §8.21, Royal Mail must ensure the integrity of the data in accordance with National Costing Rule 15.

- 5.63 We propose that Royal Mail's provides us with the Resource drivers for outdoor delivery Activities which are based on Planning Values rather than actual hours recorded. We propose these resource drivers are displayed as a proportion of the total resource required for that Cost Type and Pipeline segment. We propose that Royal Mail must include this data in the cost data it provides us confidentially and annually for the building of the CAM.
- 5.64 This data will allow us to monitor how the theoretically based Resource Drivers change from one year to another and identify any changes which may be necessary for us to understand better and investigate further.
- 5.65 As a result of our proposed changes, we expect Royal Mail to review the Resource Drivers to ensure they are calculated in accordance with the amended NCR 6.
- 5.66 We do not anticipate any specific changes in the costs as a result of this proposal.

Changes to NCR 11: Other Drivers

Current position

- 5.67 NCR 11 explains how to calculate and use Other Drivers:

8.34 Other Drivers shall be used for costs (certain Attributable Operational Costs and all Attributable Non-operational Costs and Aggregate Costs) which are directly linked to a factor other than mail traffic in the Pipeline.

8.35 Other Drivers shall be defined in a way which appropriately reflects the causal link with that factor

- 5.68 An example of Other Drivers relates to the costs associated with scanning the mail which might be driven by the time the machines are in use for rather than the number of items scanned.

Our analysis

- 5.69 Similar to NCR 6 and NCR 10, we consider that the current NCR 11 needs to include further guidance on the use of theoretical or modelled data.

Our proposal

- 5.70 We consider that our Guiding Principle of Objectivity and the NCR 2 on Operational reality require Royal Mail to use actual data where there is reliable and relevant data recorded. Theoretical or modelled data must be used only where this is not the case, because we consider there is more risk of bias when data is not grounded in actual operations and actual work done.
- 5.71 Additionally, we consider that any use of theoretical or modelled data must be done in accordance with the NCRs 14 and 15 which address the use of operational data and data integrity. We also propose changes to NCRs 14 and 15, as explained further below, to ensure all types of data and all aspects of data integrity.
- 5.72 Therefore, we propose NCR 11 to be amended as follows (amendments are in bold and strike-through letters):

8.34 Other Drivers shall be used for costs (certain Attributable Operational Costs and all Attributable Non-operational Costs and Aggregate Costs) which are directly linked to a factor other than mail traffic in the Pipeline.

8.35 Other Drivers shall be defined in a way which appropriately reflects the causal link with that factor **quantified based on appropriate operational data using actual data containing the necessary granularity which reflects the causal link to that factor.**

Only where such actual data is unavailable or lacks sufficient granularity, Royal Mail may use modelled or theoretical data, provided that this data is—

(a) based on sampling or industrial engineering studies; and

(b) prepared in accordance with relevant statistical sampling techniques and ISO standards (see National Costing Rule 14).

For the avoidance of doubt, where Royal Mail uses either actual, modelled or theoretical data under this §8.35, Royal Mail must ensure the integrity of the data in accordance with National Costing Rule 15.

5.73 As part of the submission of the Costing Manual, Royal Mail provides a file which details Activities and associated attributes/characteristics (the Activity Bible). This includes, amongst other things, details of how activity costs are assigned to products and/or services. We propose that Royal Mail should ensure it is clear which Activities are allocated using Other Drivers (as opposed to Weighted Volume Drivers or EPMU), and the basis for those allocations. This will allow us to identify anomalies which we might want to investigate further.

5.74 We do not anticipate changes in the costs as a result of these proposals to NRC 11

Changes to NCR 14: Operational data and sampling

Current position

5.75 Many of the cost allocations and NCRs use or discuss operational data. NCR 14 is in place to ensure the operational data used by Royal Mail is accurate and consistent (over time and in similar applications). It also ensures where data is not available for each and every data point, Royal Mail may use appropriate sampling techniques to obtain the necessary data:

8.40 All operational data used by the National Costing Methodology shall be regularly reviewed and, where necessary, updated to ensure the accuracy of costing and its consistency with the operational reality (see National Costing Rule 2).

