
Statement on changes to Royal Mail's regulatory reporting requirements

2022 Review of Postal Regulation

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STATEMENT:

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We have published the following annexes separately.

[A2. Statutory notification: modifications to the USP Accounting Condition \(USPAC\)](#)

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[A4. USP Accounting Condition \(USPAC\) \(changes marked up\)](#)

[A5. Regulatory Accounting Guidelines \(RAG\) \(changes marked up\)](#)

[A6. Direction under Designated USP Condition 1.3.2 and 1.3.2A regarding deliveries](#)

1. Overview

This document sets out Ofcom's decisions on changes to the regulatory reporting requirements imposed on Royal Mail.

In July 2022, we published our Review of Postal Regulation Statement. It sets out our decision on the regulation of postal services from 2022 to 2027, with the aim of ensuring postal users have access to simple, affordable and reliable postal services that meet their needs; supporting a financially sustainable and efficient universal postal service; and supporting effective competition in postal services for the benefit of consumers.

As part of this decision, we decided to strengthen our monitoring framework in relation to reporting on the financial sustainability and efficiency of the universal service. Royal Mail will now be required to annually submit to us a view of the financial sustainability of the universal service over a five-year period. It will also be required, every five years, to provide a detailed confidential forecast containing certain efficiency metrics over a five-year period and publish two measures of its efficiency expectations from that forecast. Royal Mail will also be required to publish annually its progress against those expectations. We consulted in September 2022 on how to implement these decisions via our regulatory reporting requirements, and this statement confirms how we will do so.¹

The regulatory reporting requirements imposed on Royal Mail provide us with the information we need for our monitoring regime, which is a key safeguard of our regulatory framework for postal services. The changes we are confirming in this statement largely build on the information we already require Royal Mail to provide. We have taken a proportionate approach, removing requirements where possible and appropriate.

Our decisions – in brief

We have decided to require Royal Mail to:

- **submit to Ofcom annually a financial forecast covering a period of five years (the annual financial forecast, or AFF).** This replaces the current requirement to provide its Strategic Business Plan and Annual Budget. The contents of the AFF are similar to the current content requirements of the Strategic Business Plan and Annual Budget. However, the forecast length of the Strategic Business Plan was not set, and we have now specified that the length of the AFF must be 5 years and removed the requirement to submit certain efficiency metrics annually. The forecasts must also take account of Royal Mail's latest actual results and be consistent with Royal Mail's own Board-approved business plan, ensuring that our monitoring of the financial sustainability of the universal service is based on Royal Mail's latest information, objectives and expectations. Following feedback from Royal Mail, we have decided to change the deadline for the AFF from 31 May to 30 June every year.

¹ We have also made a small number of other changes not related to our decisions in the 2022 Review Statement, to ensure that we continue to receive the information we need from Royal Mail to fulfil our duties in relation to sustainability and efficiency, while also ensuring that the reporting burden on Royal Mail is proportionate.

- **submit to Ofcom every five years a financial forecast** which includes key efficiency information covering a period of five years (the five-yearly financial forecast, or FYFF). The FYFF will be used as a benchmark against which we will track Royal Mail's efficiency progress. The deadline for this forecast will be 30 June every five years.
- **publish, every five years, two measures of its efficiency expectations from the FYFF** and in each subsequent year to publicly report on progress against those expectations. One measure (PVEO (Price, Volume, Efficiency, Other) analysis) will provide a high-level overview of its efficiency ambitions, while the other (Productivity – WIPGH (Weighted Items per Gross Hour)) will provide insight into the expected operational efficiency of its frontline staff. These expectations will provide stakeholders with visibility of Royal Mail's view of the scope for efficiencies and a benchmark for measuring its progress. Royal Mail will also be required to comment on its annual progress, so that stakeholders can understand the factors that have affected it.
- **continue to regularly report to Ofcom its actual performance** against a number of metrics, with some new requirements and some changes to the granularity of the information required and the rules relating to the preparation of supporting information. These changes will ensure that Royal Mail's actual results can be directly compared with its forecasts so that we can accurately track Royal Mail's progress, and that we have the information we need for our consideration of the financial sustainability and efficiency of the universal service.

The overview section in this document is a simplified high-level summary only. The decisions we have taken and our reasoning are set out in the full document.

The changes to the reporting requirements will come into effect at the start of the 2023-24 financial year, 27 March 2023.

2. Background and introduction

- 2.1 In this document we set out the changes we have decided to make to the Universal Service Provider Accounting Condition and the Regulatory Accounting Guidelines, and one change we have decided to make to the Delivery Exceptions Direction.²
- 2.2 This section sets out the legal duties and powers relevant to our statement and describes our existing regulatory reporting regime. It also sets out the scope of and approach to this statement and provides a brief overview of the decisions made in sections 3 and 4 of our July 2022 Review of Postal Regulation Statement ('the 2022 Review Statement'), which this statement implements.

Our legal duties and powers

Our statutory duties

- 2.3 We briefly set out below Ofcom's main statutory duties relating to postal services, as contained in the Postal Services Act 2011 (the 'PSA 2011') and the Communications Act 2003 (the 'CA 2003'). The legal framework relevant to our review is set out in more detail in Annex 2 to the 2022 Review Statement.³

Securing the provision of the universal postal service

- 2.4 Section 29(1) of the PSA 2011 requires Ofcom to carry out its postal functions in a way that it considers will secure the provision of a universal postal service.
- 2.5 In performing that duty, Ofcom is required by section 29(3) of the PSA 2011 to have regard to the need for 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).
- 2.6 Section 29 of the PSA 2011 does not require that Ofcom give more weight to one of those considerations over the other. Ofcom must take them both into account in arriving at a judgment as to how it ought to carry out its functions, including when considering imposing or modifying regulatory conditions.
- 2.7 Section 29(4) of the PSA 2011 states that the reference to 'financially sustainable' in section 29(3) of the PSA 2011 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 The direction under Designated USP condition 1.3.2 and 1.3.2A regarding deliveries.

³ See Ofcom, 2022. [Review of Postal Regulation: Statement, Annex 2](#).

Ofcom's general duties

- 2.8 Section 3 of the CA 2003 sets out Ofcom's general duties. Ofcom's principal duty in carrying out its functions is to further the interests of citizens and consumers, where appropriate by promoting competition.⁴ This duty, together with Ofcom's general duties, also applies when we carry out our functions in relation to post.
- 2.9 In performing our general duties, we are required to have regard to a range of other considerations, which appear to us to be relevant in the circumstances, including:
- the desirability of promoting competition in relevant markets;
 - the desirability of encouraging investment and innovation in relevant markets;
 - the needs of persons with disabilities, of the elderly and of those on low incomes;
 - the different interests of persons in the different parts of the United Kingdom, of the different ethnic communities within the United Kingdom and of persons living in rural and in urban areas; and
 - the extent to which, in the circumstances of the case, the furthering or securing of the matters mentioned in section 3(1) is reasonably practicable.⁵
- 2.10 In performing our duty to further the interests of consumers,⁶ we must also have regard, in particular, to the interests of those consumers in respect of choice, price, quality of service and value for money.
- 2.11 When carrying out any of our functions relating to postal services, if we were to consider that any of our general duties conflict with our duty under section 29 of the PSA 2011 to secure provision of a universal postal service, priority must be given to the latter.⁷
- 2.12 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. Ofcom has published a set of general regulatory principles on its website.⁸
- 2.13 Ofcom also has an on-going duty under section 6 of the CA 2003 to keep the carrying out of its 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 powers

- 2.14 Under the PSA 2011, Ofcom has the power to impose regulatory conditions⁹ on a universal service provider (under section 36 of the PSA 2011). This power is wide-ranging and allows Ofcom to impose a condition requiring the universal service provider to do anything that

⁴ Section 3(1) of the CA 2003.

⁵ Section 3(4) of the CA 2003.

⁶ Section 3(5) of the CA 2003.

⁷ Section 3(6A) of the [Communications Act 2003](#).

⁸ Section 3(3) of the CA 2003. See [Policies and guidelines - Ofcom](#)

⁹ See Ofcom, 2022. [Review of Postal Regulation: Statement, Annex 2](#).

Ofcom considers appropriate for the purposes of, among other things (a) providing a universal postal service (or part of such a service) throughout the UK or in a specified part of the UK; and (b) providing specified information (at such times and in such manners as Ofcom may direct) to users of postal services about the universal postal service.

- 2.15 Furthermore, Ofcom has the power to impose a Universal Service Provider Accounting Condition (USP Accounting Condition) on the universal service provider (under section 39 of the PSA 2011). This type of condition may require the universal provider to do one or more of the following:
- maintain a separation for accounting purposes;
 - comply with rules set by Ofcom made by us in relation to the identification of costs and cost orientation;
 - comply with rules made by Ofcom about the use of cost accounting systems; and
 - secure that the universal service provider's compliance with those systems is audited annually by a qualified independent auditor,¹⁰ including an obligation to meet the costs of the audit.
- 2.16 Our power to impose a regulatory condition, like the USP Accounting Condition, includes powers to impose obligations also requiring the universal service provider to comply with directions and impose obligations with respect to the matters to which the condition relates.¹¹ 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.
- 2.17 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 Act 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.

The purpose of regulatory reporting

- 2.18 As noted in section 2 of the 2022 Review Statement, our regulatory framework for postal services grants Royal Mail considerable commercial and operational flexibility. This flexibility is accompanied by a number of safeguards, including a comprehensive monitoring regime. Monitoring is a key part of our regulatory framework for postal services, as it enables us to assess how well the current framework is working to meet our regulatory objectives, and whether there might be any need to intervene.
- 2.19 The information we receive as part of our monitoring regime plays an important role in our understanding of the financial sustainability and efficiency of the provision of the universal

¹⁰ Under section 39, a qualified independent auditor means a person who is eligible for appointment as a statutory auditor under Part 42 of the Companies Act 2006 and, if the appointment were an appointment as a statutory auditor, would not be prohibited from acting by section 1214 of that Act (independence requirement).

¹¹ Paragraph 2 of Schedule 6 to the Act.

service. It is a key input to our Annual Monitoring Updates (AMU) and ensures that we can carry out our statutory duties under section 29 of the PSA 2011 (where necessary by conducting our own financial modelling). That information also ensures that we understand the changing needs of users and changing dynamics in the postal market, and enables us to monitor compliance with our regulatory controls, including our access regulations and margin squeeze control.

- 2.20 Our monitoring regime relies on regulatory reporting requirements imposed on Royal Mail (as the designated universal service provider). In line with our statutory powers and duties, we have imposed requirements on Royal Mail to provide us with financial and non-financial information.
- 2.21 The requirements on Royal Mail to provide us with financial information are set out in the USP Accounting Condition and supplemented by the Regulatory Accounting Guidelines (RAG). The requirements to provide us with non-financial information are mostly set out in the Designated Universal Service Provider Condition (DUSP Condition), with a small number contained within the Consumer Protection Conditions and the Essential Condition. We briefly summarise these below.

Existing reporting requirements on Royal Mail

- 2.22 We summarise below the reporting requirements currently applicable to Royal Mail and to which we are, as part of this consultation, proposing changes. The USP Accounting Condition and RAG contain financial reporting requirements, while the DUSP Conditions contain, among other obligations, non-financial reporting requirements.¹²

The USP Accounting Conditions and the RAG

- 2.23 Ofcom has imposed USP Accounting Conditions on Royal Mail.¹³ This includes requirements in relation to accounting separation, costing methodologies and reporting. With regard to reporting requirements, Royal Mail is required to:
- prepare financial information and statements for the Relevant Group¹⁴ as defined in the USP Accounting Condition, including a consolidated cash flow projection statement, a Strategic Business Plan and an Annual Budget;
 - prepare financial information and statements (on an annual, quarterly or monthly basis in some cases) for the Reported Business as defined in the USP Accounting Condition, including income statement, statement of capital employed, cash flow statement, and product profitability statement as part of the quarterly and annual regulatory financial statements ('RFS'), and as well as various other reports containing revenue, cost and volume data provided separately. In doing so, Royal Mail is also

¹² All of the [existing conditions](#) imposed on Royal Mail (and other postal operators) are available on our website.

¹³ Ofcom, [Consolidated USP Accounting Condition \(as at 26 March 2018\)](#).

¹⁴ While the Strategic Business Plan and Annual Budget are part of the regulatory reporting requirements applicable to Royal Mail in respect of the Relevant Group, we require (as part of these requirements) the provision of a range of information specifically about the Reported Business (for example, forecast revenues and costs for the Reported Business, including its Financeability EBIT).

required to provide Ofcom with various reconciliations (e.g. between the statements prepared on a quarterly and annual basis, or between statements prepared for the Reported Business with equivalent information prepared for the Relevant Group) to help ensure the accuracy and consistency of information. Royal Mail is also required to provide a regulatory costing methodology manual (which is also published) and an accounting methodology manual, together with methodology change control reports; and

- ensure that these statements are audited by an external auditor, except where otherwise specified.

2.24 In addition, we have imposed Regulatory Accounting Guidelines (RAG).¹⁵ While the USP Accounting Condition contains the core financial reporting requirements, the RAG is more detailed and sets out how Royal Mail must prepare the submissions required by the USP Accounting Condition.

The Designated Universal Service Provider conditions

2.25 The DUSP Conditions impose the core obligations on Royal Mail to provide the universal service as the designated universal service provider (for example, the requirement to deliver letters to every premise in the UK six days a week). We have also issued two directions under the DUSP Conditions (the Delivery Exceptions Direction and the Collection Exceptions Direction).¹⁶ The purpose of these directions is to set out clearly those exceptional circumstances in which Royal Mail can depart from the universal service requirements regarding the delivery and collection of mail (for example, where delivering to the delivery point concerned involves an immediate hazard to the health or safety of Royal Mail's staff).

2.26 In addition to the core universal service requirements included in the DUSP Condition, the condition also contains a number of reporting and publication requirements on Royal Mail, including to report on and publish its Quality of Service performance quarterly and annually, to report on the provision of letter boxes across the UK, to publish its statement of arrangements for premises more than 10km from an access point and people with mobility challenges.

2.27 These requirements help us to understand whether Royal Mail has met its Quality of Service targets, and help to provide transparency to consumers about how Royal Mail is performing as the universal service provider. We also use the information gathered under these requirements to summarise Royal Mail's quality of service performance in our AMUs.

¹⁵ Ofcom, [Consolidated Regulatory Accounting Guidelines \(as at 29 March 2020\)](#).

¹⁶ See Ofcom, 2013, [Delivery Exceptions Direction](#) and Ofcom, 2013, [Collections Exceptions Direction](#).

Scope and overview of this statement

Our changes implement the decisions made in the 2022 Review of Postal Regulation Statement

- 2.28 We set out our decisions on how we will consider the sustainability and efficiency of the universal service in sections 3 and 4 of the 2022 Review Statement. This statement sets out the changes we have decided to make to the current reporting requirements (specifically, the USP Accounting Condition and the RAG) that we consider are necessary to give effect to these decisions.

We are also making a small number of other minor changes to the reporting requirements on Royal Mail

- 2.29 While this statement is primarily focused on the changes to the reporting requirements that are necessary to implement decisions made in the 2022 Review Statement, we have taken the opportunity to make a small number of other changes that are not linked to our Statement decisions. These changes aim to remove unnecessary requirements on Royal Mail and tighten existing requirements to ensure we have the information we need to monitor effectively.

Overview of responses and our decisions

- 2.30 We received three responses to the consultation, from Royal Mail, the Consumer Council for Northern Ireland (CCNI) and the Greetings Card Association (GCA).¹⁷
- 2.31 The following sections of this statement set out our detailed rationale for our decisions to amend the regulatory reporting requirements for Royal Mail, including our assessment of the points and arguments raised by stakeholders in their responses to our consultation.
- 2.32 We will implement our decisions in the 2022 Review Statement by requiring Royal Mail to:
- a) Submit to Ofcom an AFF covering a period of five years together with more prescriptive sensitivity and downside analyses – see section 3.
 - b) Submit to Ofcom every five years an enhanced version of the AFF, referred to in our requirements as the FYFF, which will include the efficiency expectations Royal Mail expects to achieve across the five-year period, together with the supporting information and calculations for those expectations – see section 4.
 - c) Submit to Ofcom broadly the same financial information and statements for the actual performance as currently required, with proposed changes to ensure the data relating to actuals required is consistent and comparable with the forecast information – see section 5.

¹⁷ [Royal Mail, response to consultation](#). [CCNI, response to consultation](#). [GCA, response to consultation](#).

- d) Publish selected metrics for efficiency expectations from the FYFF; and publish annually the actual progress achieved against those expectations – See sections 4 and 5.
- 2.33 In section 6, we set out the other changes we are making to the reporting requirements, which are not specifically related to the decisions made in the 2022 Review Statement.
- 2.34 Finally, in section 7, we set out when these requirements will come into effect and how we consider that that our decisions meet the relevant tests set out in the 2011 Act.
- 2.35 Our modifications to the USP Accounting Condition and the RAG are published in the statutory notifications at Annexes 2-5. Our modification to the Delivery Exceptions Direction is published in the statutory notification at Annex 6.

Impact Assessment

- 2.36 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 vast majority of its policy decisions.
- 2.37 For further information about Ofcom's approach to impact assessments, see the guidelines, *Better policy-making: Ofcom's approach to impact assessment*.¹⁸ 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.
- 2.38 Royal Mail commented in its response that, while it understood that a full impact assessment may not be necessary in every case of changes to regulation, it expected us to more clearly explain why we had departed from our impact assessment guidelines.
- 2.39 We consider that we have undertaken an appropriate impact assessment. To the extent that there has been any departure from our impact assessment guidelines, this is justified, as explained further below. As noted in Royal Mail's response, an impact assessment may take the form of the consultation document itself.¹⁹ This was the approach we took in the September consultation²⁰ as well as this statement.
- 2.40 We also note that the core decisions, i.e. to require an annual financial forecast covering a five-year period, a detailed confidential forecast containing efficiency metrics over a five-year period (the five-yearly financial forecast), to publish a five-year view of its efficiency expectations and to report publicly against actual performance, had already been consulted and decided on in our 2022 Review of Postal Regulation. The September consultation and this statement are concerned with making the necessary changes to the

¹⁸ [Policies and guidelines - Ofcom](#).

¹⁹ CA 2003, Section 7.

²⁰ Ofcom, 2022, [Consultation: Review of Postal Regulation – changes to Royal Mail's regulatory reporting requirements](#).

regulatory reporting requirements to ensure that these decisions are implemented effectively and in the most proportionate manner possible. As such, we considered the proportionality of, and objective justification for, each proposal in our September consultation in turn, and do the same with our decisions in this statement. In particular, please refer to our assessment in paragraphs 3.128 and 4.119.

Equality Impact Assessment

- 2.41 Section 149 of the Equality Act 2010 (the 'EA 2010') imposes a duty on Ofcom, when carrying out its functions, to have due regard to the need to eliminate discrimination, harassment, victimisation and other prohibited conduct related to the following protected characteristics: age; disability; gender reassignment; marriage and civil partnership; pregnancy and maternity; race; religion or belief; sex and sexual orientation.
- 2.42 The EA 2010 also requires Ofcom to have due regard to the need to advance equality of opportunity and foster good relations between persons who share a protected characteristic and those who do not.
- 2.43 Section 75 of the Northern Ireland Act 1998 (the 'NIA 1998') also imposes a duty on Ofcom, when carrying out its functions relating to Northern Ireland, to have due regard to the need to promote equality of opportunity and regard to the desirability of promoting good relations across a range of categories outlined in the NIA 1998. Ofcom's Revised Northern Ireland Equality Scheme explains how we comply with our statutory duties under the 1998 Act.²¹
- 2.44 To help us comply with our duties under the EA 2010 and the NIA 1998, we assess the impact of our proposals on persons sharing protected characteristics and, in particular, whether they may discriminate against such persons or impact on equality of opportunity or good relations.
- 2.45 We do not consider that our decisions will discriminate in any way against persons with protected characteristics as they only affect Royal Mail and its internal systems and processes. We are therefore satisfied that we have complied with the public sector equality duty in the EA 2010, and the NIA 1998, in making the decisions set out in this statement.

²¹ [Revised-NI-Equality-Scheme.pdf \(ofcom.org.uk\)](#).

3. Annual financial forecasts

In section 3 of the 2022 Review Statement, we decided to require Royal Mail to submit annually to Ofcom a financial forecast, covering a period of five years, and to provide sensitivity and downside analysis on the forecast. Our full reasoning for this decision is set out in the Statement.

To give effect to this decision, we have decided that Royal Mail must submit an AFF covering a period of five years. We have also decided to give Royal Mail until 30 June every year to submit this forecast, rather than 31 May (as proposed in the consultation). The requirement for an AFF replaces the requirement to provide a Strategic Business Plan and Annual Budget. The forecast must take into account Royal Mail's latest available actual results, and if Royal Mail has a business plan that has been approved by its Board in the previous 90 days, the forecast must be consistent with this.

The information we have decided to require in the AFF is similar to the existing information requirements in the Strategic Business Plan, but with most metrics covering a five-year time period and with less detailed information for forecast years four and five. We have also decided to make some changes to the specific information requirements, including:

- a reduction in the level of detail required in the revenues and volumes forecasts (in line with our consultation proposals)
- a reduction in the level of detail required in the Cost Matrix (slightly amended from our consultation proposals)
- A new requirement for a forecast of Gross Hours and salary costs split by time category, with minor amendments to our consultation proposal to reduce the level of detail;
- a new requirement for detailed and structured information on Royal Mail's planned efficiency initiatives (in line with our consultation proposals), and
- removal of requirements to provide certain efficiency metrics annually (in line with our consultation proposals).

Royal Mail will also be subject to more prescriptive sensitivity analyses requirements, and will be required to provide downside scenario analyses. However, we have clarified that we are not prescribing a specific calculation methodology or the type of model Royal Mail must build to meet the requirements.

3.1 In this section, we summarise our consultation proposals to amend the reporting requirements in order to implement the decisions confirmed in section 3 of the 2022 Review Statement. We then set out our decisions in relation to each of these, taking into account the points raised by stakeholders in their consultation responses.

3.2 Our decisions are summarised in paragraph 3.126.

Requirement for an AFF by 31 May

Our proposals

- 3.3 In line with our decision in the 2022 Review Statement, we proposed that the AFF, which must cover a period of five years, would replace the requirement for Royal Mail to provide an Annual Budget and Strategic Business Plan, and that it must be provided by 31 May each year.
- 3.4 We also proposed that:
- the AFF must reflect Royal Mail's latest view of its objectives and expectations and, as far as possible, take account of its latest available actual results;
 - if Royal Mail's Board has approved its business plan in the 90 days prior to 31 May, the AFF must be consistent with it;
 - if Royal Mail's Board has not approved its business plan in the 90 days prior to 31 May, then it must still provide an AFF by that date, which reflects its latest view of its objectives and expectations; and once the Board has approved its business plan, Royal Mail must provide an updated AFF which takes account of any changes in its expectations and objectives resulting from the approval process, within 10 working days of the business plan being approved.

