Australian
Competition &
Consumer
Commission

Issues raised during consultation

Record Keeping Rules establishing a regulatory accounting framework for Australia Post

30 March 2005

Introduction

The *Postal Services Legislation Amendment Act 2004* made amendments to the *Australian Postal Corporation Act 1989* aimed at addressing a number of regulatory and consumer issues relating to postal services. One of the issues that these amendments seeks to address is allegations raised by competitors that Australia Post is unfairly competing in the market by subsidising its revenues from competitive services (non-reserved services) with revenues raised from its monopoly (reserved) services.[1]

The Postal Services Legislation Amendment Act aims to do this by stipulating that the Australian Competition and Consumer Commission (ACCC) must require Australia Post to keep records about its reserved services 'to enable the ACCC to scrutinise whether or not Australia Post is cross-subsidising from the reserved services to the services it provides in competition with others'.[2] The ACCC must introduce rules to this effect within twelve months of the legislation commencing, that is by 22 June 2005.

In preparation for this new role, the ACCC released draft record keeping rules and an associated Issues Paper for public consultation in March 2004. Submissions were received from:

- Australia Post
- New Zealand Postal Operators
- Major Mail Users of Australia
- Post Office Agents Association.

Since the public consultation, the ACCC has engaged Australia Post and worked through the issues it raised in its public submission to the point where both Australia Post and the ACCC are satisfied that the record keeping rules establish a regulatory accounting framework that is workable, allowing the ACCC to scrutinise whether or not Australia Post is cross-subsidising between its reserved and non-reserved services without imposing undue compliance costs on Australia Post.

This paper summarises the issues raised in the public submissions, provides a brief comment on the background, or purpose of the particular requirement commented upon and describes any changes made from the draft record keeping rules as a result of the consultation process. It also explains the rationale for other changes that have been made to the record keeping rules.

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1 Second reading speech for the Postal Services Legislation Amendment Bill 2003, 19 June 2003.

2 Explanatory memorandum for the Postal Services Legislation Amendment Bill 2003, p 40.

1. Application of record keeping rules—definition of Australia Post

Australia Post’s initial submission stated that including subsidiaries of Australia Post in the definition of Australia Post goes beyond the extent of section 50H which it says ‘applies to Australia Post only, not additionally to its subsidiaries’.

In contrast, the Major Mail Users of Australia (the MMU) was concerned that the definition of Australia Post in the draft rules did not extend to Australia Post’s ‘associated or joint venture companies’.

1.1 Comment

One of the main policy intentions of section 50H is to address allegations raised by competitors of Australia Post that it is unfairly competing in the market by subsidising its revenues from competitive services with revenues raised from its monopoly services.[3] This intention of allowing for testing of cross-subsidy from reserved services to non-reserved services would be easily avoided if services provided through Australia Post’s subsidiaries did not fall within the ambit of the record keeping rules.

The legislation allows the ACCC to require Australia Post to keep records that are relevant to, among other things, the financial relationship between parts of *its business* that relate to reserved services, and parts that do not.[4] The ACCC believes that this applies irrespective of how Australia Post chooses to structure its business; that is, whether its business is structured in the form of subsidiaries or not. It is clear, however, that the responsibility for keeping records rests with Australia Post alone.

While Australia Post maintains that the record keeping rules ‘can not be interpreted as also extending to any subsidiary companies and joint ventures’, it no longer objects to the inclusion of subsidiaries in the record keeping rules in keeping with the ‘spirit of the law’. It does, however, object to the inclusion of joint ventures.

Australia Post has four joint ventures: two with Qantas (Australian air Express and Star Track); one with Wellcom (iPrint); and one with China Post. All of these joint ventures are 50:50 partnerships which are operated at arms length from Australia Post and are not controlled by Australia Post (although Australia Post can exert influence over them).

Exclusion of joint ventures is consistent with accounting standards and the approach taken by other postal regulators. In the absence of specific allegations of cross-subsidy or other concerns related to joint ventures, the ACCC does not consider that the

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3 Explanatory memorandum for the Postal Services Legislation Amendment Bill 2003, p 39.

