

Annex 2

Regulatory Accounting Guidelines (RAG)

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Section 1: Purpose

- 1.1 The USPAC Condition imposes on Royal Mail (as the universal service provider designated by OFCOM) various obligations under section 39 of the Act. Pursuant to powers in the USPAC Condition, OFCOM are empowered from time to time to give such directions as they consider appropriate in relation to Royal Mail—
- (a) maintaining a separation for accounting purposes between such different matters as OFCOM may direct for such purposes as they may direct, including separation in relation to different services, facilities or products or in relation to services, facilities or products provided in different areas as well as the accounting methods to be used in maintaining the separation;
 - (b) complying with rules made by OFCOM in relation to those matters about the identification of costs and cost orientation, including the application of presumptions in the fixing and determination of costs and charges for any purpose as well as the publication of such accounts and other information relating to anything required to be done by OFCOM in this regard;
 - (c) complying with rules made by OFCOM about the use of cost accounting systems in relation to those matters, including the application of presumptions in the fixing and determination of costs and charges for any purpose as well as the publication of such accounts and other information relating to anything required to be done by OFCOM in this regard;
 - (d) securing that Royal Mail's compliance with those systems is audited annually by a Qualified Independent Auditor, including Royal Mail meeting the costs of the audit; and
 - (e) otherwise in relation to Royal Mail's obligations under the USPAC Condition.
- 1.2 Pursuant to the obligation in USPAC 1.2.3 on Royal Mail to comply with any direction given by OFCOM from time to time under it, the regulatory requirements in any direction (including in these Guidelines) are enforceable via the USPAC Condition in accordance with the relevant procedures in the Act.
- 1.3 By definition in the USPAC Condition, the “Regulatory Accounting Guidelines” means the document so entitled and published by OFCOM (as amended from time to time) setting out such requirements as OFCOM may direct from time to time relating to the preparation, auditing, reporting and publication, of regulatory financial statements and other regulatory financial reports to be prepared and maintained by Royal Mail by or under the USPAC Condition. Additionally to the general direction-making power referred to in §1.1 above, the USPAC Condition makes express references to these Guidelines in prescribing specific requirements on Royal Mail imposed by means of a direction, such as those concerning the manner and form in which financial statements and information should be prepared and maintained, etc.
- 1.4 Accordingly, OFCOM has directed that the USPAC Condition shall have effect by reference to these Guidelines.

Section 2: Definitions & Interpretation

2.1 For the purpose of interpreting these Guidelines—

- (a) except in so far as the context otherwise requires, words or expressions shall have the meaning assigned to them in **§2.2** and otherwise any word or expression in these Guidelines shall have the same meaning as it has been ascribed in, and for the purpose of, the USPAC Condition;
- (b) headings and titles shall be disregarded;
- (c) expressions cognate with those referred to in these Guidelines shall be construed accordingly;
- (d) the Interpretation Act 1978 (c. 30) shall apply as if these Guidelines were an Act of Parliament;
- (e) subject to **§2.1(f)**, references to “**material**”, and cognate expressions, are references to the meaning of materiality as prescribed by the Guiding Principle concerning materiality in USPAC 1.7.2(h);
- (f) in relation to the identification of material changes for the purpose of complying with the requirements set out in USPAC 1.6.3, materiality shall be determined as follows—
 - (i) for all items of the Regulatory Accounting Methodology, a change in any item (including revenues, costs, assets, liabilities, and cash flows) in any of the financial statements and/or information required by or under the USPAC Condition shall be deemed to be material if the resultant percentage difference (be it positive or negative) exceeds 5%. The resultant percentage difference shall be calculated by taking the value of the non-compliant item and subtracting from it the value of the same item if calculated under the compliant approach (“**Compliance Base Value**”), and then dividing this result by the Compliance Base Value;
 - (ii) for the purposes of the National Costing Methodology and the Zonal Costing Methodology only, a change in any reported item of product, SPHCC, or Activity Cost shall be deemed to be material if the resultant percentage difference (be it positive or negative) exceeds 1%, unless the change itself is smaller than £0.5 million. The resultant percentage difference shall be calculated by reference to the Compliance Base Value; and
 - (iii) any determination of materiality under **§2.1(f)(i) and (ii)** shall be measured by reference to the most recent quarterly or annual financial statements and/or information, as applicable.

2.2 In these Guidelines, the following words or expressions shall have the meaning assigned to them below—

<u>Word or expression</u>	<u>Meaning</u>
“Activity Based Costing”	A costing system used to allocate the costs recorded in the <u>General Ledger</u> , together with any sources of data (where necessary), to products, through an intermediate step of allocating <u>Activity Costs</u> .
“ABC Model”	‘Activity Based Costing Model’, which is the costing system that <u>Royal Mail</u> uses to allocate the costs recorded in the <u>General Ledger</u> , together with any sources of data (where necessary), to its products, through an intermediate step of allocating <u>Activity Costs</u> .
“Activity”/“Activities”	Activities, tasks or work (whether operational or non-operational) which are required to be carried out in order to complete a <u>Business Process</u> .
“Activity Cost”	Total or unit costs attributed to an <u>Activity</u> .
“Activity Drivers”	Numeric values which are used to assign <u>Activity Costs</u> to <u>SPHCCs</u> in accordance with <u>National Costing Rule 9</u> where they relate to the <u>National Costing Methodology</u> or in accordance with <u>Zonal Costing Rule 9</u> where they relate to the <u>Zonal Costing Methodology</u> .
“Aggregate Costs”	Has the meaning given to it by <u>National Costing Rule 8</u> where it relates to the <u>National Costing Methodology</u> or by <u>Zonal Costing Rule 8</u> where it relates to the <u>Zonal Costing Methodology</u> .
“Attributable Non-operational Costs”	Has the meaning given to it by §8.24(b) .
“Attributable Operational Costs”	Has the meaning given to it by §8.24(a) .
“Avoidable First Class Costs”	Has the meaning given to it by <u>National Costing Rule 3</u> where it relates to the <u>National Costing Methodology</u> or by <u>Zonal Costing Rule 8</u> where it relates to the <u>Zonal Costing Methodology</u> .
“Avoidable Second Class Costs”	Has the meaning given to it by <u>National Costing Rule 3</u> where it relates to the <u>National Costing Methodology</u> or by <u>Zonal Costing Rule 3</u> where it relates to the <u>Zonal Costing Methodology</u> .
“Bulk Mail”	A retail service offered at a price which is subject to discounts related to volume of mail per mailing or presentation of mail, typically involving conveyance of more than 250 items per mailing.
“Business Process”	<u>Operational Business Processes</u> and <u>Non-operational Business Processes</u> .
“Class Costing”	The methodologies applied in the <u>National Costing Methodology</u> and the <u>Zonal Costing Methodology</u> to quantify the additional costs of processing certain classes of mail

relative to other classes of mail.

“Compliance Base Value”	Has the meaning given to it under §2.1(f)(i) of these Guidelines.
“Cost Centre”	The basic unit of responsibility in an organisation for which costs are accumulated, such as a production or service location, function, <u>Activity</u> or item of equipment.
“Cost Element”	A cost recorded in the <u>General Ledger</u> , such as basic pay, overtime pay and National Insurance payments.
“Cost Type”	Cost figures obtained after rearranging the relevant categories of costs recorded in <u>Royal Mail's</u> financial information, including the <u>General Ledger</u> , including aggregating or separating some of those costs.
“Delivery Office”	Part of <u>Royal Mail's postal network</u> (as defined by section 38(3) of the <u>Act</u>) that is responsible for the final sortation of mail items and from which outdoor delivery of mail to recipients is undertaken.
“Downstream Services Entity”	The one entity within the <u>Four FREs</u> which contains the services (or products) as determined by <u>Line B</u> .
“EBIT”	‘Earnings Before Interest and Tax’, namely revenue less all the costs of products and services provided before the deduction of interest and tax, also referred to as operating (loss) or profit.
“End-to-end Only Products Entity”	The one entity within the <u>Four FREs</u> which contains the services (or products) as determined by <u>Line A</u> .
“EPMU”	‘Equi-Proportional Mark-Up’, which has the meaning given to it in <u>National Costing Rule 12</u> where it relates to the <u>National Costing Methodology</u> or by <u>Zonal Costing Rule 12</u> where it relates to the <u>Zonal Costing Methodology</u> .
“FAC”	‘Fully Allocated Cost’, which is a costing methodology in which all costs (including <u>Overheads</u>) are allocated to the outputs of the business.
“First Class”	A product and/or service that aims to deliver the next working day (including Saturday) after collection.
“Fixed Asset Register”	A register or list of assets held for the purpose of production of goods or rendering of services that are not held for the purpose of sale in the ordinary course of business. The list allows a company to keep track of details of each fixed asset, ensuring control and preventing misappropriation of assets. It also keeps track of the correct value of assets, which allows for computation of depreciation and for tax and insurance purposes.
“Full Time Equivalent”	The Full Time Equivalent staff headcount for a period which is calculated by dividing total frontline staff hours worked in that period (including temporary and agency staff hours but excluding contractors’ hours, and including overtime and scheduled attendance) by the total standard hours for that period; and adding the result to the average headcount of the

rest of the staff in that period.

“General Ledger”	The accounting ledger that contains the financial accounts used by <u>Royal Mail</u> for the application of the <u>National Costing Methodology</u> and the <u>Zonal Costing Methodology</u> for the <u>Reported Business</u> .
“General Overheads”	Has the meaning given to it by <u>National Costing Rule 8</u> where it relates to the <u>National Costing Methodology</u> or by <u>Zonal Costing Rule 8</u> where it relates to the <u>Zonal Costing Methodology</u> .
“Line A”	Has the meaning given to it in USPAC 1.5.1 for the purpose of defining the <u>Four FREs</u> .
“Line B”	Has the meaning given to it in USPAC 1.5.1 for the purpose of defining the <u>Four FREs</u> .
“Line C”	Has the meaning given to it in USPAC 1.5.1 for the purpose of defining the <u>Four FREs</u> .
“MCS”	‘Mails Characteristics Survey’, which is a survey conducted by <u>Royal Mail</u> of the mail product types and volumes within the mail traffic of the <u>Reported Business</u> .
“National Costing Rule(s)”	The requirements in these Guidelines, in paragraphs 8.11 to 8.43, for the purpose of the <u>National Costing Methodology</u> .
“NBV”	‘Net Book Value’, which is the historical cost of an asset less the associated accumulated depreciation.
“Non-operational Business Processes”	<p>The following business processes of the <u>Reported Business</u> as defined in the <u>Costing Manual</u>—</p> <ol style="list-style-type: none">1. commercial;2. support;3. wholesale; and4. business sustaining activities.
“non-USO Products Entity”	The one entity within the <u>Four FREs</u> which contains the services (or products) as determined by <u>Line C</u> .
“Operational Business Processes”	<p>The following business processes of the <u>Reported Business</u> as defined in the <u>Costing Manual</u>—</p> <ol style="list-style-type: none">1. access (collections);2. outward processing;3. network distribution;4. regional distribution centres processing;5. inward processing;6. local distribution;7. delivery – indoor;8. delivery – outdoor;9. walk bundling centre;10. perform mailroom management; and11. international mail.

“Other Drivers”	Has the meaning given to it by §8.26(b) , read together with <u>National Costing Rule 11</u> where it relates to the <u>National Costing Methodology</u> or by §8.26(b) , read together with <u>Zonal Costing Rule 11</u> where it relates to the <u>Zonal Costing Methodology</u> .
“Overheads”	Costs which are either <u>General Overheads</u> or <u>Pipeline Overheads</u> have the meanings given to them by <u>National Costing Rule 8</u> where they relate to the <u>National Costing Methodology</u> or by <u>Zonal Costing Rule 8</u> where they relate to the <u>Zonal Costing Methodology</u> .
“Pipeline”	All the <u>Operational Business Processes</u> involved in <u>Royal Mail</u> 's provision of its products and/or services from collection to final delivery of the products and/or services.
“Pipeline Overheads”	Has the meaning given to it by <u>National Costing Rule 8</u> where it relates to the <u>National Costing Methodology</u> or by <u>Zonal Costing Rule 8</u> where it relates to the <u>Zonal Costing Methodology</u> .
“PPI”	‘Printed Postage Impressions’, which is pre-printed postage.
“PIIA”	‘Properly Prepared In Accordance with these Guidelines and the <u>Guiding Principles</u> set out under USPAC 1.7.2’, which is an audit opinion that provides reasonable assurance that a financial statement and information, taken as a whole, have been prepared, in all material respects, in accordance with the detailed requirements prescribed by these Guidelines.
“Proportional Factors”	Factors representing the proportion of the total volume of each <u>SPHCC</u> which uses the related <u>Activity</u> and determined in accordance with the <u>National Costing Rule 10</u> where they relate to the <u>National Costing Methodology</u> or in accordance with <u>Zonal Costing Rule 10</u> where they relate to the <u>Zonal Costing Methodology</u> .
“Resource Drivers”	Numeric values which are used to attribute <u>Cost Types</u> to <u>Activities</u> and determined in accordance with <u>National Costing Rule 6</u> where they relate to the <u>National Costing Methodology</u> or in accordance with <u>Zonal Costing Rule 6</u> where they relate to the <u>Zonal Costing Methodology</u> .
“Revenue derived method”	A method of deriving the volume of a product going through the <u>Pipeline</u> , by dividing the revenue received for that product by the average unit price of that product, which is estimated by sampling.
“RMH Group”	<u>RMH plc</u> and any of its subsidiaries or holding companies, or any subsidiary of such holding companies (all as defined by section 1159 of the Companies Act 2006), or any group undertaking (as defined by section 1161 of the Companies Act 2006).
“Second Class”	A product and/or service that aims to deliver by the second or third working day (including Saturday) after collection.
“SPHCC”	‘Sales Product Handling Characteristic Combinations’, which are products and/or services sub-divided based on the

	relevant measured characteristics as prescribed by these Guidelines.
“Third Class”	A product and/or service that aims to deliver by later than the third working day (including Saturday) after collection.
“Transfer Charge(s)” or “Transfer Price(s)”	The charge or price that one part of a business may charge to another part of the same business, for the products and/or services which the former provides to the latter.
“UKLPI”	‘UK Letters & Parcels and International’, which is an operating unit of <u>Royal Mail</u> .
“USO Products Entity”	The one entity within the <u>Four FREs</u> which contains the services (or products) as determined by <u>Line C</u> .
“USPAC Condition”	The USP accounting condition imposed on <u>Royal Mail</u> as set out in the notification published by <u>OFCOM</u> at Annex 10 to the statement entitled ‘Securing the Universal Postal Service’ dated 27 March 2012, and as modified by <u>OFCOM</u> from time to time.
“Weighting Factors”	Factors representing the relative proportions of resources that units of each <u>SPHCC</u> require from the related <u>Activity</u> and determined in accordance with the <u>National Costing Rule 10</u> where they relate to the <u>National Costing Methodology</u> or in accordance with <u>Zonal Costing Rule 10</u> where they relate to the <u>Zonal Costing Methodology</u> .
“Weighted Volume Drivers”	Has the meaning given to it by <u>National Costing Rule 10</u> where it relates to the <u>National Costing Methodology</u> or by <u>Zonal Costing Rule 10</u> where it relates to the <u>Zonal Costing Methodology</u> .
“Zone”	A part of the United Kingdom (based on postcode sectors) for which <u>Royal Mail</u> is using the same price for products and/or services falling within the <u>Reported Business</u> .
“Zonal Costing Rule(s)”	The requirements in these Guidelines for the purpose of the <u>Zonal Costing Methodology</u> .