Consultation responses

The need for an annual financial forecast

- 3.5 Royal Mail argued that an AFF was unnecessary and onerous, and felt that the (FYFF) would provide a 'comprehensive reference point' against which its performance can be measured. It said that our proposal to require an AFF was akin to companies operating in regulated sectors having to produce a price control forecast, which are typically submitted once per regulatory cycle, every year.²²
- 3.6 Instead, Royal Mail said that the requirement for it to provide the FYFF, to report on actual performance, and the ability for us to make ad hoc formal requests for its business plan covering three years if we were concerned about its performance, would give us sufficient insights into its financial sustainability and proposed efficiency plans and performance. In Royal Mail's view, this would be a more proportionate way to meet our objectives.²³
- 3.7 The GCA was supportive of our proposal to require Royal Mail to provide an AFF covering a period of five years.²⁴

²² Royal Mail response to consultation, pp. 10-11.

²³ Royal Mail response to consultation, pp. 11-12.

²⁴ GCA response to consultation, p. 2.

Deadline for the annual financial forecast

- 3.8 Royal Mail argued that, if we did decide to require the AFF, a submission deadline of 31 May would not be feasible for a number of reasons, including that:
- in recent years Royal Mail's Board has not approved the business plan until late May at the earliest. It noted that while it aims to have the business plan approved by the start of the financial year, this is not always possible due to market uncertainty;
 - there are significant pressures on its finance teams during the year-end period;
 - there is not enough time between finalising the actual results and submitting the forecast to ensure it takes account of the actual results; and
 - there are additional required activities and pro formas proposed in the AFF which are not currently part of its planning process.²⁵
- 3.9 Instead, Royal Mail argued that 30 June would be a more appropriate deadline, as this would give it enough time to ensure sufficient scrutiny and oversight of the results, without compromising our ability to fulfil our statutory duties. It also noted that this should help to ensure that its Board has enough time to approve the business plan and that the information we receive has an appropriate level of assurance.²⁶
- 3.10 CCNI considered that a deadline of 31 May was appropriate, particularly if it can provide greater assurance of compliance by Royal Mail. However, it said that we should assess whether this deadline would still allow for timely intervention by Ofcom and ensure that we would not lose any regulatory oversight as a result.²⁷

Ensuring the AFF reflects Royal Mail's latest views and expectations

- 3.11 Royal Mail did not agree with our proposal for it to provide a forecast even if its board has not approved its business plan by the deadline, arguing that without Board approval the forecast would not be robust for Ofcom to use it to inform its policy. Instead, it argued that it would more proportionate, if board approval has not been received by the forecast deadline, for us to require Royal Mail to write to us to explain why this was not possible and to provide a date by which the AFF would be provided.²⁸
- 3.12 Further, Royal Mail said that the proposal for it to produce an updated AFF within 10 working days of the business plan being approved is unfeasible. It argued that we had not set out why a period of 10 days was proportionate or necessary and noted that the work it would need to perform within that period was significant. It said that a deadline of 20 working days would be more feasible and appropriate.²⁹

²⁵ Royal Mail response to consultation, pp. 12-15.

²⁶ Royal Mail response to consultation, pp. 12-16.

²⁷ CCNI response to consultation, p. 5.

²⁸ Royal Mail response to consultation, p. 17.

²⁹ Royal Mail response to consultation, pp. 17-18.

Our assessment

The need for an annual financial forecast

- 3.13 We disagree with Royal Mail that the AFF is unnecessary or disproportionate. We also disagree with its proposal for us to rely on the FYFF and ad hoc statutory information requests for its business plan in the intervening years instead. Our decision to require an AFF covering a period of five years was consulted on and confirmed in the 2022 Review Statement. As noted in that document, given the growing uncertainty around the sustainability of the universal service over the longer-term, being able to reach a robust view on any potential risks at an earlier stage is particularly important, and we considered that it necessitates a five-year forecast provided by Royal Mail to Ofcom on an annual basis.
- 3.14 Royal Mail's proposed alternative would not be sufficient to meet our needs nor fulfil our duties. As we explained in the September consultation, our effective monitoring of the financial sustainability and efficiency of the universal service (which is necessary in order to fulfil our duties in relation to both financial sustainability and efficiency) depends on having the most up-to-date financial forecasts and information from Royal Mail provided in a timely manner, on an annual basis.³⁰
- 3.15 Annual forecasts are necessary because the external factors affecting Royal Mail's financials and its plans and initiatives can vary significantly over the course of a year. This means that, without annual forecasts, our view on the likely financial sustainability of the universal service could be based on inaccurate and/or out-of-date information, which would not enable us to sufficiently discharge our duties. Our need for annual forecasts from Royal Mail is reflected in the existing requirements for the Strategic Business Plan and Annual Budget. Royal Mail is already required to provide financial forecasts to us on an annual basis.
- 3.16 Further, as the FYFFs are to be produced once every five years, relying only on Royal Mail's business plans in the years between would not be very different from the current status quo and would mean we would have *less* information and oversight of Royal Mail than we do at the moment (in particular we would receive information from Royal Mail only every five years, rather than annually, and would likely continue to have only three years of forecast instead of five years). We consider that this would be particularly inappropriate at a time when we are increasingly concerned about the financial sustainability of the universal service.³¹
- 3.17 We also do not think that it would be appropriate for us to rely on ad hoc statutory requests for further information in the years between FYFFs. One of the benefits of the regulatory reporting requirements is that they provide us with consistent information on a set timetable, which is important for the reasons noted above. They also provide clarity

³⁰ Ofcom, 2022, [Consultation: Review of Postal Regulation – changes to Royal Mail's regulatory reporting requirements](#), paragraph 3.7.

³¹ See Ofcom, [Annual Monitoring Update for postal services: Financial year 2021-22](#), p. 3.

and certainty to Royal Mail about what it will be required to provide, and by when, enabling it to plan and prepare. Statutory information requests are more suitable for situations where information is only needed on a one-off basis.

- 3.18 With respect to Royal Mail's argument that the requirement for an AFF is disproportionate, we note that the requirements in the AFF are largely for Royal Mail to provide information that it already submits to us. The main difference between it and the Strategic Business Plan and Annual Budget is that the AFF must cover a period of five years, but with some information for years four and five being less detailed.
- 3.19 While Royal Mail will be required to provide forecast information in more pro formas than currently, we have aimed where possible to ensure that the new pro formas are based on submissions Royal Mail has provided in the past, reducing the amount of additional work needed. We are also removing the requirement for some forecast information (e.g. PVEO,³² Productivity (WIPGH), Workload and Gross Hours Reduction) to be provided annually. We therefore do not consider that the requirement for an AFF is a significant step change from the existing reporting framework, nor will it entail considerably more work for Royal Mail than the Annual Budget and Strategic Business Plan currently do.
- 3.20 Finally, the comparison of the AFF to an annual price control forecast is not instructive. There are significant differences between the regulation of Royal Mail and of companies operating in more highly regulated sectors such as water. Our regulatory regime affords Royal Mail significant commercial flexibility, supported by safeguards including a price cap on Second Class stamps³³ and a monitoring regime. The detailed forecasts and financial information which we require are necessary for our monitoring regime. They enable us to monitor and ensure, among other things, the financial sustainability and efficiency of the provision of the universal service, and any risks to these.

Deadline for the annual financial forecast

- 3.21 We set out in the September consultation that we need the AFF to be submitted as close as possible to the start of each forecast period, so that we have Royal Mail's forecast for the first financial year in a timely manner and we can understand how the results of future financial years are expected to evolve based on the first financial year. Ideally, and as reflected in the current requirement, we need the information to be submitted by Royal Mail before the start of the financial year.
- 3.22 However, in recent years, to comply with the requirement to deliver to Ofcom a Strategic Business Plan before the beginning of the financial year to which it relates, Royal Mail has provided the previous year's Strategic Business Plan and has then submitted another several weeks later, which relates to the most up to date period. This delay has affected our ability to fulfil our statutory duties in relation to the financial sustainability and efficiency of the universal service.

³² See Ofcom, 2022, [Consultation: Review of Postal Regulation – changes to Royal Mail's regulatory reporting requirements](#), paragraphs 4.26-4.31, for an explanation of the PVEO metric.

³³ For standard and large letters, and some parcels.

- 3.23 As noted in the September consultation, we recognise that providing the Strategic Business Plan by the start of the financial year has proven challenging for Royal Mail in recent years, and that it may be more so for the AFF, as the information must now cover a period of five years. For this reason, we proposed a deadline of 31 May which would have given Royal Mail an additional two months to provide the forecast, compared to the current requirements. However, as set out above, Royal Mail argued that 31 May would still be unfeasible. Royal Mail also noted in its consultation response that, since 2016, its business plan has been approved by its Board by [X].
- 3.24 One of our key proposals is that the AFF must be consistent with Royal Mail's Board-approved business plan if one has been approved by the AFF deadline. We consider that this is important because it ensures that the forecast will reflect Royal Mail's latest views, objectives and ambitions, as well as its latest expectations of the trends in the market and wider economy, thereby making our monitoring as effective and accurate as possible.
- 3.25 Having considered Royal Mail's arguments, we consider that 30 June would be an appropriate deadline for the AFF.³⁴ This is for two reasons. Firstly, we accept that additional work is required to provide a five-year forecast (rather than three, which has been the typical length of forecasts provided by Royal Mail in recent years). This is particularly pertinent given the new requirement for the forecast to take account of Royal Mail's latest available actual results.
- 3.26 Secondly, and in response to CCNI, while this delay will have some impact on our internal monitoring work, we consider that it should provide us with greater assurance that we will get the information we need at the same time every year, that the forecast will be consistent with a Board-approved business plan, and that Royal Mail will have had sufficient time to take account of the latest actual results. This in turn should reduce the likelihood of triggering the requirement to provide an updated forecast if there is not a Board-approved business plan by the forecast deadline (for which see more below).

Ensuring the AFF reflects Royal Mail's latest views and expectations

- 3.27 To enable us to fulfil our duties in relation to the sustainability and efficiency of the universal service, it is essential that Royal Mail's AFF reflects its latest performance objectives and ambitions as well as its latest expectations of the trends in the market and the wider economy.
- 3.28 There is an existing requirement in the USP Accounting Condition for Royal Mail to ensure that financial statements and information required by the USP Accounting Condition comply with the Guiding Principles,³⁵ specifically accuracy, objectivity, completeness, consistency and causality. This should help to ensure that Royal Mail's AFF reflects its latest objectives and expectations. To further ensure this, we have decided that:
- the AFF must reflect Royal Mail's latest view of its objectives and expectations and as far as possible, take account of its latest available actual results;

³⁴ We have made the same decision with respect to the deadline for the FYFF, which we discuss in the next section.

³⁵ See USPAC 1.7.

- if Royal Mail has a Board-approved business plan by 30 June, the AFF must be consistent with it;
- if Royal Mail does not have a Board-approved business plan by 30 June, then it must still provide an AFF by that date, which reflects its latest view of its objectives and expectations;
 - Once the Board has approved its business plan, Royal Mail must provide an updated AFF which takes account of any changes in its expectations and objectives resulting from the approval process.

3.29 We discuss each of these requirements in turn below.

Reflecting Royal Mail's latest view and taking account of the latest actual results

3.30 The AFF must reflect Royal Mail's latest view of its objectives and expectations, and, as far as possible, it must take account of its latest available actual results, specifically, the actual results from the financial year immediately preceding the forecast period of the AFF. The latter requirement will act as a further check to ensure that the AFF Royal Mail provides relates to the forthcoming five-year period, rather than the previous period.

If Royal Mail has a Board-approved business plan by 30 June

3.31 We expect Royal Mail will continue to produce a business plan for its own purposes after the requirement to provide the Strategic Business Plan has been removed. The business plan reflects Royal Mail's latest view of its objectives and expectations, and we expect Royal Mail will continue to put it forward to be approved by its Board.

3.32 Therefore, if Royal Mail has a business plan that has been approved by its Board in the 90 days prior to 30 June, the AFF provided to us must be consistent with it. As noted above, Royal Mail's consultation response indicated that Board approval for its business plan [X].

3.33 In particular, the AFF must be consistent with all the financial data in the business plan (for example, the volume, revenue, and costs information in the AFF and the main assumptions and key drivers must be as far as possible identical or otherwise consistent with the information in the business plan).

3.34 This consistency requirement specifically means that certain information in the AFF related to the forecast years included in Royal Mail's business plan must be the same. It also means the forecasts for any further years that are not included in Royal Mail's business plan must be built on the forecasts in the business plan, to ensure the AFF is as far as possible reflective of Royal Mail's expectations and objectives.

If Royal Mail does not have a board approved business plan by 30 June

3.35 While it is very likely that Royal Mail will have a board-approved business plan by 30 June each year, we recognise that there may occasionally be exceptional circumstances that mean that board approval of Royal Mail's business plan is delayed. In such a situation, Royal Mail, once its board has approved the business plan, will be required to submit to us an updated AFF which is consistent with any changes in its expectations and objectives resulting from the approval process.

- 3.36 We disagree with Royal Mail's suggestion that, instead of providing an AFF by 30 June in situations where the business plan has not been approved by the Board in time, it should write to us explaining why it was not possible to approve a forecast and to commit to a future date to submit the AFF.
- 3.37 One of the rationales for our proposals for the AFF and its deadline is to reduce delays in provision of the forecast which we have experienced in the past few years. Our proposals do this by decoupling what needs to be submitted to us from Royal Mail's internal business plan so that we are not as dependent on Royal Mail's own internal timings. Royal Mail's proposal (see paragraph 3.11 above) would simply lead to the continuation of the current situation which we do not consider adequately meets our information needs for monitoring. Royal Mail's proposal could also reduce its incentive to provide an AFF by the deadline.
- 3.38 However, following feedback from Royal Mail, we consider that it would be appropriate to set a deadline for the updated forecast of 20, rather than 10 working days, following approval of the business plan by Royal Mail's board. This is for three reasons.
- 3.39 Firstly, we understand that updating the AFF would involve Royal Mail updating more forecast years than the Strategic Business Plan (five vs three years typically provided by Royal Mail) as well as some data which may not be included in the Strategic Business Plan. Having an extra 10 working days would therefore provide Royal Mail with additional time to make the necessary updates.
- 3.40 Secondly, we do not consider that the additional 10 working days would have a significant impact on our internal monitoring work, given we will already have the forecast provided by Royal Mail on 30 June.
- 3.41 Thirdly, we note that extending the deadline from 31 May to 30 June should make it even more likely that Board approval will have been received by the deadline and therefore the update window is less likely to be necessary.
- 3.42 More generally, we expect that the deadline of 30 June each year will in normal circumstances give Royal Mail sufficient time to finalise its business plan and have it approved by its Board. We would therefore expect that the requirement for amendments will only be used in exceptional circumstances.

Content requirements for the AFF

Our proposals

- 3.43 We proposed to retain similar content requirements for the AFF as the Strategic Business Plan and Annual Budget, although covering a five-year time period. In recognition that extending the length of any forecast means that further judgements are needed for higher uncertainties in later years, we proposed that less detail and granularity will be required for the information relating to years four and five of the AFF.
- 3.44 We proposed to make a number of changes, specifically to:


- reduce the level of detail in the revenues and volumes forecasts and update the Cost Matrix forecast;
- require a forecast of Gross Hours and salary costs broken down by time category;
- remove the requirement to provide an annual forecast of PVEO, Productivity (WIPGH), Gross Hours Reduction and Workload; and
- require more detailed and structured information on efficiency initiatives and an update of the list of main assumptions and key drivers

Consultation responses

3.45 We received comments on three elements of these proposals. Royal Mail also requested that one other element be removed, which is an existing requirement in the RAG (headcount and FTE).

Revenues, volumes and Cost Matrix

3.46 Royal Mail asked that we remove the proposed requirement for a forecast of the proportion of volumes that are USO mail, as it considered that this would be too complex and detailed to provide. It also noted that it is possible that some rows may contain USO Mail as well as Non-USO volumes and that the percentage could vary over time, so there may need to be a different column for each year.³⁶

3.47 Royal Mail asked that we use the same the Cost Matrix for both the AFF and FYFF and require the same level of detail for both.³⁷ It argued that we should remove what it considered to be 'excessive detail' and that some of the cost lines represent less than []% of the Reported Business total cost base.

Gross Hours and salary costs broken down by time category

3.48 Royal Mail argued that it would be neither meaningful nor accurate for it to provide a five-year Gross Hours forecast, broken down by time category (e.g. ordinary, casual etc.). It noted that the way in which it supplies its needed hours is dependent on the wider labour market conditions and agreements in place at the time. Instead, it proposed that we should require only a one-year forecast of Gross Hours split by time category.³⁸

Requiring more detailed and structured information on efficiency initiatives, and updating the list of key drivers and assumptions

3.49 Royal Mail's comments on our proposed requirement for reporting on efficiency initiatives and cost movements were set out in the FYFF section of its response and largely relevant to that forecast. However, it did make one comment on our proposed pro forma for the

³⁶ Royal Mail response to consultation, p. 20.

³⁷ We proposed to require a more detailed version of the Cost Matrix forecast in the FYFF than the AFF (see Figures 2 and 5 of Appendix 1 to the [draft RAG](#)).

³⁸ Royal Mail response to consultation, p. 18.

AFF, arguing that we should require less detailed information for years four and five. It also asked us to use the same pro forma for the AFF and FYFF.³⁹

3.50 CCNI, while noting that it was unable to comment on the technicalities, agreed with our proposal to require more structured information on forecast efficiency initiatives, particularly if it gives us better flexibility in our analysis.⁴⁰

3.51 We did not receive any comments on our proposal to update the list of key drivers and assumptions.

Other comments

3.52 Royal Mail said that we should remove the existing requirement to provide a forecast of headcount and FTE, ✂, and it is produced only to meet our requirement. It argued that the forecast PVEO should be sufficient for us to understand its efficiency; that we would have visibility of forecast hours through the Gross Hours forecast requirement; and that we can see frontline staff split out from managerial staff in the Cost Matrix.⁴¹

3.53 Royal Mail also disagreed with our proposal to add volumes into the requirement for forecast revenues and costs of the Reported Business showing how the Financeability EBIT is calculated, arguing that it is unnecessary as it already provides us with a revenues and volumes schedule for the Reported Business volumes.⁴²

Our assessment

Revenues and volumes and Cost Matrix

Revenues and volumes

3.54 We are significantly reducing the level of detail required (compared to the existing requirement) for the revenues and volumes forecasts for years one to three of the AFF. Royal Mail was previously required to provide us with considerably more detailed forecasts (approximately 500 lines), while the new forecast requires approximately 60 lines. The new forecast also aligns with what Royal Mail already provides to us in its management accounts.

3.55 With respect to Royal Mail's comment on the forecast revenues and volumes of USO mail, we must carry out our postal functions in a way that we consider will secure the provision of a universal postal service.⁴³ We accept that the forecast of USO evolution will not be exact, but having transparency on volumes and revenues by USO and Non-USO helps to inform us how Royal Mail currently expects the USO to evolve and of the expected future size of the USO. It not only assists Ofcom in considering whether a scope of USO change may be appropriate in future, but also in assessing and monitoring whether the USO is

³⁹ Royal Mail response to consultation, p. 23.

⁴⁰ CCNI response to consultation, p. 5.

⁴¹ Royal Mail response to consultation, pp. 19-20.

⁴² Royal Mail response to consultation, p. 20.

⁴³ Section 29(1) of the PSA 2011.

expected to be financially sustainable. Understanding the expected future size of the USO is particularly pertinent at the moment, given the recent request from Royal Mail to Government to change the scope of the USO by amending the number of days it is required to deliver letters from six days a week to five.⁴⁴

- 3.56 Additionally, we note that Royal Mail is required to provide the Data Extract File,⁴⁵ which provides granular revenue analysis by product. Therefore, it has completed the process of mapping each product (revenue) to the corresponding SPHCC (cost) for the actuals reporting. This same file also includes the SPHCC hierarchy, which we use in conjunction with the SPHCC Masterlist,⁴⁶ which enables us to produce a view of USO Mail. While we accept that there might be differences in the complexity and detail between the process of actuals and forecast, we consider that Royal Mail should be able to apply similar principles to create the mappings for the forecast. Therefore, we continue to consider it necessary to understand the proportion of USO mail Royal Mail expects to process and deliver.
- 3.57 The format of the required information is set out in the pro forma in Figure 1 of Appendix 1 to the RAG.

Cost Matrix

- 3.58 For the Cost Matrix, we disagree with Royal Mail's proposal that the pro forma for the AFF and FYFF should contain the same level of detail. The forecasts are intended for different purposes. The AFF is required to inform our understanding of ongoing financial sustainability. The FYFF allows us to fully understand Royal Mail's efficiency plans, underpins the published efficiency expectations, and provides transparency and assurance as to how the expectations have been calculated, and therefore requires slightly more detail than the AFF.
- 3.59 Royal Mail argued that we are requiring 'excessive detail', as some of the cost lines represent less than [~~5~~] % of total costs. While we agree that some cost lines within both the AFF and FYFF could be aggregated in years four and five to make the requirement more proportionate, we do not consider that this should be implemented to the extent suggested by Royal Mail.
- 3.60 In considering where cost lines could be aggregated, we have had regard to the Guiding Principle of materiality.⁴⁷ This defines a material item as one which is reasonably expected to affect the views of a competent user of regulatory financial information. We consider that if a cost line represents at least [~~5~~] % of total costs (either people or non-people), then it is material.
- 3.61 We outline the method used to determine which cost lines are likely to represent at least [~~5~~] % of total people or non-people costs in section 4 (see paragraphs 4.61 to 4.64). We

⁴⁴ International Distributions Services plc, [Results for the Half Year ended 25 September 2022](#), p. 1

⁴⁵ The Data Extract File is a schedule of actual revenue, cost, and volume information for Short SPHCCs, and Transfer Prices between Upstream Services and Downstream Services for products and services Royal Mail handles as set out in Appendix 2 to the RAG.

⁴⁶ The SPHCC Masterlist is a detailed list of all SPHCCs and the associated attributes and characteristics, including where each sits in Royal Mail's reporting hierarchy.

⁴⁷ See USPAC 1.7.1 and 1.7.2.

have amended the pro forma to require less detail for years four and five for the cost lines that do not meet that threshold. Additionally, as proposed in the consultation, we note that in general Royal Mail will be required to provide less detail for the AFF than the FYFF in years four and five, for example in relation to the breakdown of people costs for frontline staff.

- 3.62 More generally, we consider it is necessary to require this level of detail for the AFF, as it also provides the basis for meaningful analysis when tracking actuals against forecasts.
- 3.63 We also think it is necessary to make some changes to the Cost Matrix pro forma, specifically adding sub-totals and separating out cost lines where additional detail is required e.g., Collection, Delivery and Conveyance charges.
- 3.64 These changes will ensure that we have the appropriate level of granularity to monitor the financial sustainability of the universal service, including where necessary by conducting our own modelling, while also ensuring that the reporting requirements remain proportionate overall.
- 3.65 In line with our approach to require less detail for years four and five, the revenues, volumes and costs information for those years is less detailed than for years one to three. The format of the required information is set out in the pro forma in Figure 2 of Appendix 1 to the RAG.

