

## A5. Annex 5

### Statutory Notification in accordance with paragraph 4(3) of Schedule 6 to the Postal Services Act 2011: proposed modifications to the Regulatory Accounting Guidelines (RAG)

#### NOTIFICATION OF PROPOSED MODIFICATIONS TO OFCOM'S DIRECTION OF 18 DECEMBER 2017 CONTAINING ISSUE NO.3 OF THE REGULATORY ACCOUNTING GUIDELINES (RAG) GIVEN UNDER, AND FOR THE PURPOSES OF APPLYING, THE USP ACCOUNTING CONDITION

##### BACKGROUND

- (A) On 27 March 2012, following consultation, Ofcom published a statement entitled '*Securing the Universal Postal Service: Decision on the new regulatory framework*'<sup>1</sup> (the "**2012 Statement**") setting out various decisions relating to the new regulatory framework for the postal sector, including the imposition on the universal service provider of a USP accounting condition ("**USPAC No.1**") to make provision about the matters set out in section 39 of the Act.
- (B) At Annex 11 to the 2012 Statement, Ofcom also gave a direction in accordance with section 53 of, and paragraph 4 of Schedule 6 to, the Act and pursuant to powers in USPAC No.1 that the condition shall have effect by reference to Regulatory Accounting Guidelines ("**RAG Issue 1**") set out in the Schedule to the direction.
- (C) On 27 January 2014, following consultation, Ofcom published a statement entitled '*Updating the Regulatory Reporting Framework – Statement – USP Accounting Condition*'<sup>2</sup>. Also on 27 January 2014, Ofcom separately published a notification entitled '*Updating the Regulatory Reporting Framework – Statutory Notification – USP accounting condition*'<sup>3</sup> (the "**2014 Modification**") in which Ofcom set out its decision to modify USPAC No.1 and RAG Issue 1. The revised USP accounting condition and revised Regulatory Accounting Guidelines (clean copies as well as copies with tracked changes showing the updates) were set out in Annex 1 ("**USPAC No.2**") and Annex 2 (the "**RAG Issue 2**") to the 2014 Modification, respectively. The revisions took effect from the date of publication of the 2014 Modification.
- (D) On 18 December 2017, following consultation, Ofcom published a statement entitled '*Regulatory financial reporting for Royal Mail*'<sup>4</sup> in which Ofcom published at Annex 1 its notification<sup>5</sup> revoking USPAC No.2 with effect from 25 March 2018 and imposing on Royal Mail a new USP accounting condition, as specified in the Schedule to the Notification ("**USPAC No.3**"), to make provision about the matters set out in section 39 of the Act, which condition took effect on 26 March 2018.

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<sup>1</sup> <http://stakeholders.ofcom.org.uk/binaries/consultations/review-of-regulatory-conditions/statement/statement.pdf>

<sup>2</sup> [https://www.ofcom.org.uk/data/assets/pdf\\_file/0020/71534/statement.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0020/71534/statement.pdf)

<sup>3</sup> [https://www.ofcom.org.uk/data/assets/pdf\\_file/0033/79863/statutory-notification.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0033/79863/statutory-notification.pdf)

<sup>4</sup> [https://www.ofcom.org.uk/data/assets/pdf\\_file/0032/108869/financial-reporting-Royal-Mail.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0032/108869/financial-reporting-Royal-Mail.pdf)

<sup>5</sup> [https://www.ofcom.org.uk/data/assets/pdf\\_file/0024/108870/Annex-1.-New-USPAC.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0024/108870/Annex-1.-New-USPAC.pdf)

- (E) At Annex 2 to that statement, Ofcom also gave a direction<sup>6</sup> in accordance with section 53 of, and paragraph 4 of Schedule 6 to, the Act and pursuant to powers in USPAC No.2 that the condition shall have effect by reference to new Regulatory Accounting Guidelines (“RAG Issue 3”) set out in the Schedule to the direction. By that direction, Ofcom withdrew RAG Issue 2 with effect from 25 March 2018 and directed that USPAC No.3 had effect by reference to the specific requirements in RAG Issue 3, which took effect on 26 March 2018.