Section 3: Obligations relating to the Relevant Group under USPAC 1.3

- 3.1** For the purpose of USPAC 1.3.2, Royal Mail must prepare the financial statements and information specified in **Column 1 of Table 1** by using the pro-forma corresponding to the statement or information as specified in **Column 2 of that Table** (including notes disclosing a breakdown and explanations of any material items).

Table 1: Pro-formas for the financial statements and information for the Relevant Group

<i>Column 1: Financial statement/information referred to in USPAC 1.3.1</i>		<i>Column 2: Pro-forma specified in Appendix 1 of these Guidelines</i>
USPAC 1.3.1(a)	<u>consolidated</u> income statement	Figure 1, Appendix 1
USPAC 1.3.1(b)	<u>consolidated</u> balance sheet statement	Figure 2, Appendix 1
USPAC 1.3.1(c)	<u>consolidated</u> cash flow statement	Figure 3, Appendix 1
USPAC 1.3.1(d)	<u>consolidated</u> cash flow projection statement	<i>Not applicable</i>
USPAC 1.3.1(e)	<u>Strategic Business Plan</u>	<i>Not applicable</i>
USPAC 1.3.1(f)	Reconciliation of <u>consolidated</u> income, balance sheet and cash flow statements with the <u>consolidated</u> accounts of <u>RMH plc</u>	Figures 1 , 2 and 3, Appendix 1
USPAC 1.3.1(g)	<u>Annual Budget</u>	<i>Not applicable</i>

- 3.2** For the purpose of USPAC 1.3.3, Royal Mail must prepare each of the financial statements and information specified in **Column 1 of Table 2** in accordance with the additional requirements corresponding to the statement or information as prescribed by **Column 2 of that Table**.

Table 2: Additional requirements for the financial statements and information for the Relevant Group

<i>Column 1: Financial statement/information referred to in USPAC 1.3.1</i>		<i>Column 2: Additional requirements in these Guidelines</i>
USPAC 1.3.1(a)	<u>consolidated</u> income statement	<i>Not applicable</i>
USPAC 1.3.1(b)	<u>consolidated</u> balance sheet statement	<i>Not applicable</i>
USPAC 1.3.1(c)	<u>consolidated</u> cash flow statement	<i>Not applicable</i>

<p>USPAC 1.3.1(d)</p>	<p><u>consolidated</u> cash flow projection statement</p>	<p>The <u>consolidated</u> cash flow projection statement shall include the following—</p> <p>(a) figures projected for the <u>Financial Quarter</u> for which the statement must be prepared together with the five <u>Financial Quarters</u> that follow that <u>Financial Quarter</u> showing the cash flows and the cash position for the <u>Relevant Group</u>.</p> <p>(b) an explanation of the key assumptions underpinning the scenarios referred to in (a) above;</p> <p>(c) if <u>Royal Mail</u> changes its projections from one <u>Financial Quarter</u> to another, a reconciliation of the new projections to the previous projections, together with an explanation of the material changes;</p> <p>(d) figures showing the actual cash position of the <u>Relevant Group</u> at the beginning of the <u>Financial Quarter</u> in question, including a breakdown of material balances and movements in those balances since the beginning of the preceding <u>Financial Quarter</u>, together with an explanation of those material movements and differences with the projections for that preceding <u>Financial Quarter</u>;</p> <p>(e) <u>Royal Mail</u>'s assessment of the financial sustainability of the <u>Relevant Group</u>, including its identification of key risks that may affect that sustainability;</p> <p>(f) a statement of financing facilities available to the <u>Relevant Group</u> as at the beginning of the <u>Financial Quarter</u> in question, together with information on the extent to which these facilities have been utilised;</p> <p>(j) the cash flows referred to in (a) above shall include at least the following—</p> <p>(1) 'EBITDA', namely revenue less all the costs of products and services provided before interest, tax, depreciation and amortisation;</p> <p>(2) pension costs;</p> <p>(3) working capital;</p> <p>(4) dividends;</p> <p>(5) investments;</p> <p>(6) capital expenditure and proceeds from disposals;</p> <p>(7) exceptional items, including redundancy, restructuring costs and <u>Royal Mail</u>'s "Colleague share" share scheme; and</p> <p>(k) if there are material presentational or methodological changes in the cash flow projections between the <u>Financial Quarter</u> in question and the preceding <u>Financial Quarter</u>,</p>
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		<p><u>Royal Mail</u> must restate the information relating to the latter together with explanatory notes.</p> <p>This additional requirement shall apply for the second <u>Financial Quarter</u> of the first <u>Financial Year</u> and subsequent <u>Financial Quarters</u>.</p>
USPAC 1.3.1(e)	<u>Strategic Business Plan</u>	<p>The <u>Strategic Business Plan</u> shall set out separately the forecast of the revenues and operating expenditure of the <u>Reported Business</u> from that of the <u>Relevant Group</u>. This requirement shall come into effect from 1 April 2014.</p> <p>Quarterly forecast of the revenues and operating expenditure of the <u>Reported Business</u> shall be provided alongside the quarterly income statement of the <u>Reported Business</u> required under USPAC 1.4.1(b).</p> <p>If there are material presentational or methodological changes in the <u>Strategic Business Plan</u> between the <u>Financial Year</u> in question and the preceding <u>Financial Year</u>, <u>Royal Mail</u> must restate the information relating to the latter together with explanatory notes. This additional requirement shall apply for the second and subsequent <u>Financial Years</u>.</p>
USPAC 1.3.1(f)	Reconciliation of <u>consolidated</u> income, balance sheet and cash flow statements with the <u>consolidated</u> accounts of <u>RMH plc</u>	<i>Not applicable</i>
USPAC 1.3.1(g)	<u>Annual Budget</u>	<i>Not applicable</i>

Section 4: Obligations relating to the Reported Business under USPAC 1.4

- 4.1** For the purpose of USPAC 1.4.2, Royal Mail must prepare the financial statements and information specified in **Column 1 of Table 3** by using the pro-forma corresponding to the statement or information as specified in **Column 2 of that Table** (including notes disclosing a breakdown and explanations of any material items).

Table 3: Pro-formas for the financial statements and information for the Reported Business

<i>Column 1: Financial statement/information referred to in USPAC 1.4.1</i>		<i>Column 2: Pro-forma specified in Appendix 1 of these Guidelines</i>
USPAC 1.4.1(a)	Annual income statement	Figure 4, Appendix 1
USPAC 1.4.1(b)	Quarterly income statement	Figure 5, Appendix 1
USPAC 1.4.1(c)	Annual reconciliation of statements/information specified in USPAC 1.4.1(c)	<i>Not applicable</i>
USPAC 1.4.1(d)	Annual reconciliation of statements/information specified in USPAC 1.4.1(d)	Figure 9, Appendix 1
USPAC 1.4.1(e)	Annual capital employed statement	Figure 10, Appendix 1
USPAC 1.4.1(f)	Annual reconciliation of statements/information specified in USPAC 1.4.1(f)	Figure 11, Appendix 1
USPAC 1.4.1(g)	Annual cash flow statement	Figure 12, Appendix 1
USPAC 1.4.1(h)	Annual reconciliation of statements/information specified in USPAC 1.4.1(h)	Figure 13, Appendix 1
USPAC 1.4.1(i)	Annual product profitability statement	Figure 14, Appendix 1
USPAC 1.4.1(j)	Quarterly product profitability statement	Figure 14, Appendix 1
USPAC 1.4.1(k)	Monthly revenue, cost and volume information statement	Figures 15(a) and 15(b), Appendix 1

- 4.2** For the purpose of USPAC 1.4.3, Royal Mail must prepare the financial statements and information specified in **Column 1 of Table 4** in accordance with the additional requirements corresponding to the statement or information as prescribed by **Column 2 of that Table**.

Table 4: Additional requirements for the financial statements and information for the separated Reported Business

Column 1: Financial statement/information referred to in USPAC 1.4.1		Column 2: Additional requirements in these Guidelines
USPAC 1.4.1(a) and (b)	Annual income statement and quarterly income statement	<p>The rules in Section 8 of the Guidelines concerning annual and quarterly income statements shall apply.</p> <p>The annual income statement shall include a statement of <u>Transfer Charges</u> setting out each material <u>Transfer Charge</u> separately as shown in Figure 4 of Appendix 1 of these Guidelines.</p> <p>The quarterly income statement shall include a statement of <u>Transfer Charges</u> setting out each material <u>Transfer Charge</u> separately as shown in Figure 5 of Appendix 1 of these Guidelines.</p> <p>The annual and quarterly income statements shall set out a breakdown of items of revenue or cost which <u>Royal Mail</u> categorises as exceptional in these statements, together with explanations as to the nature of each item and the reasons why it arose.</p> <p>Royal Mail shall deliver to OFCOM The quarterly income statement required under USPAC 1.4.1(b) within 60 days after the end of the <u>Financial Quarter</u> for which they have been prepared; starting from the quarterly income statement for the second <u>Financial Quarter</u> of 2014-15 <u>Financial Year</u>. Royal Mail shall deliver the quarterly income statement for the <u>Financial Quarters</u> preceding the above-mentioned <u>Financial Quarter</u> within 90 days after the end of the <u>Financial Quarter</u> for which they have been prepared.</p>
USPAC 1.4.1(c)	Annual reconciliation of statements/information specified in USPAC 1.4.1(c)	<p>The rules in Section 8 of the Guidelines concerning annual & quarterly income statements shall apply.</p> <p>The annual reconciliation shall set out each of the quarterly financial statements and information to be prepared for USPAC 1.4.1(b) and then reconcile the combined total of these four statements with the financial statement and information to be prepared for USPAC 1.4.1(a). Where there are any reconciling differences, <u>Royal Mail</u> must provide accompanying notes and explanations to describe these reconciling differences.</p>
USPAC 1.4.1(d)	Annual reconciliation of statements/information specified in USPAC 1.4.1(d)	<p>The rules in Section 8 of the Guidelines concerning annual and quarterly income statements shall apply.</p> <p>The annual reconciliation shall be reconciled giving appropriate detail and explanation of any reconciling items. Each reconciliation shall</p>

		<p>include the following two steps as shown in Figure 9 of Appendix 1 of these Guidelines—</p> <p>(a) a reconciliation between the <u>Reported Business</u> and <u>UKLPI</u>; and</p> <p>(b) a reconciliation between <u>UKLPI</u> and the <u>Relevant Group</u>.</p> <p>In addition, <u>Royal Mail</u> must provide in the accompanying notes the detail of the material reconciling differences in the annual reconciliation.</p>
USPAC 1.4.1(e)	Annual capital employed statement	<p>The rules in Section 8 of the Guidelines concerning annual capital employed statement shall apply.</p> <p>A breakdown of the total fixed asset <u>NBV</u> allocated to the <u>Reported Business</u> as a whole, by main asset classes.</p> <p>In addition, <u>Royal Mail</u> must provide in the accompanying notes the detail of long term debt and financing costs at the level of detail as described in the statutory accounts of the <u>Royal Mail</u>.</p>
USPAC 1.4.1(f)	Annual reconciliation of statements/information specified in USPAC 1.4.1(f)	<p>The annual reconciliation shall be reconciled giving appropriate detail and explanation of any reconciling items. Each reconciliation shall include the following two steps as shown in Figure 11 of Appendix 1 of these Guidelines—</p> <p>(a) a reconciliation between the <u>Reported Business</u> and <u>UKLPI</u>; and</p> <p>(b) a reconciliation between <u>UKLPI</u> and the <u>Relevant Group</u>.</p> <p>In addition, <u>Royal Mail</u> must provide in the accompanying notes the detail of the material reconciling differences in the annual reconciliation.</p>
USPAC 1.4.1(g)	Annual cash flow statement	<p>The rules in Section 8 of the Guidelines concerning annual cash flow statement shall apply.</p>
USPAC 1.4.1(h)	Annual reconciliation of statements/information specified in USPAC 1.4.1(h)	<p>The annual reconciliation shall be reconciled giving appropriate detail and explanation of any reconciling items. Each reconciliation shall include the following two steps as shown in Figure 13 of Appendix 1 of these Guidelines—</p> <p>(a) a reconciliation between the <u>Reported Business</u> and <u>UKLPI</u>; and</p> <p>(b) a reconciliation between <u>UKLPI</u> and the <u>Relevant Group</u>.</p> <p>In addition, <u>Royal Mail</u> must provide in the</p>

		accompanying notes the detail of the material reconciling differences in the annual reconciliation.
USPAC 1.4.1(i)	Annual product profitability statement	<p><u>Royal Mail</u> must prepare and maintain separate annual product profitability statements for each of the products specified in Column 2 of Table 5 as corresponding to the scope specified in Column 3 of that Table.</p> <p>Each of these statements shall only include the costs covered in the <u>National Costing Methodology</u>.</p>
USPAC 1.4.1(j)	Quarterly product profitability statement	<p><u>Royal Mail</u> must prepare and maintain separate quarterly product profitability statements for each of the products specified in Column 2 of Table 5 as corresponding to the scope specified in Column 3 of that Table.</p> <p>Each of these statements shall only include the costs covered in the <u>National Costing Methodology</u>.</p> <p><u>Royal Mail</u> shall deliver to OFCOM The quarterly product profitability statement required under USPAC 1.4.1(j) within 60 days after the end of the Financial Quarter for which they have been prepared; starting from the quarterly product profitability statement for the second <u>Financial Quarter</u> of 2014-15 <u>Financial Year</u>. <u>Royal Mail</u> shall deliver the quarterly product profitability statement for the <u>Financial Quarters</u> preceding the above-mentioned <u>Financial Quarter</u> within 90 days after the end of the <u>Financial Quarter</u> for which they have been prepared.</p>
USPAC 1.4.1(k)	Monthly revenue, volume and cost information statement	<p><u>Royal Mail</u> must prepare a reconciliation of the monthly Total workload for Processing and Total workload for Collection/Delivery reported in Table 15(b), to the monthly Total volumes reported in Table 15(a). The reconciliation must show how the workloads (including weightings) and the operational volumes are derived from the revenue derived volumes.</p> <p>Budgeted revenue, volume and cost information shall be provided from the second <u>Financial Month</u> of the <u>Financial Year</u> (the month of May) onwards, i.e. the first monthly reports of the <u>Financial Year</u> containing budget information shall be the reports for the the second <u>Financial Month</u> of the <u>Financial Year</u> (the month of May).</p>

Table 5: Product profitability statements

Column 1: Statement number	Column 2: Products specified by <u>OFCOM</u> to be contained in the statement referred to in Column 1	Column 3: Scope specified by <u>OFCOM</u> in relation to products specified in Column 2
1	<u>Access</u> products D+2 and later letters and large letters	<u>Downstream Services Entity</u>
2	Other <u>Access</u> products	
3	<u>Business, Advertising, and Sustainable Advertising Mail</u> D+2 Letters and Large Letters	<u>non-USO Products Entity</u>
4	Other <u>Bulk Mail</u> products	
5	<u>non-USO</u> B2X Deferred Light (1kg - 2kg) PPS	
6	<u>non-USO</u> B2X Deferred Light (< 1kg) PPS	
7	<u>non-USO</u> International	
8	Other <u>non-USO</u> services	
9	<u>USO</u> single piece <u>First Class</u> letters sold via stamps payment channel	<u>USO Products Entity</u>
10	<u>USO</u> single piece <u>First Class</u> large letters and parcels < 2kg sold via stamps payment channel	
11	<u>USO</u> single piece <u>First Class</u> large letters and parcels > 2kg sold via stamps payment channel	
12	<u>USO</u> single piece <u>Second Class</u> letters sold via stamps payment channel	
13	<u>USO</u> single piece <u>Second Class</u> large letters and parcels < 2kg sold via stamps payment	

	channel	
14	<u>USO</u> single piece <u>Second Class</u> large letters and parcels > 2kg sold via stamps payment channel	
15	<u>USO</u> single piece <u>First Class</u> products sold via non-stamps payment channel	
16	<u>USO</u> single piece <u>Second Class</u> products sold via non-stamps payment channel	
17	<u>USO</u> Special Delivery products	
18	<u>USO</u> International	
19	Other <u>USO</u> services	
20	<u>non-USO</u> Special Delivery products	<u>End-to-end Only Products Entity</u>
21	<u>non-USO</u> B2X Deferred Heavy (>2kg) PPS	
22	<u>Relay</u>	
23	<u>PAF</u>	
24	International Contract Bulk	
25	Other end to end only products	

- 4.3** For the purpose of interpreting the full meaning of the products specified in **Column 2** of **Table 5**, words or expressions shall be interpreted in accordance with **Section 2** of these Guidelines but, where relevant, also read in conjunction with the market studies referred to in **§9.15(a)** that correspond to the product descriptions in question.