Gross Hours and salary costs broken down by time category

- 3.66 Royal Mail explained that it does not forecast supply hours (the volume of hours that are required to meet the Workload demand) by time category for more than one year.
- 3.67 However, in order to forecast its pay costs (which is necessary for the Cost Matrix forecast), we understand that Royal Mail uses a blended pay rate over the five years. This means that it assumes certain proportions of ordinary, casual/temporary and overtime hours to create the blended rate, which we would expect to see this reflected in the Gross Hours forecast.
- 3.68 Further, we disagree with Royal Mail that this requirement represents 'micro-management' of its resource planning. We are not telling Royal Mail how to resource or plan its business. However, it is important that we have clear information about its plans, particularly with regard to people costs. People costs are a key consideration for our monitoring of the financial sustainability of the universal service as they are a significant proportion of Royal Mail's operational costs.
- 3.69 A forecast of total Gross Hours and frontline salary costs, broken down by time category (specifically normal/ordinary, casual/temporary, overtime, and any other) will help us to better understand, and model over the forecast period, the evolution of Royal Mail's people costs. As the different time categories command different pay rates, changes in certain time categories could make a material difference to Royal Mail's costs. For

example, if Royal Mail were to replace all overtime with casual staff, the difference in pay rates between these two could [X].⁴⁸

3.70 However, we accept there are likely to be broad assumptions being applied for this forecast and that Royal Mail may not plan its resourcing needs to the detail we had proposed. Therefore, we have reduced the detail Royal Mail is required to provide for years two to five, so that it is not required to provide the split between ordinary and agency for casual/temporary hours, or the split between contractual and non-contractual for overtime hours. It will only be required to provide the sub-totals for the three core categories of ordinary/normal, casual/temporary, overtime, and total Gross Hours.

3.71 Additionally, in line with the other requirements in the AFF, the information required for years four and five of these forecasts is less detailed than for years one to three. The format of the required information is set out in the pro forma in Figure 3 of Appendix 1 to the RAG.

Removal of the requirement to provide an annual forecast of PVEO, Productivity (WIPGH), Gross Hours Reduction and Workload

3.72 Reflecting the changes to our monitoring regime set out in the 2022 Review Statement (specifically, to require Royal Mail to set its five-year efficiency expectation upfront and that the FYFF and the expectations are not amended in the intervening years), we are removing the requirement for Royal Mail to submit an annual forecast of PVEO, Productivity (WIPGH), Gross Hours Reduction and Workload.

3.73 Instead, this information will be required only once every five years, as part of the FYFF. We set this out further in section 4.

Requiring more detailed and structured information on efficiency initiatives and updating the list of main assumptions and key drivers

Efficiency initiatives and cost movements

3.74 We consider that we need more detailed and structured information about Royal Mail's planned efficiency initiatives and cost movements to help us track its plans and performance in a more consistent and transparent way.

3.75 Royal Mail is currently required to explain all the main assumptions and key drivers it has used in its forecasts of volumes, revenues, costs and other financial data within the Strategic Business Plan. We intend to require the same in future for the AFF.⁴⁹ These assumptions and drivers include Royal Mail's planned efficiency initiatives.

3.76 These initiatives have in the past included automation of parcels operations at Mail Centres, delivery revisions, and introduction of scan-in scan-out technology.⁵⁰ This information is necessary for our modelling of financial sustainability because it informs our

⁴⁸ Example included is for illustrative purposes only.

⁴⁹ See Table 2, clause j in the [existing RAG](#), that currently applies to the Strategic Business Plan.

⁵⁰ See Ofcom, 2021, [Annual Monitoring Update on Postal Services, Financial Year 2020-21](#), paragraphs 7.23-7.32, and Ofcom, 2020, [Annual Monitoring Update on Postal Services, Financial Year 2019-20](#), paragraphs 6.22-6.32.

forecast of costs. It is also important for our monitoring of efficiency to understand Royal Mail's planned efficiency initiatives and the areas these relate to, because these are the specific actions by which Royal Mail plans to make efficiency savings.

- 3.77 While the current requirement has been useful for our monitoring of financial sustainability and efficiency, it is general, with no prescription of detail, and consequently the level of detail provided by Royal Mail in its Strategic Business Plans has not been consistent.
- 3.78 As a result, in recent years we have frequently had to rely on making statutory information requests to Royal Mail to be able to carry out our own modelling of costs for monitoring financial sustainability to help us fully understand Royal Mail's efficiency initiatives and its progress on those initiatives. [X]
- 3.79 We therefore consider that it is necessary to specify the structure and level of detail Royal Mail must provide about its planned efficiency initiatives as part of the AFF. [X]. Specifically, the efficiency initiatives information must include, for each forecast year, an overview of the costs savings which are forecast to be achieved by efficiency initiatives. The information must also include the impact of all factors such as changes in pay and Workload which could act as cost pressures reducing the impact of efficiency initiatives.
- 3.80 The efficiency initiative information for forecast years four and five is less detailed which is in line with our other less detailed requirements for those years, as discussed above. While we do not need as much detail as we do for the FYFF (as discussed in section 4) we do need sufficient detail for years four and five to support our modelling.
- 3.81 Royal Mail's proposed efficiency initiatives pro forma (provided in its consultation response) for both the AFF and FYFF only provides detail of total cost savings and total cost pressures for years four and five. We do not think this pro forma would give us the insight we need, as the impact and risks associated with efficiency initiatives and cost pressures between hours, pay and non-hours costs are different.
- 3.82 Information about the types of initiatives Royal Mail expects to implement in order to save costs over a five-year period will help our modelling of financial sustainability to be more accurate and specific, which in turn helps us to fulfil our duty in relation to financial sustainability. For example, we can input the specific savings Royal Mail expects to make across the five years of the forecast in each initiative type into our model and as a result understand the impact of each one on the financial sustainability of the universal service, including what the impact would be of it *not* being achieved.
- 3.83 More generally, seeing by which types of initiative Royal Mail plans to achieve the total savings helps us to form a view on the likelihood of the total savings being achieved in the latter years of the forecast. This in turn improves our understanding of the long-term financial sustainability of the universal service.
- 3.84 Finally, we note that for the AFF (for years four and five), Royal Mail will be required to submit only a total cost saving for each type of initiative (hours, pay and non-hours), rather than for each specific project.

- 3.85 We consider that this information will not represent a significant additional burden on Royal Mail because [X]. Building this into our reporting requirements will also enable the consistent provision of information that is necessary to fulfil our duties.
- 3.86 The format of the required information is set out in the pro forma in Figure 4 of Appendix 1 to the RAG.

Updating the main assumptions and key drivers

- 3.87 To ensure all of the key inputs will be included, it is necessary to update the list of the main assumptions and key drivers in the forecast which must be identified and explained to Ofcom. The additions are e-commerce and e-substitution which we consider to be among the main assumptions needed to forecast letter and parcel volumes. We have also added Productivity (both WIPGH and WIPWH) and Workload to the list, because we understand Royal Mail will be using these metrics as inputs to its forecasts of costs and we want to ensure that Royal Mail also provides explanations about these.
- 3.88 Finally, we expect Royal Mail to provide information on any changes to frontline pay and the Shorter Working Week⁵¹ and other pay arrangements as part of the 'pay and pension arrangements' assumptions included in the list of main assumptions and key drivers. This information is necessary for our understanding of people costs and will enable us to continue to do our own modelling of financial sustainability. We have not included this in the RAG as it is not practicable to have complete lists of all such arrangements, and we consider the guidance here to be sufficient.

Other comments

Headcount and FTE

- 3.89 We do not agree with Royal Mail's proposal to remove the requirement for a forecast of headcount and FTE and for us to use the forecast pay by pipeline instead. We have previously set out why we need this information (in our 2017 regulatory reporting statement) and we continue to consider it is necessary for the reason set out in that document.⁵² Specifically, this information is an important indicator of how different efficiency initiatives are expected to yield results, as the drivers for determining the headcount of frontline and management staff are considerably different (in particular, their pay and unionisation attributes). The forecast pay by pipeline only includes frontline, not management staff and therefore would not provide these insights.
- 3.90 Additionally, headcount and FTE information, in conjunction with Gross Hours, help us to understand the proportion of changes in hours resulting from voluntary redundancies, attrition or anything else. This insight is required because Royal Mail incurs costs in some but not all of these circumstances.

⁵¹ The Shorter Working Week (SWW) is the reduction in the weekly contract of full-time staff from 39 hours to 35 hours, agreed as part of the Pensions, Pay and Pipeline agreement in February 2018. See CWU, 2018. [LTB 059/18 – Pay and Four Pillars Agreement](#).

⁵² Ofcom, 2017, [Statement: Regulatory Financial Reporting for Royal Mail](#), paragraphs 5.20-5.23.

- 3.91 The information also enables us to understand if there will be movement of staff between frontline and management grades, which in turn gives us insight into the extent to which changes in hours are driven by movement in grades as opposed to headcount reductions. Further, it provides insight into Royal Mail's forecast assumptions, in particular relating to its forecast of voluntary redundancy costs, and enables us to apply and adjust those assumptions in our financial sustainability modelling.
- 3.92 Further, we understand that Royal Mail does not only use headcount and FTE for reporting to Ofcom. For example, in its half-year results update on 17 November 2022, International Distributions Services (IDS)⁵³ set out plans for a reduction in Royal Mail FTEs through reductions in hours and attrition.
- 3.93 Royal Mail also said that [X]. [X] in the past, it has stated what assumed hours it used to convert to FTEs in its management accounts. Therefore, to help us interpret the information, it should make clear in the forecast the number of hours it has used to calculate one FTE and if that changes over time.
- 3.94 For the reasons set out above, we continue to think it is necessary and proportionate to require Royal Mail to provide FTE and headcount information.

Volumes in forecast revenues and costs of the Reported Business

- 3.95 We have added volumes to the requirement for forecast revenues and costs of the Reported Business (showing how the Financeability EBIT is calculated) to ensure that the requirements to restate on an equivalent 52-week basis (in the Financial Years that comprise 53 weeks) capture volumes as well as revenues and costs (see section 6 for further detail on this point). In response to Royal Mail's comment, we confirm that this is not a new requirement for additional data. As it pointed out, we already have other requirements in place for the Reported Business volumes.

Sensitivity analyses and downside scenarios

Our proposals

- 3.96 We proposed to retain the requirement for Royal Mail to conduct sensitivity analyses and to extend it to cover a period of five years. We also proposed some further prescription to ensure that it fully meets our needs. Specifically, we proposed that:
- the sensitivity analysis must include an analysis that calculates the range of values within which the Financeability EBIT could fall, over each of the five forecast years, as a result of the main assumptions and the key drivers changing within the range of their reasonably likely values.
 - Royal Mail must submit the calculations underlying the sensitivity analysis, including the model(s) by which the sensitivity analyses have been calculated. It is important for us to understand how these analyses are carried out, for example, what assumptions

⁵³ Previously known as Royal Mail plc (see paragraph 6.75).

and drivers are flexed, in what ranges they are flexed and for what reason, and how the outputs are calculated as a result.

- the assumptions and the drivers in relation to which the sensitivity analyses are done must include the updated list of the key assumptions and key drivers.

3.97 We also proposed to require Royal Mail to provide downside scenarios but did not specify what these should be.

Consultation responses

3.98 Royal Mail supported our ambition to better scrutinise the sustainability of the universal service in the longer term, but felt that our proposed requirements would not produce meaningful insights. It noted that it does not have a sensitivity analysis model that it could readily provide to us, and that while it has tried to create 'end-to-end financial planning models' in the past, these have not been successful. It noted that the complexity of its business makes building such a model challenging.⁵⁴

3.99 Royal Mail also said that it already shares relevant sensitivity information with us, for example, a ready reckoner.

3.100 Therefore, Royal Mail suggested that we should take a more pragmatic approach, amending the requirement to require it to provide a high and low scenario around a base case that reflects the high and low outcomes.

3.101 Royal Mail also said that it already provides us with a downside scenario. It referred in particular to its annual reported accounts which include downside analyses that inform the viability statement which Royal Mail shares with us.

3.102 The GCA suggested that we should require upside scenarios as well as downsides, to improve our understanding of its business and ability to protect consumers.

Our assessment

Sensitivity analyses

3.103 Financial forecasts are inevitably based on assumptions and expectations of future events which are uncertain. Sensitivity analyses enable us to understand better the extent to which these uncertainties and risks could cause outcomes to be different from the forecast, by showing how sensitive the outputs of the forecasts are to changes in the inputs (in particular the main assumptions and the key drivers).

3.104 We therefore need sensitivity analysis for the key main assumptions and the key drivers which have a significant risk of deviating from the values assumed in the AFF. These analyses should include a restatement of the relevant calculations and outputs of the AFF in the relevant forecast years, such as revenues, costs, profitability, cash flows, and health metrics, assuming those risks materialise. They should also explain and quantify the impact of the main drivers of the changes, including but not limited to the changes in assumptions

⁵⁴ Royal Mail response to consultation, pp. 18-19.

with regard to: economic growth (including GDP), inflation (including CPI), market developments, competition, pricing, sales and marketing initiatives, efficiency metrics, and pay and pension arrangements.

- 3.105 Royal Mail's knowledge and understanding of its business mean that it is well placed to identify the nature and the extent of these risks and uncertainties and how they may impact the forecast. Royal Mail is therefore best positioned to carry out sensitivity analyses on the AFF.
- 3.106 We currently require Royal Mail to include sensitivity analyses as part of its Strategic Business Plan. Our requirement in the RAG includes the key points set out above. For the reasons set out above, we believe that sensitivity analyses are key to monitoring financial sustainability of the universal service. For this reason, we are retaining this requirement as part of the AFF.
- 3.107 As we explained in section 3 of the 2022 Review Statement, uncertainty in a forecast increases for forecast years further out in the future, so the sensitivity analyses must cover all five forecast years.
- 3.108 The sensitivity analyses which Royal Mail has provided in line with our current requirements have been helpful. We have also benefited from the viability statement set out in the annual report of Royal Mail plc with regard to the key risks affecting financial performance and hence the assumptions underpinning financial forecasts. However, for the purposes of our own monitoring of financial sustainability, we have needed to expand on certain aspects of the sensitivity analyses and do further analysis of our own to ensure we fully understand the impact of the key risks and uncertainties.
- 3.109 As we explain in our September consultation, in recent years, Royal Mail has provided analysis of how forecast Financeability EBIT (amongst other metrics) may change with some of its key drivers, including analysis showing how [REDACTED].⁵⁵ However, these analyses have not been as detailed and comprehensive as we have needed them to be. In particular, we have needed to carry out our own further sensitivity analysis on the Financeability EBIT which is a key metric in monitoring long term financial sustainability. Our further work has involved analysis of more of the main assumptions and key drivers and it has been done [REDACTED]. These additional analyses have allowed us to have a better and more detailed understanding of the extent to which various risks could impact financial sustainability over the forecast period.
- 3.110 Therefore, we consider that the sensitivity analysis should include an analysis that calculates the range of values within which the Financeability EBIT could fall, over each of the five forecast years, as a result of the main assumptions and the key drivers changing within the range of their reasonably likely values. This requirement will therefore provide us with more complete information and detailed insights from Royal Mail into the evolution of the financial sustainability of the USO and what would cause it to come under strain.

⁵⁵ This has been provided as part of the Strategic Business Plan.

- 3.111 Further, Royal Mail must submit the calculations underlying the sensitivity analysis, including the model(s) by which the sensitivity analyses have been calculated. It is important for us to understand how these analyses are carried out, for example, what assumptions and drivers are flexed, in what ranges they are flexed and for what reason, and how the outputs are calculated as a result. This detailed knowledge is necessary for us to have a clearer understanding of the risks associated with the forecasts.
- 3.112 We do not prescribe in the requirements a specific calculation methodology or type of model Royal Mail must build to carry out the calculations underpinning its sensitivity analyses. It is for Royal Mail to decide the most appropriate approach to produce clear and transparent analyses that meet our proposed requirements. We simply require Royal Mail to submit the supporting calculations or models it has chosen to use to produce the required sensitivity analyses.
- 3.113 We will expect to find in these supporting calculations and models adequate information on how the impact of the deviations from each main assumption and key driver is calculated. This information, where applicable and practicable, should include the underlying calculations of these impacts as well. If the underlying calculations are designed and carried out for the sole purpose of the sensitivity analyses, we will expect them to be provided. We understand that Royal Mail may use other secondary models to arrive at the values of some of the impacts. We expect Royal Mail to explain what other models are used, and to provide a high-level description of the key inputs and assumptions and the methodologies of those models. But we do not expect Royal Mail to submit these secondary models.
- 3.114 Royal Mail has also suggested that we should take a more pragmatic approach, amending our additions to the sensitivity requirement to ask for a high and low scenario around a base case that reflects the high and low outcomes. Our new addition to the sensitivity analysis requirement is intended to provide us with the range in which the Financeability EBIT could fall as a result of the range of reasonably likely deviations of the main assumptions and key drivers of the forecast. A high and low scenario around a base case would meet our requirement only if it genuinely demarcates such a range, not if they are simply arbitrary high and low scenarios.
- 3.115 As with the method of calculation, we do not prescribe how Royal Mail should go about estimating such a range, and we consider Royal Mail is best positioned to choose the best approach. We simply set out what the range must signify.
- 3.116 To ensure that all the main assumptions and the key drivers that could affect the forecasts significantly are included, we think it is necessary to update the assumptions and drivers in relation to which the sensitivity analyses are conducted, in line with the updated list referred to in paragraph 3.87.

Downside scenarios

- 3.117 Sensitivity analysis provides insight into the effect of changing the main assumptions and key drivers. However, it is also important to understand how these main assumptions and

key drivers are likely to vary as a result of real events and cause the financial outcomes to differ from the forecast.

- 3.118 Downside scenario analyses help us understand how potentially damaging certain events could be to the financial sustainability of the universal service and to what extent any remedial action would mitigate the adverse consequences. They also enable us to consider these impacts in light of their likelihood and develop a more informed and considered view of financial sustainability.
- 3.119 We do not currently have explicit requirements for downside scenarios in the Strategic Business Plan. However, Royal Mail has chosen to provide downside scenarios in its past Strategic Business Plans when providing its view of sensitivity analyses. Royal Mail also provides downside scenarios in relation to its quarterly cash flow projection (a necessary report for our consideration of short-term financial sustainability). As explained above, we have also benefited from the viability statement set out in the annual report of Royal Mail plc with regard to the key risks affecting financial performance and hence the assumptions underpinning financial forecasts.
- 3.120 We consider that formally requiring downside scenario analyses for the AFF and the quarterly cash flow projections will ensure greater clarity for Royal Mail about our requirements, consistency for us in terms of what we will receive from Royal Mail, and will mitigate against a potential risk that Royal Mail might stop providing this information to us. The requirement will also ensure that the information covers the full period of the AFF (i.e. five years). We consider this requirement is proportionate as it mostly formalises what Royal Mail has been providing to us already.
- 3.121 The specific downside scenarios to be provided are for Royal Mail to decide. This is because downside scenarios are likely to change from one year to another depending on which key factors become more risky and more damaging in impact. Furthermore, Royal Mail is best placed every year to determine what downside scenarios may be relevant to any given year. The setting of a prescribed set of scenarios by Ofcom could therefore be restrictive and risk relevant information being overlooked, while Royal Mail is best positioned to identify all relevant scenarios in light of its knowledge of its own business.
- 3.122 However, we are providing examples of potentially relevant downside scenarios, to provide further guidance to Royal Mail, specifically:
- significant changes in volumes and revenues of letters and/or parcels;
 - significant delays in efficiency initiatives and network transformation; and
 - industrial action.
- 3.123 These examples provide a guide as to the types of events we have seen in the past which have had a significant impact (both positive and negative) on Royal Mail's financial performance.
- 3.124 Finally, in response to the GCA, we do not think it would be necessary or proportionate to require Royal Mail to provide us with upside scenarios in addition to downside scenarios. Unlike downside scenarios, upside scenarios are not necessary for our monitoring and understanding of the risks to the financial sustainability of the universal service, although

they could be useful for considering the risks associated with potential excessive pricing. On an ongoing basis, we monitor these risks on a more granular level, i.e. at the product price and unit cost level, using data which we receive on a monthly, quarterly and annual basis. We could request an upside scenario or build one ourselves, if we consider that this would be a necessary addition to our ongoing monitoring.

- 3.125 We do not think they are necessary for our monitoring and understanding of the financial sustainability or efficiency of the universal service.

Our decisions

- 3.126 Having carefully considered stakeholder responses, we have decided that:

- Royal Mail must submit annually by 30 June a financial forecast covering a period of five forecast years (the AFF), replacing the existing requirement to provide a Strategic Business Plan and an Annual Budget.
 - The AFF must reflect Royal Mail's latest view and, as far as possible, take account of its latest available actual results, specifically, the actual results from the financial year immediately preceding the forecast period of the AFF.
 - If Royal Mail's business plan has been approved by its Board in the 90 days prior to 30 June, then the AFF provided to us must be consistent with it.
 - If Royal Mail does not have a Board-approved business plan by 30 June, then it must still provide an AFF by that date. Once the Board has approved its business plan, Royal Mail must provide an updated AFF which is consistent with any changes to the expectations and objectives resulting from the approval process, within 20 working days of the business plan being approved.
- The AFF includes broadly the same level of detail for the areas currently required in the Strategic Business Plan and Annual Budget for years one to three, with less detailed information for years four and five for some areas.
- The main changes to the content required in the AFF compared to the existing Strategic Business Plan requirements are:
 - a reduction in the level of detail required for the revenues and volumes forecasts, and an update to the Cost Matrix forecast;
 - a new requirement for a forecast of Gross Hours and salary costs, split by time category;
 - removal of the requirement for an annual forecast of PVEO, Productivity (WIPGH), Gross Hours Reduction and Workload; and
 - a requirement for more detailed and structured information on efficiency initiatives, and updates to the list of main assumptions and key drivers.
- Royal Mail must conduct sensitivity analyses on all five years of the forecast, and will be subject to a specific requirement to provide:
 - an analysis that calculates the range of values within which the Financeability EBIT could fall, over each of the five forecast years, as a result of the main assumptions and the key drivers changing within the range of their reasonably likely values; and

- the underlying calculations or models used to conduct the sensitivity analyses.
 - Royal Mail must include downside scenario analysis in the AFF.
- 3.127 These requirements are set out in USPAC 1.1.2, 1.3.1(b), 1.3.3 and 1.3.6(b) and (d) (Annex 2, pages 3-6 and 8-9), Table 2 of the RAG (Annex 3, pages 12-13 and 16), and the associated pro formas are in Figures 1-4 of Appendix 1 to the RAG.
- 3.128 We consider that our decisions in relation to the AFF are objectively justifiable and proportionate because they enable us to fulfil our duty in relation to the financial sustainability and efficiency of the universal service. In particular, we note that:
- They implement the decisions consulted on and confirmed in the 2022 Review of Postal Regulation, specifically to require Royal Mail to submit annual financial forecasts covering a five-year period.
 - We continue to need annual forecasts from Royal Mail in order to effectively monitor the financial sustainability and efficiency of the universal service. Annual forecasts are necessary because the external factors affecting Royal Mail's financials and its plans and initiatives often vary significantly from one year to the next.
 - In order to ensure the AFF is proportionate, we have kept the content requirements as similar as possible to Royal Mail's existing annual reporting requirements. This means that Royal Mail should be familiar with the required information, and has previously produced it in the same or a similar format. The new requirements should therefore not require significant changes to Royal Mail's internal reporting systems or processes. Where we are requiring new information, we have aimed where possible to ensure that the new pro formas are based on submissions Royal Mail has provided in the past. We have also removed the requirement to provide an annual forecast of PVEO, Productivity (WIPGH), Gross Hours Reduction and Workload.
 - In recognition that uncertainty increases in the outer years of any forecast, Royal Mail is required to provide less detail for years four and five. We have also amended the Cost Matrix and Gross Hours further to reduce some detail, in light of Royal Mail's comments.
 - We have modified the deadlines, also following feedback from Royal Mail, to give it more time to prepare the forecasts. We have decided to give Royal Mail an additional month to provide the AFF every year, and 20 rather than 10 days to provide an updated forecast if Royal Mail does not have a Board-approved business plan by 30 June.
 - We have clarified that we are not prescribing a specific calculation methodology or type of model that Royal Mail is not required to develop to meet the sensitivity analysis requirements. We are simply requiring Royal Mail to provide us with the supporting calculations and models which it has chosen to use to create its own analysis.