## PROPOSALS

1. Ofcom hereby proposes, in accordance with section 53 of, and paragraph 4 of Schedule 6 to, the Act—and pursuant to anticipated powers under USPAC No.3—to modify RAG Issue 3 in the manner specified in the Schedule to this Notification in order to direct Royal Mail to comply with the proposed requirements.
2. The proposed modifications to RAG Issue 3 are—
  - (a) marked up against the text of existing RAG Issue 3 to show the changes which are being proposed to its substance, as shown in red text and highlighted in yellow; and
  - (b) proposed to take effect on [the date of the publication of the statement of Ofcom’s decisions].
3. The effect of, and Ofcom’s reasons for making, these proposals are set out in the accompanying consultation document.

## OFCOM’S DUTIES AND LEGAL TESTS

4. Ofcom is satisfied that these proposals satisfy the general test in paragraph 4(2) of Schedule 6 to the Act.
5. In making these proposals, Ofcom has considered and acted in accordance with its principal duty in section 29 of the Act and its general duties in section 3 of the Communications Act 2003.

## MAKING REPRESENTATIONS

6. Representations may be made to Ofcom about the proposals set out in this Notification by no later than 27 February 2019.
7. Copies of this Notification and the accompanying consultation document have been sent to the Secretary of State in accordance with paragraph 5(1) of Schedule 6 to the Act.
8. By virtue of paragraph 4(8) of Schedule 6 to the Act, Ofcom may give effect, with or without modifications, to a proposal with respect to which it has published a notification only if Ofcom has—
  - (a) considered every representation about the proposal that is made to Ofcom within the period specified in paragraph 6 of this Notification; and
  - (b) had regard to every international obligation of the United Kingdom (if any) which has been notified to Ofcom for this purpose by the Secretary of State.

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<sup>6</sup> [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0025/108871/Annex-2.-New-RAG.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0025/108871/Annex-2.-New-RAG.pdf)

## INTERPRETATION

9. Except insofar as the context otherwise requires, words or expressions shall have the meaning assigned to them in this Notification and otherwise any word or expression shall have the same meaning as it has been ascribed for the purpose of Part 3 of the Act or for the purpose of USPAC No.3 (as relevant).
10. In this Notification—
- (a) “Act” means the Postal Services Act 2011 (c.5);
  - (b) “Ofcom” means the Office of Communications;
  - (c) “RAG Issue 3” has the meaning given to it in recital (E) to this Notification;
  - (d) “Royal Mail” means Royal Mail Group Ltd, whose registered company number in England and Wales is 04138203, which is the current universal service provider for the purposes of section 39 of the Act; and
  - (e) “USPAC No.3” has the meaning given to it in recital (D) to this Notification;
11. For the purpose of interpreting this Notification—
- (a) headings and titles shall be disregarded;
  - (b) expressions cognate with those referred to in this Notification shall be construed accordingly;
  - (c) the Interpretation Act 1978 (c. 30) shall apply as if this Notification were an Act of Parliament.
12. The Schedule to this Notification shall form part of this Notification.

Signed by



David Brown

**Director of Financial Economics, Ofcom**

*A person duly authorised by Ofcom under paragraph 18 of the Schedule to the Office of Communications Act 2002*

**19 December 2018**

## SCHEDULE

### (Proposed modifications to RAG Issue 3)

Section 8 (entitled 'Regulatory Accounting Methodology') of RAG Issue 3 to be amended as follows—

1. for §8.19 (concerning National Costing Rule 5: Activities) substitute—

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

2. for §8.21 (concerning National Costing Rule 6: Resource Drivers) substitute—

**"8.21** The Resource Driver for each Cost Type shall be—

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

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

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

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

3. for §8.24(d)(ii) (concerning National Costing Rule 8: Activity Costs) substitute—