8.41 Royal Mail must ensure that all sampling used by the National Costing Methodology is applied by a qualified professional statistician as such sampling must be based on statistical techniques regarded as appropriate for such purposes. The reference to a “qualified professional statistician” is a reference to a person with the relevant statistical knowledge.

- 5.76 One example of the use of sampled data is in the Mail Characteristics Survey (MCS) which provides a representative sample of the mail traffic processed across the Reported Business.

Our analysis

- 5.77 The rule refers to operational data and not explicitly to theoretical and modelled data. However, we would expect all data sources etc. to be reviewed and updated for accuracy and consistency, so we propose to link NCR 14 to NCR 15.
- 5.78 As explained in NCR 6 (see paragraphs 5.52 to 5.66), Royal Mail made some changes to the use of data used for Resource Drivers. To support the changes Royal Mail has conducted studies using Industrial Engineers (IE). It states that IEs accompany delivery postmen and postwomen on their delivery route and measure the time taken for each element of work observed. Thousands of observations are captured in this way across delivery operations. The information is collated in a database, which is then used alongside calculated workloads to produce standard (or ‘should take’) hours for each Activity.
- 5.79 Sampling can be defined as a statistical method of obtaining representative data or observations from a group or population, as such, the IE studies could be considered sampling, however this is not explicitly mentioned in our rules.

Our proposal

- 5.80 We propose NCR 14 to be amended as follows (amendments are in bold letters):

8.40 All operational data —**whether actual, modelled or theoretical data**— used by the National Costing Methodology shall be regularly reviewed **by Royal Mail** and, where necessary, updated to ensure the accuracy of costing and its consistency with the operational reality (see National Costing Rule 2). **In so doing, for the avoidance of doubt, Royal Mail must ensure the integrity of all the data in accordance with National Costing Rule 15.**

8.41 Royal Mail must ensure that all sampling used by the National Costing Methodology is applied by a qualified professional statistician as such sampling must be based on statistical techniques regarded as appropriate for such purposes. The reference to a “qualified professional statistician” is a reference to a person with the relevant statistical knowledge and expertise, who shall have a qualification in statistics from a recognised professional body, such as the Royal Statistical Society in the United Kingdom.

5.81 We do not anticipate any specific movement to the costs as a result of this change.

Changes to NCR 15: Data integrity

Current position

5.82 National Costing Rule 15 explains how to ensure the integrity of financial and operational data:

8.42 The integrity of financial and operational data used for the National Costing Methodology shall be preserved by adequate checks and controls, which shall include reconciliation of total cost data at appropriate points in the National Costing Methodology.

8.43 The total amount of input costs relating to any element of the National Costing Methodology shall be equal to the total amount of output costs relating to that element. In particular, the following total figures shall be reconciled to each other—

- a) the total costs in the General Ledger;
- b) the total Activity Costs; and
- c) the total costs of all SPHCCs.

Our analysis

5.83 Financial and operational data, whether actual, modelled or theoretical, could be subject to changes in methodology and techniques. Royal Mail is required to ensure any such changes are consistent with the relevant Guiding Principles and the relevant rules in the RAG.

5.84 However, in the absence of appropriate checks and controls, such changes mean that the consistency of this data over time is not necessarily assured and may lead to unintended or artificial year-on-year variances. This could mean that we are unable to accurately compare financial and operational data over time and appropriately inform our decisions.