4. Five-yearly financial forecasts

In section 4 of the 2022 Review Statement, we decided to require Royal Mail to provide to Ofcom, every five years, detailed confidential forecasts including key efficiency metrics covering a period of five years, and to publish two measures of its efficiency expectation from this. These expectations will be set at the start of the five-year period. Our full reasoning for these decisions is set out in the 2022 Review Statement.

To give effect to these decisions, we have decided that every five years, by 30 June, Royal Mail must submit a financial forecast covering a five-year period to Ofcom. This forecast must include a forecast of Workload, PVEO, Productivity (WIPGH and WIPWH), Gross Hours Reduction, Gross Hours broken down by hours type, but we have decided not to require a reconciliation of Royal Mail's planned efficiency initiatives to the forecast PVEO. More detail will be required for years four and five of the FYFF than the AFF.

The FYFF must also include the information required for the AFF (with some changes), meaning that every five financial years (starting in 2023-24) the requirement to provide an AFF will be replaced by the requirement to provide a FYFF. We will not accept updates to the FYFF, except in exceptional circumstances agreed with Ofcom.

We have decided to make a small number of changes to the proposed content requirements for the FYFF, specifically to slightly reduce the level of detail Royal Mail is required to provide in the Cost Matrix and PVEO forecast, and to clarify the index Royal Mail must use to forecast its people costs within the PVEO forecast.

Additionally, every five years, starting in June 2023, Royal Mail must publish its five-year PVEO and Productivity (WIPGH) expectations, which must be consistent with those provided confidentially to Ofcom in the FYFF.

- 4.1 In this section, we summarise our consultation proposals to amend the reporting requirements in order to implement the decisions confirmed in section 4 of the 2022 Review Statement. We then set out our decisions in relation to each of these, taking into account the points raised by stakeholders in their consultation responses.
- 4.2 Our decisions in relation to the FYFF are summarised in paragraph 4.117.

Core requirements of the five-yearly financial forecasts

Our proposals

- 4.3 The information we proposed to require in the FYFF is broadly similar to the current requirements for efficiency information (which are discussed in paragraphs 4.6-4.34 of the September consultation), but with two main differences – the information must cover a five-year period, and be provided every five years rather than annually.
- 4.4 Specifically, we proposed that Royal Mail would be required to provide a five-year forecast of:

- Workload;
 - Gross Hours Reduction;
 - Gross Hours (broken down by hours type);
 - Productivity (both WIPGH and WIPWH);
 - PVEO; and
 - A reconciliation of its planned efficiency initiatives to the forecast PVEO.
- 4.5 We proposed that the FYFF would comprise this information as well as the information required in the AFF, with a small number of changes (in relation to the level of detail required for years four and five of the forecast). This means that every five financial years (starting in 2023-24), the requirement to provide an AFF would be replaced by the requirement to provide a FYFF.
- 4.6 We proposed to require the same level of detail for each of the five financial years for all the efficiency metrics and the efficiency initiative assumptions in the FYFF.
- 4.7 Further, as for the AFF, we proposed that the FYFF must reflect Royal Mail's latest view of its objectives and expectations and, as far as possible, take account of its latest available actual results from the financial year immediately preceding the forecast period of the FYFF. It must also be consistent with Royal Mail's own board-approved business plan (if one has been approved by the board in the 90 days prior to 31 May),⁵⁶ and be accompanied by sensitivity and downside scenario analyses.
- 4.8 We proposed some changes to the existing efficiency information requirements⁵⁷ in the Strategic Business Plan, which are summarised below:
- extending the use of Workload to all Operational Business Processes for which Royal Mail can calculate a Workload figure, including Workload calculated as an overlay. We also proposed that Royal Mail must explain which activities are included within each Operational Business Process, including any overlays, and that in doing so, it must separate activities within the new parcel hubs from other Operational Business Processes.
 - In addition to a forecast of Gross Hours Reduction (which is currently required), that Royal Mail would be required to provide a forecast of Gross Hours broken down by Operational Business Process and hours type (specifically Worked Hours (split into Measured and Unmeasured Worked Hours) and absence (split into sickness absence and other absence), together with the corresponding Standard Hours (Workload).
 - In addition to a forecast of Productivity (WIPGH – Weighted Items per Gross Hour), that Royal Mail would be required to provide a forecast of Productivity using its own frontline measure, WIPWH (Weighted Items per Worked Hour).
 - For the forecast PVEO, that:

⁵⁶ If Royal Mail does not have a Board-approved business plan by 31 May, then as for the AFF, the FYFF must represent its latest view.

⁵⁷ We set out the background to, and detail of, the metrics and information we use to monitor the efficiency of the universal postal service in paragraphs 4.6-4.34 of the September consultation.

- CPI should be used as the inflation measure for non-people costs and the AWE index for people costs;
 - Royal Mail can include in the PVEO cost movements due to volumes for all the Operational Business Processes for which it has a Workload measure; and
 - cost changes must be outside management's control and non-recurring in nature in order to be classified as Other, and that Royal Mail must explain how each of the Other cost changes adheres to those requirements.
- In relation to efficiency initiatives, we proposed that Royal Mail would be required to provide the information in the same format as the AFF, but with the same level of detail provided for all five financial years of the forecast (rather than less detailed information for years four and five).

Consultation responses

General comments

- 4.9 CCNI noted that it considered consumers would benefit from efficiency measures put in place by Royal Mail, particularly by reducing its reliance on price rises. It also noted the importance of affordability as one of the overarching principles of the universal postal service. CCNI also set out some results of its recent research into the affordability of post in Northern Ireland, and asked us to include a section in the AMU setting out consumers' views on the affordability of the universal postal service.⁵⁸
- 4.10 CCNI also commented that it would be beneficial for stakeholders to understand how Royal Mail's efficiency performance contributes to better consumer outcomes, including on affordability. It proposed that Ofcom should make its analysis of Royal Mail's efficiency performance and how this ensures the universal postal service is affordable to consumers, available to stakeholders.⁵⁹

Level of detail required for the forecasts

- 4.11 Royal Mail disagreed with the level of detail we proposed to require for some of the forecasts. It argued that some of the pro formas were too prescriptive and that we hadn't explained why we need five years' worth of detail to fulfil our duties.⁶⁰
- 4.12 We discuss Royal Mail's specific comments and proposals in relation to the level of detail in the relevant sub-sections below.

Efficiency initiatives and cost movements, and reconciliation to PVEO

- 4.13 Royal Mail said the requirement to provide a detailed five-year forecast of efficiency initiatives and cost movements was unduly onerous and would not be useful to Ofcom. Royal Mail argued that to 'fully itemise' the efficiency savings expected across the five

⁵⁸ CCNI response to consultation, pp. 5-7.

⁵⁹ CCNI response to consultation, p 7.

⁶⁰ Royal Mail response to consultation, p. 22.

years would be meaningless, in particular in the latter years of the forecast as it would not necessarily know from which part of the pipeline the efficiency would come.

- 4.14 Royal Mail also asked us to clarify which items should be included in the sub-total entitled 'Hours Pay Cost Reduction Projects'. It also suggested that we should rename 'Costs Avoided' to 'Costs Saved' to more accurately reflect its own reporting.⁶¹
- 4.15 Royal Mail also suggested that our proposal was 'micro-management' of its business and that we should be indifferent to how it delivers efficiencies as long as it meets its overall efficiency ambition. Instead, Royal Mail suggested that efficiency initiatives and cost savings should be provided at a total level in years four and five.⁶²
- 4.16 Royal Mail also argued against the requirement to provide a reconciliation between the cost movements and PVEO, noting that it is unlikely that each row would align, and provided several supporting examples to demonstrate this. It said that the reconciliation would be a mathematical exercise which would not be useful for Ofcom.⁶³


Workload

- 4.17 The GCA supported our proposal to extend the use of Workload to all Operational Business Processes for which Royal Mail has a Workload calculation.⁶⁴

Productivity (WIPGH and WIPWH)

- 4.18 The GCA supported our proposal to require a forecast of Productivity (WIPWH) in addition to Productivity (WIPGH), on the basis that it provides additional transparency.⁶⁵

PVEO and Cost Matrix

- 4.19 Royal Mail proposed a new, less detailed pro forma for the Cost Matrix (for both the AFF and FYFF) and the PVEO (which uses the same cost lines as the Cost Matrix).⁶⁶ It argued that some of the cost lines we proposed to include in the Cost Matrix represent [, %] or less of the total Reported Business cost base and were therefore unnecessary. As for efficiency initiatives, Royal Mail argued that requiring this level of detail appears to be 'micro-management' by Ofcom of its business and that we had not set out why we need this level of detail.
- 4.20 Royal Mail also argued that, given the PVEO cost lines are the same as those in the Cost Matrix, we should amend the PVEO pro forma to require less detail, in line with its proposal for the Cost Matrix forecast (see above).⁶⁷
- 4.21 Royal Mail argued that our proposal to apply the PVEO calculation to each type of transformation cost is too detailed, as this would require performing calculations on

⁶¹ Royal Mail response to consultation, p. 23.

⁶² Royal Mail response to consultation, pp. 23-24.

⁶³ Royal Mail response to consultation, p. 23.

⁶⁴ GCA response to consultation, p. 3.

⁶⁵ GCA response to consultation, pp. 3-4.

⁶⁶ Royal Mail response to consultation, Annex 2.

⁶⁷ Royal Mail response to consultation, p. 22.

relatively immaterial items. It noted that in the current RAG, the PVEO pro forma requires the calculation to be performed on transformation costs in aggregate.⁶⁸

- 4.22 The GCA agreed with our proposal to use the OBR Average Weekly Earnings Index as the inflation measure for people costs. It also commented that our proposal for Royal Mail to be required to explain how each of the 'Other' items within the PVEO forecast meet the two conditions would be critical in supporting consumers' interests.⁶⁹

Other comments

- 4.23 We did not receive any comments on our proposals to require a forecast of Gross Hours split by hours type, or Gross Hours Reduction.
- 4.24 Royal Mail asked us to remove two reporting requirements from the FYFF. These are both existing requirements which we had transposed to the FYFF from the current USP Accounting Condition and RAG.
- 4.25 Firstly, Royal Mail argued that we should remove the requirement to reconcile forecast operational volumes to revenue-derived volumes as it considers this to be a 'legacy' requirement. It said that it did not consider that this forecast reconciliation would be meaningful to either Ofcom or to Royal Mail, and that it does not have insight on the detail of future differences between its operational and revenue-derived volumes.⁷⁰
- 4.26 Secondly, it argued that we should remove the requirement to produce a subtotal of Delivery & Collections and Processing results in the Cost Metrics forecast. It considered that this is a legacy requirement from when a combination of Delivery and Processing made up all of the pipeline segments for which Royal Mail had a Workload calculation. Royal Mail also noted that it is unsure whether Ofcom uses the subtotal of Workload and hours.⁷¹

Our assessment

General comments

- 4.27 In response to CCNI, we must have regard to the need for the provision of the universal postal service to be financially sustainable and efficient within a reasonable period.
- 4.28 Efficiency is a key aspect of ensuring financial sustainability. While we do not specifically measure the impact of efficiency on affordability, the implications are clear; Royal Mail not improving its efficiency performance and instead relying on price rises could undermine affordability.
- 4.29 The requirements we are confirming in this statement should increase transparency and scrutiny of Royal Mail's efficiency by its stakeholders.

⁶⁸ Royal Mail response to consultation, p. 23.

⁶⁹ GCA response to consultation, p. 4.

⁷⁰ Royal Mail response to consultation, pp. 23-25.

⁷¹ Royal Mail response to consultation, p. 25.

- 4.30 With regard to affordability, the regulatory reporting requirements do not directly seek to ensure affordability of postal services, although they support our broader objectives for the postal sector, which include ensuring that postal users have access to simple, affordable and reliable postal services that meet their needs. As set out in our 2022-23 Plan of Work, we are currently reviewing the safeguard caps that apply to some universal service products.⁷² These caps help to ensure the affordability of certain USO products. To determine the appropriate scope and level of the caps, if any, that will apply from April 2024, we are considering the affordability of USO services.

Level of detail required for the forecasts

- 4.31 We consider it is necessary for the FYFF to broadly contain the same level of detail for all 5 years of the forecast, as this will help us to fulfil our duty in relation to efficiency, and to ensure the effectiveness of the changes to the reporting regime confirmed in the 2022 Review Statement.⁷³ Firstly, it will help to ensure we have a detailed understanding of Royal Mail's efficiency ambitions in different areas, which in turn helps us to judge the likelihood of the efficiency expectations being achieved.
- 4.32 Secondly, a crucial element of our new approach to monitoring efficiency is the publication of five-year efficiency expectations. As the efficiency expectations will be in place for a five-year period and a subset of them will be published, it is essential that these expectations are reliable, and that we and stakeholders can have confidence in them. As the expectations are underpinned by the forecasts, requiring the same level of detail for each year) should ensure that Royal Mail puts together its expectations with appropriate consideration of how each metric either links to, or forms part of, the overall efficiency expectations. It should also provide us (and, indirectly, Royal Mail's stakeholders) with assurance that Royal Mail has given due consideration to the expectations, as we will be able to see the detailed information and assumptions underpinning them.
- 4.33 We appreciate that providing a detailed five-year forecast for this information may entail additional work for Royal Mail compared to what is currently required in the Strategic Business Plan. We also appreciate that there may be greater challenges in producing five-year projections for some of the assumptions within the forecast. For example, precise efficiency initiatives are unlikely to be known across the whole period, and we are not requiring Royal Mail to create plans where they do not currently exist. Where it does not have a specific plan for a particular area, or where plans exist but have not been finalised, we would expect this to be clearly noted. However, we expect Royal Mail to be clear on the ambition it has within different areas. Requiring a detailed forecast for all five years will help to ensure we can see this.
- 4.34 We respond to specific points raised by Royal Mail on the level of detail required for the different forecasts in the following sub-section.

⁷² The existing safeguard caps expire on 31 March 2024.

⁷³ This is in contrast to our approach for the AFF, for which (as noted in section 3) less detail for some metrics will be required for years four and five.

Efficiency initiatives and cost movements, and reconciliation to PVEO

- 4.35 As noted in section 3, it is important for our monitoring of efficiency to understand Royal Mail's planned efficiency initiatives and the areas these relate to, because these are the specific and 'real world' actions by which Royal Mail plans to make efficiency savings. They also give further context to the forecasts, which are based on assumptions and judgment as well as facts.
- 4.36 It is also important for us to understand the detail of the cost pressures (such as changes in pay and Workload), and the assumptions Royal Mail has made in calculating those, as this helps us to better understand how the efficiency initiatives will work against cost pressures to deliver efficiencies. As explained in section 3, we consider that it is necessary for us to receive this information on an annual basis. This is because it is necessary for our modelling of financial sustainability as it informs our forecast of costs. It is therefore included as a requirement in the AFF.
- 4.37 However, we need more detailed efficiency initiative information in the FYFF than the AFF, because the published efficiency expectations (PVEO and Productivity (WIPGH)) are a subset of the FYFF. To provide assurance that these expectations are reliable, and to ensure that we and stakeholders can have confidence in them, it is important that we understand the extent to which the expectations are underpinned by specific initiatives or plans. Requiring this level of detail in the forecasts helps to understand this, and the likelihood of Royal Mail achieving its expectations.
- 4.38 However, we accept that Royal Mail will not necessarily have a fully planned set of initiatives for all five years of the forecast. The pro forma enables Royal Mail to show where it has plans or initiatives to achieve savings and where the saving is an ambition and therefore the plan or initiative is yet unspecified. Further, understanding the specific initiatives (and projects within each of these) for the five-year period will help us to understand the likelihood of the efficiency expectations being achieved, which in turn informs our overall view of Royal Mail's future efficiency. This detail will also help us to better understand the likelihood of Royal Mail achieving its expectations.
- 4.39 We do not consider that requiring this level of detail is 'micro-management' of Royal Mail's business, as it argued. Our requirements relate to reporting information; we are not requiring Royal Mail to take specific actions in relation to efficiency. As Royal Mail considers we should be, we are indifferent to how it achieves, or how it should achieve, efficiencies. What we are concerned with is fully understanding its plans, to the extent that these are developed, so that we can effectively monitor the efficiency of the universal service and in doing so fulfil our duty in relation to efficiency.
- 4.40 Having considered representations from Royal Mail, we have decided not to require it to provide an annual reconciliation of the total savings from its efficiency initiatives and the total efficiency in the forecast PVEO. We accept that it would place an additional reporting burden on Royal Mail and could involve time-consuming calculations. Should we need to compare the differences between these efficiency estimates, we will be able to use the other required information about planned efficiency initiatives, specifically, the

requirement for Royal Mail to categorise the savings and costs into Price, Volume, Efficiency and Other.

- 4.41 In relation to the clarification and wording change Royal Mail requested for the pro forma, the erroneous subtotal (Hours Pay Cost Reduction Projects') has been removed, and we have replaced the term 'Costs Avoided' with 'Costs Saved'. The format of the required information is set out in the pro forma in Figure 9 of Appendix 1 to the RAG.

Workload

- 4.42 Royal Mail set out in its response to our March 2021 Call for Inputs on our Review of Postal Regulation ('March 2021 CFI'), that the current view of Workload does not recognise that increased Workload will lead to increased costs in national distribution, and that this means that its efficiency, measured by PVEO, will be understated.⁷⁴
- 4.43 Although national distribution represents a small portion of Royal Mail's cost base, and we therefore do not expect its inclusion to have a significant impact on the PVEO calculation, to address Royal Mail's concern, we think it is appropriate to extend the use of Workload to all Operational Business Processes for which Royal Mail can calculate a Workload figure, including Workload calculated as an overlay. This will ensure that the forecast better reflects Royal Mail's operational reality and provide greater transparency.
- 4.44 In addition, to ensure transparency and provide a clear reference point at the time of setting the forecast, it is important for Royal Mail to explain which activities are included within each Operational Business Process, including any overlays. This will help us to better understand the structure of its current operation and how it maps to Workload. In doing so, Royal Mail must separate activities within the new parcel hubs from other Operational Business Processes, because we need to understand the contribution of parcel hubs to Royal Mail's efficiency ambitions.
- 4.45 Finally, Royal Mail is currently required to provide a forecast of Workload using both its latest estimates of weights and the weights from the 2015 Business Plan, which was adopted as the benchmark for operations that were in place at the start of the 2017 to 2022 regulatory review period. Now, it will only be required to provide a forecast of Workload on the basis of the weights in place at the start of each FYFF (i.e., 2023-24 for the first forecast).
- 4.46 This will ensure that the Workload forecast, and all other metrics that rely upon Workload as an input (for example, Productivity (both WIPGH and WIPWH)), will reflect Royal Mail's most up to date view of its operations. It will also reduce the amount of work that Royal Mail is required to perform. The format of the required information is set out in the pro forma in Figure 7 of Appendix 1 to the RAG.

⁷⁴ Royal Mail, [response to March 2021 CFI](#), paragraph 4.14.

Gross Hours and Gross Hours Reduction

- 4.47 We currently require Royal Mail to provide a forecast of Gross Hours Reduction by Operational Business Process. However, in practice, we use Gross Hours as well as Gross Hours Reduction.
- 4.48 The breakdown of Gross Hours by hours type, which we typically request from Royal Mail on a regular basis using our statutory information gathering powers, provides us with important insight into the level and management of resources being used for a significant proportion of Royal Mail's operations. It enables us to understand the size of the 'worked gap', as targeted by Royal Mail in the Pathway to Change agreement, and the gap between Gross Hours and Standard Hours, both of which help us to understand any potential for efficiency savings. In turn, this helps us to fulfil our duty to have regard to the need for the provision of the universal postal service efficient within a reasonable period.
- 4.49 We therefore consider that it is necessary to require Royal Mail to provide a forecast of Gross Hours by Operational Business Processes including Delivery & Collections, Processing and Regional Distribution Centres (RDCs), split out by type of hours, specifically Worked Hours (split into Measured and Unmeasured Worked Hours) and absence (split into sickness absence and other absence), together with the corresponding Standard Hours (Workload). These breakdowns will help us better understand Royal Mail's plans in relation to Measured Hours and absence. By using the pay information we will receive in the AFF, we can monitor how changes to pay impact the savings opportunity over time.
- 4.50 Incorporating this into our reporting requirements will enable the consistent provision of information that is necessary for the reasons noted in paragraph 4.48, in a more efficient manner than ad hoc information requests. It will give both us and Royal Mail clarity on what it will be required to provide, and by when. It also should not be burdensome for Royal Mail, as it has previously provided the information in the proposed format.
- 4.51 Finally, we have not made changes to the calculation of Gross Hours Reduction. However, this forecast will now be required for a five-year time period (in line with all other information in the FYFF). The format of the required information is set out in the pro forma in Figure 7 of Appendix 1 to the RAG.

Productivity (WIPGH and WIPWH)

- 4.52 As outlined above, we currently require Royal Mail to provide its measure of Productivity which relates Workload to Gross Hours (WIPGH). However, more recently Royal Mail has introduced a new frontline Productivity measure, WIPWH.
- 4.53 We intend to continue to use WIPGH to inform our view of efficiency, because WIPGH uses Gross Hours, the change in which captures absence and unmeasured efficiencies, in addition to those efficiencies associated with the change in Measured Worked Hours. We therefore consider that it is a more comprehensive measure of efficiency than WIPWH. We do not think any changes to the calculation of the Productivity (WIPGH) metric are necessary.