Section 5: Obligations relating to the separated Reported Business under USPAC 1.5

- 5.1** For the purpose of USPAC 1.5.3, Royal Mail must prepare the financial statements and information specified in **Column 1 of Table 6** by using the pro-forma corresponding to the statement or information as specified in **Column 2 of that Table** (including notes disclosing a breakdown and explanations of any material items).

Table 6: Pro-formas for the financial statements and information for the separated Reported Business

<i>Column 1: Financial statement/information referred to in USPAC 1.5.2</i>		<i>Column 2: Pro-forma specified in Appendix 1 of these Guidelines</i>
USPAC 1.5.2(a)	Annual income statement	Figure 4, Appendix 1
USPAC 1.5.2(b)	Quarterly income statement	Figure 5, Appendix 1
USPAC 1.5.2(c)	Annual reconciliation of statements/information specified in USPAC 1.5.2(c)	<i>Not applicable</i>
USPAC 1.5.2(d)	Annual end to end income statement	Figure 6, Appendix 1 (for statements to be published by USPAC 1.5.8); and Figure 7, Appendix 1 (for statements to be delivered to <u>OFCOM</u> by USPAC 1.5.10)
USPAC 1.5.2(e)	Quarterly end to end income statement	Figure 8, Appendix 1
USPAC 1.5.2(f)	Annual capital employed statement	Figure 10, Appendix 1
USPAC 1.5.2(g)	Annual cash flow statement	Figure 12, Appendix 1

- 5.2** For the purpose of USPAC 1.5.4 and USPAC 1.6.1, Royal Mail must prepare the financial statements and information specified in **Column 1 of Table 7** in accordance with the additional requirements corresponding to the statement or information as prescribed by **Column 2 of that Table**.

Table 7: Additional requirements for the financial statements and information for the separated Reported Business

<i>Column 1: Financial statement/information referred to in USPAC 1.5.2</i>		<i>Column 2: Additional requirements in these Guidelines</i>
USPAC 1.5.2(a)	Annual income statement	The rules in Section 9 of the Guidelines concerning annual & quarterly income statements shall apply. The annual income statement shall set out a

		breakdown of items of revenue or cost which <u>Royal Mail</u> categorises as exceptional in these statements, together with explanations as to the nature of each item and the reasons why it arose.
USPAC 1.5.2(b)	Quarterly income statement	<p>The rules in Section 9 of the Guidelines concerning annual & quarterly income statements shall apply.</p> <p>The quarterly income statement shall set out a breakdown of items of revenue or cost which <u>Royal Mail</u> categorises as exceptional in these statements, together with explanations as to the nature of each item and the reasons why it arose.</p> <p>Royal Mail shall deliver to OFCOM The quarterly income statement within 60 days after the end of the <u>Financial Quarter</u> for which they have been prepared; starting from the quarterly income statement for the second <u>Financial Quarter</u> of 2014-15 <u>Financial Year</u>. Royal Mail shall deliver the quarterly income statement for the <u>Financial Quarters</u> preceding the above-mentioned <u>Financial Quarter</u> within 90 days after the end of the <u>Financial Quarter</u> for which they have been prepared.</p>
USPAC 1.5.2(c)	Annual reconciliation of statements/information specified in USPAC 1.5.2(c)	<p>The annual reconciliation shall set out each of the quarterly financial statements and information to be prepared for USPAC 1.5.2(b) and then reconcile the combined total of these four statements with the financial statement and information to be prepared for USPAC 1.5.2(a). Where there are any reconciling differences, <u>Royal Mail</u> must provide accompanying notes and explanations to describe these reconciling differences.</p>
USPAC 1.5.2(d)	Annual end to end income statement	<i>Not applicable</i>
USPAC 1.5.2(e)	Quarterly end to end income statement	<p>Royal Mail shall deliver to OFCOM The quarterly end to end income statement within 60 days after the end of the <u>Financial Quarter</u> for which they have been prepared; starting from the quarterly end to end income statement for the second <u>Financial Quarter</u> of 2014-15 <u>Financial Year</u>. Royal Mail shall deliver the quarterly end to end income statement for the <u>Financial Quarters</u> preceding the above-mentioned <u>Financial Quarter</u> within 90 days after the end of the <u>Financial Quarter</u> for which they have been prepared.</p>
USPAC 1.5.2(f)	Annual capital employed statement	The rules in Section 9 of the Guidelines concerning annual capital employed statement shall apply.

		<p>Operational fixed assets utilised in the day to day trading operations of the business shall be included, but excluding properties the depreciation costs of which are not captured in the <u>FAC</u> product costing system in accordance with the <u>National Costing Methodology</u>, and working capital.</p> <p>A breakdown of the total fixed asset <u>NBV</u> allocated to each of the <u>Four FREs</u>, by main asset classes.</p>
USPAC 1.5.2(g)	Annual cash flow statement	<p>The rules in Section 9 of the Guidelines concerning annual cash flow statement shall apply.</p> <p>Trading cash flows and investment cash flows related to operational fixed assets shall be included.</p>
USPAC 1.6.2	Quarterly update of the Costing Manual, and Quarterly update of the Accounting Methodology Manual	<p>Royal Mail shall publish a quarterly update of the <u>Costing Manual</u> within 60 days after the end of the <u>Financial Quarter</u> for which it has been prepared, starting from the update for the second <u>Financial Quarter</u> of 2014-15 <u>Financial Year</u>.</p> <p>Royal Mail shall deliver the update for the <u>Financial Quarters</u> preceding the above-mentioned <u>Financial Quarter</u> within 90 days after the end of the <u>Financial Quarter</u> for which they have been prepared.</p> <p>Royal Mail shall deliver to OFCOM a quarterly update of the <u>Accounting Methodology Manual</u> and any confidential information in a quarterly update of the <u>Costing Manual</u> that has been excluded from publication, within 60 days after the end of the <u>Financial Quarter</u> for which the updates in question have been prepared; starting from the update for the second <u>Financial Quarter</u> of 2014-15 <u>Financial Year</u>. Royal Mail shall deliver the updates for the <u>Financial Quarters</u> preceding the above-mentioned <u>Financial Quarter</u> within 90 days after the end of the <u>Financial Quarter</u> for which they have been prepared.</p>

Section 6: Obligations relating to the Costing Manual and the Accounting Methodology Manual under USPAC 1.6

- 6.1 For the purpose of USPAC 1.6.1, Royal Mail must prepare, maintain and keep up-to-date the Costing Manual and the Accounting Methodology Manual in accordance with the general requirements set out in this **Section 6** concerning the Costing Manual and the Accounting Methodology Manual, respectively.

The Costing Manual

General requirements

- 6.2 Royal Mail must comply with the rules in **Section 8** of the Guidelines concerning the National Costing Rules and the Zonal Costing Rules.
- 6.3 Subject to §6.4, Royal Mail must prepare, maintain and keep up-to-date the Costing Manual to a comprehensive level of detail to demonstrate compliance with the rules referred to in §6.2.
- 6.4 Royal Mail must prepare and present the Costing Manual in a manner that contains the level of detail necessary to allow a competent user of the Costing Manual with a reasonable degree of professional skill to reproduce the results of the National Costing Methodology and the Zonal Costing Methodology without the need for further instruction or interpretation.
- 6.5 Royal Mail must provide information to OFCOM for each separate material change to the Costing Manual in a format that is clear and transparent using the pro-formas set out in **Appendix 3** of these Guidelines.

Technical appendices

- 6.6 OFCOM hereby direct that—
- (a) for the purpose of USPAC 1.6.1, Royal Mail must include in the technical appendices of the Costing Manual the information prescribed in, and the manner required by the pro-forma specified in, **Appendix 4** of these Guidelines; and
 - (b) for the purpose of USPAC 1.6.6, the technical appendices of the Costing Manual that contain commercially confidential information to Royal Mail is prescribed as confidential for that purpose.

The Accounting Methodology Manual

- 6.7 Royal Mail must in the Accounting Methodology Manual include all the detailed documentation of the Regulatory Accounting Methodology that Royal Mail is not required to document in the Costing Manual.
- 6.8 Royal Mail must prepare, maintain and keep up-to-date the Accounting Methodology Manual in accordance with §6.9 and to a comprehensive level of detail to demonstrate compliance with its obligation referred to in §6.7. Without prejudice to the generality of that obligation to include a comprehensive level of detail in the Accounting Methodology Manual, Royal Mail must include—

- (a) a detailed description of the methodology followed in the identification of the relevant Royal Mail costs for the Relevant Group and the Reported Business as a whole and each of the Four FRES; and
 - (b) separate descriptions of the detailed Regulatory Accounting Methodology used by Royal Mail shall be provided for all the main items in the income statements, capital employed statement and cash flow statements, and including—
 - (i) a detailed description of the methodology used by Royal Mail to prepare the financial statements and information for the Four FRES and a mapping of all Activities, products and/or services to the Four FRES;
 - (ii) a description of the data sources used to calculate inputs and allocations; and
 - (iii) the methodology and calculations used by Royal Mail to determine that the Transfer Charges are presented in sufficient detail to enable OFCOM to ensure that the calculated Transfer Charges follow the requirements in these Guidelines.
- 6.9** Royal Mail must prepare and present the Accounting Methodology Manual in a manner that contains the level of detail necessary to allow a competent user of the Accounting Methodology Manual with a reasonable degree of professional accounting skill, and when used in conjunction with the Costing Manual, to gain a clear understanding of how the financial statements and information required by or under the USPAC Condition have been prepared without the need for further instruction or interpretation.
- 6.10** Royal Mail must provide information to OFCOM for each separate material change to the Accounting Methodology Manual in a format that is clear and transparent using, the pro-formas as set out in **Appendix 3** of these Guidelines.

Section 7: Product Allocations for Accounting Separation

- 7.1 For the purpose of USPAC 1.5.1(d), OFCOM hereby direct that Royal Mail must, as its starting point, allocate products across Line A, Line B and Line C as set out in USPAC 1.5.1 in conformity with the allocations set out in **Appendix 2** of these Guidelines.
- 7.2 Subject to Royal Mail allocating its products and services in a manner consistent with the descriptions of Line A, Line B and Line C as set out in USPAC 1.5.1, Royal Mail may make changes to those product allocations for any Financial Year to which the USPAC Condition applies.
- 7.3 For the purpose of USPAC 1.4.7(b), OFCOM hereby direct that, in relation to product profitability statements numbered 1 and 31 in **Column 1** of **Table 5** in **Section 4** of these Guidelines, Royal Mail is only required to publish the combined figures for Access products < 2kg and Access products > 2kg.
- 7.4 Royal Mail must specify in the Accounting Methodology Manual every product and service that falls into each financial reporting entity allocated to the Four FRES, together with any changes Royal Mail may make pursuant to **§7.2** above. For the avoidance of doubt, such changes by Royal Mail shall be treated as a change subject to the obligation referred to in **§6.10**.

Section 8: Regulatory Accounting Methodology

- 8.1 Royal Mail must ensure that the Regulatory Accounting Methodology complies with the detailed rules set out in this **Section 8**, which relate to the allocation and apportionment of costs, revenues, assets and cash flows for the Reported Business.

Annual & quarterly income statements

Introduction

- 8.2 Royal Mail must ensure that its preparation of any income statement for the Reported Business required by or under the USPAC Condition complies with the rules set out below.

Levels of preparation

- 8.3 Royal Mail must ensure, for the purposes of USPAC 1.4.1(a) and (d), that annual income statements and annual reconciliations of such income statements are prepared to the level of EBIT.
- 8.4 Royal Mail must ensure, for the purposes of USPAC 1.4.1(b) and (c), that quarterly income statements and annual reconciliations of such income statements are prepared to the level of operating profit/(loss) before exceptional items.

Revenue Accounting

- 8.5 References to “**revenue**” in this **Section 8** are references to external and internal turnover used in the preparation of any income statement. External and internal turnover shall consist of income for products and/or services arising from the fair value of the consideration received or receivable for products and/or services provided as part of the operational trading of the Reported Business.
- 8.6 To recognise revenue, Royal Mail must follow the revenue recognition accounting policies adopted by Royal Mail as part of their compliance with the accounting standards used in producing its audited annual statutory accounts.
- 8.7 Revenue shall be assigned directly to the appropriate products and/or services using the relevant information in Royal Mail’s billing systems, and shall be consistently applied across all products and/or services, including stamped and metered mail.
- 8.8 Where it is not possible to directly allocate revenue to products and/or services, Royal Mail must use its best endeavours to find the most appropriate and objective driver to apportion the revenue to product and to document this apportionment of revenue in the Accounting Methodology Manual.
- 8.9 Royal Mail must report the revenue by showing the following separately—
- (a) external revenues relating to the sales of any product or service outside of the Relevant Group; and
 - (b) internal revenues (resulting from Transfer Charges) relating to the sales of any product or service within the Relevant Group.

Volumes

8.10 Royal Mail must follow National Costing Rule 13 as the sole basis for traffic measurement used in the financial statements and information.