- 5.85 Our observations in the 2016/17 costing data set out below provide two examples of changes in the methodology or technique used to measure operational data. These examples highlight the importance of having checks and controls on the development of data from one period to another.
- 5.86 In 2016/17, when Royal Mail introduced the new method for categorising parcel products to formats (Volumetric methods, see paragraphs 4.15 to 4.18), it used sampling data obtained through MCS. The data for SPHCCs with similar characteristics is segmented into a number of product groups (i.e. stamp parcels or tracked parcels) based on statistically valid samples. Prior to 2016/17, the sample data used included two product groups, Tracked and Untracked Parcels, which are collectively referred to as Domestic Account Parcels.
- 5.87 The method used for the MCS survey, which informed the 2016/17 cost allocations, did not produce statistically significant sample sizes for Tracked Parcels, which led Royal Mail to combine these samples with Untracked Parcels to create a single product group. Royal Mail stated that using separate product groups “could not be justified or supported by empirical data from MCS and [it] could not therefore be confident that this would give a more accurate cost attribution”.³⁸
- 5.88 The way the MCS is conducted at present means that issues such as this are not identified until after the survey period has ended. Royal Mail has confirmed that the issue, which resulted in sample sizes that were not statistically significant in Tracked Parcels, has now been addressed and the distribution by format for Tracked and Untracked Parcels is separated back into two groups.³⁹ As a result the data in the 2016/17 financial year is not comparable to that in 2015/16 and 2017/18.
- 5.89 Royal Mail’s reasons for the above changes appear to be valid. However, Royal Mail must as far as possible design sampling surveys and engineering studies, prior to commencing those surveys or studies, in a way that ensures the surveys or studies produce statistically valid outputs.
- 5.90 Another example of changes in how data are measured relate to the weight bands of parcels used for sampling. We noted that in 2016/17 Royal Mail made an additional change to the size bandings of parcels. It removed the more than 5kg weight band and combined these items with the 2-5kg parcels to create a single +2kg weight band.
- 5.91 [X]⁴⁰ Royal Mail’s changes to the weight bands appear appropriate in light of the operational reality, although they may make data for the weight bands in question harder to compare for periods before and after the change.
- 5.92 Overall, Royal Mail’s reasons for the changes in the above two examples appear to be valid. However, these examples highlight the importance of having checks and controls on

³⁸ Source: Royal Mail’s response to Question 2(b) of “Phase II of Review of Regulatory Financial Reporting for Royal Mail: Costing System Changes for 2014 and 2017” sent on 14th March 2018, dated 28 March 2018 (“RRFR”).

³⁹ Ibid.

⁴⁰ [X]

the development of data from one period to another. These checks and controls ensure the maintenance and assurance of accuracy and consistency of any data over time.

- 5.93 The overall purpose of any data integrity requirement is to ensure data is recorded exactly as intended and when later utilised, ensure the data is the same as it was when it was originally recorded. In short, data integrity aims to prevent unintentional changes to information. It is a critical aspect to the design, implementation and usage of any system or model which stores, processes or retrieves business data.
- 5.94 Any unintended changes to data as the result of a storage, retrieval or processing operation, including malicious intent, unexpected hardware failure, and human error, could be seen as a failure of data integrity.
- 5.95 NCR 15 does not currently state that data integrity includes the assurance of the consistency of data from one period to another. We therefore propose to set out our guidance when changes to the structure of underlying data is deemed acceptable in accordance with NCR 15.

Our proposal

- 5.96 We propose NCR 15 to be amended as follows (amendments are in bold and strike-through letters):

8.42 **Data integrity is the maintenance of, and the assurance of the accuracy and consistency of any data over time, and the data includes (but is not limited to) inputs, models and outputs.** The **data** integrity of financial and operational data —**whether actual, modelled or theoretical data**— used for the National Costing Methodology shall be preserved by adequate checks and controls ~~which~~ **on the data for the same period as well as adequate checks and controls on the development of data from one period to another.** The checks and controls shall include, **(but are not limited to)** reconciliation of total cost data at appropriate points in the National Costing Methodology.

8.43 The total amount of input costs relating to any element of the National Costing Methodology shall be equal to the total amount of output costs relating to that element. In particular, the following total figures shall be reconciled to each other—

- a) the total costs in the General Ledger;
- b) the total Activity Costs; and
- c) the total costs of all SPHCCs.

- 5.97 We do not anticipate any specific changes in the costs as a result of the proposed changes.