- 4.54 However, so that we can understand Royal Mail's ambitions with respect to its own Productivity measure (i.e. WIPWH), and ensure that we have a comprehensive view of Royal Mail's productivity ambitions, it is necessary to require Royal Mail to provide a forecast of WIPWH, in addition to WIPGH.
- 4.55 In practice, this information can be calculated from the breakdown of Gross Hours by hours type, and therefore the additional reporting burden on Royal Mail will be minimal. However, making this an explicit requirement ensures that the information we receive is always prepared on a consistent basis, and that we understand the specific number Royal Mail expects to achieve. The format of the required information is set out in the pro forma in Figure 7 of Appendix 1 to the RAG.

PVEO and Cost Matrix

Core PVEO requirement

- 4.56 The PVEO metric provides an overall measure of efficiency by disaggregating annual cost movements by driver; 'Price' (or inflation), 'Volume', 'Efficiency' and 'Other'.
- 4.57 We will require PVEO rather than PVE, as we consider that the separation of 'Other' cost changes provides a more consistent and comparable, and therefore more reliable, measure of 'Efficiency'. The separation of 'Other' cost changes will allow us to exclude one-off factors that are outside of Royal Mail's control and could differ from one year to the next. This also reflects our current approach to how we require Royal Mail to provide PVEO.
- 4.58 Royal Mail will be required to produce a PVEO analysis for each of the five years of the FYFF, and, as now, it is important for the PVEO to have the same level of granularity as the Cost Matrix. As we are seeking less granular information for years four and five for the Cost Matrix, which we also discuss in section 3, we similarly require less granular information for years four and five for the PVEO than we require for years one to three. The format of the required information is set out in the pro formas in Figure 5 (Cost Matrix) and Figures 6a and 6b (PVEO) of Appendix 1 to the RAG.

Level of detail required

- 4.59 Royal Mail challenged the level of detail we proposed to require in the Cost Matrix and therefore the PVEO forecasts. In general, as noted above, it is important for us to see the specified level of detail in order for us to fully understand Royal Mail's efficiency plans and to provide transparency and assurance as to how the expectations have been calculated.
- 4.60 However, we agree that some cost lines in the Cost Matrix could be aggregated in years four and five to make the requirement more proportionate, but not to the extent of aggregation suggested by Royal Mail.
- 4.61 In considering where cost lines could be aggregated, we have had regard to the Guiding Principle of Materiality.⁷⁵ This defines a material item as one which is reasonably expected

⁷⁵ USPAC 1.7.2(h).

to affect the views of a competent user of regulatory financial information. We consider that if a cost line represents at least [~~5~~] % of total costs (either people or non-people), then it is material.

- 4.62 To determine which cost lines are likely to represent at least [~~5~~] % of total costs, and therefore where detail for years four and five is necessary, we considered Royal Mail's cost information that it has previously submitted to us. Specifically, we considered its 2019-20 operating costs, as these are unaffected by the additional and extraordinary costs Royal Mail incurred as a result of Covid-19.
- 4.63 Additionally, we have considered one-off cost items from the PVEO analysis (e.g., changes in provisions or Covid-19 costs) and taken an average of these for each cost line over the last four years (2018-19 to 2021-22) to represent the average impact one-off costs have on cost lines. We then took the cost lines that represented at least [~~5~~] % of total people or non-people costs in 2019-20, including where one-off items (e.g. changes in provisions) have contributed to this, and amended the pro forma to require less detail for years four and five for the cost lines that do not meet that threshold. As a result of this exercise, both the AFF and the FYFF pro formas now require detail for years four and five for one additional cost line which we have identified as being material (Staff & Agents Related Costs and Consumables).
- 4.64 We consider that this represents an appropriate and proportionate compromise between ensuring we have sight of all potentially material costs without being overly burdensome on Royal Mail. As this change will also apply to the PVEO forecast, it is necessary to create an additional pro forma for years four and five (see Figures 6a and 6b in Appendix 1 to the RAG).
- 4.65 More generally, we consider it is necessary to require this level of detail as it provides transparency as to which cost lines contribute to the PVEO expectation. It also provides the basis for meaningful analysis when tracking actuals against forecasts.

Changes to Cost Matrix pro forma which affect the PVEO pro forma

- 4.66 As noted in paragraph 3.63, we have made some additional changes to the Cost Matrix forecast and therefore to the PVEO forecast, specifically adding sub-totals and separating out cost lines where additional detail is required e.g., Collection, Delivery and Conveyance charges.

Transformation costs

- 4.67 It is important for Royal Mail to continue to forecast the PVEO both excluding and including transformation costs. This is because over a longer timeframe the uneven distribution of these costs is likely to be smoothed out, and the calculation of PVEO both including and excluding transformation costs helps us to have a comprehensive view of Royal Mail's efficiency ambitions.
- 4.68 We note that Royal Mail pointed out that the detail for transformation costs did not mirror the existing PVEO requirement. We have therefore modified our proposal to require Royal Mail to provide transformation costs in aggregate, to reflect the existing requirement.

Changes to specific Price, Volume and Other rules

- 4.69 The current rules provide Royal Mail with a significant degree of freedom when choosing the assumptions about input price inflation, volume-related cost movements and other cost changes, which can result in differences in the reporting of efficiency progress. To ensure reliability and transparency in the calculation of PVEO, reflecting its importance as one of the published efficiency expectations, we consider it necessary to amend some of the rules regarding the calculation of PVEO. We explain our changes and rationale for these in turn below.

Price

- 4.70 Royal Mail is currently required to estimate the cost changes due to inflation using an appropriate index.
- 4.71 Because efficiency is calculated by comparing actual costs with expected costs, if the estimated impact of inflation on costs is incorrect, the estimated impact of efficiency savings will also be incorrect. The choice of index is therefore significant.
- 4.72 The appropriate inflation index should reflect the inflationary pressures on Royal Mail which are outside its control. It needs to be available on both a forecast and actual basis to allow a consistent methodology to be applied to both actual and forecast PVEO metrics.
- 4.73 The inflationary pressure on Royal Mail will reflect its mix of inputs and the different macroeconomic pressures on those inputs. However, a Royal Mail specific index is not available, and therefore a proxy is required which balances cost-reflectiveness with the need to have a public and reliable source for forecasts and actual indices.
- 4.74 We currently require a single index for reasons of simplicity, but we do not mandate which index must be used. As a result, the calculation is typically performed on two bases, CPI for our reporting of PVEO within the AMU, and RPI for estimates Royal Mail submits to us. To avoid this duplication and potential confusion from different estimates of efficiency, we think it is necessary to specify the index or indices to be used.
- 4.75 We previously adopted CPI as a single index which we felt to be reflective of the overall costs. While we consider that CPI continues to provide a reasonable proxy for inflation on Royal Mail's non-people costs, we have taken the opportunity to consider if there is an alternative index for better estimating the underlying cost pressures on wages, given that people costs represent a significant proportion of Royal Mail's costs.
- 4.76 A wage index is likely to be more representative of pay pressures and movements over time, and so we consider that such an index provides the appropriate basis for forecasting changes in Royal Mail's people costs. We therefore consider that Royal Mail should use two indices to forecast its costs: CPI for non-people costs, and OBR Average Earnings for people costs.
- 4.77 In the September consultation, we said that we were minded to use an OBR Average Weekly Earnings (AWE) index as the wage inflation index, but we now understand that there is no such index. Instead, we consider that Royal Mail should use the OBR Average Earnings index (AEI), which has similar characteristics, remains an index based on earnings,

and does not change the substance of our original proposal. We note that there were no stakeholder responses to our original proposal.

- 4.78 The OBR AEI provides an annual measure of average earnings per employee on both an actual and forecast basis. The forecasts are based on the wages and salaries element of the national accounts (i.e. total wages and salaries in the whole economy) which is then divided by everyone in the labour force.
- 4.79 The OBR AEI also more accurately represents the pay pressures and movements across time facing Royal Mail with regards to its people costs. CPI, by contrast, shows the price pressures consumers are facing for goods. Further, the OBR AEI forecasts are released for up to five years which aligns with the requirement for the FYFF.
- 4.80 We recognise that this index is calculated for the economy as a whole and not solely for Royal Mail's industry, but disaggregation at a sector-level is only available for actuals, not forecasts. Therefore, we think that this an appropriate index for Royal Mail to use when estimating the effects of inflation on its people costs.

Volume

- 4.81 With regards to volume drivers, we will continue to adopt Royal Mail's methodology of using Workload movements to estimate the short run variability of costs.
- 4.82 Extending the use of Workload to all Operational Business Processes for which Royal Mail calculates a Workload figure (see paragraph 4.43) means that Royal Mail can include in the PVEO cost movements due to volumes for all the Operational Business Processes for which it has a Workload measure. This should address Royal Mail's concern, set out in its response to our March 2021 Call for Inputs and noted above, that its efficiency, measured by PVEO, will be understated.

Other

- 4.83 The 'Other' in the PVEO metric captures non-recurring items, typically outside of Royal Mail's control, that have the effect of reducing or increasing costs in the year. The categorisation of cost movements between Efficiency and Other can have a significant impact on the estimate of the efficiency element of the PVEO.
- 4.84 For example, Royal Mail, in its response to our March 2021 CFI, said that our restatement of its 2018-19 PVEO did not capture the £800m in avoided costs that Royal Mail delivered through its 2018 Pay, Pension and Pipeline agreement.⁷⁶ We disagreed, as the £800m was not a cost incurred in the year and it was within Royal Mail's management's control. The restatement reduced the estimate of efficiency achieved in the year from over 10% to - 0.6%.
- 4.85 Therefore, to ensure that the PVEO is a clear and consistent and transparent measure of efficiency, as well as reflecting the importance that the PVEO metric will have as a

⁷⁶ Royal Mail, [response to March 2021 CFI](#), paragraph 4.15.

benchmark for our ongoing assessment of Royal Mail's efficiency progress, we think it is necessary to further specify the changes that can be classified as 'Other'.

4.86 Where 'Other' costs are expected to be incurred, we consider that Royal Mail can include them in the forecast PVEO only if each cost change satisfies both of the following requirements:

- outside management's control. This is a new requirement; and
- non-recurring in nature (which does not necessarily mean it can only occur in one year). This is an existing requirement.

4.87 We consider that the Guiding Principles (which include objectivity and materiality), which apply to all of the financial information that Royal Mail is required to provide to us, will ensure that the items classified as 'Other' are material. In our view, therefore, the requirement for any cost change classified as 'Other' to be at least £5m in absolute terms is no longer necessary. Provided that each 'Other' cost change meets the other two requirements noted in the paragraph above, removing this requirement gives Royal Mail flexibility to decide whether the size of the item means that it should be included.

4.88 The requirements set out above provide a framework to ensure that the PVEO reflects Royal Mail's underlying operational efficiency. However, we recognise that the requirements still involve an element of judgement, as it is difficult to predict all of the possible cost movements which would fit into this category.

4.89 Therefore, we think that it is necessary for Royal Mail to explain how each of the 'Other' items meets the conditions set out above when it submits the PVEO forecast. This will also act as an additional check to ensure that we are satisfied that the items adhere to the requirements, as well as providing transparency.

Other comments

4.90 The subtotal of Delivery & Collections and Processing within the Cost Metrics report was introduced at a time when Royal Mail only had Workload calculations for Delivery and Processing pipeline elements. As we think it is appropriate to extend the use of Workload to all Operational Business Processes for which Royal Mail can calculate a Workload figure, this subtotal is no longer required, and we have removed it from the pro forma (Figure 7 of Appendix 1 to the RAG) in response to Royal Mail's request.⁷⁷

4.91 As for the reconciliation of operational volumes to revenue-derived volumes, this requirement was introduced in 2017 to help answer questions relating to the monitoring of financial sustainability and efficiency.⁷⁸ Royal Mail uses operational volumes for the calculation of Workload, but for other traffic measurements within its regulatory reporting, it must use the revenue-derived method. The reconciliation helps us to understand how the reported volumes resulting from the use of these two methods are reconciled, and

⁷⁷ We have also removed it from the corresponding pro forma for reporting on actual performance.

⁷⁸ Ofcom, 2017, [Review of Regulatory Financial Reporting for Royal Mail: Consultation](#), Tables 6.1 and 6.2.

provides us with further transparency and assurance as to the accuracy of the reported volumes and Workload calculations.

- 4.92 Workload is a key component in the calculation of Productivity (WIPGH) and (WIPWH) and we consider that this is still necessary to understand how the Workload has been calculated. This is particularly important going forward as Royal Mail will be required to publish its Productivity (WIPGH) expectation and we and other stakeholders need to have confidence in the expectations and calculation which support them. We have therefore retained the requirement for reconciliation of operational volumes to revenue-derived volumes in the FYFF.

FYFF deadline and submission requirements, and publication of efficiency expectations

Our proposals

- 4.93 We proposed that, every five years, starting in 2023, Royal Mail must submit a FYFF to Ofcom by 31 May. We noted our intention to use the forecast provided to us on that date to track Royal Mail's efficiency performance. To this end, we proposed that, in contrast to the AFF, there would be no requirement for Royal Mail to provide any updates to the FYFF (and therefore the published efficiency expectations) to us.
- 4.94 We also proposed that Royal Mail must, every five years (starting in 2023), publish its five-year PVEO and Productivity (WIPGH) expectations 90 days after the start of the first financial year to which they relate. This would mean that they would be published around the end of June.

Consultation responses

- 4.95 Royal Mail argued that the deadline for submission of the FYFF should be 30 June, rather than 31 May, for the same reasons as the AFF.⁷⁹
- 4.96 Royal Mail also argued that the deadline for publication of efficiency expectations should be 31 July. This is because this would mean that it would continue to have a month between submission of the FYFF and publication of the expectations.⁸⁰
- 4.97 Royal Mail said that it would publish the expectations separately from the Regulatory Financial Statements (RFS), as the RFS are audited. It argued that publishing the expectations in the RFS might lead to stakeholders mistakenly believing that the expectations had also been audited.⁸¹
- 4.98 We did not receive any comments on the commentary we proposed to require Royal Mail to provide alongside the expectations.

⁷⁹ Royal Mail response to consultation, p. 25.

⁸⁰ Royal Mail response to consultation, p. 25.

⁸¹ Royal Mail response to consultation, p. 23.

Our assessment

Deadline for the FYFF

- 4.99 As for the AFF, we need the FYFF to be submitted as close as possible to the start of each forecast period, but we also recognise that preparing the forecast will entail work for Royal Mail during a busy period (i.e. the end of the financial year).
- 4.100 For the same reasons as for the AFF (set out in paragraphs 3.21-3.26), we think that it is appropriate to extend the deadline for submission of the FYFF to Ofcom from 31 May to 30 June every five years. This means that the first FYFF will be due by 30 June 2023.
- 4.101 We set out our view in the 2022 Review Statement that using a consistent benchmark of efficiency expectations throughout the five-year period, set at the start of the period, provides the most straightforward and transparent basis for consideration of Royal Mail's efficiency ambitions, for Royal Mail, us, and other stakeholders.
- 4.102 We recognise that during the forecast period, Royal Mail may make decisions, or events may occur, which mean that the efficiency expectations become outdated. We also appreciate that Royal Mail may wish to update its forecast in the intervening years for this reason, and it is of course free to do so for its own purposes. However, if we were allow Royal Mail to update the FYFF from time to time, this would undermine our objective to have a consistent and stable benchmark by which to consider efficiency progress, and in turn undermine stakeholder confidence in the expectations.
- 4.103 Further, as we explain in section 5, when Royal Mail publishes its actual annual progress, it will have an opportunity to explain any divergence from the published expectations, and, if necessary, may wish to explain the impact of any forecasting error when it comes to the measurement of actual performance against expectations. The requirement for an AFF will also ensure that we have up-to-date (confidential) forecasts on an annual basis.
- 4.104 Therefore, in contrast to the AFF, it is unnecessary to require Royal Mail to provide any updates to the FYFF (and therefore the published efficiency expectations) to us. Indeed, unless there are exceptional circumstances (see paragraphs 4.107 and 4.108 below), any such updates or revisions to that forecast will not be considered by us, as we will maintain our monitoring of efficiency progress against the consistent and stable benchmark provided by the FYFF.
- 4.105 As for the AFF, it is important that the FYFF reflects Royal Mail's latest view of its objectives and expectations, and, as far as possible, takes account of its latest actual results, specifically, the actual results from the financial year immediately preceding the forecast period of the FYFF. This means that, for the FYFF due by 30 June 2023, it must take account of results for 2022-23.
- 4.106 Further, if Royal Mail has a board-approved business plan in place by 30 June, the FYFF must be consistent with that (specifically, for the FYFF due by 30 June 2023, this means that it must be consistent with Royal Mail's business plan covering the financial years 2023-24 onwards). Given the importance and prominence of the FYFF and related efficiency

expectations (the latter of which will be published), our expectation is that this will be the case.

Exceptional circumstances

- 4.107 We recognise that exceptional circumstances may occur which are outside of Royal Mail's control (for example, the Covid-19 pandemic) and which mean we may consider it is appropriate to update the FYFF. We expect these instances to be exceptional and unlikely to occur. If such a circumstance were to arise, we would expect Royal Mail to explain the impact of the exceptional circumstance on the previously submitted FYFF and submit to us revised forecasts. The updated FYFF (and related efficiency expectations) would then only be accepted as the new benchmark with our public written consent.
- 4.108 In deciding whether to adopt an updated FYFF under the above-mentioned exceptional circumstances, we would consider to what extent the exceptional circumstance affects the previously submitted FYFF, in accordance with the Guiding Principles for regulatory financial reporting, which include the principles of accuracy, objectivity, completeness, consistency and causality.

Publication of efficiency expectations

- 4.109 We decided in the 2022 Review Statement that, from 2023, Royal Mail must publish two of its five-year expectations from the FYFF (specifically, PVEO and Productivity (WIPGH)). The period the first set of expectations will cover is 2023-24 to 2027-28. We expect publication of these expectations to increase stakeholders' understanding of Royal Mail's progress on efficiency and provide a public reference point for future considerations of Royal Mail's efficiency. We also decided in the 2022 Review Statement to require Royal Mail to annually publish its performance against these expectations.
- 4.110 In deciding the level of detail and format of the publication requirement, we have had regard to potential concerns relating to commercial sensitivity. As such, we consider that the intended published information is either already disclosed by Royal Mail as part of the forward look in annual results briefings (Productivity), or is of a high enough level that any details of projects or programmes are obscured (PVEO), ensuring that commercially sensitive information will not be disclosed.
- 4.111 The PVEO expectation must be published in both percentage and absolute terms, while the expected change in Productivity (WIPGH) should be published in percentage terms. The PVEO set out in absolute terms will provide stakeholders with the extent of Royal Mail's efficiency ambitions in monetary terms, to which they could compare the monetary value of other changes in costs, revenues and other cash flows.
- 4.112 We consider that Royal Mail should publish its PVEO forecast including transformation costs.⁸² Transformation costs are planned for a longer timeframe and their potential uneven distribution over the years is likely to be smoothed out over a longer-term forecast.

⁸² This is in contrast to the confidential forecast, for which Royal Mail will be required to provide PVEO both including and excluding transformation costs.

Therefore, the calculation of PVEO including transformation costs will provide not only a comprehensive view of costs and efficiency but will also reflect the requirement for the forecast to be prepared for a longer time period (i.e. five years).

- 4.113 We disagree with Royal Mail that a deadline of late July for the publication of the expectations is necessary, and consider that a deadline of 90 days after the start of the financial year remains appropriate.
- 4.114 While we appreciate that this means that Royal Mail will not have a month between submission of the FYFF to Ofcom and publication of the expectations (as would have been the case in our consultation proposal),⁸³ we do not consider that this time is actually necessary to prepare the expectations, given that the expectations are simply a summary of two specific elements of the FYFF. They are not a separate forecast that Royal Mail will need to prepare, and there is no requirement to provide accompanying commentary. Finally, the one month's gap in the proposals was not designed to provide some additional time. It was merely the consequence of our proposal requiring the FYFF to be submitted earlier by 30 May.
- 4.115 Further, and as noted in the September consultation, this deadline (i.e. 90 days after the financial year-end) aligns with the deadline for the other information, e.g. the income statement for the Reported Business, that Royal Mail is already required by Ofcom to publish annually, which it meets via the publication of the RFS. This means that stakeholders will likely already be reading information Royal Mail publishes at the same time and can consider the expectations with that broader context in mind.
- 4.116 Finally, Royal Mail noted its intention to publish the expectations as a separate schedule rather than within the RFS. As noted by Royal Mail in its response, we did not propose to require the expectations to be published within the RFS. While we set out the information and statements Royal Mail must publish, we do not mandate how these information and statements are packaged. It is Royal Mail's decision to publish some of the information within the RFS and some in other documents (e.g. the Costing Manual). This is why we are now simply requiring the efficiency expectations to be published by being placed in a prominent place in an appropriate and publicly accessible website operated or controlled by the Relevant Group. This is to ensure the information are easily accessible to stakeholders. For that reason, we have also slightly amended all other publication requirements in the USPAC to be consistent with the above. The format of the required information is set out in the pro forma in Figure 10 of Appendix 1 to the RAG.

Our decisions

- 4.117 Having carefully considered stakeholder responses, we have decided:
- That Royal Mail must, every five years, submit a FYFF to Ofcom by 30 June, starting in 2023, which comprises:

⁸³ Our consultation proposal was for the FYFF to be due by 31 May 2023, and the expectations 90 days after the financial year-end, which falls in late June.