Costing

National Costing Methodology

8.11 Royal Mail must—

- (a) ensure that the National Costing Methodology complies with the National Costing Rules set out in this **Section 8**;
- (b) document the National Costing Methodology in the Costing Manual; and
- (c) apply the National Costing Methodology to all the costs of the products and/or services of the Reported Business.

National Costing Rules

National Costing Rule 1: Activity Based Costing ('ABC')

8.12 The National Costing Methodology shall—

- (a) be based on Activity Based Costing;
- (b) identify—
 - (i) all the Activities that the Reported Business performs as part of its Operational Business Processes and Non-operational Business Processes;
 - (ii) all the products and/or services and SPHCCs which the Reported Business provides;
- (c) calculate Activity Costs, using appropriate Resource Drivers, and ensure that the costs of the resources which each Activity consumes are attributed to that Activity; and
- (d) assign Activity Costs, using appropriate Activity Drivers, to all the products and/or services and SPHCCs which are provided as a result of, or are supported by, that particular Activity. The assignment of Activity Costs shall be undertaken in one of the following two ways—
 - (i) attributing, where a direct causal link between an Activity and the relevant products and/or services and SPHCCs can be identified and used as the basis for assigning costs; or
 - (ii) allocating, where no direct causal link can be identified between an Activity and the relevant products and/or services and SPHCCs, and instead a reasonable assumption shall be made to assign the Activity Costs to the relevant products and/or services and SPHCCs.

National Costing Rule 2: Operational reality

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

National Costing Rule 3: Class Costing

First Class mail

- 8.14** Class Costing shall be applied to all Avoidable First Class Costs which meet the following criteria—
- (a) the costs would be avoided, if Royal Mail were not to offer First Class, but the current operational specifications of all other products and/or services were to remain unchanged¹; and
 - (b) the costs exclude any incremental costs which would be incurred, if all Second Class using the First Class Activities were to be processed alongside other Second Class.

Avoidable First Class Costs

- 8.15** All Avoidable First Class Costs shall be attributed only to First Class. Avoidable First Class Costs may include, but is not limited to, the following Cost Types—
- (a) accommodation;
 - (b) shift pay allowance; and
 - (c) plant and machinery non-running time costs.

Second Class mail

- 8.16** Class Costing shall be applied to all Avoidable Second Class Costs which meet the following criteria—
- (a) the costs would be avoided, if Royal Mail were not to offer First Class or Second Class, but the current operational specifications of Third Class were to remain unchanged; and
 - (b) the costs exclude any incremental costs which would be incurred, if all Third Class using First Class or Second Class Activities were to be processed alongside other Third Class.

Avoidable Second Class Costs

- 8.17** All Avoidable Second Class Costs shall be attributed only to Second Class. Avoidable Second Class Costs may include, but is not limited to, the following Cost Types—
- (a) accommodation;

¹ For example, that Second Class mail would continue to be collected and delivered six days a week.

- (b) shift pay allowance; and
- (c) plant and machinery non-running time costs.

National Costing Rule 4: General Ledger costs and Cost Types

8.18 The relevant categories of costs recorded in Royal Mail's financial records (including the financial statements and information required by or under the USPAC Condition), including in the General Ledger, may be aggregated into a set of Cost Types before attributing those costs to Activities. Cost Types shall be selected such that each represents the costs of a single key resource being utilised (e.g. staff, machines, accommodation, vehicles).

National Costing Rule 5: Activities

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

National Costing Rule 6: Resource Drivers

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

8.21 The Resource Driver for each Cost Type shall be—

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

National Costing Rule 7: Products and SPHCCs

8.22 Where applicable, each product and/or service, or a group of similar products and/or services, shall be divided into a range of SPHCCs which identifies, and differentiates between, all the applicable and relevant measured characteristics which affect how processing an item of that product and/or service, or group of products and/or services, incurs costs. The measuring characteristics shall, as a minimum, include the following—

- (a) format (e.g. letter, large letter, packet, etc.);
- (b) class (e.g. First Class, Second Class, Third Class, etc.);
- (c) payment method (e.g. stamped, metered, account, PPI, etc.); and
- (d) handling (e.g. mechanised versus manual, etc.).

8.23 The National Costing Methodology shall apply a cost to the whole range of SPHCCs. For the avoidance of doubt, Royal Mail may use additional measuring characteristics.

National Costing Rule 8: Activity Costs

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

- (a) **Attributable Operational Costs:** Activity Costs within a single Operational Business Process which have a direct causal link to the processing of some or all of the SPHCCs;
- (b) **Attributable Non-operational Costs:** Activity Costs which are directly related to certain products and/or services, but are not part of the Operational Business Processes; and
- (c) **Aggregate Costs:** Activity Costs, or a proportion of an Activity Cost, which are assigned in aggregate to notional SPHCCs and not incorporated into the unit costs of other SPHCCs, for the following reasons—
 - (i) the costs do not follow the handling characteristics which are used to define SPHCCs (see National Costing Rule 7); or
 - (ii) the costs relate to Activities carried out on behalf of other Royal Mail business units for products and/or services that do not result in external revenues attributed to the Reported Business, and do not relate to any of the products and/or services of the Reported Business. These costs shall be included in the costing covered by the National Costing Methodology to ensure reconciliation of costs and data integrity.
- (d) Overheads, which shall be classed either—
 - (i) if the Activity Costs relate to one or more Operational Business Processes which do not have a direct causal link to any of the SPHCCs being processed, as Pipeline Overheads; or
 - (ii) if the Activity Costs relate to Non-operational Business Processes, as General Overheads.

National Costing Rule 9: Activity Drivers

8.25 The assignment of Activity Costs to SPHCCs shall be undertaken using appropriate Activity Drivers which shall be identified and quantified based on the following rules—

- (a) each Activity Cost shall be assigned to all the SPHCCs which that Activity directly contributes to, or indirectly supports; and
- (b) Activity Drivers shall reflect the relative proportions of the workload which the totality of all the units of each SPHCC creates for the related Activity.

8.26 Three types of Activity Drivers shall be used—

- (a) **Weighted Volume Drivers** (see National Costing Rule 10): These drivers represent the relative workload of processing all the units of each SPHCC taking

into account the proportion of the total number of units which consume the relevant Activity.

- (b) **Other Drivers** (see National Costing Rule 11): These drivers shall be used for costs which are directly linked to a factor other than mail traffic in the Pipeline (e.g. certain network distribution costs which depend on vehicle runs).
- (c) **EPMU** (see National Costing Rule 12): EPMU methods which allocate costs based on the relative proportions of the costs which have already been assigned to the relevant SPHCCs.

8.27 **Table 8** below shows how each type of Activity Cost shall be assigned to SPHCC (which is illustrated by a tick in the Table).

Table 8: Activity Cost assignment to SPHCC

	<u>Attributable Operational Costs and Attributable Non-operational Costs</u>	<u>Overheads</u>	<u>Aggregate Costs</u>
<u>Weighted Volume Drivers</u>	✓		
<u>Other Drivers</u>	✓		✓
<u>EPMU</u>		✓	

National Costing Rule 10: Weighted Volume Drivers

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

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

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

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

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

- (c) size: appropriate operational data must be used.
- 8.31** Royal Mail must carry out for each Financial Year a review to ascertain which Proportional Factors and Weighting Factors need to be reviewed and, if necessary, must update them to ensure that they continue to reflect operational reality accurately.
- 8.32** To identify the Proportional Factors and the Weighting Factors which may need adjusting referred to in **§8.31**, Royal Mail must consider what (if any) changes have occurred during the Financial Year in question in the following areas—
- (a) working practices;
 - (b) technology; and
 - (c) SPHCCs mix (relative volumes).
- 8.33** Royal Mail may carry out ad hoc event-driven reviews and updates if necessary.

National Costing Rule 11: Other Drivers

- 8.34** Other Drivers shall be used for costs (certain Attributable Operational Costs and all Attributable Non-operational Costs and Aggregate Costs) which are directly linked to a factor other than mail traffic in the Pipeline.
- 8.35** Other Drivers shall be defined in a way which appropriately reflects the causal link with that factor.

National Costing Rule 12: Equi-Proportional Mark-Up ('EPMU')

- 8.36** EPMU shall be used for allocating Overheads 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.
- 8.37** EPMU shall be applied for each of the Activity Costs within Overheads separately, and be based only on the proportions of the Attributable Operational Costs and the Attributable Non-operational Costs, once they have been attributed. EPMU applications shall not take account of any other costs already allocated using EPMU ("non-nested" approach).

National Costing Rule 13: Traffic measurement

- 8.38** Royal Mail must use the Revenue derived method of traffic measurement, whereby the traffic volume for products and/or services is calculated by dividing the total revenue of the products and/or services by the average unit price of them, in the National Costing Methodology.
- 8.39** The measurement method used for each SPHCC shall be applied consistently within the National Costing Methodology and over time.

National Costing Rule 14: Operational data and sampling

- 8.40** All operational data used by the National Costing Methodology shall be regularly reviewed and, where necessary, updated to ensure the accuracy of costing and its consistency with the operational reality (see National Costing Rule 2).
- 8.41** Royal Mail must ensure that all sampling used by the National Costing Methodology is applied by a qualified professional statistician as such sampling must be based on statistical techniques regarded as appropriate for such purposes. The reference to a “qualified professional statistician” is a reference to a person with the relevant statistical knowledge and expertise, who shall have a qualification in statistics from a recognised professional body, such as the Royal Statistical Society in the United Kingdom.

National Costing Rule 15: Data integrity

- 8.42** The integrity of financial and operational data used for the National Costing Methodology shall be preserved by adequate checks and controls, which shall include reconciliation of total cost data at appropriate points in the National Costing Methodology.
- 8.43** The total amount of input costs relating to any element of the National Costing Methodology shall be equal to the total amount of output costs relating to that element. In particular, the following total figures shall be reconciled to each other—
- (a) the total costs in the General Ledger;
 - (b) the total Activity Costs; and
 - (c) the total costs of all SPHCCs.

Zonal Costing Methodology

- 8.44** Royal Mail must—
- (a) ensure that the Zonal Costing Methodology complies with the Zonal Costing Rules set out in this **Section 8**;
 - (b) document the Zonal Costing Methodology in the Costing Manual; and
 - (c) apply the Zonal Costing Methodology where Royal Mail uses different prices for products and/or services falling within the Reported Business for different parts of the United Kingdom, but only where the provision of such products and/or services are subject to obligations under regulatory conditions (as defined by section 28(2) of the Act).

Zonal Costing Rules

Zonal Costing Rule 1: Activity Based Costing ('ABC')

- 8.45** The National Costing Rule 1 shall apply and the reference in that Rule to the National Costing Methodology is to be read as a reference to Zonal Costing Methodology.

Zonal Costing Rule 2: Operational reality

8.46 The National Costing Rule 2 shall apply and references in that Rule to—

- (a) the National Costing Methodology is to be read as a reference to Zonal Costing Methodology; and
- (b) National Costing Rule 3 is to be read as a reference to Zonal Costing Rule 3.

Zonal Costing Rule 3: Class costing

8.47 The National Costing Rule 3 shall apply.

Zonal Costing Rule 4: Zonal General Ledger costs and Cost Types

8.48 Non-staff costs attributed to the Delivery Office shall be broken down by Cost Type. (For the avoidance of doubt, any differences relating to a geographic area in these Cost Types shall be included in the Zonal Costing Methodology in accordance with Zonal Costing Rule 16.) Subject to that qualification, the National Costing Rule 4 shall apply.

Zonal Costing Rule 5: Activities

8.49 The National Costing Rule 5 shall apply.

Zonal Costing Rule 6: Resource Drivers

8.50 The National Costing Rule 6 shall apply.

Zonal Costing Rule 7: Zonal Products and SPHCCs

8.51 Royal Mail must attribute costs to products and/or services falling within the Reported Business referred to in **§8.44(c)** by sub-dividing them into SPHCCs in accordance with the following measured characteristics—

- (a) format (e.g. letter, flat, packet, etc.);
- (b) class (e.g. First Class, Second Class, Third Class, etc.); and
- (c) payment method (e.g. stamped, metered, account, PPI, etc.); and
- (d) handling (e.g. mechanised versus manual, etc.).

8.52 For the avoidance of doubt, Royal Mail may use additional measuring characteristics, provided that the measured characteristics referred to in **§8.51** are used.

Zonal Costing Rule 8: Activity Costs

8.53 The National Costing Rule 8 shall apply and references in that Rule to—

- (a) the National Costing Methodology is to be read as a reference to Zonal Costing Methodology; and
- (b) National Costing Rule 3 is to be read as a reference to Zonal Costing Rule 7.

Zonal Costing Rule 9: Activity Drivers

8.54 The National Costing Rule 9 shall apply and references in that Rule to—

- (a) the National Costing Methodology is to be read as a reference to Zonal Costing Methodology;
- (b) National Costing Rule 10 is to be read as a reference to Zonal Costing Rule 10;
- (c) National Costing Rule 11 is to be read as a reference to Zonal Costing Rule 11; and
- (d) National Costing Rule 12 is to be read as a reference to Zonal Costing Rule 12.

Zonal Costing Rule 10: Weighted Volume Drivers

8.55 The National Costing Rule 10 shall apply.

Zonal Costing Rule 11: Other Drivers

8.56 The National Costing Rule 11 shall apply.

Zonal Costing Rule 12: Equi-proportional Mark-up ('EPMU')

8.57 The National Costing Rule 12 shall apply.

Zonal Costing Rule 13: Zonal Traffic measurement

8.58 The National Costing Rule 13 shall apply and references in that Rule to the National Costing Methodology are to be read as references to Zonal Costing Methodology.

8.59 With the commencement of the second Financial Quarter of the first Financial Year, Royal Mail must ensure that any MCS sampling used for estimating costs in relation to Zones for downstream services must include all volumes associated with the downstream services. References to downstream services for that purpose are references to services relating to the final sortation conducted at the Inward Mail Centre and Delivery Offices, and the conveyance of mail items from the Inward Mail Centre to final delivery destination.

Zonal Costing Rule 14: Zonal Operational data and sampling

8.60 Subject to ~~§§8.61-8.63~~, the National Costing Rule 14 shall apply and references in that Rule to—

- (a) the National Costing Methodology is to be read as a reference to Zonal Costing Methodology; and
- (b) National Costing Rule 2 is to be read as a reference to Zonal Costing Rule 2.

8.61 Royal Mail must review its operational data for the estimation of costs of products and/or services falling within the Reported Business referred to in **§8.44(c)**. In addition, Royal Mail must update its estimation of such costs to ensure that it is consistent with—

- (a) the updated values of the explanatory variables² of the relevant cost functions (e.g. postcode sector volumes, number of delivery points, area, volume delivered per delivery point and proportion of business delivery);
- (b) the updated variable coefficients³ of the relevant cost functions (updated variable coefficients⁴);
- (c) the updated mapping of postcode sectors, Delivery Offices, and Inward Mail Centres to Zones; and
- (d) the updated differentials in costs for each Zone arising from geographic differentials in pay rates and other input costs.