Changes to Transfer Charges

Current position

- 5.98 We currently require Royal Mail to set transfer charges for the services which the Reported Business may provide to other companies or business units within the Relevant Group, and for services which it may receive from them. The transfer charges are necessary to ensure that the costs and revenues of the Reported Business represent those of an independent commercial entity. This is important for our considerations of the financial sustainability and efficiency of the provisions of the universal service which we carry out by monitoring the costs and revenues of the Reported Business.
- 5.99 The RAG requires that these transfer charges are calculated on an arm's length basis following the rules below⁴¹:
- a) Equivalence pricing:
 - i) if the Reported Business provides a service to another entity within the Relevant Group, it must charge that entity a transfer price that is equivalent to the price it charges to third parties in the open market for a similar service; and
 - ii) if an entity within the Relevant Group provides a service to the Reported Business, it must charge the Reported Business a transfer price that is equivalent to the price it charges to third parties in the open market for a similar service.
 - b) Cost-plus pricing - if there are no similar services provided to or by third parties in the open market, the transfer price must be equal to the FAC of the service plus a mark-up of 10% on the FAC.
- 5.100 We also require Royal Mail to provide us with transfer prices between its upstream services (collection, outward processing and trunking services) and downstream services (inward processing and delivery services) for certain end to end, mainly retail bulk, products. These transfer prices are based on the assumption that the retail products in question receive services from the downstream operations as the access operators receive similar services from Royal Mail wholesale services.
- 5.101 These requirements provide us with the information necessary to calculate separately the profitability of the upstream and downstream parts of the retail products in question. The products captured by this requirement are those which could potentially be at the risk of margin squeeze and include all the products within our margin squeeze control as well as those outside that control.
- 5.102 The RAG requires the transfer prices between the upstream services and the downstream services to be set following the rules below⁴²:

⁴¹ Paragraphs 8.72 to 8.76, https://www.ofcom.org.uk/data/assets/pdf_file/0025/108871/Annex-2.-New-RAG.pdf

⁴² Paragraphs 9.8 to 9.13, https://www.ofcom.org.uk/data/assets/pdf_file/0025/108871/Annex-2.-New-RAG.pdf

- a) Equivalence pricing - Where there are appropriate comparable access products, Royal Mail must base the transfer price of the service in question on the price of that product, adjusting for the FAC differences, plus a mark-up of 10% on those FAC differences, of the operational and activity differences between the service in question and the equivalent access product.
- b) Cost-plus pricing - Where there are no appropriate comparable Access products, Royal Mail must set the transfer price of the service in question as equal to the FAC of that service plus a mark-up of 10% on that FAC. As explained above, where we require cost-plus pricing and where we require FAC adjustments for differences in equivalent pricing (between equivalent retail and access products in question), we currently require a 10% mark-up to be added to the FAC of the services or differences in question respectively. This is to ensure a measure of return is included in the FAC, because Royal Mail's ABC costing system generates FAC numbers which do not include any measure of return or profit.

Our analysis

- 5.103 Since March 2012, when we put in place the above requirements, Royal Mail's business has undergone significant changes including its privatisation. The privatisation and the required additional financial reporting to the markets and our regulatory financial reporting requirements have resulted in Royal Mail being subject to significantly more transparency about its financial performance. We now consider there is sufficient data to estimate an appropriate return to be used instead of the approximate 10% mark-up on FAC.
- 5.104 We therefore propose to replace the requirement to include a 10% mark-up on FAC with a requirement to include "an appropriate return". We expect this return to be that which an investor would demand to receive from Royal Mail's downstream services (including its wholesale services) if it were an independent entity. As we concluded in our March 2017 Statement⁴³, for an asset-light and labour-intensive business such as Royal Mail, a return on sales metric is a more appropriate metric, and investors are more likely to use it as a measure of the returns they demand, as opposed to a return on assets metric.

Our proposal

- 5.105 For those reasons, we set out below our proposed amendments to the relevant transfer pricing rules in the RAG (the amendments are in bold and strike-through letters):

⁴³ Paragraphs 3.44 to 3.63, https://www.ofcom.org.uk/data/assets/pdf_file/0033/97863/Review-of-the-Regulation-of-Royal-Mail.pdf

8.76 Subject to §§8.77-78, Royal Mail must calculate a Transfer Charge on an arm's length basis in accordance with §8.72 by securing that—

- (a) if the product and/or service provided is provided to persons other than the Relevant Group, the Transfer Price shall be equivalent to the price charged to those persons;
- (b) if the product and/or service is provided to the Relevant Group by other persons, the Transfer Price shall be equivalent to the price charged by those persons; and
- (c) if the product and/or service does not fall within §8.76(a) or (b), the Transfer Price shall be equal to the FAC of that product and/or service plus **an appropriate return** ~~a mark up of 10% on FAC.~~

Equivalence pricing

9.9 Where there are appropriate comparable Access products and/or services provided by Royal Mail to external customers, Royal Mail must apply the equivalence pricing approach referred to §9.10 in determining Transfer Prices.