- The following information, with changes compared to the existing requirements in brackets:
 - Workload (alongside an explanation of the activities which are included within each Operational Business Process, including any overlays, including separation of activities within the new parcel hubs from other Operational Business Processes, and to provide the forecast for all Operational Business Processes for which Royal Mail has a Workload calculation)
 - PVEO (using CPI as the inflation measure for non-people costs and the OBR Average Earnings Index (AEI) for people costs), change to the requirements for cost changes classified as Volume (see Workload above) and Other (changes to guidelines), and a requirement to explain how each of the Other cost changes adhere to those requirements)
 - Productivity (WIPGH and WIPWH);
 - Gross Hours Reduction; and
 - Gross Hours broken down by Operational Business Process and hours type.
 - Together with all of the information required in the AFF, with the following changes:
 - for the cost forecasts set out in the Cost Matrix, a slightly increased level of detail for years four and five (in relation to frontline people costs and voluntary redundancy); and
 - for the efficiency initiatives and related cost information, the same level of detail for each of the five years.
 - that the FYFF must reflect Royal Mail's latest view of its objectives and expectations, take into account Royal Mail's latest available actual information, and be consistent with Royal Mail's business plan if one has been approved by the board in the 90 days prior to 30 June, but there is no requirement to provide an updated forecast if board approval is later than 30 June; and
 - that Royal Mail must, every five years (starting in 2023), publish its five-year PVEO and Productivity (WIPGH) expectations within 90 days of the start of the first financial year to which they relate.
 - that Royal Mail must continue to provide the reconciliation of revenue-derived volumes to operational volumes; and
 - to remove the subtotal 'Delivery & Collections and Processing' from the Cost Metrics forecast.
- 4.118 The changes to the requirements are set out in USPAC 1.1.2, 1.3.1(c), 1.3.3, 1.3.5 and 1.3.6(c) (Annex 2, pages 3-6 and 8-9) and Table 2 and paragraph 8.83 of the RAG (Annex 3, pages 13-16 and 44-45). The associated pro formas are in Figures 5-10 of Appendix 1 to the RAG.
- 4.119 We consider that our decisions in relation to the FYFF are objectively justifiable and proportionate because they enable us to fulfil our duty in relation to the efficiency of the universal service. In particular, we note that:

- They implement the decisions consulted on and confirmed in the 2022 Review of Postal Regulation, specifically, to require Royal Mail to provide a detailed confidential forecast containing efficiency metrics covering a five-year period, to publish two measures of its efficiency expectations from this forecast, and to publish its annual performance against those expectations.
- As for the AFF, our starting point for the information requirements in the FYFF is what is currently required in the Strategic Business Plan and Annual Budget. This means that Royal Mail should be familiar with the required information as it has previously produced it in the same or a similar format.
- While we accept that providing the same level of detail for each of the five years of the forecast is likely to entail more work for Royal Mail than is currently required, we consider this is necessary because:
 - It gives us assurance that they have been put together with appropriate consideration by Royal Mail. This is important as the forecasts underpin the efficiency expectations. The expectations will be published and in place for five years, and it is important that we, and Royal Mail's stakeholders, have confidence in them.
 - It will give us a detailed understanding of Royal Mail's efficiency ambitions in different areas, which in turn helps us to understand the likelihood of them being achieved.
- We have removed the requirement for a reconciliation of Royal Mail's planned efficiency initiatives to the forecast PVEO, in light of Royal Mail's comments.
- We have considered where we can reduce detail in light of Royal Mail's comments and have reduced the level of detail required in the Cost Matrix and PVEO, in line with the Guiding Principle of materiality.
- While Royal Mail will be required to provide a detailed forecast and publish efficiency expectations, these will only be required once every five years. The AFF, which is required in the intervening years, will entail less work for Royal Mail than the FYFF.
- As for the AFF, we have decided to extend the deadline for the FYFF by one month (to 30 June), to give Royal Mail more time to prepare the forecast.

5. Reporting on actual performance

In section 4 of the 2022 Review Statement, we decided to continue to require Royal Mail to provide information on actual performance and confirmed a new requirement on Royal Mail to publish annually its actual performance against its published efficiency expectations.

All existing requirements on Royal Mail to report its actual performance to Ofcom will be retained. However, we have decided to make some changes to these requirements which largely seek to ensure that there is comparability between the financial forecasts and Royal Mail's actual performance data.

In addition, Royal Mail will be required to publish annually, from 2024 onwards, its cumulative PVEO and Productivity (WIPGH) performance, and to provide commentary on its performance in that financial year. It will also be required to provide some additional confidential commentary to Ofcom alongside its annual PVEO and Productivity (WIPGH) performance information.

- 5.1 In this section, we summarise our consultation proposals to amend the reporting requirements with respect to the actual performance information that must be reported to Ofcom, the information (PVEO and Productivity (WIPGH)) that Royal Mail will be required to publish, including commentary, and the additional confidential commentary that must be provided to Ofcom. We then set out our decisions in relation to each of these, taking into account the points raised by stakeholders in their consultation responses.
- 5.2 Our decisions are summarised in paragraph 5.59.

Background to actual performance information

- 5.3 Actual performance information is necessary for our monitoring of the financial sustainability and efficiency of the provision of the universal service.
- 5.4 When compared with forecasts, actual performance information can provide insight into Royal Mail's progress against its business plans and the likelihood of those plans being achieved, including Royal Mail's efficiency forecasts. Together with the reasons for the deviations from business plans and forecasts, this information allows us to ground our monitoring in financial and operational reality.
- 5.5 Actual information requirements therefore typically follow the same format as those of the forecast information to allow easy and transparent comparability.
- 5.6 The actual performance information that Royal Mail currently provides, as set out in Table 4 of the RAG, enables us to carry out the above tasks.

Changes to actual performance information

Our proposals

- 5.7 We proposed to continue to broadly require the same actual performance information that Royal Mail currently provides to us. However, we did propose some changes to the actual reporting requirements in relation to efficiency to ensure consistency and comparability between the financial forecasts and Royal Mail's actual performance, which will help track Royal Mail's progress more effectively over time. These changes related to revenues and volumes, Cost Matrix, Workload, Gross Hours and salary costs, Productivity (WIPWH), PVEO and efficiency initiatives.
- 5.8 We also proposed some changes to the actual reporting requirements to ensure that we continue to receive the information we need to monitor financial sustainability and to perform our own modelling for that purpose. These changes related to Gross Hours and salary costs.
- 5.9 Finally, we proposed changes to better ensure the completeness and internal consistency (including further reconciliations) of the information provided to us. These changes related to voluntary redundancy cash costs and Productivity (WIPGH).

Consultation responses

- 5.10 Royal Mail made comments on the following items in relation to our proposals for the AFF and FYFF, which we understand also apply to our proposals for changes to actuals reporting. These are:
- the application of the PVEO calculation to transformation costs (see paragraph 4.21);
 - its request to remove the requirement to reconcile the efficiency initiatives and cost movements to the PVEO (see paragraph 4.16);
 - its request to clarify Category 3 (in the efficiency initiatives pro forma and rename 'Costs Avoided' 'Costs Saved' (see paragraph 4.14); and
 - its request to remove the subtotal of Delivery & Collections and Processing from the Cost Metrics pro forma (see paragraph 4.26).
- 5.11 For the following items, Royal Mail made the same requests for changes to actuals reporting as for the forecasts, but used slightly different arguments:
- Royal Mail asked us to remove the requirement for the reconciliation of operational traffic to revenue-derived traffic on a quarterly basis, arguing that it takes time to produce, that it is a legacy requirement, and that Royal Mail does not know how the information is used by Ofcom to discharge its duties.
 - Royal Mail said that we should remove the requirement to provide the USO mail volume percentage in the actual quarterly revenues and volumes pro forma (Figure 16 of Appendix 1 to the RAG). It argued that this requirement is unnecessary as Ofcom

already has the data to calculate this information. It also noted (as for the forecast) that it is likely to be complex for it to provide the information.⁸⁴

5.12 Finally, Royal Mail also made a small number of additional specific comments on our proposals to amend some of the actual reporting requirements. These were:

- a request to remove the requirement to attribute specific items in Figure 11 (Reported Business Annual statement) to USO Mail and Other, and in Figure 12 (Reported Business quarterly and annual income statement) to USO Mail, Non-USO Mail and Non-Mails. Royal Mail noted these costs are not included in the Financeability EBIT.⁸⁵
- a request to update the Reported Business Annual Income Statement and Reported Business quarterly and annual income statement to reflect the statutory results, specifically, that transformation costs should be shown in the pay and non-pay rows rather than as a separate reporting row.⁸⁶
- a request to update the Cost Matrix pro forma to reflect Royal Mail's current business structure, specifically to amend it so that transformation costs are reported in the pay and non-pay rows. Royal Mail argued that the current template is a legacy reporting structure and, as such, complying with this requirement creates additional costs for the business.⁸⁷

5.13 The GCA suggested that Ofcom could require more granular reporting from Royal Mail, including disaggregating Royal Mail's letters performance in December from the rest of the year. It considered that this would deliver several benefits, including encouraging Royal Mail to explore pricing or service incentives around the Christmas period.⁸⁸

Our assessment

5.14 For the comments made by Royal Mail on the actual reporting requirements set out in paragraph 5.10 above, our response in the relevant sub-sections of sections 3 and 4 also apply (see paragraphs 4.67 (application of the PVEO to transformation costs), 4.40 (reconciliation of PVEO to efficiency initiatives), 4.41 (clarification of sub-total and wording used) and 4.90 (Delivery & Collections and Processing subtotal)).

Revenues and volumes and Cost Matrix

5.15 To ensure comparability between the forecasts and actual performance, in relation to actual revenues and volumes and Cost Matrix information, it is important that Royal Mail reports using the same product groupings and breakdowns as the first forecast year in the corresponding forecasts. The format of the required information is set out in the pro formas in Figure 15 (Cost Matrix) and Figure 16 (revenues and volumes) of Appendix 1 to the RAG.

⁸⁴ Royal Mail response to consultation, p. 27.

⁸⁵ Royal Mail response to consultation, p. 26.

⁸⁶ Royal Mail response to consultation, p. 32.

⁸⁷ Royal Mail response to consultation, p. 27.

⁸⁸ GCA response to consultation, pp. 4-5.

- 5.16 In response to Royal Mail's request to remove the requirement to provide the USO Mail volume percentage as part of the revenues and volumes submission, we agree that the split between USO and Non-USO products can be derived from the Data Extract File and the SPHCC Masterlist provided as part of the Costing Manual. As such, we consider that it is unnecessary for Royal Mail to provide the USO/Non-USO split for the reporting of actual quarterly revenues and volumes. We have updated the revenues and volumes pro forma (Figure 16) accordingly.
- 5.17 However, we disagree with Royal Mail that transformation costs should be reported within the pay and non-pay cost lines of the Cost Matrix. Although transformation costs are ongoing, it is important that these are separated as there is an expected uneven distribution of transformation costs from one year to the next, which can distort the view of performance (for example, it may overstate or understate Royal Mail's EBIT performance or efficiency changes in a given year, which does not give us an accurate picture of its financial sustainability or efficiency). Having the transformation costs reported on separate lines will allow us to understand better the impact of any fluctuations in transformation costs over time.
- 5.18 Finally, in response to the GCA, with some exceptions,⁸⁹ pricing and service offerings are a commercial decision for Royal Mail. We therefore do not think that additional reporting requirements to encourage changes to its pricing or services would be appropriate.

Workload

- 5.19 To ensure comparability between the forecasts and actual performance, in relation to actual Workload information, it is important for Royal Mail to:
- explain which activities are included within each Operational Business Process, including any overlays, and, in doing so, separate the activities within parcel hubs from other Operational Business Processes;
 - where new Operational Business Processes are introduced into its operations, include any related overlays within the Workload calculation for each Operational Business Process. This should be accompanied by a breakdown of those overlays and how each one has been calculated, and a description of the new Operational Business Process it relates to. The Workload reported in the prior year comparative should be consistent with the current year's method of calculation, including new overlays.
- 5.20 We will continue to require Royal Mail to report on two bases: the Workload assumptions from the latest FYFF, and Royal Mail's latest Workload assumptions, which will be updated every year. We will also continue to require Royal Mail to provide the reconciliation between the two bases of Workload.
- 5.21 With regard to the reconciliation of operational volumes to revenue-derived volumes, Royal Mail uses operational volumes for the calculation of Workload, rather than revenue-derived volumes which are used for all other traffic measurements within its regulatory

⁸⁹ For example, the safeguard caps on second class standard letters, large letters and some parcels, and the minimum requirements of the Universal Service.

reports. The revenue-derived volumes in those regulatory reports are required to be reconciled to each other and the totals are subject to audit requirements in the regulatory accounts.

- 5.22 Workload is a key component in the calculation of Productivity (WIPGH), which Royal Mail will be required to publish to show its progress against its efficiency expectations.
- 5.23 It is important to continue to require that operational volumes are reconciled with revenue-derived traffic to ensure that Workload is consistent with the volumes data used in all other regulatory reports. This provides us with further transparency and assurance as to the accuracy of the operational volumes used in the Workload, and therefore Productivity (WIPGH), calculations.
- 5.24 Therefore, we consider it necessary to retain the requirement for Royal Mail to produce a reconciliation of operational volumes to revenue-derived traffic for actuals reporting. The format of the required information is set out in the pro forma in Figure 17 of Appendix 1 to the RAG.

Gross Hours and pay

- 5.25 To ensure comparability between the forecasts and actual performance, in relation to actual Gross Hours and pay information,⁹⁰ it is important for Royal Mail to:
- provide, on an annual basis:
 - total Gross Hours broken down by hours type and Operational Business Process (Delivery & Collections, Processing and RDCs); and
 - provide, on a quarterly basis:
 - total Gross Hours broken down by time category (normal/ordinary, casual/temporary, overtime and any other); and
 - total frontline pay, broken down by time (normal/ordinary, casual/temporary, overtime and any other) and by pay component (specifically salary, employer National Insurance and pension contributions).
- 5.26 The quarterly frequency of selected information will enable us to understand better the impact of the seasonality of Royal Mail's business in our ongoing monitoring of financial sustainability and efficiency. Royal Mail's business experiences seasonal peaks and troughs in terms of volumes and, as a result, it considers it necessary to resource different types of workers at different times, for example temporary workers at Christmas. [X].
- 5.27 Including National Insurance and pension contributions within the actual pay information will allow us to understand and quantify differences between actuals and expectations and if changes in people costs are a result of changes to salaries, National Insurance or pensions.
- 5.28 We currently use our statutory information gathering powers to request actual Gross Hours, broken down by time category, on a quarterly basis from Royal Mail. As for the

⁹⁰ For the avoidance of doubt, we will continue to require Gross Hours Reduction actual information on a quarterly basis.

forecast information, building this into our reporting requirements instead will enable the consistent provision of information that is necessary to fulfil our duties, in a more efficient and proportionate manner than ad hoc information requests.

- 5.29 Further, we consider that adding these to our reporting requirements is proportionate and will not represent a significant burden to Royal Mail, as it will be familiar with, and has previously produced, information in the same or similar format. The format of the required information is set out in the pro forma in Figure 19 of Appendix 1 to the RAG.

Average voluntary redundancy cash costs

- 5.30 We use information about voluntary redundancy costs in our modelling to understand the cash impact of voluntary redundancy activity within the year and how many heads this relates to. [✂]
- 5.31 Therefore, we consider it necessary to require Royal Mail to report (within the quarterly Cost Matrix report (Figure 15 of Appendix 1 to the RAG)) on average YTD cash voluntary redundancy costs, split by Frontline, Management and Other.

Productivity (WIPGH and WIPWH)

- 5.32 To ensure comparability between the forecasts and actual performance, it is important for Royal Mail to report quarterly on actual Productivity (WIPWH) performance. Further, in order to implement the decision made in section 4 of the 2022 Review Statement, and to enable us and stakeholders to track its efficiency performance over time, Royal Mail must also report annually on Productivity (WIPGH). The format of the required information is set out in the pro forma in Figure 17 of Appendix 1 to the RAG.

PVEO

- 5.33 To ensure comparability between the forecasts and actual performance, in relation to actual PVEO, the following rules are necessary:
- Price: Use CPI as the inflation measure for non-people costs and the OBR Average Earnings (AE) index for people costs
 - Volume: Continue to adopt Workload movements as the volume drivers, with the following changes, reflecting the proposed changes to the actual Workload reporting requirement above:
 - adopt the Workload for all Operational Business Processes for which Royal Mail calculates a Workload figure; and
 - use the assumptions from the latest FYFF.
 - Other:
 - ensure that these cost changes are outside management's control and non-recurring in nature (the latter is an existing requirement);
 - no longer ensure that these cost changes are in excess of £5m in absolute terms; and
 - explain how each of the Other cost changes adheres to the requirements.

- 5.34 The format of the required information is set out in the pro forma in Figure 6a of Appendix 1 to the RAG.

Efficiency initiatives and cost movements, and reconciliation to PVEO

- 5.35 To ensure comparability between the forecasts and actual performance, in relation to efficiency initiatives, it is important for Royal Mail to report actual performance on the efficiency initiatives, including related cost information/pressures, as set out in the FYFF, using the same structure and level of detail as those forecasts. This will replace the 'Cost Savings from initiatives' section in the existing quarterly Cost Metrics report (see the pro forma in Figure 17 of Appendix 1 to the RAG).
- 5.36 As noted in section 4, it is important for our monitoring of efficiency to understand Royal Mail's planned efficiency initiatives and the areas these relate to, because these are the specific actions by which Royal Mail plans to make efficiency savings.
- 5.37 As for all other metrics, we need actual information in order to track performance against forecasts. In relation to efficiency initiatives, this will give us a comprehensive understanding of how Royal Mail is performing against its plans and the extent to which it has succeeded against the savings it forecast.
- 5.38 The reporting should include not only the actual performance against the initiatives included in the FYFF, but also actual performance against any new initiatives that Royal Mail has introduced since then (which will have been included in the AFF), in order to continue to understand the likelihood of Royal Mail achieving the efficiency expectations at the end of the five-year period.
- 5.39 For the same reasons as for the FYFF (see paragraph 4.40), we no longer consider that the reconciliation of the total savings from Royal Mail's efficiency initiatives and the total efficiency in the PVEO is necessary, and have accordingly removed it from the requirements. The format of the required information is set out in the pro forma in Figure 21 of Appendix 1 to the RAG.

Annual and quarterly income statements

- 5.40 We agree with Royal Mail that the requirement to attribute specific items in the Reported Business Annual Income Statement, to USO Mail and Other (Figure 11), and in the Reported Business Quarterly and Annual income statement, to USO Mail, Non-USO Mail and Non-Mails (Figure 12) is not required, as these attributions are not needed for the calculation of the total Financeability EBIT. As now, Royal Mail will not be required to report specific items which sit outside the calculation of the total Financeability EBIT. We have amended the pro formas accordingly (see Figures 11 and 12 of Appendix 1 to the RAG).
- 5.41 However, we disagree with Royal Mail that transformation costs should be reported within the pay and non-pay cost lines of the Reported Business Annual Income Statement and Reported Business Annual and Quarterly Income Statement, rather than separately. As explained above (see paragraph 5.17), although transformation costs are ongoing, it is

important that these are separated from ongoing operating costs. This is because it is likely that transformation costs will be unevenly distributed from one year to the next, which can distort the view of performance.

- 5.42 Further, Royal Mail argues that reporting transformation costs within pay and non-pay cost lines would make the statement more consistent with the statutory accounts. However, the Regulatory Financial Statements (RFS) are produced for the regulated entity (i.e. the Reported Business), not the statutory entity (Royal Mail Group Ltd), and serve a different purpose to the statutory accounts. As such, we consider these costs need to be separated.

Published reporting and commentary

Our proposals

- 5.43 We proposed that Royal Mail must, from the 2024-25 financial year onwards, publish annually:
- the cumulative progress for PVEO (including transformation costs and in both percentage and absolute terms) and Productivity (WIPGH), including its final progress at the end of the five-year period (i.e. 2027-28); and
 - commentary on its performance against both metrics in each financial year, including the factors which Royal Mail considers have affected its performance, either favourably or adversely. This assessment must be based on, and consistent with, the information Royal Mail submits to us confidentially (see the next sub-section).
- 5.44 We said that we expected that, as for the efficiency expectations, this information would be published in the RFS.

Consultation responses

- 5.45 Royal Mail made only one comment on these proposals. As for the efficiency expectations, it said that it would publish the expectations separately from the RFS, as the RFS are audited. It argued that publishing the expectations in the RFS might lead to stakeholders mistakenly believing that the expectations had also been audited.⁹¹

Our assessment

- 5.46 As set out in section 4 of the 2022 Review Statement, publication of Royal Mail's actual annual performance on PVEO and Productivity (WIPGH) will ensure that there is sufficient transparency to stakeholders about its progress towards meeting its efficiency expectations.⁹²
- 5.47 Publishing a PVEO expectation including transformation costs will ensure comparability and enable stakeholders to track Royal Mail's performance over time using a consistent metric. We will continue to receive confidentially, as now, Royal Mail's annual PVEO

⁹¹ Royal Mail response to consultation, p. 23.

⁹² See Ofcom, 2022. [Review of Postal Regulation: Statement](#), paragraphs 4.64-4.67.

performance both including and excluding transformation costs which would allow us to understand better the impact of any fluctuations in transformation costs over the forecast years. Similarly, reporting on PVEO in both absolute and percentage terms will enable stakeholders to track Royal Mail's performance over time using both expressions of the metric.

- 5.48 To support our aim of increasing stakeholders' understanding and interpretation of Royal Mail's efficiency performance, we consider that Royal Mail should also provide commentary on its actual progress, specifically, the reasons that explain its performance, including the factors that it considers have affected performance (whether favourably or adversely).
- 5.49 This will give Royal Mail the opportunity to explain its progress, providing relevant context to its shareholders and wider stakeholders to ensure that they understand the data published on the efficiency progress. Royal Mail may also wish to explain the impact of any forecasting error when setting out its actual performance.
- 5.50 We noted above (see paragraph 4.116) that while we set out the information and statements Royal Mail must publish, we do not mandate how these information and statements are packaged, and it is Royal Mail's decision to publish some of the information within the RFS and some in other documents (e.g. the Costing Manual). This is why Royal Mail will be required to publish its annual performance in a prominent place in an appropriate and publicly accessible website operated or controlled by the Relevant Group. As for the expectations, we also require Royal Mail to publish its efficiency performance in a prominent place in an appropriate and publicly accessible website operated or controlled by the Relevant Group. These requirements will ensure that all the information is easily accessible to stakeholders. The format of the required information is set out in the pro forma in Figure 22 of Appendix 1 to the RAG.

Commentary provided confidentially to Ofcom

Our proposals

- 5.51 We noted that Royal Mail is already required to confidentially report its actual PVEO and Productivity (WIPGH) performance to us on an annual basis, together with supporting information. We said that we would retain these requirements with some changes, as set out above.
- 5.52 To accompany this information, we proposed to require Royal Mail to provide some further confidential commentary to Ofcom, including its view on how its cumulative performance on both of these metrics to date compares to its overall five-year expectations and whether it considers it will meet both of the expectations by the end of the five-year period.
- 5.53 If Royal Mail considers that it is not on track to meet either or both of its expectations, we proposed that it must set out any additional steps it intends to take to ensure it meets them, including any specific efficiency initiatives that it intends to implement.

Consultation responses

5.54 We did not receive any comments on these proposals.

Our assessment

5.55 We consider that some further confidential commentary on Royal Mail's performance should be provided to us because it could be commercially sensitive and therefore unsuitable for publication, but would be necessary to help us fulfil our duties.

5.56 Specifically, it will enable us to gain greater insight into Royal Mail's cumulative PVEO and Productivity (WIPGH) performance, and understand the likelihood of the expectations being achieved, both of which should help to inform any future regulatory decisions, and provide advice to Government on the universal service, if requested.

5.57 Ensuring that this commentary is by reference to the information about efficiency initiatives that Royal Mail will be required to provide in the AFF (see paragraphs 3.74-3.86), will ensure we have a consistent and comprehensive view of Royal Mail's intentions and the specific actions by which it is planning to make efficiency savings.