4 Paragraph 50H(4)(b) of the Australian Postal Corporation Act.

benefits from including joint ventures would outweigh the costs at this time. The ACCC notes, however, that this issue can be revisited by the review mechanism contained in the record keeping rules should specific allegations or other concerns about joint ventures be raised with the ACCC.

The term 'subsidiaries' has been removed from the definition of Australia Post and the record keeping rules now require Australia Post to keep records for it and its subsidiaries. Joint ventures remain excluded.

2. Statement of Financial Position or Capital Employed Statement

Relevance of either statement

In its public submission, Australia Post stated that it did not consider either statement appropriate.

Inclusion of current assets

If either statement is necessary, Australia Post believed it should be a Capital Employed Statement and that it should be limited to fixed assets as the ACCC did not allow a return on working capital in the 2002 stamp price notification and a number of working capital account items (totalling approximately $1bn as at 30 June 2003) would create allocation difficulties (ie. any allocation would be largely arbitrary).

2.1 Comment

Relevance of either statement

The ACCC believes a return on capital is a legitimate cost to business. Accordingly, in seeking to identify the existence of cross-subsidy, it is appropriate to identify and quantify this cost. A capital employed statement or a statement of financial position is a necessary input in determining the cost of capital for each of the service groups.[5]

Australia Post has acknowledged that it understands the ACCC's desire for this data.

5 Moreover, it is not uncommon that regulatory accounting regimes for postal operators require balance sheet information. For example, under condition 14 of Royal Mail's licence, Postcomm requires that Royal Mail provide accounts that comprise a profit and loss account, a balance sheet and a cash flow statement. Likewise, An Post, under a proposed direction from the Director of Telecommunications Regulation, will be required to produce profit and loss statements and balance sheets—although there are varying degrees of segmentation required for these reports.

Inclusion of current assets

Information to be obtained under the record keeping rules and approaches taken to analysing that information may not necessarily be the same for each of the ACCC's regulatory roles. The ACCC is able to use a variety of approaches to the different issues that it is required to deal with.

Testing for cross-subsidy, for example, will be conducted on an *ex post* basis, using the actual revenues generated by, and the actual costs incurred in, providing Australia Post's various services. In contrast, the ACCC's role in assessing proposed price increases under the prices surveillance provisions of the *Trade Practices Act 1974* involves an assessment of the efficiency of a declared company's cost base and the rate of return it is seeking—this usually involves an *ex ante* approach that is aimed at calculating the amount of revenue required in future years to cover the total costs of an efficient service.[6]

However, in view of the largely arbitrary allocation of working capital items the Statement of Capital Employed has been limited to non-current assets.

The record keeping rules now limit the Statement of Capital Employed to non-current assets.

3. Volatility in the Capital Employed Statement

The draft record keeping rules required Australia Post to record working capital figures on a monthly basis and report these figures if the year's end working capital figures vary from the arithmetic mean of the month end figures by more than 10 per cent.

Australia Post commented:

> Clauses 15(4) & 15(5) in particular look to be an excessive application of the monitoring process.
>
> Clause 15(4) is unclear in its extent. Simply reporting at the corporate level presents no difficulties. However, if the Account items are required for each Service Group on a monthly basis then they will be potentially highly volatile because of both general ledger volatility for some items and volatility in the allocation drivers on a monthly basis.

3.1 Comment

The purpose of sub rules 15(4) and 15(5) was to capture this sort of volatility and allow the ACCC to reach a view as to whether the year end current asset values were representative of the year round values. However, as the Statement of Capital

6 For a more detailed description of the ACCC's approach to assessing proposed price increases, see the *Draft Statement of regulatory approach to price notifications*, available on the ACCC's website.

Employed has been limited to non-current assets, these sub rules are no longer necessary.

The record keeping rules no longer require the Australia Post to record monthly working capital values.

4. Level of segmentation

The Issues Paper called for comment on the appropriate level of segmentation and highlighted the need for service group definitions to be both exhaustive and mutually exclusive. In addition, it is likely the service group definitions will need to change over time (eg. when new services are introduced). The Issues Paper also sought comment on whether the service group definitions should be contained in the rules or in the regulatory accounting procedures manual.