Except for the first Financial Year, Royal Mail must comply with these obligations before the start of every Financial Year. In relation to the first Financial Year, Royal Mail must comply with these obligations by the end of that Financial Year.

- 8.62** Where regressions⁵ are used to estimate the costs referred to in **§8.61**, Royal Mail must include in the Costing Manual information demonstrating that the regressions⁶ are statistically valid. Royal Mail must ensure that such regressions are derived by a qualified professional econometrician using data in accordance with the Zonal Costing Rules. The reference to a “qualified professional econometrician” is a reference to a person with the relevant knowledge and expertise in econometrics, who is qualified in the application of mathematics and statistical methods to economic data.
- 8.63** Royal Mail must ensure that all sampling used for the estimation of costs referred to in **§8.61** is applied by a qualified professional statistician as such sampling must be based on statistical techniques regarded as appropriate for such purposes. The reference to a “qualified professional statistician” is a reference to a person with the relevant statistical knowledge and expertise, who shall have a qualification in statistics from a recognised professional body, such as the Royal Statistical Society in the United Kingdom. Royal Mail must include in the Costing Manual information demonstrating that the sampling is statistically valid.

Zonal Costing Rule 15: Zonal Data consistency

- 8.64** The National Costing Rule 15 shall apply and references in that Rule to the National Costing Methodology are to be read as references to Zonal Costing Methodology.
- 8.65** Royal Mail must also ensure that the following figures are reconciled to each other—
- (a) any estimated costs for the postcode sectors served by each Delivery Office shall be reconciled with the total relevant costs of that Delivery Office; and

² The reference to an explanatory variable is a reference to a variable which is used to explain or to predict changes in the value of another variable.

³ The reference to a variable coefficient is a reference to figure multiplied with a variable or an unknown quantity in an algebraic formula.

⁴ *Ibid.*

⁵ The reference to a regression is a reference to a relationship between the mean value of a random variable and the corresponding values of one or more independent variables.

⁶ *Ibid.*

- (b) geographically de-averaged costs used for estimating costs in relation to Zones shall be reconciled with the corresponding costs to be derived under National Costing Rule 15.

Zonal Costing Rule 16: Geographic cost reflectivity

- 8.66** Royal Mail must ensure that its estimation of costs in relation to Zones includes all material differences between costs that vary by each geographical area encompassed by the Zone in question.

Zonal Costing Rule 17: Postcode sector cost estimation

- 8.67** Royal Mail must, where it uses estimates of costs in relation to postcode sectors as inputs for estimating costs in relation to Zones, use actual postcode sector data.

Zonal Costing Rule 18: Amendment of Zones

- 8.68** Royal Mail must comply with the following rules in relation to defining and amending Zones—
- (a) for the first Financial Year, the total number of Zones shall not exceed four; and
 - (b) Royal Mail must review the boundaries of Zones and Royal Mail may define new or additional Zones, provided that Zones having the similarly estimated unit costs shall always be treated as part of the same Zone.

Except for the first Financial Year, Royal Mail must comply with the obligation in **§8.68(b)** before the start of every Financial Year. In relation to the first Financial Year, Royal Mail must comply with that obligation by the end of that Financial Year.

Zonal Costing Rule 19: Reconciliation of zonal and national cost estimates

- 8.69** Royal Mail must review changes in its estimation of costs in relation to Zones to ensure that—
- (a) in deriving each unit cost estimate, the estimated total postcode sector volumes and estimated total volumes in relation to Zones both equal the total national volumes derived under National Costing Rule 15, and
 - (b) the average unit costs in relation to Zones derived from the volumes referred to in **§8.69(a)** remains equal to the corresponding average unit costs derived under the National Costing Methodology.

Except for the first Financial Year, Royal Mail must comply with these obligations before the start of every Financial Year. In relation to the first Financial Year, Royal Mail must comply with these obligations by the end of that Financial Year.

Exceptional costs

- 8.70** Royal Mail must account for all exceptional costs arising from the trading operations of Royal Mail relevant to the Reported Business which are not already included in the National Costing Methodology. Royal Mail must account for such exceptional costs in the annual income statements for the Reported Business. Examples of such

exceptional costs are the costs of Royal Mail's "Colleague Share" share scheme, redundancy and restructuring costs.

- 8.71** Royal Mail must allocate the exceptional costs referred to in **§8.70** to the Reported Business by using an appropriate cost driver. The basis of the allocation concerned shall be set out in the Accounting Methodology Manual.

Transfer Charges

- 8.72** Royal Mail must ensure that the following types of Transfer Charges are applied in compliance with the rules set out in **§§8.73-8.80**—

- (a) Transfer Charges between the Relevant Group and the rest of RMH Group; and
- (b) Transfer Charges between the Reported Business and the rest of the Relevant Group.

For **§8.72(a) and (b)**, a Transfer Charge shall be calculated on an arm's length basis for each product and/or service provided. For the avoidance of doubt, the Transfer Charges between the Four FREs within the Reported Business shall be applied in accordance with the relevant rules set out in **Section 9** concerning Transfer Prices.

- 8.73** Royal Mail must set a Transfer Charge for the provision of each product and/or service—

- (a) between the Relevant Group and the rest of RMH Group; and
- (b) between the Reported Business and the rest of the Relevant Group.

- 8.74** The consolidated income statement for the Relevant Group shall include the Transfer Charges between the Relevant Group and the rest of RMH Group.

- 8.75** All income statements for the Reported Business shall include the Transfer Charges between the Reported Business and the rest of Relevant Group.

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

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

- 8.77** Royal Mail is not required to set a Transfer Price for the services provided by central finance, human resources, and purchasing and customer management services which are used by UKLPI and are managed centrally.

- 8.78** Royal Mail must apply the rule referred to in **§8.76(c)** in relation to any use of its vehicles, where the use of vehicles is shared between the Reported Business and the rest of the Relevant Group.
- 8.79** Royal Mail must provide a statement setting out all Transfer Charges as part of the notes to the annual and quarterly income statements.
- 8.80** Royal Mail must include in the Accounting Methodology Manual a detailed description of the approach and the assumptions used for the calculation of the Transfer Charges.

Annual capital employed statement

Introduction

- 8.81** Royal Mail must ensure that the preparation of the annual capital employed financial statement for the Reported Business complies with the rules set out in **§§8.82-8.120**.
- 8.82** The annual capital employed statement shall include operational assets and net working capital (net value of current assets and current liabilities).
- 8.83** The annual capital employed statement shall represent the closing balances of the items as at the end of the Financial Year to which the annual capital employed statement relates.
- 8.84** All the assets and liabilities which are wholly related to the operations and trading of products and services of the Reported Business shall be included in the annual capital employed statement.
- 8.85** Those assets and liabilities which are partly related to the operations and trading of products and services of the Reported Business shall be apportioned to the Reported Business in compliance with the rules set out in **§§8.86-8.120**.

Non-current assets

- 8.86** Royal Mail must include in the annual capital employed statement the non-current assets specified in (and in the manner prescribed in) **§§8.87-8.97**.

Fixed assets (property, plant and equipment)

- 8.87** The value of the fixed assets shall be based on the historical costs and depreciation records kept in the Fixed Asset Register.
- 8.88** The value of the fixed assets shall be consistent with the values reported in the statutory accounts and the depreciation costs calculated by the National Costing Methodology.
- 8.89** Royal Mail must include a note to the annual capital employed statement setting out the main asset categories together with their associated NBV, costs and depreciations.
- 8.90** The allocation of fixed assets which are wholly or partly used by the products and/or services of the Reported Business shall be based on the relative extent to which those assets are used by the products and/or services concerned, where applicable

consistent with the allocation of corresponding depreciation charges in the National Costing Methodology.

- 8.91** If a Transfer Price is charged to the Reported Business by the rest of Royal Mail for the use of a fixed asset, that fixed asset shall be excluded from the annual capital employed statement of the Reported Business.
- 8.92** Any internal transfer of fixed assets shall be disclosed in the notes to the annual capital employed statement.

Intangible assets

- 8.93** The categorisation of intangible assets for the Reported Business shall be consistent with the categorisation in the Royal Mail's statutory accounts.
- 8.94** Royal Mail is not required to include goodwill in intangible assets.
- 8.95** The allocation of software, master franchise licences and customer listing assets shall be based on the relative extent to which such assets are used by the products and/or services of the Reported Business.

Other non-current assets

- 8.96** Subject to **§8.97**, Royal Mail may include in aggregate other non-current assets.
- 8.97** Royal Mail must include a note to the annual capital employed statement setting out the main items included in other non-current assets.

Current assets

- 8.98** Royal Mail must include in the annual capital employed statement the current assets specified in (and in the manner prescribed in) **§§8.99-8.110**.

Trade and other receivables

- 8.99** Trade and other receivables shall include prepayments.
- 8.100** Prepayments shall be allocated based on the allocation of the costs of the associated products and/or services.
- 8.101** Trade receivables shall be allocated based on the revenues of the products and/or services to which they relate.
- 8.102** Royal Mail must include a note to the annual capital employed statement setting out details of the amount of any bad debt provisions allocated to trade receivables.
- 8.103** Royal Mail may include in aggregate other receivables, but Royal Mail must include a note to the annual capital employed statement setting out the main items included in other receivables.

Cash and cash equivalent

- 8.104** The categorisation of cash and cash equivalents for the Reported Business shall include items that are maintained for the purpose of financing business operations and to enable trading of the products and/or services in the Reported Business.

- 8.105** Overdrafts shall be netted off against cash and cash equivalents.
- 8.106** Cash and cash equivalents that are managed centrally within the Relevant Group shall be allocated to the Reported Business to identify the cash requirements for the purpose of financing the operations and trading of the products and/or services of the Reported Business.
- 8.107** The cash requirements of the Reported Business shall be determined based on the operating cash flows and capital expenditure commitments identified to the Reported Business by the rules in these Guidelines.
- 8.108** The cash requirements of the Reported Business may be estimated based on the actual operating and capital expenditures.
- 8.109** Royal Mail must include a note to the annual capital employed statement setting out the main items included in cash and cash equivalents.

Other current assets

- 8.110** Royal Mail may include in aggregate other items in other current assets, but Royal Mail must include a note to the annual capital employed statement setting out the main items included in other current assets.

Current liabilities

- 8.111** Royal Mail must include in the annual capital employed statement at least the current liabilities specified in (and in the manner prescribed in) **§§8.112-8.120**.

Trade and other payables

- 8.112** The allocation of trade payables between the Reported Business and the rest of Royal Mail shall be based on the allocation of the costs of the Activities, products and/or services to which they relate.
- 8.113** Trade and other payables shall include deferred income. The allocation of deferred income between the Reported Business and the rest of Royal Mail shall be based on the allocation of the corresponding income.
- 8.114** Royal Mail may include in aggregate other items in other payables, but Royal Mail must include a note to the annual capital employed statement setting out the main items included in other payables.

Financial liabilities

- 8.115** Financial liabilities shall include interest bearing loans (with less than a year maturity), leases and derivative financial liabilities.
- 8.116** The allocation of financial liabilities between the Reported Business and the rest of the Relevant Group shall be carried out as follows—
- (a) An analysis of the loans shall be undertaken to identify whether the loans have been obtained in relation to a specific asset or group of assets, in which case, the loan shall be allocated based on the allocation of the corresponding asset or group of assets. If the loan does not relate to a specific asset or group of assets, it must be allocated to the Reported

Business using the same basis used for the allocation of cash and cash equivalents.

- (b) The allocation of lease liabilities to the Reported Business shall be based on the allocation of the assets to which the associated leases relate.

8.117 Royal Mail must include a note to the annual capital employed statement setting out the details of the facilities (for example, due date, interest rates, etc.).

Provisions and other current liabilities

8.118 The allocation of provisions and other current liabilities to the Reported Business shall be based on the costs and Activities to which those provisions and other current liabilities relate.

8.119 Where possible, allocation of provisions and other current liabilities to the Reported Business shall be based on the allocation of related costs and activities to the Reported Business.

8.120 Royal Mail may include in aggregate provisions and other current liabilities, but Royal Mail must include a note to the annual capital employed statement setting out the main items included in provisions and other current liabilities.

Annual cash flow statement

8.121 Royal Mail must ensure that the preparation of the annual cash flow statement for the Reported Business complies with the rules set out in **§§8.122-8.123**.

8.122 The annual cash flow statement shall include all operational cash flows of the Reported Business.

8.123 The allocation of cash flow items to the Reported Business shall be consistent with the allocation of costs and revenues in the corresponding income statements, or the allocation of assets and liabilities in the corresponding capital employed statements.

Section 9: Separation Methodology

Introduction

- 9.1 Royal Mail must ensure that the Regulatory Accounting Methodology complies with the detailed rules set out in this **Section 9**, which relate to the separation, allocation and apportionment of costs, revenues, assets and cash flows between the Four FREs and product groups within the Reported Business.

Annual & quarterly income statements

- 9.2 Royal Mail must ensure that its preparation of any income statement for the Four FREs complies with the rules set out in **§§9.3-9.15**.

Levels of preparation

- 9.3 Royal Mail must ensure, for the purposes of USPAC 1.5.2(a) and (d), that annual income statements and annual end to end income statements are prepared to the level of EBIT.
- 9.4 Royal Mail must ensure, for the purposes of USPAC 1.5.2(b), (c) and (e), that quarterly income statements, annual reconciliations of such income statements and quarterly end to end income statements are prepared to the level of operating profit/(loss) before exceptional items.

Apportionment of revenues

- 9.5 References to “**revenue**” in this **Section 9** are references to external and internal turnover used in the preparation of any income statement. External and internal turnover shall consist of income for products and/or services arising from the fair value of the consideration received or receivable for products and/or services provided as part of the operational trading of the Four FREs.
- 9.6 Revenues shall be allocated to products and/or services in accordance with **Section 7** of these Guidelines.

Apportionment of costs

- 9.7 Costs shall be allocated across the Four FREs within the Reported Business as follows—
- (a) All SPHCCs in the National Costing Methodology shall be mapped to one or more of the Four FREs.
 - (b) The costs which are within the scope of the National Costing Methodology shall be allocated to the Four FREs in accordance with the National Costing Methodology. Where SPHCCs are mapped to more than one of the Four FREs, the basis of the allocation of the SPHCC costs concerned shall be included in the National Costing Methodology and set out in the Costing Manual.
 - (c) The exceptional costs referred to in **§8.70** shall be allocated to the Four FREs using an appropriate underlying driver. The basis of the allocation concerned shall be set out in the Accounting Methodology Manual.

Transfer Pricing between separated entities

- 9.8** Where one of the Four FREs provides a product or service to one or more other of the Four FREs, Royal Mail must determine a Transfer Price for that product or service.

Transfer Pricing across Line A

- 9.9** Where products and/or services within the USO Products Entity use the services whose costs are allocated to the End-to-end Only Products Entity, the Transfer Prices shall be determined by applying a mark-up of 10% to the FAC costs of the products and/or services concerned of the End-to-end Only Products Entity.