9.10 The equivalence pricing approach means—

- (a) An appropriate comparable Access product and/or service shall be identified for the internal product and/or service for which the Transfer Price is to be determined.
- (b) The operational and Activity differences between the internal product and/or service for which the Transfer Price is to be determined, and the appropriate comparable product or service shall be identified.
- (c) The FAC differences of the operational and Activity differences referred to in §9.10(b) above shall be identified in a manner consistent with the National Costing Methodology.
- (d) The Transfer Price shall be determined as the sum of the price of the appropriate comparable Access product and/or service, the FAC differences referred to in §9.10(c) plus **an appropriate return** ~~a mark up of 10% on those FAC differences.~~

...

Cost-plus pricing

9.12 Where there are no appropriate comparable Access products and/or services, Royal Mail must set the Transfer Price as equal to the FAC of the product and/or service in question plus **an appropriate return** ~~a mark up of 10% on that FAC.~~

5.106 We consider that it is reasonable to base the appropriate rate of return on the Financeability EBIT range of 5-10% which we have set as a measure of Royal Mail's commercial rate of return for the provision of the universal service⁴⁴. We expect Royal Mail

⁴⁴ Paragraphs 3.58 to 3.60, https://www.ofcom.org.uk/data/assets/pdf_file/0033/97863/Review-of-the-Regulation-of-Royal-Mail.pdf

to regularly evaluate the appropriateness of the rate of return it uses and monitor the available information to ensure the rate of return remains reasonable for downstream services.

- 5.107 We expect the equivalent pricing approach to be applicable in the majority of cases, in particular in relation to the transfer prices for retail bulk products between upstream and downstream services where there are equivalent access products. As a result, we do not expect our proposals to have a significant effect on the total value of the transfer prices currently set by Royal Mail.

Clarification to NCR 2: Operational reality

Current position

- 5.108 NCR 2 states:

8.13 As far as is practicable, the National Costing Methodology shall reflect the trading operations of Royal Mail as they are undertaken with the exception of National Costing Rule 3 below concerning Class Costing, but subject to the additional requirements of the Zonal Costing Rules.

- 5.109 For example, if a product is collected from a Post Box in a Van then the cost allocation should reflect this, and that product should take an appropriate share of the costs of the Van.

Our analysis

- 5.110 As explained before, in 2013/14 and 2016/17, Royal Mail made various significant changes to its costs allocation methods to reflect the new delivery methods it adopted. Royal Mail's submissions to us on the reasons for the changes and how they have been applied rely heavily on NCR 2 and the need to observe operational reality without significant references to the other rules in the RAG or the Guiding Principles.

Our clarification to the rule

- 5.111 We emphasise that Royal Mail is required to comply with all relevant rules in the RAG in each instance (including all the NCRs). There is no hierarchy or priority among the rules in the RAG or the NCRs. The only hierarchy we recognise is that specific rules in the RAG override the Guiding Principles in the USPAC 1.7.1⁴⁵. In other words, if there is a clear and specific rule in the RAG for an issue, that rule will take precedent over any alternative application of the Guiding Principles to that issue.
- 5.112 However, we also recognise that there may be cases where Royal Mail considers there to be a conflict between two or more rules in the RAG. In such cases, Royal Mail must satisfy

⁴⁵ Ofcom, USP ACCOUNTING CONDITION, dated 18 December 2017, https://www.ofcom.org.uk/_data/assets/pdf_file/0024/108870/Annex-1.-New-USPAC.pdf

itself that, in giving priority to one rule over another, it complies with the Guiding Principles. Royal Mail must also demonstrate its reasoning to us as part of its Change Control submissions if necessary or upon request.

- 5.113 We do not propose any changes to NCR 2 because we consider it to be adequate for our purposes.

Effective date

- 5.114 We propose the modifications set out in this Section to come into effect from the date of the statement of our decisions. We expect this timing to be proportionate as we do not expect Royal Mail to need to make any significant changes to its costing methodology as a result of the modifications we propose.