Australia Post provided a set of service group definitions that was broadly consistent with the level of segmentation in the draft rules and recommends placement of the definitions in the manual.

New Zealand Postal Operators submitted that it is vital that Australia Post be required to disclose information about both reserved and non-reserved services, and that the greater the level of segmentation within reserved and non-reserved services the greater will be the chance of preventing cross-subsidisation. The New Zealand Postal Operators supported the level of segmentation proposed by the draft record keeping rules.

The MMU submitted that where a component of a service group is a significant competitor to other businesses, then that component should be reported separately. Accordingly, MMU submitted that EDI Post should be reported separately rather than as a component of the ‘customised services’ service group. MMU also suggested splitting parcels into two sub categories and differentiating express freight and general freight.

The Post Office Agents Association believed the degree of segmentation should not involve breaking down to pricing structures for individual items such as pens and reams of copying paper, but rather should stay in groupings.

4.1 Comment

The level of segmentation within reserved and non-reserved services is critical to the assessment of cross-subsidy. The more detailed the segmentation, the more likely it is that cross-subsidisation of an individual product can be identified. However, there is also a need to balance the level of segmentation against the cost incurred by Australia Post in providing this information.

Australia Post also advised that it does not believe that there is any advantage in reporting ‘minor services such as EDI Post’ separately. Australia Post stated that EDI

Post represents only 0.2 per cent of its revenue and that it has only 5 per cent of the relevant market.

Australia Post does not object to the level of segmentation proposed by the draft rules and has provided a product list segmentation that it believes is both exhaustive and mutually exclusive, and that is generally consistent with the level of segmentation proposed by the draft record keeping rules.

Schedule 1 has been amended to reflect the product segmentation provided by Australia Post, and the record keeping rules now require Australia Post to update the segmentation annually as part of the regulatory accounting procedures manual.

5. Substance over form

The draft record keeping rules required Australia Post to report the substance of transaction and events.

Australia Post submitted that accounting standard AASB1001 already provides that substance over form must be adopted by a reporting entity and that rule 11 therefore does not serve any useful purpose.

5.1 Comment

There does not appear to be any conflict between AASB1001 and rule 11.

The record keeping rules retain this requirement.

6. Materiality

The draft record keeping rules required the disclosure of all material items. An item was defined as being material if its omission, misstatement or non statement has the potential to prejudice the understanding of the financial or operational position and nature of the services, gained by reading the regulatory accounts. Australia Post argued that this may not be feasible:

> Items not material at a corporate level are more likely to become material at a product level because a small corporate-level change may be relatively large to a particular service group.
>
> There is no obvious way to identify cost changes that are material at the product level when the product costing system is based on cost pools comprising a variety of different costs.

6.1 Comment

This is a standard requirement in the ACCC’s regulatory accounting guidelines for other industries, and is fundamental to the ACCC’s requirements.

If Australia Post is not able to provide regulatory accounts that disclose all material items, it appears unlikely the ACCC will be able to draw any meaningful conclusions from the analysis it undertakes on the data supplied under the record keeping rules.

The record keeping rules retain this requirement.

7. Application of the record keeping rules—first reporting period

Sub-rule 4(3) of the draft record keeping rules provided that the ACCC may vary the first reporting period by notification in writing. Australia Post submitted that this was contrary to sub-rule 4(2) which provided that the first reporting period will be the first full financial year after the record keeping rules take effect.

7.1 Comment

The purpose of sub rule 4(3) was to allow flexibility given the uncertainty about when the Bill would be passed, and how soon thereafter the legislation would commence, at the time of the public consultation. Australia Post has now indicated its willingness to produce regulatory accounts from the 2004–05 financial year.

The record keeping rules now require Australia Post to produce regulatory accounts for each full financial year from the 2004–05 financial year.

8. Disclosure of information

Disclosure of information provided under the record keeping rules is a major concern to Australia Post—it does not consider that financial data should be released to its competitors.

8.1 Comment

As stated in the Issues Paper, the ACCC has a general responsibility to protect any confidential information it receives in this and other capacities.

A separate consultation on the use and disclosure of information provided under the record keeping rules is planned.

The record keeping rules retain this requirement.