5.58 Overall, this requirement will help us to better interpret and assess Royal Mail's efficiency performance.

Our decisions

5.59 Having carefully considered stakeholder responses, we have decided to:

- Continue to require Royal Mail to confidentially provide actual performance information on all of the metrics it currently provides, with some changes, specifically:
 - Revenues and volumes and the Cost Matrix: report using updated product groupings and cost breakdowns;
 - Workload:
 - provide calculations for all Operational Business Processes for which Royal Mail has a Workload calculation;
 - explain which activities are included in each Operational Business Process, including any overlays, and in doing so, separate the activities within parcel hubs from other Operational Business Processes; and
 - where new Operational Business Processes are introduced into its operations, include any related overlays within the Workload calculation for each Operational Business Process, provide a breakdown of those overlays and how each one has been calculated, and a description of the new Operational Business Process it relates to.
 - Gross Hours and salary costs:
 - report, on an annual basis, total actual Gross Hours broken down by hours type and Operational Business Process (Delivery & Collections, Processing and RDCs); and

- report, on a quarterly basis, total actual Gross Hours broken down by time category (normal/ordinary, casual/temporary, overtime and any other) and total frontline pay, broken down by time category (normal/ordinary, casual/temporary, overtime and any other) and by pay component (specifically salary, employer National Insurance and pension contributions).
 - Introduce new requirements for Royal Mail to report:
 - on a quarterly basis, average YTD cash voluntary redundancy costs, split between Frontline, Management and Other;
 - on a quarterly basis, actual Productivity (WIPWH) performance;
 - on an annual basis, actual performance against efficiency initiatives.
 - Require Royal Mail, from the 2024-25 financial year onwards, to publish annually its cumulative progress for PVEO and Productivity (WIPGH), and to provide commentary on its performance in that financial year. These must be published in a prominent place in an appropriate and publicly accessible website operated or controlled by the Relevant Group.
 - Require Royal Mail to provide some further confidential commentary to Ofcom alongside its annual PVEO and Productivity (WIPGH) performance, including its view on how its cumulative performance on both of these metrics to date compares to its overall five-year expectations, and whether it considers it will meet both of the expectations by the end of the five-year period.
- 5.60 The changes to the requirements are set out in USPAC 1.4 (Annex 2, pages 10-12) and Table 4 of the RAG (Annex 3, pages 18-22), and the associated pro formas are in Figures 15-17 and 19-22 of Appendix 1 to the RAG.

6. Other changes to reporting requirements

We have decided to make a number of changes to the reporting requirements which are not related to our decisions in the 2022 Review Statement. These changes seek to ensure that we continue to receive the information we need from Royal Mail, in an appropriate format, to fulfil our duties in relation to sustainability and efficiency, while also ensuring that the reporting burden on Royal Mail is proportionate. Specifically, we have decided to:

- simplify the change control requirement and to further amend it in accordance with Royal Mail's suggestion;
- remove the requirement to provide Reported Business statements of capital employed and cash flow;
- amend the definition of Financial Year, Quarter and Month;
- require, for 53-week financial years, Royal Mail to restate some forecast and actual information on both a 52- and 53-week basis (and we have clarified some elements of this requirement);
- remove the ad hoc requirement for Royal Mail to report multi-premises delivery suspensions to Ofcom;
- remove the requirement for Royal Mail to provide copies of published information to any person at their written request; and
- update the definitions of Relevant Group and RM UK.

We have also decided to make two changes following Royal Mail's additional requests in its consultation response. Specifically, we have decided to:

- remove the audit requirement for the split between non-USO Mail and non-Mails within the Annual Regulatory End to End Income Statement; and
- replace all references in the USPAC and RAG to 'Royal Mail plc' with 'International Distributions Services plc'.

6.1 In this section, we summarise our consultation proposals to amend the reporting requirements to ensure the information we receive from Royal Mail continues to meet our needs and remains proportionate. We then set out our decisions in relation to each of these, taking into account the points raised by stakeholders in their consultation responses.

6.2 Our decisions are summarised in paragraph 6.83.

Change control

Background and our proposals

6.3 The change control process allows us to understand how:

- in addition to the changes brought about by purchase price and volume changes, costs may change from one period to another purely as a result of the changes Royal Mail makes to the regulatory costing methodology, and;

- other items of financial reporting, i.e. revenues, assets, liabilities, and cash flows, may similarly change from one period to another, purely as a result of a change in the regulatory accounting methodology.
- 6.4 We considered the information provided by Royal Mail under this provision over the last four years and how this contributes to our work to fulfil our duties and objectives. As a result, we proposed to modify this requirement to ensure it remains fit for purpose and proportionate. Our proposals aimed to simplify the requirement and make it less burdensome for Royal Mail.
- 6.5 Specifically, we proposed to:
- move from an annual to a quarterly submission;
 - set a deadline of 30 days before the year end for Royal Mail to submit any changes;
 - reduce the level of detail required; and
 - require only material changes to be reported individually.

Consultation responses

- 6.6 Royal Mail agreed in principle with our proposal to simplify the change control approach, noting that it would reduce the reporting burden and make it more likely that it could make changes during the financial year rather than at the end of it.
- 6.7 However, it proposed a minor change to the pro forma, in which it would model the cumulative impact of all changes. This would mean that a total combined impact of all non-material and material changes would be reported, rather than Royal Mail having to do additional runs of its costing system to report a separate sub-total for non-material changes. Royal Mail considered this more appropriate and proportionate as it could model the combined impact of methodology changes that affect the same part of the pipeline, and, where changes affect different parts of the pipeline, the two changes in combination would only affect the allocation of general overheads.
- 6.8 Royal Mail also asked us to clarify in the pro forma that the attribution of general overheads between upstream and downstream services should follow the same apportionment as that in the Data Extract File.⁹³
- 6.9 The GCA expressed concern that our proposal to reduce the level of detail Royal Mail is required to provide would mean that we would be unable to discharge our duty to further the interests of citizens and consumers.⁹⁴

Our assessment

Annual rather than quarterly submission

- 6.10 In the last four years Royal Mail has only made changes to its costing methodology or accounting methodology outside the final quarter once. The changes reported under the

⁹³ Royal Mail response to consultation, p. 30.

⁹⁴ GCA response to consultation, pp. 7-8.

change control, regardless of the quarter in which they are proposed or identified by Royal Mail are only implemented, and therefore their effects observed, in the full year reports including the published regulatory accounts. Therefore, we consider that an annual requirement will provide sufficient oversight of methodology changes we require going forward.

Deadline of 30 days before the year end

- 6.11 The requirement for Royal Mail to submit the change control seven days prior to the change being made was intended to provide an opportunity for us to review any changes and indicate to Royal Mail if a change may be cause for concern. If we considered the change to be inconsistent with the USP Accounting Condition and the RAG or our regulatory objectives, then we would have the option to consult to amend or potentially block Royal Mail's change.
- 6.12 In practice, we have found that seven days is not sufficient time to carefully consider all changes and their implications as it does not allow us sufficient time to raise queries and for Royal Mail to respond appropriately. Whenever Royal Mail has planned to make significant changes in the past, it has informed us in advance of the official notification deadline, in order to explain the rationale, provide evidence to support the change and allow us to properly engage with the process.
- 6.13 As such, we think it is appropriate and more proportionate to require Royal Mail to submit the annual change control 30 days prior to the financial year end. This deadline will allow us sufficient time to review the changes before the new financial year, and avoid coinciding with Royal Mail's resources being engaged in preparing various financial reports around the year end date.

Reduction of detail required

- 6.14 The current change control requirement requires information to be provided at the lowest level of detail for products and SPHCCs (Sales Product Handling Characteristic Combinations),⁹⁵ as well as the individual activities depending on the nature of the change, when any change is made.
- 6.15 A material change to the costing methodology may result in a small change in the unit cost of a single product, but this level of detail is often not particularly useful for determining how a change could impact a particular group of consumers. In conducting reviews of the impacts internally, we often review the changes at a higher level, and only occasionally drill down to the impacts on the detailed product level when we need a clear understanding of the impacts.
- 6.16 As such, we consider that it would be more proportionate for Royal Mail to report the impact of the changes between total USO products, non-USO products, Access and Non-Mails; and between total upstream and downstream activities. These two splits are the key

⁹⁵ Sales Product Handling Characteristic Combinations are products and/or services sub-divided based on the relevant measured characteristics as prescribed by the RAG.

high-level impacts we review in the first instance for our monitoring purposes. It is also important for Royal Mail to provide the impact information at the level of SPHCC and activity detail if required. We will therefore retain the option to request further detail about the impact of changes if and when necessary.

- 6.17 In response to the GCA, we note that the change control requirement relates only to changes to the methodologies within Royal Mail's costing system, and how those changes impact how costs are allocated to products. The changes we are making to our requirement will ensure that it remains proportionate while still giving us sufficient insight into any changes Royal Mail has made to its costing system. More broadly, the regulatory reporting requirements imposed on Royal Mail will continue to provide us with the information we need for our monitoring regime, including pricing and unit cost data, and as such we will continue to have the information we need to fulfil our regulatory duties.
- 6.18 Further, we understand that the GCA was referring to the determination of appropriate pricing for potential premium Saturday and Sunday letter delivery services and/or which products should fall within the scope of the USO. As noted above, with some exceptions, pricing and service offerings are a commercial decision for Royal Mail.

Reporting of material changes only

- 6.19 We understand that the level of work and time required to run the costing model is significant, and that Royal Mail will need to run the model for each change to determine if each change is material or not. However, these runs would not capture the impact of cumulative changes, as the impact of all the changes combined would not necessarily be the same as if the impact of individual changes were added together. Therefore, to calculate the cumulative impact of the material and non-material changes, the costing model would need to be run an additional two times.
- 6.20 Royal Mail's solution not only gives us the individual impact of the material changes, but also the individual impact of the non-material changes, as it has calculated these as part of the process. Therefore, we consider that providing the cumulative impact of all the changes run for both material and non-material changes together is sufficient to help us understand the impact of changes on the costing system and on each product and services group.
- 6.21 This fulfils our requirement to understand how and why Royal Mail's treatment and allocation of its costs to activities and products changes over time, and the financial impact of those changes. It remains essential for informing our monitoring of Royal Mail's efficiency progress and understanding the impact of Royal Mail's commercial pricing freedom on competition and consumers.
- 6.22 To clarify this, we have amended the RAG as well as the relevant pro forma (Table A of Appendix 3 to the RAG). In response to Royal Mail's request for clarification on the attribution of general overheads, Royal Mail should follow the costing rules as set out in section 8 of the RAG, as before. We do not think it is necessary to amend the pro forma.

Reported Business statements of capital employed and cash flow

Background and our proposal

- 6.23 We currently require Royal Mail to prepare and publish a capital employed statement and a cash flow statement for the Reported Business as part of the annual RFS. These statements reflect the actual financial results and position of the Reported Business in each financial year. We have used the statements in the past to consider our financial sustainability assessments.
- 6.24 However, since we have not recently used these statements as regularly as before, and do not expect that we will need these statements on a regular basis in the future, we proposed to remove the requirement on Royal Mail to provide them. We also proposed to remove the requirements for the accompanying reconciliations of these statements to the capital employed and cash flow statements of the Relevant Group.

Consultation responses

- 6.25 Royal Mail welcomed our proposal to remove the requirement to produce a capital employed statement and cash flow statement for the Reported Business, as this would reduce the regulatory burden of financial reporting.⁹⁶

Our assessment

- 6.26 We consider that the income statement of the Reported Business, its supporting details and the balance sheet and cash flow statements of the Relevant Group,⁹⁷ are sufficient for our monitoring purposes. We use this information on a regular basis for our analyses. We also note that if we do require the information from these statements for ad hoc analysis, we can use our statutory information gathering powers to request this information from Royal Mail.
- 6.27 We therefore think it is appropriate to remove the requirement for the Reported Business statements of capital employed and cash flow to be provided in the annual RFS.

53-week and equivalent 52-week financial year restatements

Background and our proposal

- 6.28 Royal Mail is currently required to prepare the regulatory financial statements required under the USP Accounting Condition by applying the accounting standards and

⁹⁶ Royal Mail response to consultation, p. 31.

⁹⁷ The Relevant Group is defined as comprising '(i) IDS plc; (ii) its subsidiaries and holding companies; (iii) its subsidiary undertakings and parent undertakings; and (iv) subsidiaries and subsidiary undertakings of such holding companies and such parent undertakings (all as defined by sections 1159 and 1162 of the Companies Act 2006 as applicable)'. See paragraph 6.66 for more detail.

methodologies used in the statutory consolidated accounts of Royal Mail plc as well as the accounting and costing rules set out in the USP Accounting Conditions and the RAG.

- 6.29 The terms Financial Year, Financial Quarter and Financial Month are defined in the USP Accounting Condition. Royal Mail is required to provide the regulatory reports and submissions based on these periods using pro formas outlined in the RAG.
- 6.30 Royal Mail operates a week-based financial year ending on the closest Sunday before or including 31 March. In most years this equates to 52 weeks, but occasionally a financial year under this approach will be a 53-week year.
- 6.31 We proposed that the definitions of financial year, quarter and month are amended so that each includes a reference to the number of weeks it should contain:
- Financial year: 52, or where relevant 53, consecutive weeks in a financial year to align with the annual statutory financial statements of RM plc.
 - Financial quarter: 13 consecutive weeks in a financial year. In financial years comprising of 53-weeks the final quarter will consist of 14 consecutive weeks.
 - Financial month: A period of four or five consecutive weeks in a financial year. In financial years comprising of 53-weeks financial years the final month will consist of five consecutive weeks.
- 6.32 We also proposed to:
- for any financial year which comprises 53 weeks, require Royal Mail to provide the revenues, volumes, costs and Financeability EBIT of the Reported Business on both the 53-week and 52-week equivalent bases; together with explanations of the methodologies applied to restate that information on an equivalent 52-week Financial Year basis; and also require Royal Mail to provide Cost Matrix, PVEO and Productivity (WIPGH) based on a 53-week Financial Year together with explanations of the appropriate methodologies to restate that information on an equivalent 52-week Financial Year basis; and
 - for any forecast year in the AFF or FYFF which comprises 53 weeks, require Royal Mail to provide the revenues, volumes, costs and Financeability EBIT of the Reported Business for that forecast year on both the 53-week and 52-week equivalent bases, together with explanations of the methodologies applied to restate that information on an equivalent 52-week basis.

Consultation responses

- 6.33 Royal Mail noted that in relation to the Annual Product Profitability statements, we had proposed in the draft RAG to require it, in a 53-week year, to provide an explanation of the appropriate methodologies used to restate that information on an equivalent 52-week Financial Year basis, which was not in the consultation.
- 6.34 It also noted that our consultation proposal would require the revenues, volumes, costs and Financeability EBIT of the Reported Business to be produced on a 53-week and an equivalent 52-week basis, but not the splits of USO and non-USO mail or any regulatory reporting entity within the Reported Business for which the figures are to be produced on

a 53-week only. However, Royal Mail said that it understands that this is our intention but that it would not be feasible to produce the USO and Non USO split, or for any other regulatory entity, below the Reported Business level.

6.35 It requested that we provide clarity on these two points.

6.36 Royal Mail made no comment on our proposed new definitions of Financial Year, Quarter and Month.

Our assessment

6.37 Our objective for adding this requirement to the RAG was to formalise the requirement at the Reported Business level and provide consistent methodologies, which we can apply to restate lower-level information on an equivalent 52-week basis. Our proposals were included within the consultation document, as well as the draft USPAC and RAG.

6.38 The Annual Product Profitability statements report on a sub-set of products within the Reported Business income statement, and we were seeking to understand the method to restate these schedules. This proposal was included in the draft RAG but we did not propose to require the restatement itself.

6.39 Additionally, the draft RAG proposed that Royal Mail should provide:

- a) The total Reported Business revenues, costs, volumes and Financeability EBIT for both 53 and equivalent 52 weeks;
- b) The method Royal Mail used to calculate the equivalent 52-week figures in a);
- c) The Cost Matrix, adjustments made to re-state the DB Pension Service Costs on a cash paid basis, PVEO Analysis and Productivity (WIPGH) on the 53-week basis only; and
- d) The specific method(s) either from b) above or another specific method which should be used to recalculate each of the schedules/figures in c) above to an equivalent 52-week basis.

6.40 For clarity therefore, the requirement relating to reporting the forecast and actual revenues, volumes, costs and Financeability EBIT of the Reported Business on a 52-week basis *only* applies to the Reported Business, not to any entity below that reporting level. The level of detail corresponds to the total Reported Business column of Figure 11 in Appendix 1 of the RAG (excluding separating out specific items). We have amended the RAG to ensure this requirement is clear.

6.41 We have also taken this opportunity to further clarify that Royal Mail should make it clear on which basis (52- or 53- week) each report has been prepared in order to inform us which reporting will need to be adjusted (by Ofcom) to an equivalent 52-week basis, so that it can be used meaningfully in our comparisons and trends analyses. If a report has been prepared on a 53-week basis, Royal Mail should state which of the methodologies should be applied to restate to a 52-week basis.

6.42 We note that the occurrence of a 53-week year is relatively rare and happens approximately every six years. For example, prior to 2018-19, the last time Royal Mail had

a 53-week financial year was in 2012-13.⁹⁸ Therefore, we do not consider that this requirement places significant additional burden on Royal Mail. In addition, Royal Mail will know in advance if a financial year will be 53 rather than 52 weeks so will have sufficient time to plan accordingly. We expect that the next 53-week year will fall in the financial year 2023-24.

- 6.43 We continue to consider it appropriate to adopt new definitions of Financial Year, Quarter and Month, so that each includes a reference to the number of weeks it should contain. This reflects that Royal Mail operates a week-based financial year ending on the closest Sunday before or including 31 March and has the benefit of ensuring that the time periods are transparent for all users. We have made some further changes to the wording of these definitions for clarity, without changing the substance.

USO delivery suspensions notification

Background and our proposal

- 6.44 Royal Mail, as the designated Universal Service Provider, is required to deliver letters every Monday to Saturday and postal packets every Monday to Friday to every home and premise in the UK. However, the PSA 2011 states that the obligation to make daily deliveries does not need to be met in geographical or other circumstances that we consider to be exceptional.⁹⁹ We can specify the circumstances we consider to be exceptional by making a direction under DUSP 1.3.2 and 1.3.2A.
- 6.45 In 2013 we published such a direction (the Delivery Exceptions Direction).¹⁰⁰ It sets out the circumstances we consider to be exceptional, the procedural steps Royal Mail must follow to apply such an exception and its obligations to make alternative arrangements where a premise is exempted. In addition, it set out how Royal Mail is required to inform consumers and Ofcom when exceptional circumstances arise. One of the requirements contained in this direction is for Royal Mail to notify us within one week of any new delivery suspension that affects more than one delivery point.
- 6.46 Specifically, it must inform us of the address of each affected delivery point, the reasons why it considers exceptional circumstances exist, the steps taken, if any, to resolve the issue, and the date by which it expects to resume delivery to the point.¹⁰¹ There is no such requirement where Royal Mail applies a delivery exception to a single premise.
- 6.47 We proposed to remove the requirement for Royal Mail to notify us within one week of any new delivery suspension that affects more than one delivery point.

⁹⁸ Royal Mail Group Limited, [Annual Report and Financial Statements 2012-13](#) [accessed 06/02/2023].

⁹⁹ PSA 2011, section 33(2)(b).

¹⁰⁰ Ofcom, 2013. [Delivery Exceptions Direction](#).

¹⁰¹ Ofcom, 2013. [Delivery Exceptions Direction](#), paragraph 23.

Consultation responses

- 6.48 Royal Mail agreed with our proposal to remove this requirement.¹⁰²
- 6.49 The GCA expressed concern about our proposal. It referred to Royal Mail's request to reduce the number of days it is required to deliver mail under the Universal Service Obligation from six to five, and felt that the cumulative effect of these changes would be damaging for a declining business. It further argued that the removal of this requirement would risk Ofcom's ability to protect consumers, by reducing our ability to act quickly should a spike in delivery suspensions occur. It proposed an alternative approach, of moving to quarterly reporting, and if an increase of more than 5% was observed in a given quarter, Royal Mail would be required to revert to weekly reporting.¹⁰³
- 6.50 CCNI asked us to clarify the definition of a 'multi-premises' delivery point. It noted that if this included a communal post room in a block of flats (or similar), removal of this reporting requirement could lead to us losing sight of delivery suspensions which affect vulnerable consumers. Such consumers may be less likely to use their right to appeal the decision.
- 6.51 CCNI also said that while it is not in favour of unnecessary data gathering, if we decide to remove the requirement, we must continue to ensure that the annual monitoring provides sufficient protection to consumers, and be able to reassess whether weekly reporting is again necessary. It supported the retention of all other delivery exception requirements.
- 6.52 Finally, CCNI noted that while the information on Royal Mail's website about delivery suspensions and appeals of such decisions is clear and transparent, it suggested that the information on Ofcom's website on this topic should be reviewed. In particular, it asked us to ensure there is a standalone page on our website to provide full transparency of the appeals process.¹⁰⁴

Our assessment

- 6.53 We continue to consider it appropriate to remove the requirement for Royal Mail to report on an ad hoc basis on delivery suspensions that affect more than one delivery point.
- 6.54 In response to the GCA, and as noted in the September consultation, we have not observed any significant or sudden increases in delivery suspensions in the past nine years. We therefore consider that the likelihood of any such increase in future remains very low, and that annual, rather than quarterly or ad hoc reporting, is sufficient for us to understand whether there has been a spike in delivery suspensions.
- 6.55 In response to CCNI, the requirement to report to us applies only where a delivery suspension affects more than one delivery point. This includes blocks of flats or apartments.

¹⁰² Royal Mail response to consultation, p. 35.

¹⁰³ GCA response to consultation, pp. 8-9.

¹⁰⁴ CCNI response to consultation, pp. 7-8.

- 6.56 We note that paragraph 13 of the Delivery Exceptions Direction requires Royal Mail to consider whether, where exceptional circumstances affect a delivery point used by a potentially vulnerable consumer (for example, because of their age or health), it would be appropriate and proportionate to make deliveries in spite of those exceptional circumstances. Royal Mail must also consider whether and what alternative delivery arrangements ought to be made. We consider that these requirements, alongside the requirements for affected consumers to be notified about the suspension and their ability to appeal, provide adequate protection to vulnerable consumers who are affected by delivery suspensions.
- 6.57 We will continue to have visibility of all suspensions Royal Mail has made and which persist for 12 months or more, in the end of year report we require Royal Mail to submit to us and to publish (in an anonymised format). This report must contain all instances of delivery suspensions, not just those that affect more than one delivery point, giving us a comprehensive view of delivery suspensions that have persisted for a significant period of time. Further, we have the ability to make ad hoc requests for information on delivery suspensions to Royal Mail using our statutory information gathering power, should we consider it necessary at any time.
- 6.58 Consumers' rights to be immediately informed about a delivery suspension to their address and to request a review of this decision will also continue.¹⁰⁵ Consumers will also remain able to request a second review from Royal Mail.¹⁰⁶ If the outcome of the second stage review is that the exceptional circumstance continues to exist, the consumer has the right to appeal to Ofcom the decision, and the decision by Ofcom as to whether exceptional circumstances exist is binding.¹⁰⁷
- 6.59 In response to CCNI's comment on the information about the appeals process on our website, while we think that it is likely that consumers will go to Royal Mail's website in the first instance to check what they can do if deliveries to their address have been suspended, we agree that it is important for us to ensure the information on our website is as clear as possible.
- 6.60 This information can be found in a drop-down on the 'Advice for consumers' area of our website, under 'Post', which we consider to be an appropriate location.¹⁰⁸ However, we have refreshed the text on our website to ensure it reflects the current process and links to the correct page on Royal Mail's website.