Transfer Pricing across Line B

- 9.10** Where products and/or services within the USO Products Entity and the non-USO Products Entity use the services whose costs are allocated to Downstream Services Entity, the Transfer Prices shall be determined in compliance with the rules set out in §§9.11-9.15.

Equivalence pricing

- 9.11** Where there are appropriate comparable Access products and/or services provided by Royal Mail to external customers, Royal Mail must apply the equivalence pricing approach referred to **§9.12** in determining Transfer Prices.

- 9.12** The equivalence pricing approach means—

- (a) An appropriate comparable Access product and/or service shall be identified for the internal product and/or service for which the Transfer Price is to be determined.
- (b) The operational and Activity differences between the internal product and/or service for which the Transfer Price is to be determined, and the appropriate comparable product or service shall be identified.
- (c) The FAC differences of the operational and Activity differences referred to in **§9.12(b)** above shall be identified in a manner consistent with the National Costing Methodology.
- (d) The Transfer Price shall be determined as the sum of the price of the appropriate comparable Access product and/or service, the FAC differences referred to in **§9.12(c)** plus a mark up of 10% on those FAC differences.

- 9.13** Royal Mail may use prices for First Class Access products and/or services, provided that the equivalence pricing approach referred to **§9.12** is followed and that they have—

- (a) sufficient sales volumes to form a statistically valid basis for the calculation of the FAC of the product and/or service in question; and
- (b) material sales volumes.

Where Royal Mail wishes to use prices for First Class Access products and/or services but is unable to satisfy **§9.13(a) and (b)**, Royal Mail must use the price for the most comparable Second Class Access products and/or services.

Cost-plus pricing

- 9.14** 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 a mark up of 10% on that FAC.

Grouping

- 9.15** Single Transfer Prices may be applied to groups of products and/or services, provided that all of the following requirements are met—
- (a)** in determining such groups, Royal Mail must only include products and/or services in a group that fall within the same market definition as out in the following market studies—
 - (i)** Market study decisions on wholesale & packets markets published in November 2010⁷.
 - (ii)** Market study proposals on retail markets published in March 2011.
 - (iii)** Market study proposals on international outbound mail market published in May 2011.
 - (b)** in determining such groups, Royal Mail must not include in a group products and/or services that have materially different handling characteristics as defined in the Costing Manual.
 - (c)** in determining such groups, Royal Mail must not include in a group products and/or services that are subject to different obligations under regulatory conditions (as defined by section 28(2) of the Act).

Annual capital employed statement

- 9.16** Royal Mail must ensure that the preparation of the annual capital employed statements for each of the Four FREs complies with the rules set out below set out in **§§9.17-9.39**.
- 9.17** The format of the annual capital employed statements for each of the Four FREs shall be the same as that for the annual capital employed statement provided for the Reported Business as a whole.
- 9.18** The annual capital employed statement for each of the Four FREs shall represent the closing balances of the items as at the end of the Financial Year to which the annual capital employed statement for each of the Four FREs relates.

⁷<http://www.nationalarchives.gov.uk/webarchive/communications-media.htm>

9.19 Royal Mail must ensure that the allocation of the annual capital employed statement items to the Four FREs is consistent with—

- (a) the allocation of costs and revenues in the corresponding income statements of the Four FREs; and
- (b) the allocation of annual capital employed statement items to the Reported Business as a whole,

but where there is a conflict between the rules in **§9.19(a) and (b)**, Royal Mail must give priority to the rule in **§9.19(a)**.

Non-current assets

9.20 Royal Mail must include in the annual capital employed statement for each of the Four FREs the non-current assets specified in (and in the manner prescribed in) **§§9.21-9.24**.

Fixed assets (property, plant and equipment)

9.21 The allocation of each fixed asset to the Four FREs shall be consistent with the extent to which the fixed asset is used by the Activities, products and/or services identified to each of the Four FREs. If a fixed asset is used solely by the Activities, products and/or services identified to one of the Four FREs, the fixed asset shall be allocated to that entity. Where a fixed asset is used by the Activities, products and/or services identified to more than one of the Four FREs, the value of the fixed asset concerned shall be apportioned between the relevant Four FREs using an appropriate basis which is consistent with the basis for apportioning depreciation costs in the National Costing Methodology.

9.22 The basis of allocation of fixed assets to the Four FREs shall also be consistent with the basis of allocation of fixed assets to the Reported Business as a whole.

9.23 Royal Mail must include a note to the annual capital employed statement for each of the Four FREs setting out the main asset categories together with their associated NBV, costs and depreciations.

Intangible assets

9.24 The categorisation of intangible assets for the Four FREs shall be consistent with the categorisation used in the annual capital employed statement of the Reported Business as a whole.

Current assets

9.25 Royal Mail must include in the annual capital employed statement for each of the Four FREs the current assets specified in (and in the manner prescribed in) **§§9.26-9.31**.

Trade and other receivables

9.26 Trade and other receivables shall include prepayments.

9.27 Prepayments shall be allocated to the Four FREs based on the allocation of the costs of the associated products and/or services.

- 9.28** Trade receivables shall be allocated to the Four FREs based on the revenues of the products and/or services to which they relate.

Cash and cash equivalent

- 9.29** Overdrafts shall be netted off against cash and cash equivalents.
- 9.30** Cash and cash equivalents must be allocated to each of the Four FREs in accordance with their cash requirements for the purpose of financing the operations and trading of the products and/or services of the entity in question.
- 9.31** The cash requirements of each of the Four FREs may be estimated based on the actual operating and capital expenditures allocated to each of the Four FREs.

Current liabilities

- 9.32** Royal Mail must include in the annual capital employed statement for each of the Four FREs the current liabilities specified in (and in the manner prescribed in) §§9.33-9.39.

Trade and other payables

- 9.33** The allocation of trade payables shall be based on the allocation of the costs of the Activities or products and/or services to which they relate.
- 9.34** Trade and other payables shall include deferred income. The allocation of deferred income shall be based on the allocation of the corresponding income.

Financial liabilities

- 9.35** Financial liabilities shall include interest bearing loans (with less than a year maturity), leases and derivative financial liabilities.
- 9.36** The allocation of financial liabilities between the Four FREs shall be carried out as follows—
- (a)** An analysis of the loans must be undertaken to identify whether the loans have been obtained in relation to a specific asset or asset group, in which case the loan shall be allocated to the Four FREs based on the allocation of the corresponding asset or asset group to the Four FREs. If the loan relates to the Reported Business as a whole, it shall be allocated to all the Four FREs using the same basis used for the allocation of cash and cash equivalents.
 - (b)** The allocation of lease liabilities to the Four FREs shall be based on the allocation of the assets to which the associated leases relate.
- 9.37** Royal Mail must include a note to the annual capital employed statement setting out the details of the facilities (for example, due date, interest rates, etc.).

Provisions and other current liabilities

- 9.38** The allocation of provisions and other current liabilities to the Four FREs shall be based on the costs and the Activities to which the provisions and other current liabilities relate.

- 9.39** Royal Mail may include in aggregate provisions and other current liabilities for each the Four FREs, but Royal Mail must include a note to the annual capital employed statement setting out the main items included in provisions and other current liabilities.

Annual cash flow statement

- 9.40** Royal Mail must ensure that the preparation of the annual cash flow statements for each of the Four FREs complies with the rules set out below set out in **§§9.41-9.42**.
- 9.41** The annual cash flow statement shall include all operational cash flows of the Four FREs.
- 9.42** Royal Mail must ensure that the allocation of the annual cash flow statement items to the Four FREs is consistent with—
- (a)** the allocation of costs and revenues in the corresponding income statements of the Four FREs or the allocation of assets and liabilities in the corresponding capital employed statements of the Four FREs; and
 - (b)** the allocation of annual cash flow statement items to the Reported Business as a whole,

but where there is a conflict between the rules in **§9.42(a) and (b)**, Royal Mail must give priority to the rule in **§9.42(a)**.

Section 10: Auditing

10.1 For the purpose of USPAC 1.3.4, Royal Mail must secure an appropriate audit opinion by a Qualified Independent Auditor in respect of the financial statements and information specified in **Column 1 of Table 9** on the basis specified in **Column 2 of that Table**.

Table 9: Auditing bases directed for the purpose of USPAC 1.3.4

<i>Column 1: Financial statement/information referred to in USPAC 1.3.1</i>		<i>Column 2: Auditing basis</i>
USPAC 1.3.1(a)	<u>consolidated</u> income statement	<u>PPIA</u>
USPAC 1.3.1(b)	<u>consolidated</u> balance sheet statement	<u>PPIA</u>
USPAC 1.3.1(c)	<u>consolidated</u> cash flow statement	<u>PPIA</u>
USPAC 1.3.1(d)	<u>consolidated</u> cash flow projection statement	<i>Not applicable</i>
USPAC 1.3.1(e)	<u>Strategic Business Plan</u>	<i>Not applicable</i>
USPAC 1.3.1(f)	Reconciliation of <u>consolidated</u> income, balance sheet and cash flow statements with the <u>consolidated</u> accounts of <u>RMH plc</u>	<u>PPIA</u>
USPAC 1.3.1(g)	<u>Annual Budget</u>	<i>Not applicable</i>

10.2 For the purpose of USPAC 1.4.4, Royal Mail must secure an appropriate audit opinion by a Qualified Independent Auditor in respect of the financial statements and information specified in **Column 1 of Table 10** on the basis specified in **Column 2 of that Table**.

Table 10: Auditing bases directed for the purpose of USPAC 1.4.4

<i>Column 1: Financial statement/information referred to in USPAC 1.4.1</i>		<i>Column 2: Auditing basis</i>
USPAC 1.4.1(a)	Annual income statement	<u>PPIA</u>
USPAC 1.4.1(b)	Quarterly income statement	<i>Not applicable</i>
USPAC 1.4.1(c)	Annual reconciliation of statements/information specified in USPAC 1.4.1(c)	<i>Not applicable</i>
USPAC 1.4.1(d)	Annual reconciliation of statements/information specified in USPAC 1.4.1(d)	<u>PPIA</u>

USPAC 1.4.1(e)	Annual capital employed statement	<u>PPIA</u>
USPAC 1.4.1(f)	Annual reconciliation of statements/information specified in USPAC 1.4.1(f)	<u>PPIA</u>
USPAC 1.4.1(g)	Annual cash flow statement	<u>PPIA</u>
USPAC 1.4.1(h)	Annual reconciliation of statements/information specified in USPAC 1.4.1(h)	<i>Not applicable</i>
USPAC 1.4.1(i)	Annual product profitability statement	<u>PPIA</u>
USPAC 1.4.1(j)	Quarterly product profitability statement	<i>Not applicable</i>
USPAC 1.4.1(k)	Monthly revenue and volume information statement	<i>Not applicable</i>
USPAC 1.4.1(l)	<u>Monthly Management Report</u>	<i>Not applicable</i>

10.3 For the purpose of USPAC 1.5.5, Royal Mail must secure an appropriate audit opinion by a Qualified Independent Auditor in respect of the financial statements and information specified in **Column 1 of Table 11** on the basis specified in **Column 2 of that Table**.

Table 11: Auditing bases directed for the purpose of USPAC 1.5.5

Column 1: Financial statement/information referred to in USPAC 1.5.2		Column 2: Auditing basis
USPAC 1.5.2(a)	Annual income statement	<u>PPIA</u>
USPAC 1.5.2(b)	Quarterly income statement	<i>Not applicable</i>
USPAC 1.5.2(c)	Annual reconciliation of statements/information specified in USPAC 1.5.2(c)	<i>Not applicable</i>
USPAC 1.5.2(d)	Annual end to end income statement	<u>PPIA</u>
USPAC 1.5.2(e)	Quarterly end to end income statement	<i>Not applicable</i>
USPAC 1.5.2(f)	Annual capital employed statement	<u>PPIA</u>
USPAC 1.5.2(g)	Annual cash flow statement	<u>PPIA</u>

Appendix 1

Pro-formas

Figure 1: Consolidated income statement and reconciliation to RMH plc consolidated accounts

Consolidated income statement annual

	Relevant Group	POL and other reconciling items	RMH plc consolidated
Continuing operations			
Turnover	xxx	xxx	xxx
Network Subsidy Payment	xxx	xxx	xxx
Revenue	xxx	xxx	xxx
People costs excluding ColleagueShare and restructuring costs	xxx	xxx	xxx
Distribution and conveyance operating costs	xxx	xxx	xxx
Other operating costs	xxx	xxx	xxx
Share of post tax profit/(loss) from joint ventures and associates	xxx	xxx	xxx
Operating profit/(loss) before exceptional items	xxx	xxx	xxx
Modernisation costs – operating exceptional items	xxx	xxx	xxx
ColleagueShare – ‘share’ scheme value	xxx	xxx	xxx
dividend	xxx	xxx	xxx
business transformation	xxx	xxx	xxx
Restructuring costs	xxx	xxx	xxx
Impairments	xxx	xxx	xxx
Operating profit/(loss) after modernisation costs before other operating exceptional items	xxx	xxx	xxx
Other operating exceptional items	xxx	xxx	xxx
Operating profit/(loss)	xxx	xxx	xxx
Profit on disposal of property, plant and equipment	xxx	xxx	xxx
Profit on disposal of associate company	xxx	xxx	xxx
Profit/(Loss) before financing and taxation	xxx	xxx	xxx
Finance costs	xxx	xxx	xxx
Finance income	xxx	xxx	xxx
Net pensions interest	xxx	xxx	xxx
Profit/(Loss) before taxation	xxx	xxx	xxx
Taxation charge	xxx	xxx	xxx
Profit/(Loss) for the financial year from continuing operations	xxx	xxx	xxx
(Loss)/profit attributable to:			
Equity holder of the parent company	xxx	xxx	xxx
Non-controlling interest	xxx	xxx	xxx

Figure 2: Consolidated balance sheet statement and reconciliation to RMH plc consolidated accounts

Consolidated balance sheet statement annual

	Relevant Group	POL and other reconciling items	RMH plc consolidated
Non-current assets			
Property, plant and equipment	xxx	xxx	xxx
Leasehold land payment	xxx	xxx	xxx
Goodwill	xxx	xxx	xxx
Intangible assets	xxx	xxx	xxx
Investments in joint ventures and associates	xxx	xxx	xxx
Financial assets – pension escrow investments	xxx	xxx	xxx
investments	xxx	xxx	xxx
derivatives	xxx	xxx	xxx
Other receivables	xxx	xxx	xxx
Deferred tax assets	xxx	xxx	xxx
	xxx	xxx	xxx
Non-current assets held for sale	xxx	xxx	xxx
Current assets			
Inventories	xxx	xxx	xxx
Trade and other receivables	xxx	xxx	xxx
Income tax receivable	xxx	xxx	xxx
Financial assets - investments	xxx	xxx	xxx
derivatives	xxx	xxx	xxx
Cash and cash equivalents	xxx	xxx	xxx
	xxx	xxx	xxx
Total assets	xxx	xxx	xxx
Current liabilities			
Trade and other payables	xxx	xxx	xxx
Financial liabilities – interest bearing loans and borrowings	xxx	xxx	xxx
obligations under finance lease and hire purchase contracts	xxx	xxx	xxx
derivatives	xxx	xxx	xxx
Income tax payable	xxx	xxx	xxx
Provisions	xxx	xxx	xxx
	xxx	xxx	xxx
Non-current liabilities			
Financial liabilities - interest bearing loans and borrowings	xxx	xxx	xxx
obligations under finance lease and hire purchase contracts	xxx	xxx	xxx
derivatives	xxx	xxx	xxx
Provisions	xxx	xxx	xxx
Retirement benefit obligation – pension deficit	xxx	xxx	xxx
Other payables	xxx	xxx	xxx
Deferred tax liabilities	xxx	xxx	xxx
	xxx	xxx	xxx
Total liabilities	xxx	xxx	xxx
Net liabilities	xxx	xxx	xxx
Equity			
Share capital			
Share premium	xxx	xxx	xxx
Retained earnings	xxx	xxx	xxx
Reserves	xxx	xxx	xxx
Equity attributable to equity holder of parent company	xxx	xxx	xxx
Non-controlling interest	xxx	xxx	xxx
Total equity	xxx	xxx	xxx