Assessment of statutory tests, duties and policy objectives for our proposals

- 5.115 In Section 2 of this consultation, we explain that our proposals to modify the RAG must satisfy relevant tests set out in Schedule 6 of the PSA 2011. We explain below why we consider our proposals satisfy those tests, namely that our proposals:
- are objectively justifiable;
 - do not unduly discriminate against a particular person or a particular description of persons;
 - are proportionate; and
 - are transparent in relation to what it is intended to achieve.
- 5.116 Our proposals are objectively justifiable because, as we have explained in respect of each respective proposal in this Section 5, the modifications to the RAG we are proposing are necessary for us to effectively achieve the objectives for regulatory financial reporting in the light of the overall decisions we made in the March 2017 Statement, namely monitoring the financial sustainability and efficiency of the provision of the universal service as well as monitoring competition and consumer issues.
- 5.117 More specifically, we consider that these reporting obligations are objectively justifiable, as they will enable us to:
- see the revenues, costs and profitability of the Reported Business's products (including universal service products) that use Royal Mail's network and are provided to meet the needs of users in different markets, to help us (i) monitor the risk of cross-subsidisation and (ii) assess the relative cost reflectivity of the pricing of the products in these different groups;
 - understand the basis by which Royal Mail's total costs of its network are allocated to various parts of that network and its products for the purpose of relevant regulatory decisions; and

- discharge our general duties in section 3 of the Communications Act 2003 to further the interests of citizens in relation to communications matters and to further the interests of consumers in relevant markets, where appropriate by promoting competition.
- 5.118 Our proposals are not unduly discriminatory because they aim to address Royal Mail's unique position as the universal service provider.
- 5.119 Our proposals are proportionate because they are necessary to enable us to discharge our statutory duties and effectively monitor Royal Mail's position and activities. In our view, these obligations are no more onerous than is required to comply with our statutory duties and effectively achieve our objectives for regulatory financial reporting set out in Section 2 of this consultation, nor do they produce adverse effects which are disproportionate to those duties and objectives.
- 5.120 Our proposals are transparent because we consider it is clear from the wording of the respective changes to the rules in the RAG what Royal Mail must do and by when. We further consider that the transparency of these obligations is aided by our explanations in this consultation.

Consultation question

- 5.121 In this consultation, we are seeking input relating to the following question:

Question: Do you agree with our proposals regarding changes to the Regulatory Accounting Guidelines, as discussed in Section 5 above?

A1. Responding to this consultation

How to respond

- A1.1 Ofcom would like to receive views and comments on the issues raised in this document, by 5pm on 27 February 2019.
- A1.2 You can download a response form from <https://www.ofcom.org.uk/consultations-and-statements/category-1/review-regulatory-financial-reporting-royal-mail>. You can return this by email or post to the address provided in the response form.
- A1.3 If your response is a large file, or has supporting charts, tables or other data, please email it to postal.regulation@ofcom.org.uk, as an attachment in Microsoft Word format, together with the cover sheet (<https://www.ofcom.org.uk/consultations-and-statements/consultation-response-coversheet>).
- A1.4 Responses may alternatively be posted to the address below, marked with the title of the consultation:
- Hannah Timberlake
Ofcom
Riverside House
2A Southwark Bridge Road
London SE1 9HA
- A1.5 We welcome responses in formats other than print, for example an audio recording or a British Sign Language video. To respond in BSL:
- Send us a recording of you signing your response. This should be no longer than 5 minutes. Suitable file formats are DVDs, wmv or QuickTime files. Or
 - Upload a video of you signing your response directly to YouTube (or another hosting site) and send us the link.
- A1.6 We will publish a transcript of any audio or video responses we receive (unless your response is confidential)
- A1.7 We do not need a paper copy of your response as well as an electronic version. We will acknowledge receipt if your response is submitted via the online web form, but not otherwise.
- A1.8 You do not have to answer all the questions in the consultation if you do not have a view; a short response on just one point is fine. We also welcome joint responses.
- A1.9 It would be helpful if your response could include direct answers to the questions asked in the consultation document. The questions are listed at Annex 4. It would also help if you could explain why you hold your views, and what you think the effect of Ofcom's proposals would be.

- A1.10 If you want to discuss the issues and questions raised in this consultation, please contact Hannah Timberlake on 020 7783 4697 or Kamak Arzhanghi on 020 7783 4339, or by email to Hannah.Timberlake@ofcom.org.uk or kamak.arzhanghi@ofcom.org.uk.