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

4. for §8.28(b) (concerning National Costing Rule 10: Weighted Volume Drivers) substitute—

**"(b)** Weighting Factors, which represent the relative proportions of amount of work that units of each SPHCC require from the related Activity, when compared to a different SPHCC using the same Activity.";

5. for §8.29 (concerning National Costing Rule 10: Weighted Volume Drivers) substitute—

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

6. for §8.30 (concerning National Costing Rule 10: Weighted Volume Drivers) substitute—

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

(a) time (needed to carry out the Activity): ~~where appropriate, industrial engineering studies must be carried out in accordance with relevant ISO standards;~~

(b) weight (of an item): ~~appropriate operational data must be used;~~ and

(c) size (or physical dimensions of an item): ~~appropriate operational data must be used,~~

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

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

~~(d) based on sampling or industrial engineering studies; and~~

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

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

7. for §8.35 (concerning National Costing Rule 11: Other Drivers) substitute—

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

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

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

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

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

8. for §8.36 (concerning National Costing Rule 12: Equi-Proportional Mark-Up ('EPMU')) substitute—
  - “8.36 EPMU shall be used for allocating Overheads (see National Costing Rule 8) by treating them in the following manner—
    - (a) Pipeline Overheads shall be allocated to all, and only, those SPHCCs which are processed by that element of the Pipeline; and
    - (b) General Overheads shall be allocated to all SPHCCs which are processed through the Pipeline.”;
9. for the heading ‘National Costing Rule 14: Operational data and sampling’ substitute the heading ‘National Costing Rule 14: Data and sampling’;
10. for §8.40 substitute—
  - “8.40 All operational data ~~—whether actual, modelled or theoretical data—~~ used by the National Costing Methodology shall be regularly reviewed by Royal Mail and, where necessary, updated to ensure the accuracy of costing and its consistency with the operational reality (see National Costing Rule 2). In so doing, for the avoidance of doubt, Royal Mail must ensure the integrity of all the data in accordance with National Costing Rule 15.”; and
11. for §8.42 (concerning National Costing Rule 15: Data integrity) substitute—
  - “8.42 Data integrity is the maintenance of, and the assurance of the accuracy and consistency of any data over time, and the data includes (but is not limited to) inputs, models and outputs. The data integrity of financial and operational data — whether actual, modelled or theoretical data— used for the National Costing Methodology shall be preserved by adequate checks and controls, which on the data for the same period as well as adequate checks and controls on the development of data from one period to another. The checks and controls shall include (but are not limited to) reconciliation of total cost data at appropriate points in the National Costing Methodology.”.
12. for §8.76(c) (concerning Transfer Charges) substitute—
  - “(c) if the product and/or service does not fall within §8.76(a) or (b), the Transfer Price shall be equal to the FAC of that product and/or service plus an appropriate return a mark-up of 10% on FAC.”
13. for §9.10(d) (concerning equivalence pricing) substitute—
  - “(d) The Transfer Price shall be determined as the sum of the price of the appropriate comparable Access product and/or service, the FAC differences referred to in §9.10(c) plus an appropriate return a mark-up of 10% on those FAC differences.”
14. for §9.12 (concerning cost-plus pricing) substitute—

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

15. in Appendix 4 (concerning Information to be included in the pro-formas for the technical appendices of the Costing Manual) insert—

**“Data Template G**

**Scope:** all Cost Types whose cost is allocated to Activities by the application of Planning Values or theoretical or modelled operational data

**Significant digits:** to minimise the impact of rounding errors please provide all data to the maximum number of significant figures allowed by the RM system”

		Cost Type Account			
		Cost Type Description			
		Resource Driver Description			
Activity Code	Activity Description	Pipeline Segment	<i>This row has been deliberately left blank</i>		
			FY%	FY%	FY%
<b>All Pipeline segment Activities</b>			<b>100%</b>	<b>100%</b>	<b>100%</b>

-----END OF SCHEDULE-----