Figure 3: Consolidated cash flow statement and reconciliation to RMH plc consolidated accounts

Consolidated cash flow statement (annual)

	Relevant Group	POL and other reconciling items	RMH plc consolidated
Cash flow from operating activities			
Operating profit before exceptional items	xxx	xxx	xxx
Adjustment for:	xxx	xxx	xxx
Depreciation and amortisation	xxx	xxx	xxx
Share of post tax profit from joint ventures and associates	xxx	xxx	xxx
Working capital and other non-cash movements:	xxx	xxx	xxx
Increase in inventories	xxx	xxx	xxx
Decrease in receivables	xxx	xxx	xxx
Decrease in payables	xxx	xxx	xxx
Increase in client receivables	xxx	xxx	xxx
Increase/(decrease) in client payables	xxx	xxx	xxx
Net increase in derivative assets	xxx	xxx	xxx
Increase in non-exceptional provisions	xxx	xxx	xxx
Cash paid in respect of retirement benefit obligations in excess of that charged in operating profit	xxx	xxx	xxx
Cash payments in respect of operating exceptional items (see note (a) below):	xxx	xxx	xxx
ColleagueShare/business transformation payments	xxx	xxx	xxx
Other	xxx	xxx	xxx
Cash outflow from operations	xxx	xxx	xxx
Income tax paid	xxx	xxx	xxx
Net cash outflow from operating activities	xxx	xxx	xxx
Cash flows from investing activities	xxx	xxx	xxx
Dividends received from joint ventures and associates	xxx	xxx	xxx
Finance income received	xxx	xxx	xxx
Proceeds from sale of property, plant and equipment	xxx	xxx	xxx
Proceeds from disposal of associate company	xxx	xxx	xxx
Purchase of property, plant and equipment	xxx	xxx	xxx
Acquisition of businesses	xxx	xxx	xxx
Purchase of intangible assets	xxx	xxx	xxx
Payment of deferred consideration in respect of prior years' acquisitions	xxx	xxx	xxx
Net sale/(purchase) of financial assets investments (non-current)	xxx	xxx	xxx
Net proceeds from financial assets investments (current)	xxx	xxx	xxx
Net cash inflow/(outflow) from investing activities	xxx	xxx	xxx
Net cash outflow before financing activities	xxx	xxx	xxx
Cash flows from financing activities	xxx	xxx	xxx
Finance costs paid	xxx	xxx	xxx
Payment of capital element of obligations under finance lease contracts	xxx	xxx	xxx
Cash received on sale and leasebacks	xxx	xxx	xxx
New loans	xxx	xxx	xxx
Repayment of borrowings	xxx	xxx	xxx
Net cash inflow from financing activities	xxx	xxx	xxx
Net increase/(decrease) in cash and cash equivalents	xxx	xxx	xxx
Effect of exchange rates on cash and cash equivalents	xxx	xxx	xxx
Cash and cash equivalents at the beginning of the period	xxx	xxx	xxx
Cash and cash equivalents at the end of the period	xxx	xxx	xxx

Figure 4: Annual income statement

Income statement annual

	USO Products	Non USO Products	Total upstream	Downstream Services	Total excluding End-to-end only products	End-to-end only products	Total Reported Business
Revenues	XX	XX	XX	XX	XX	XX	XX
Transfer charges	XX	XX	XX	XX	XX	XX	XX
Operating costs	XX	XX	XX	XX	XX	XX	XX
People costs	XX	XX	XX	XX	XX	XX	XX
Depreciation, amortisation and impairments	XX	XX	XX	XX	XX	XX	XX
Other operating cost	XX	XX	XX	XX	XX	XX	XX
Transfer charges	XX	XX	XX	XX	XX	XX	XX
Operating profit/(loss)	XX	XX	XX	XX	XX	XX	XX
Operating exceptional items	XX	XX	XX	XX	XX	XX	XX
Modernisation costs	XX	XX	XX	XX	XX	XX	XX
Other	XX	XX	XX	XX	XX	XX	XX
EBIT	XX	XX	XX	XX	XX	XX	XX
EBIT as % of total revenues	x%	x%	x%	x%	x%	x%	x%
Volumes	XX	XX	XX	XX	XX	XX	XX

Statement of transfer charges - annual

	Between Relevant Group & other RMH group entities			Between Reported Business & rest of Relevant Group			Between Four FREs									
							Across Line A		Across Line B							
									USO products				Non-USO products			
Service(s)/product(s) transfer-priced	P1	P2	P3	P4	P5	P6	P7	P8	P9	P10	P11	P12	P13	P14	P15	
Total transfer revenue	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
Unit transfer price (where applicable)	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
Volume (where applicable)	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
	Equivalen ce or Cost-plus	Equivalen ce or Cost-plus	Equivalen ce or Cost-plus	Equivalen ce or Cost-plus	Equivalen ce or Cost-plus	Equivalen ce or Cost-plus	Equivalen ce or Cost-plus	Equivalen ce or Cost-plus	Equivalen ce or Cost-plus	Equivalen ce or Cost-plus	Equivalen ce or Cost-plus	Equivalen ce or Cost-plus	Equivalen ce or Cost-plus	Equivalen ce or Cost-plus	Equivalen ce or Cost-plus	Equivalen ce or Cost-plus
Approach - Equivalence or Cost-plus?																
Equivalent service/product used as basis (where applicable)	E1	E2	E3	E4	E5	E6	E7	E8	E9	E10	E11	E12	E13	E14	E15	
Total revenue of RM equivalent product (where applicable)	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
Unit market price (where applicable)	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
Source of market price	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
Equivalence adjustments (where applicable)	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX

Notes

Where the equivalent service being used for transfer pricing is not sold in discrete units, the alternative basis for pricing must be stated.

Where the equivalent product or service being used for transfer pricing has multiple prices (e.g. to reflect different Sales Product Handling Characteristics) the different prices used, and the basis of their application for transfer pricing, must be stated.

Where a cost-plus basis for transfer pricing is being used, the source and, where applicable, basis of derivation of the relevant unit costs must be stated

Figure 5: Quarterly income statement

Income statement quarterly

	USO Products	Non USO Products	Total upstream	Downstream Services	Total excluding End-to-end only products	End-to-end only products	Total Reported Business
Revenues	xx	xx	xx	xx	xx	xx	xx
Transfer charges	xx	xx	xx	xx	xx	xx	xx
Operating costs	xx	xx	xx	xx	xx	xx	xx
People costs	xx	xx	xx	xx	xx	xx	xx
Depreciation, amortisation and impairments	xx	xx	xx	xx	xx	xx	xx
Other operating cost	xx	xx	xx	xx	xx	xx	xx
Transfer charges	xx	xx	xx	xx	xx	xx	xx
Operating profit/(loss)	xx	xx	xx	xx	xx	xx	xx
Operating exceptional items	xx	xx	xx	xx	xx	xx	xx
Modernisation costs	xx	xx	xx	xx	xx	xx	xx
Other	xx	xx	xx	xx	xx	xx	xx
EBIT	xx	xx	xx	xx	xx	xx	xx
EBIT as % of total revenues	x%	x%	x%	x%	x%	x%	x%
Volumes	xx	xx	xx	xx	xx	xx	xx

Figure 6: Annual end to end income statement (published version)

Income statement published end to end annual

	USO Mail	Other	Total Reported Business
Revenues	xx	xx	xx
Transfer charges	xx	xx	xx
Operating costs	xx	xx	xx
People costs	xx	xx	xx
Depreciation, amortisation and impairments	xx	xx	xx
Other operating cost	xx	xx	xx
Transfer charges	xx	xx	xx
Operating profit/(loss)	xx	xx	xx
Operating exceptional items	xx	xx	xx
Modernisation costs	xx	xx	xx
Other	xx	xx	xx
EBIT	xx	xx	xx
EBIT as % of total revenues	x%	x%	x%
Volumes	xx	xx	xx

Figure 7: Annual end to end income statement (confidential version)

Income statement confidential end to end annual

	USO Mail	Non USO Mail	Non Mails	Total Reported Business
Revenues	XX	XX	XX	XX
Transfer charges	XX	XX	XX	XX
Operating costs	XX	XX	XX	XX
People costs	XX	XX	XX	XX
Depreciation, amortisation and impairments	XX	XX	XX	XX
Other operating cost	XX	XX	XX	XX
Transfer charges	XX	XX	XX	XX
Operating profit/(loss)	XX	XX	XX	XX
Operating exceptional items	XX	XX	XX	XX
Modernisation costs	XX	XX	XX	XX
Other	XX	XX	XX	XX
EBIT	XX	XX	XX	XX
EBIT as % of total revenues	x%	x%	x%	x%
Volumes	XX	XX	XX	XX

Figure 8: Quarterly end to end income statement

Income statement end to end quarterly

	USO Mail	Non USO Mail	Non Mails	Total Reported Business
Revenues	XX	XX	XX	XX
Transfer charges	XX	XX	XX	XX
Operating costs	XX	XX	XX	XX
People costs	XX	XX	XX	XX
Depreciation, amortisation and impairments	XX	XX	XX	XX
Other operating cost	XX	XX	XX	XX
Transfer charges	XX	XX	XX	XX
Operating profit/(loss)	XX	XX	XX	XX
Operating profit/(loss) as % of total revenues	x%	x%	x%	x%
Volumes	XX	XX	XX	XX

Figure 9: Reconciliation of the annual income statement to the Relevant Group

Income statement reconciliation annual

	Total Reported Business	Other operations	UKLPI	Other units, eliminations and recharges	Relevant Group
Revenues	XX	XX	XX	XX	XX
Transfer charges	XX	XX	XX	XX	XX
Operating costs	XX	XX	XX	XX	XX
People costs	XX	XX	XX	XX	XX
Depreciation, amortisation and impairments	XX	XX	XX	XX	XX
Other operating cost	XX	XX	XX	XX	XX
Transfer charges	XX	XX	XX	XX	XX
Operating profit/(loss)	XX	XX	XX	XX	XX
Operating exceptional items	XX	XX	XX	XX	XX
Modernisation costs	XX	XX	XX	XX	XX
Other	XX	XX	XX	XX	XX
EBIT	XX	XX	XX	XX	XX
EBIT as % of total revenues	x%	x%	x%	x%	x%
Volumes	XX	XX	XX	XX	XX

Figure 10: Annual capital employed statement

Capital employed statement annual

	USO Products	Non USO Products	Total upstream	Downstream Services	Total excluding End-to-end only products	End-to-end only products	Total Reported Business
Assets	XX	XX	XX	XX	XX	XX	XX
Fixed assets	XX	XX	XX	XX	XX	XX	XX
Tangible assets	XX	XX	XX	XX	XX	XX	XX
Goodwill and Intangible assets	XX	XX	XX	XX	XX	XX	XX
Other non current assets	XX	XX	XX	XX	XX	XX	XX
Current assets	XX	XX	XX	XX	XX	XX	XX
Trade and other receivables	XX	XX	XX	XX	XX	XX	XX
Cash and cash equivalents	XX	XX	XX	XX	XX	XX	XX
Other current assets	XX	XX	XX	XX	XX	XX	XX
Current liabilities							
Trade and other payables	XX	XX	XX	XX	XX	XX	XX
Financial liabilities	XX	XX	XX	XX	XX	XX	XX
Provisions and other current liabilities	XX	XX	XX	XX	XX	XX	XX
Capital employed (total assets less current liabilities)	XX	XX	XX	XX	XX	XX	XX
ROCE	XX	XX	XX	XX	XX	XX	XX

Figure 11: Reconciliation of the capital employed statement to the Relevant Group

Capital employed statement reconciliation annual

	Total Reported Business	Other operations	UKLPI	Other units, eliminations and recharges	Relevant Group
Assets	xx	xx	xx	xx	xx
Fixed assets	xx	xx	xx	xx	xx
Tangible assets	xx	xx	xx	xx	xx
Goodwill and Intangible assets	xx	xx	xx	xx	xx
Other non current assets	xx	xx	xx	xx	xx
Current assets	xx	xx	xx	xx	xx
Trade and other receivables	xx	xx	xx	xx	xx
Cash and cash equivalents	xx	xx	xx	xx	xx
Other current assets	xx	xx	xx	xx	xx
Current liabilities					
Trade and other payables	xx	xx	xx	xx	xx
Financial liabilities	xx	xx	xx	xx	xx
Provisions and other current liabilities	xx	xx	xx	xx	xx
Capital employed (total assets less current liabilities)	xx	xx	xx	xx	xx
Non current liabilities					
Financial liabilities					xx
Provisions					xx
Retirement benefit obligation – pension deficit					xx
Other payables					xx
Deferred tax liabilities					xx
Total liabilities					xx
Net liabilities					xx
Total equity					xx

Figure 12: Annual cash flow statement

Cash flow statement annual

	USO Products	Non USO Products	Total upstream	Downstream Services	Total excluding End-to-end only products	End-to-end only products	Total Reported Business
Operating profit/(loss) before exceptional items	XX	XX	XX	XX	XX	XX	XX
Add back non cash costs							
Depreciation	XX	XX	XX	XX	XX	XX	XX
Pension Charge	XX	XX	XX	XX	XX	XX	XX
Share of profit of joint venture and associates	XX	XX	XX	XX	XX	XX	XX
Operating earnings before non-cash costs	XX	XX	XX	XX	XX	XX	XX
Less cash outflows							
Working capital and other non cash movements							
Trade and other receivables	XX	XX	XX	XX	XX	XX	XX
Cash and cash equivalents	XX	XX	XX	XX	XX	XX	XX
Other current assets	XX	XX	XX	XX	XX	XX	XX
Trade and other payables	XX	XX	XX	XX	XX	XX	XX
Financial liabilities	XX	XX	XX	XX	XX	XX	XX
Provisions and other current liabilities	XX	XX	XX	XX	XX	XX	XX
Pension cash contribution							
Ongoing	XX	XX	XX	XX	XX	XX	XX
Net cash outflow from operating activities	XX	XX	XX	XX	XX	XX	XX
Purchase of intangibles and fixed asset investments	XX	XX	XX	XX	XX	XX	XX
Purchases of property, plant and equipment	XX	XX	XX	XX	XX	XX	XX
Proceeds from disposals of property, plant and equipment	XX	XX	XX	XX	XX	XX	XX
Cash flows from other investment activities	XX	XX	XX	XX	XX	XX	XX
Net cash outflow from operating and investment activities	XX	XX	XX	XX	XX	XX	XX
Exceptional cash flow	XX	XX	XX	XX	XX	XX	XX
Operational financing costs paid	XX	XX	XX	XX	XX	XX	XX
Net cash outflow after exceptional items and financing costs	XX	XX	XX	XX	XX	XX	XX