¹⁰⁵ Ofcom, 2013. [Delivery Exceptions Direction](#), paragraphs 16-22 and 24.

¹⁰⁶ Ofcom, 2013. [Delivery Exceptions Direction](#), paragraph 26.

¹⁰⁷ Ofcom, 2013. [Delivery Exceptions Direction](#), paragraphs 27-28.

¹⁰⁸ Ofcom, [Advice for consumers, Postal services](#) [accessed 07/02/23].

Provision of copies of published information on request

Our proposal

- 6.61 We proposed to remove the requirement for Royal Mail to provide a copy of certain information it publishes to any person at their written request.

Consultation responses

- 6.62 Royal Mail supported our proposal to remove this requirement.¹⁰⁹

Our assessment

- 6.63 We consider that the requirements to provide a copy of published information at any person's written request is no longer necessary. This is because we consider that the audience for such information is likely to be businesses, who should be able to easily access the information on Royal Mail's website. Therefore, we think it is appropriate to remove these requirements.

Definitions of RM UK and the Relevant Group

- 6.64 In our proposed RAG, we replaced the term 'UKPIL' meaning 'UK Parcels, International and Letters', with the term 'RM UK' which is currently used by Royal Mail to refer to the same group of companies and operating units as UKPIL did.
- 6.65 RM UK includes Royal Mail Group Limited, which is a UK company and the designated universal service provider, and all of its subsidiary undertakings. Royal Mail Group Limited also contains the Reported Business and ParcelForce Worldwide as operating units within itself. RM UK is in effect the UK group of companies and operating units within the Relevant Group. In the final RAG, in addition to introducing the new term 'RM UK', we have also updated the definition to capture the above.
- 6.66 We have also updated the definition of the Relevant Group in the final USPAC by replacing the term 'RM plc' with 'IDS plc' as the current ultimate parent company of the Relevant Group. This is because (as noted below) Royal Mail plc ('RM plc') has been renamed to International Distribution Services plc ('IDS plc'). We have also expanded the definition to encompass any new parent company and any subsidiaries of such new parent companies. This will help ensure the definition is still appropriate in the event of any further group restructuring.

Other requests from Royal Mail

- 6.67 Royal Mail used its consultation response to make a number of other requests for changes to the reporting requirements.

¹⁰⁹ Royal Mail response to consultation, p. 34.

6.68 It suggested that we should:

- rename 'Royal Mail plc' 'International Distributions Services plc' in the USPAC and RAG, to reflect the recent change (in October 2022) in name of the company;
- remove the requirement to reconcile the annual results to the quarterly regulatory income statements;
- extend the deadline for the unaudited Q4 reports from 54 days after the year end to 90 days after year end, and to extend the deadline for *all* actual information by two weeks;
- allow two additional weeks for the audited regulatory financial schedules to be provided to Ofcom; and
- remove the audit requirement on the Annual Regulatory End to End Income statement; and
- amend the Essential Condition to remove the requirement to report on the number of prosecutions.

6.69 We discuss our response to each of these requests in turn below.

Our assessment

Reconciliation of annual results to quarterly income statements

6.70 Royal Mail requested that we remove the requirement to reconcile the annual results to the quarterly regulatory income statements. It explained that it currently processes its reporting model on a cumulative basis, so each quarterly report is year to date, and the Q4 and full year reports are one and the same. This means that no adjustments are introduced to the annual results after the fourth quarter's results have been prepared, as such the annual results are identical to the accumulation of the four quarters' results. Therefore, it argues that the reconciliation is no longer required as a check that the quarterly and annual models produce the same results.

6.71 We disagree that we should remove the requirement to reconcile the annual results to the quarterly regulatory income statements, because we have designed our requirements to allow for changes in Royal Mail's systems. If Royal Mail's accounting system or the data preparation timeline changes in the future, in a way that results in adjustments being introduced to the annual results after the fourth quarter's results have been prepared, then our requirement will capture those adjustments and provide us with sufficient transparency. Additionally, we do not consider that the requirement currently places a burden on Royal Mail, as the required reconciliation can be simply met by a statement to Ofcom (to the effect that no such reconciliation is needed).

Removal of the audit requirement on the Annual Regulatory End to End Income statement

6.72 The annual regulatory end to end income statement provides us with a split of the income statement of the Reported Business between the USO Mail and other in the published version and a split between the USO Mail, non-USO mail and non-Mails in the confidential version. We consider the separation of the USO Mail income and expenditure necessary

information for our work. Therefore, we do not intend to remove the audit requirement from that element of the split because it gives us further assurance about its accuracy.

- 6.73 However, while we consider the further split between non-USO Mail and non-Mails important for our work, we could gain sufficient assurance about its accuracy from the granular revenue and cost data we receive (e.g. in the quarterly data extracts and the Cost Allocation Model data). We have therefore decided to remove the audit requirement from this further split. We have amended the RAG accordingly (see Table 10).

Extension of the submission deadline for actual information

- 6.74 We do not consider it appropriate to change any deadlines related to the financial information on actual performance. This is because, after considering Royal Mail's response about the regulatory reporting workload it faces after each financial year end, we have decided to change our proposed deadline for AFF and FYFF from 30 May to 30 June, as well as increasing the AFF update deadline from 10 working days to 20 working days (see sections 3 and 4).
- 6.75 We consider that the new AFF and FYFF deadlines will allow Royal Mail with adequate time to continue to provide the regulatory financial reports on actual performance, including the audited information, to the current deadlines.

Changing the name of Royal Mail plc

- 6.76 To ensure the USPAC and RAG are clear on affected entities, we agree with Royal Mail that it is necessary to replace all references to Royal Mail plc with International Distributions Services plc (IDS), reflecting the name change that took effect in October 2022.

Removal of reporting on the number of prosecutions instigated by Royal Mail

- 6.77 We disagree with Royal Mail's proposal to remove the requirement from the Essential Condition to report on the number of prosecutions in relation to offences in connection with mail integrity. While we understand that Royal Mail is moving away from prosecutions and using alternative outcomes where appropriate, we do not think that this means that reporting on the number of prosecutions is no longer important nor meaningful.
- 6.78 [REDACTED]. As such, it is important for us to continue to have sight of the number of prosecutions so that we can monitor trends over time and potentially take action if the number of prosecutions were to increase significantly.
- 6.79 Further, Royal Mail is welcome to report on the alternative outcomes to prosecutions in addition to the number of prosecutions, to provide us with any context it considers would be useful in our interpretation of the prosecutions figure. [REDACTED]
- 6.80 Royal Mail [REDACTED].
- 6.81 Finally, [REDACTED], we do not consider this to be a burdensome requirement for Royal Mail to comply with.

6.82 For these reasons, we think it is appropriate to retain the requirement in Essential Condition 1 for Royal Mail to report on the number of prosecutions.

Our decisions

6.83 We have decided to:

- For the change control:
 - require an annual rather than quarterly submission of changes;
 - require submission of the changes 30 days prior to the year-end;
 - require Royal Mail to report the impact of the changes between total USO products, non-USO products, Access and Non-Mails; and between total upstream and downstream activities, instead of the impact of the changes on individual products; and
 - require Royal Mail to report the impact of each material change and the cumulative impact of all changes, using the latest annual financial information.
- remove the requirements to:
 - provide Reported Business statements of capital employed and cash flow in the RFS, and the accompanying reconciliations of these statements to the capital employed and cash flow statements of the Relevant Group;
 - notify Ofcom within one week of a USO delivery suspension that affects more than one premise; and
 - provide copies of published information to any person at their written request.
- amend the definitions of Financial Month, Quarter and Year, and, for 53-week financial years, require Royal Mail to restate some forecast and actual information on both a 52- and 53-week basis.
- retain the requirement for a reconciliation of annual results to the quarterly income statement;
- retain the audit requirement for the Annual Regulatory End to End Income statement, but remove it for the split between non-USO Mail and non-Mails;
- make no changes to the deadlines for provision of the audited regulatory financial schedules to Ofcom;
- replace all references in the USPAC and RAG to 'Royal Mail plc' with 'International Distributions Services plc'
- retain the requirement in Essential Condition 1 for Royal Mail to report on the number of prosecutions it has instigated.

6.84 Our changes to the requirements are set out in:

- USPAC 1.1 and section 8 of the RAG (change of name from RM plc to IDS plc);
- USPAC 1.6 and sections 2 and 6 and Appendix 3 of the RAG (change control);
- USPAC 1.1 and tables 2 and 4 of the RAG (reporting on a 52/53 week basis);
- USPAC 1.4.1 and Table 4 and section 8 of the RAG (statements of capital employed and cash flow);
- USPAC 1.4, 1.5 and 1.6 (provision of copy on request); and
- page 7 of the Delivery Exceptions Direction.

7. Timetable, legal tests and overview of requirements

This section sets out our decision that the changes to the reporting requirements will come into effect on 27 March 2023, the start of the 2023-24 financial year.

We also set out how we consider that our decisions to modify the USP Accounting Condition and the RAG meet the relevant tests set out in the 2011 Act.

Implementation timetable

Our proposal

- 7.1 We proposed that the changes to the reporting requirements proposed in this consultation should come into effect on 27 March 2023, i.e., the start of the 2023-24 financial year.

Consultation responses

- 7.2 Royal Mail asked us to consider delaying implementation of the requirements to the 2024-25 financial year rather than 2023-24, except for the changes to the Delivery Exceptions Direction, which it asked to come into effect as soon as the statement is published.
- 7.3 Royal Mail argued that it has insufficient time to implement the new requirements, noting that our 2017 statement was published around three months ahead of the requirements coming into force. It also said that it will not have clarity on the specific requirements until we publish the statement, and that without this, preparing for the new framework risks being a waste of resources.
- 7.4 Finally, it argued that the current UK macroeconomic outlook and Royal Mail's commercial and operating environments are highly uncertain, meaning that it may not be an appropriate year from which to set five-year efficiency expectations.

Our assessment

- 7.5 We disagree with Royal Mail that we should delay implementation of the new framework until 2024-25. We appreciate that there will be work involved for Royal Mail to adapt and prepare its reporting systems to be able to meet the new requirements set out in this statement. However, and as discussed above, the first FYFF and efficiency expectations will not be due until 30 June, giving Royal Mail four months to put it together. We consider that this time is sufficient.
- 7.6 This is because, as discussed in the September consultation and above, the requirements in the AFF and FYFF are not significantly different from the existing Strategic Business Plan and Annual Budget requirements. This means that Royal Mail is familiar with the majority of the requirements and has systems and processes in place to provide the information in

the format we require. We appreciate that providing the information for a five-year time-period will require additional work, as will providing some information in new pro formas (although Royal Mail should already be familiar with these). However, we consider this is largely additional work of a similar kind which does not require new systems or processes. Further, while we accept that Royal Mail will not have complete clarity on the requirements until the publication of this statement, the consultation proposals set out a clear direction of travel on which it could begin to make preparations. We also note that our decision with regard to the length of the forecasts (i.e. periods of five years) was made in July 2022.

- 7.7 With respect to Royal Mail's third argument about uncertainty and the effect of this on its efficiency expectations, we appreciate that there is some uncertainty at the moment, both regarding Royal Mail's own business plans and ambitions, and also the wider economic outlook for the UK. However, we are of the view that it is important, both in terms of fulfilling our duty in relation to both financial sustainability and efficiency, and for stakeholders in terms of transparency, to put the requirements in place as soon as we are able.
- 7.8 This is because of the concerns we identified about Royal Mail's efficiency performance, and our need to be able to continue to adequately monitor the long-term financial sustainability of the USO. The latter is of particular importance given our increasing concern about the financial sustainability of the USO.¹¹⁰ As Royal Mail itself notes, there is no guarantee that 2024-25 would be a more 'usual' year, and therefore delaying could bring about the worst of both worlds – delaying for a year while also still having to set efficiency expectations during a period of uncertainty.
- 7.9 Most importantly, in a challenging period such as the current period for Royal Mail, the need to have a clearly set out strategy and a business plan about how to become more efficient, together with expectations that are transparent to its stakeholders, appears to be even more pressing.
- 7.10 We also note that Royal Mail will have an opportunity, when it publishes its efficiency expectations, to provide context and explain which factors it considers could affect the likelihood of it meeting the expectations.
- 7.11 Implementation of the new framework for the 2023-24 financial year supports our decision for Royal Mail to be required to:
- submit its first FYFF, including efficiency expectations, by 30 June 2023; and
 - publish its efficiency expectations within 90 days of the first financial year to which they relate (late June).
- 7.12 For the avoidance of doubt, the requirements coming into force on 27 March 2023 means that all submissions (forecasts and actuals) related to the financial year 2022-23 must be provided as per the requirements in the existing USP Accounting Condition and RAG.

¹¹⁰ See Ofcom, [Annual Monitoring Update for postal services: Financial year 2021-22](#), p. 3

- 7.13 We also think it is appropriate that all other changes (i.e. those not related to our decisions in the 2022 Review Statement) should come into force on the same date (i.e. 27 March 2023). Aligning these dates means that Royal Mail can make all changes to its internal processes necessary to implement all of our proposals at the same time. In addition, this date aligns with any other changes Royal Mail may itself be making in its internal processes for the new financial year.
- 7.14 Additionally, the other changes we propose to our requirements (as set out in section 6) are relatively minor (and in some cases, deregulatory) and as such are unlikely to represent a significant burden on Royal Mail to implement.
- 7.15 Finally, we agree with Royal Mail's suggestion for the changes to the Delivery Exceptions Direction to come into force the day after this statement is published (i.e. 1 March 2023), as this does not require any changes to Royal Mail's internal systems or processes.

Our decision

- 7.16 Having carefully considered stakeholder responses, we have decided that the changes set out in this statement to the USPAC and RAG will come into force on 27 March 2023, the start of the 2023-24 financial year. The changes to the Delivery Exceptions Direction will come into force on 1 March 2023.

Legal tests

General test for imposing regulatory conditions

- 7.17 Schedule 6 to the Act provides that we may modify a regulatory condition (and a direction affecting the operation of a regulatory condition) only if we are satisfied that the modification:
- 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.
- 7.18 For the reasons set out in the previous Sections and below, we consider that our modifications to the USP Accounting Condition and Regulatory Accounting Guidelines, as described above, meets the relevant tests set out in paragraph 1 of Schedule 6 to the 2011 Act:
- **Objectively justifiable** – we believe that our modifications to the USP Accounting Condition and Regulatory Accounting Guidelines are objectively justifiable as they aim to ensure that we have the information we need to ensure we understand Royal Mail's view of its longer-term financial sustainability, and there is sufficient transparency on Royal Mail's efficiency expectations and progress. This information supports our duty to secure the provision of a universal postal service, and in doing so to have regard to the need for the 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).

- **Not unduly discriminatory** – we believe that our modifications to the USP Accounting Condition and Regulatory Accounting Guidelines are not unduly discriminatory as, while Royal Mail is subject to more stringent reporting requirements than other postal operators, this reflects the fact that Royal Mail is the Universal Service Provider for post.
- **Proportionate** – we believe that our modifications to the USP Accounting Condition and Regulatory Accounting Guidelines are proportionate as:
 - we have amended some of our proposals in light of Royal Mail's comments in its consultation response. In particular, we have decided to amend the deadline for the AFF and FYFF to give Royal Mail an extra month to provide it, and to remove the requirement to reconcile the efficiency initiatives to the PVEO for the FYFF and actuals.
 - while we are requiring further detail in some areas (for example, in relation to Gross Hours and efficiency initiatives), this information is important to our monitoring regime given the importance of people costs to Royal Mail's operations and efficiency ambitions, and therefore to the financial sustainability and efficiency of the universal service. Where possible, we have based the pro formas on the format of information that Royal Mail already provides to us. This means that Royal Mail will already be familiar with the format of some of the information we are requesting.
 - Royal Mail will be required to provide less detailed information for later years of the AFF (i.e. years four and five). We consider that this balances the fact that Royal Mail currently provides us with three years' worth of detailed forecasts in the Strategic Business Plan, and the fact that we appreciate that there may be greater uncertainty for the later years of the forecast, while supporting our objective to get longer-term forecasts. As noted in section 3 of the 2022 Review Statement, longer term forecasts will enable us to have a more robust view of the longer-term returns that might be expected to be made by the universal service, and therefore of any risks to its financial sustainability. This is particularly important given growing uncertainty around the sustainability of the universal service over the longer term;
 - we have removed the requirement for Royal Mail to provide PVEO, Productivity (WIPGH), Gross Hours Reduction and Workload forecasts annually, instead moving to this being provided only every five years (in line with our 2022 Review Statement decision) We are also proposing to reduce the reporting burden on Royal Mail where possible (for example, by simplifying the change control requirement, removing the requirement to provide the statements of capital employed and cash flow, and to report on multi-premise USO delivery suspensions).
- **Transparent** – we believe that our proposed modifications to the USP Accounting Condition and the Regulatory Accounting Guidelines are transparent as they clearly set out what is expected from Royal Mail. We also provide pro formas so that Royal Mail can understand exactly what it is required to provide. In addition, the reasons for introducing the modifications to the condition and guidelines are set out in detail above.

Summary of our decisions on the regulatory financial reporting requirements

- 7.19 Table 7.1 below summarises the regulatory financial reporting requirements we have decided to set for Royal Mail. The more detailed requirements are set out in the updated USPAC and RAG at Annexes 2 and 3 to this statement as referenced in the table.

Table 7.1: Summary of the regulatory financial reporting requirements

Reports / Data submissions	Frequency	Disclosure	Audit	Deadline	USPAC requirement (Annex 2)	Pro formas in RAG (Annex 3)	Sections in this statement
Income statement of Reported Business, together with Cost Matrix, PVEO Analysis, Productivity (WIPGH), explanations of efficiency performance, Gross Hours split by hours type, information on efficiency initiatives, annual reconciliation of quarterly income statements, end-to-end split between universal service and other products, and end-to-end split between universal service, non-universal service, and non-mail products	Annual	Published, except for Cost Matrix, Gross Hours split by hours type, information on efficiency initiatives, and end-to-end split between universal service, non-universal service, and non-mail products	Audited, except for Cost Matrix, PVEO Analysis, Productivity (WIPGH), explanations of efficiency performance, Gross Hours split by hours type, information on efficiency initiatives, and end-to-end split between universal service, non-universal service, and non-mail products	90 days after Financial Year end	USPAC 1.4.1 (a) and (c); and USPAC 1.5.2 (a)	Appendix 1, Figures 6, 11, 12, 15, 20, 21 and 22	5
Product Profitability Statements for access and PAF	Annual	Published	Audited	90 days after Financial Year end	USPAC 1.4.1 (e)	Appendix 1, Figure 14	N/A
Reconciliation of Reported Business income statement to Relevant Group income statement	Annual	Published	Audited	90 days after Financial Year end	USPAC 1.4.1 (d)	Appendix 1, Figure 13	N/A
Annual financial forecast	Annual	Confidential	Not audited	30 June; Board-approved business plan update (when applicable) 20 working days after approval	USPAC 1.3.1 (b)	Appendix 1, Figures 1, 2, 3, and 4	3

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Five-yearly financial forecast	Once every five years	Confidential, except for 5-year cumulative expectation which is to be published	Not audited	30 June	USPAC 1.3.1 (c)	Appendix 1, Figures 5, 6a, 6b, 7, 8, and 9 (confidential); Figure 10 (for publication)	4
Cost and volume input and output data at SPHCC level for Cost Allocation Model (CAM)	Annual	Confidential	Not audited	90 days after Financial Year end	USPAC 1.6.1	Appendix 4	N/A
Second Class safeguard cap submission	Annual	Confidential	Not audited	One month after the implementation of any new prices	DUSP 2.2.4 and 3.2.4	N/A	N/A
Cash flow projections for the Relevant Group	Quarterly	Confidential	Not audited	Before start of Financial Quarter	USPAC 1.3.1 (a)	N/A	N/A
Income statement of Reported Business together with Cost Matrix, and end-to-end split between universal service, non-universal service, and non-mail products	Quarterly	Confidential	Not audited	54 days after Financial Quarter end	USPAC 1.4.1 (b); and USPAC 1.5.2 (b)	Appendix 1, Figures 12, 15	5
Product Profitability Statements for Access	Quarterly	Confidential	Not audited	54 days after Financial Quarter end	USPAC 1.4.1 (f)	Appendix 1, Figure 14	N/A
Volume and revenue report	Quarterly	Confidential	Not audited	54 days after Financial Quarter end	USPAC 1.4.1 (h)	Appendix 1, Figure 16	5
Cost metrics report, and information on Workload, Gross Hours Reductions, and Productivity (WIPGH) and (WIPWH) calculations, and Gross Hours split by time category	Quarterly	Confidential	Not audited	54 days after Financial Quarter end	USPAC 1.4.1 (h)	Appendix 1, Figure 17, and 19	5

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Granular Data Extract File (Revenue, cost and volume data at Short SPHCC level), and related reconciliations of cost and volume information to other reports	Quarterly	Confidential	Not audited	54 days after Financial Quarter end	USPAC 1.4.1 (h)	Appendix 1, Figure 18	N/A
Costing Methodology Manual	Annually	Published, except for Technical Appendices	Not audited	54 days after Financial Quarter end	USPAC 1.6.1	N/A	6
Accounting Methodology Manual	Annually	Confidential	Not audited	54 days after Financial Quarter end	USPAC 1.6.1	N/A	6
Change control submissions	Annually	Confidential	Not audited	30 days prior to the end of the Financial Year in which the changes have been made	USPAC 1.6.3	Appendix 3	6
Royal Mail's management accounts for the Board to meet our requirement for monthly sales and volumes information (provided for all Financial Months except for the 1 st Financial Month of the Financial Year)	Monthly	Confidential	Not audited	54 days after Financial Month end for the 6 th and 12 th Financial Month, and 30 days after Financial Month end for all other Financial Months (except for the 1 st Financial Month)	USPAC 1.4.1 (g)	N/A	N/A

A1. Glossary

- A1.1 The key terms used in this consultation are defined in:
- Annex 2: Statutory Notification: modifications to the USP Accounting Condition (USPAC); and
 - Annex 3: Direction: modifications to the Regulatory Accounting Guidelines (RAG).
- A1.2 To avoid duplication and due to the technical nature of this consultation, we are not replicating these here.