Confidentiality

- A1.11 Consultations are more effective if we publish the responses before the consultation period closes. In particular, this can help people and organisations with limited resources or familiarity with the issues to respond in a more informed way. So, in the interests of transparency and good regulatory practice, and because we believe it is important that everyone who is interested in an issue can see other respondents' views, we usually publish all responses on our website, www.ofcom.org.uk, as soon as we receive them.
- A1.12 If you think your response should be kept confidential, please specify which part(s) this applies to, and explain why. Please send any confidential sections as a separate annex. If you want your name, address, other contact details or job title to remain confidential, please provide them only in the cover sheet, so that we don't have to edit your response.
- A1.13 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and try to respect it. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A1.14 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's intellectual property rights are explained further at <https://www.ofcom.org.uk/about-ofcom/website/terms-of-use>.

Next steps

- A1.15 Following this consultation period, Ofcom plans to publish a statement in the first half of the 2019/20 financial year.
- A1.16 If you wish, you can register to receive mail updates alerting you to new Ofcom publications; for more details please see <https://www.ofcom.org.uk/about-ofcom/latest/email-updates>

Ofcom's consultation processes

- A1.17 Ofcom aims to make responding to a consultation as easy as possible. For more information, please see our consultation principles in Annex 2.
- A1.18 If you have any comments or suggestions on how we manage our consultations, please email us at consult@ofcom.org.uk. We particularly welcome ideas on how Ofcom could more effectively seek the views of groups or individuals, such as small businesses and residential consumers, who are less likely to give their opinions through a formal consultation.
- A1.19 If you have any concerns regarding how this consultation was managed, please contact Ofcom's Corporation Secretary:

Corporation Secretary
Ofcom
Riverside House
2a Southwark Bridge Road
London SE1 9HA
Email: corporationsecretary@ofcom.org.uk

A2. Ofcom's consultation principles

Ofcom has seven principles that it follows for every public written consultation:

Before the consultation

- A2.1 Wherever possible, we will hold informal talks with people and organisations before announcing a big consultation, to find out whether we are thinking along the right lines. If we do not have enough time to do this, we will hold an open meeting to explain our proposals, shortly after announcing the consultation.

During the consultation

- A2.2 We will be clear about whom we are consulting, why, on what questions and for how long.
- A2.3 We will make the consultation document as short and simple as possible, with a summary of no more than two pages. We will try to make it as easy as possible for people to give us a written response. If the consultation is complicated, we may provide a short Plain English / Cymraeg Clir guide, to help smaller organisations or individuals who would not otherwise be able to spare the time to share their views.
- A2.4 We will consult for up to ten weeks, depending on the potential impact of our proposals.
- A2.5 A person within Ofcom will be in charge of making sure we follow our own guidelines and aim to reach the largest possible number of people and organisations who may be interested in the outcome of our decisions. Ofcom's Consultation Champion is the main person to contact if you have views on the way we run our consultations.
- A2.6 If we are not able to follow any of these seven principles, we will explain why.

After the consultation

- A2.7 We think it is important that everyone who is interested in an issue can see other people's views, so we usually publish all the responses on our website as soon as we receive them. After the consultation we will make our decisions and publish a statement explaining what we are going to do, and why, showing how respondents' views helped to shape these decisions.

A3. Consultation coversheet

BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

Please tick below what part of your response you consider is confidential, giving your reasons why

Nothing ☐

Name/contact details/job title ☐

Whole response ☐

Organisation ☐

Part of the response ☐

If there is no separate annex, which parts? _____

If you want part of your response, your name or your organisation not to be published, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response that Ofcom can publish. However, in supplying this response, I understand that Ofcom may need to publish all responses, including those which are marked as confidential, in order to meet legal obligations. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name

Signed (if hard copy)

A4. Consultation questions

- A4.1 In this consultation, we are seeking input relating to our proposals to update our regulatory reporting requirements for Royal Mail.
- A4.2 Below is the question in this consultation:

Question: Do you agree with our proposals regarding changes to the Regulatory Accounting Guidelines, as discussed in Section 5?

A5. Legal instruments

A5.1 The legal instruments are published separately.