Figure 13: Reconciliation of the annual cash flow statement to the Relevant Group

Cash flow reconciliation annual

	Total Reported Business	Other operations	UKLPI	Other units, eliminations and recharges	Relevant Group
Operating profit/(loss) before exceptional items	XX	XX	XX	XX	XX
Add back non cash costs					
Depreciation	XX	XX	XX	XX	XX
Pension Charge	XX	XX	XX	XX	XX
Share of profit of joint venture and associates	XX	XX	XX	XX	XX
Operating earnings before non-cash costs	XX	XX	XX	XX	XX
Less cash outflows					
Working capital and other non cash movements					
Trade and other receivables	XX	XX	XX	XX	XX
Cash and cash equivalents	XX	XX	XX	XX	XX
Other current assets	XX	XX	XX	XX	XX
Trade and other payables	XX	XX	XX	XX	XX
Financial liabilities	XX	XX	XX	XX	XX
Provisions and other current liabilities	XX	XX	XX	XX	XX
Pension cash contribution					
Ongoing	XX	XX	XX	XX	XX
Net cash outflow from operating activities	XX	XX	XX	XX	XX
Purchase of intangibles and fixed asset investments	XX	XX	XX	XX	XX
Purchases of property, plant and equipment	XX	XX	XX	XX	XX
Proceeds from disposals of property, plant and equipment	XX	XX	XX	XX	XX
Cash flows from other investment activities	XX	XX	XX	XX	XX
Net cash outflow from operating and investment activities	XX	XX	XX	XX	XX
Exceptional cash flow	XX	XX	XX	XX	XX
Net cash outflow after exceptional items and financing costs	XX	XX	XX	XX	XX

Figure 14: Annual and quarterly product profitability statement

Product profitability statement - split by Line B annual and quarterly

	Product X		Total Product X
	Upstream	Downstream	
Revenues	XX	XX	XX
Transfer charges	XX	XX	XX
Operating costs	XX	XX	XX
People costs	XX	XX	XX
Depreciation, amortisation and impairments	XX	XX	XX
Other operating cost	XX	XX	XX
Transfer charges	XX	XX	XX
Operating profit/(loss)	XX	XX	XX
Volumes	XX	XX	XX

Product profitability statement - not split by Line B annual and quarterly

	Total Product X
Revenues	XX
Transfer charges	XX
Operating costs	XX
People costs	XX
Depreciation, amortisation and impairments	XX
Other operating cost	XX
Transfer charges	XX
Operating profit/(loss)	XX
Volumes	XX

Figure 15(a): Monthly revenue and volume information statements

Financial Year	
Financial Period	

	Revenue					Volume				
	YTD Actual	YTD Prior Year	%Var	YTD Budget	%Var	YTD Actual	YTD Prior Year	%Var	YTD Budget	%Var
Products										
First Class - Stamp										
First Class - Meter										
First Class - Account										
Second Class - Stamp										
Second Class - Meter										
Second Class - Account										
Breakdown of Bulk Mail products										
Breakdown of Access products (also broken down into CDA and Non-CDA)										
Breakdown of non-USO parcels, Tracked, Special Delivery, and remaining addressed inland products										
Total Addressed Inland products										
Other (see breakdown below)										
Door to Door										
International (see breakdown below)										
Ancillary/Elections/Other (see breakdown below)										
TOTAL										
Other										
Breakdown										
TOTAL										
International										
Breakdown										
TOTAL										
Ancillary/Elections/Other										
Breakdown										
TOTAL										
Analysis by format										
Letters and large letters - End to end inland										
Letters and large letters - Access										
Letters and large letters - International										
Parcels - End to end inland										
Parcels - Access										
Parcels - International										
Parcels - Parcelforce										
Unaddressed mail										
TOTAL										

Figure 15(b): Monthly cost information statements

Financial Year	
Financial Period	

	Month					Year to date				
	Actual	Prior Year	%Var	Budget	%Var	Actual	Prior Year	%Var	Budget	%Var
Reported Business staff										
Headcount										
Full Time Equivalent (as defined in paragraph 2.2)										
Processing productivity										
Productivity % change										
Workload % change										
Gross hours % change										
Total workload										
Total gross hours										
Delivery/Collection productivity										
Productivity % change										
Workload % change										
Gross hours % change										
Total workload										
Total gross hours										
Total productivity (Processing/Delivery/Collection)										
Productivity % change										
Workload % change										
Gross hours % change										
Total workload										
Total gross hours										
Transformation										
Total number of Mail Centres										
Number of Mail Centre closures										
Number of Mail Centre openings										
Total number of fully modernised Delivery Offices										
Voluntary Redundancy costs ('VR')										
Operating and capital expenditure on transformation excluding VR										

Appendix 2: Product Allocations for Accounting Separation

Allocations of products and/or services to the Four FREs

In the event of conflict between the following product allocations and Royal Mail's published universal service products listing, Royal Mail must give priority to the latter in allocating products and services to the Four FREs.

Line A		Line A	
Line C			
USO products (also separated by Line B below)	Non-USO products (also separated by Line B below) - See Note 1	End to end only products - Mails (not separated by Line B)	End to end only products - non-Mails (not separated by Line B)
1st Class Stamp 1st Class Stamp RM Signed For Prepaid Stationery 1st 2nd Class Stamp 2nd Class Stamp RM Signed For Prepaid Stationery 2nd Parcels-2ND <2kg 1st Class Franking 1st Class Franking RM Signed For 1st Class Account 1st Class Account RM Signed For Sales Agents Standard Tariff 1st 2nd Class Franking 2nd Class Franking RM Signed For 2nd Class Account 2nd Class Account RM Signed For Sales Agents Standard Tariff 2nd Special Delivery Next Day Stamp Special Delivery Prepaid Stationery Special Delivery Next Day Franking Proof of Delivery Recorded Delivery Keepsafe Local Collect Return to Sender USO RLB Postings (Belfast) Articles for the Blind Poste Restante Unofficial Redirections Surcharges (Social) Redirection Business and Social Aerogrammes Aircard Airmail Articles for the Blind-Air Surface Mail International Signed For & Signed For Plus Inward Airmail Inward Registered Inward Surface Mail Inward Surface Insured/Registered Inward Air Prime Registered & Express Franking Machine Resetting	Business Mail High Sort 1st class Business Mail High Sort 2nd class Business Mail High Sort Economy Business Sorted Bespoke Advertising Mail High Sort 1st class Advertising Mail High Sort 2nd class Advertising Mail High Sort Economy Advertising Mail Big Book-Econ < 2kg Advertising Mail Heavyweight-Econ < 2kg Bespoke Advertising Mail Big Book-Econ Advertising Mail Multi Stage Business Mail Low Sort 1st class Business Mail Low Sort 2nd Class Advertising Mail Low Sort 1st class Advertising Mail Low Sort 2nd Class Publishing Mail High Sort 1st class Publishing Mail High Sort 2nd class Publishing Mail Low Sort 1st class Publishing Mail Low Sort 2nd Class Publishing Premium Business Mail Unsorted 1st class Business Mail Unsorted 2nd class Advertising Mail Unsorted 1st Class Advertising Mail Unsorted 2nd class Advertising with Response Royal Mail 24 parcels < 2kg account Royal Mail 48 parcels < 2kg account Royal Mail Tracked 48 < 2kg Royal Mail Tracked 24 < 2kg Royal Mail Tracked Returns 24 Royal Mail Tracked Returns 48 Freepost Plus and Standard Freepost Name Admail Business Reply Plus Business Reply Standard Postal Voting Sales Agents Business Reply Business Collections Collection from Locked Private Box Mailrooms Mail Collect Safebox Special Delivery Bespokes Callers Service Mailroom Consultancy & Management Newspaper Registration Fee Floor Fees Pouch Services Business Keepsafe Rural Carriage of Goods Rural Newspaper Delivery Service Rural Roadside Locked P Letter Boxes Selectapost Timed Delivery Safebox Pre Sorted Delivery Early Extraction Early Collect Business Mail Secure Market Reach Return to Sender Non USO Santa Mail Government Postage General Election Surcharges (Business) Private Boxes Collection from Private PO Box Diversion (Del at Another Address) Do Not Redirect Airpacks British Forces Mail (Outward) British Forces Mail (Inward) International Admail IBRS Import Swiftair & Swiftair Plus Aisre & Aisre Plus Direct Entry 3 Islands International Goods Returns International Redirection Large Mail Order Returns < 2kg	Royal Mail 24 > 2kg Royal Mail 48 > 2kg Royal Mail Tracked 48 > 2kg Royal Mail Tracked 24 > 2kg Royal Mail Tracked Returns 24 > 2kg Royal Mail Tracked Returns 48 > 2kg Advertising Mail Heavyweight-Econ > 2kg Publishing Mail High Sort 2nd > 2kg Business Mail Unsorted > 2kg Freepost (all variants) >2kg Business Reply Plus > 2kg Business Reply >2kg Unaddressed Mail Sales Agents Unaddressed Mail Special Delivery 9am Stamp Special Delivery 9am Franking Special Delivery 9am Account Special Delivery Guaranteed Returns Special Delivery Next Day Account Sales Agents Special Delivery Application of India International Destination Sort International Mailing Options International Bundle Sort International Zone Sort International Format Sort International No Sort International Bulk Mail Contract Aisre Aisre plus Compensation International Contract Signed for Large Mail Order Returns > 2kg	PAF Products AMC Product Postbuses Data Services Sameday Relay (inc Branch Direct and Parts Express) External and Internal Warehousing Parcelforce IB Other IB Revenue POL UKPIL Intra Revenue Stamps & Collectibles Consultancy & Agency Work International Mailshots Online
Line B Downstream services (access products below and downstream elements of USO and non-USO products above) - See Note 2			
Network Access Premium 70 Network Access 70 Network Access 70 Tray Network Access 1400 Premium Network Access 1400 Network Access Missorts Network Access Under Volume Bags Network Access COP extraction			

Notes:
 1. All inland product variants are below 2 kg weight / Includes Sustainable variants of sorted mail, and products sold via Sales Agents
 2. Includes all access products regardless of weight

Appendix 3

Material change pro-formas

Royal Mail must—

- (a) in relation to any material change to the Costing Manual, use the pro-forma set out in **Table 12** of this **Appendix 3**; or
- (b) in relation to any material change to the Accounting Methodology Manual, use the pro-forma set out in **Table 13** of this **Appendix 3**.

In using these pro-formas, Royal Mail must ensure that—

- (a) the description of the change is explained in a manner that can be easily understood by a reader who does not have a detailed technical knowledge of Royal Mail's operations and systems (e.g. avoiding acronyms and technical jargon to the greatest extent possible);
- (b) in giving reasons for the change, a brief explanation of the available options for change and Royal Mail's assessment of those options are provided; and
- (c) in stating the compliance with these Guidelines, a reference to the relevant obligations in these Guidelines and an explanation of how Royal Mail considers that the change complies with these obligations.

Table 12: Material changes to the Costing Manual

Description of change:						
Date change effective from:						
Area of the <u>National Costing Methodology</u> or <u>Zonal Costing Methodology</u> affected:						
Area of the <u>Pipeline</u> affected:						
Reasons for change:						
Compliance with the <u>Regulatory Accounting Guidelines</u> :						
		(a)	(b)	(c)	(c) / (a)	
Items affected		Value before change	Value after change	Difference	% difference	Comments
<u>Activity Costs</u>						
Cost of products and/or services	Total					
	<u>USO</u> product					
	<u>Access</u> product					
	<u>non-USO</u> (remainder)					

Table 13: Material changes to the Accounting Methodology Manual

Description of change:
Date change effective from:
Reasons for change:
Compliance with the <u>Regulatory Accounting Guidelines</u> :

Income statement: material changes					
	(a)	(b)	(c)	(c) / (a)	
Reported Item	Value before change	Value after change	Difference	% difference	Comments
Item 1					
Item 2					
....					
Item x					

Capital employed statement: material changes					
	(a)	(b)	(c)	(c) / (a)	
Reported Item	Value before change	Value after change	Difference	% difference	Comments
Item 1					
Item 2					
....					
Item x					

Cash flow statement: material changes					
	(a)	(b)	(c)	(c) / (a)	
Reported Item	Value before change	Value after change	Difference	% difference	Comments
Item 1					
Item 2					
....					
Item x					

Notes to the statements: material changes	
Reported Item	Notes
Item 1	
Item 2	
....	
Item x	

Appendix 4: Information to be included in the pro-forma's for the technical appendices of the Costing Manual

(a) Annual information required in the technical appendices submitte for the Financial Year

Data Template A

Scope: all SPHCCs with a non-zero FAC or traffic volume in the year

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

					RDT Volume	Total FAC (£)	Unit FAC (p)
SPHCC Group	SPHCC Code	SPHCC Description	Sales Product Code Description	Mon-mails Flag	FY	FY	FY

Data Template B

Scope: all Activities with a non-zero value in the year

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 (£)
Activity Code	Activity Description	Pipeline Segment	Attribute Description	FY

Data Template C

Scope: all Activities whose cost is allocated by the application of PFs and WFs (excluding "class activities")

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

		PF %	WF
Activity Code	SPHCC Code	FY	FY

Data Template D

Scope: all "class activities" whose PFs and WFs are assigned by reference to another "source activity" on the basis of class

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

			Should Class adopt PF of source Activity	Should Class adopt WF of source Activity
Activity Code of Class Activity	Activity Code of Source Activity	Class	Yes = 1, No = 1	Yes = 1, No = 1

Data Template E

Scope: list all activities whose cost is allocated on an EPMU basis

Activity Code
e.g. HD0104XX

Data Template F

Scope: all SPHCC x Activity combinations with a non-zero total FAC in any quarter

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

		FAC (£)
Activity Code	SPHCC Code	FY

(b) Quarterly information required in the technical appendices submitted for each Financial Quarter

Data Template G

Scope: Total costs per SPHCC per Activity

SPHCC Group	SPHCC Code	SPHCC Description	Sale Product Code Description	Non-mails flag	Activities								Total
					X	X	X	X	X	X	X	X	X

Data Template H

Scope: Revenue-derived traffic volume per SPHCC per Activity

SPHCC Group	SPHCC Code	SPHCC Description	Sale Product Code Description	Non-mails flag	Total
					X

Data Template I

Scope: Unit cost per SPHCC per Activity

SPHCC Group	SPHCC Code	SPHCC Description	Sale Product Code Description	Non-mails flag	Activities								Total
					X	X	X	X	X	X	X	X	X