9. Objects of the Rules

Paragraph 3(1)(b) of the draft record keeping rules stated:

> The object of these Rules is to provide:
>
> …
>
> principles to be applied by Australia Post in developing detailed allocation methodologies in compliance with these Rules

In its public submission, Australia Post stated that:

> this is an unacceptable extension of the Commission's role in what is specifically a monitoring process. Product costing principles and policies are a management/board responsibility and do not fall under the auspices of any regulator.

9.1 Comment

The allocation methodologies at issue are relevant only to Australia Post's compliance with the record keeping rules and are not intended to impact on Australia Post's costing principles and policies, which as Australia Post points out, remain the responsibility of its management and Board.

The record keeping rules retain this requirement.

10. Allocation of account items—direct and attributable

Sub-rule 13(2) of the draft record keeping rules required all account items to be reported as either:

> a **direct** Account Item—that is, one solely associated with the particular service;
>
> an **attributable** Account Item—that is, part of a pool of common Account Items that are identifiable to a particular service by a separable cause and effect relationship; or
>
> an **unattributable** Account Item—that is, part of a pool of common Account Items but is not identifiably related in whole or in part to any particular service by a separable cause and effect relationship.

In its public submission, Australia Post submitted that a fully distributed cost approach was appropriate and that further segmentation (into direct, attributable and unattributable) may be misleading.

10.1 Comment

The categorisation in the draft record keeping rules is consistent with fully distributed costs. The further breakdown into direct, attributable and unattributable costs is important for two reasons.

First, it should assist the ACCC in understanding the relationships between particular service groups.

Second, it has implications for the analysis of the information provided under the record keeping rules. For example, a subsidy is generally considered to occur where the revenue generated by providing a particular service is not sufficient to meet the costs of providing that service. However, if the revenue is sufficient to meet the sum of the *direct* and *attributable* costs of providing that service, it could be argued that there is no subsidy as the revenue is sufficient to meet all of the costs that have a causal relationship with providing that service (ie. the costs that could be avoided if the service was not provided). Conversely, if the revenue is not sufficient to meet the *direct* costs of providing that service, then it appears unequivocal that the service is the recipient of a subsidy.

This approach is consistent with the regulatory accounting framework that applies to certain telecommunications carriers, and is similar to requirements in regulatory accounting regimes for postal operators in other jurisdictions.[7]

The record keeping rules retain this requirement.

11. Allocation of account items—unattributable

In its public submission, Australia Post noted that:

> In practice, it is likely that a great deal of common sense will be needed to assess unattributable item allocation. In many cases it simply will not be possible to identify an allocation driver that is clearly superior to all others. Choice of one driver rather than another may produce quite different results.

11.1 Comment

By distinguishing between direct, attributable and unattributable account items and by requiring explanation of all ‘account drivers’ (or allocators), the ACCC is seeking to gain a better understanding of the influence that ‘driver selection’ may have on the accounts.

The record keeping rules retain this requirement.

7 For example, PostComm requires that Royal Mail and Speedmail International identify costs as ‘direct’, ‘direct cause and effect’, ‘indirect cause and affect’ and allocated by a ‘general allocator’.

12. Definition of account items

Australia Post requested the flexibility of including account item definitions as part of the manual rather than the prescriptive definitions contained in the draft record keeping rules.

12.1 Comment

The ACCC indicated in its Issues Paper that the account items contained in schedules 3, 4 and 6 of the draft record keeping rules were intended as a starting point for establishing appropriate account items and definitions and invited submissions on this issue.

As the record keeping rules will apply only to Australia Post, it seems reasonable that the ACCC adopt account items that are determined by Australia Post—provided these meet the ACCC's requirements.

Australia Post has since indicated that it considers the account items in the draft record keeping rules are acceptable.

The record keeping rules specify the account items upon which Australia Post is required to report; however, the record keeping rules now allow changes to these items to be made through the ACCC's annual approval of the regulatory accounting procedures manual.

13. Account mapping

Australia Post's public submission stated that it would not be able to complete the account mapping in the format prescribed by the draft record keeping rules.

13.1 Comment

Australia Post is developing an alternative format—which is yet to be finalised—that will satisfy the outcome required by the ACCC. The ACCC has agreed to specify the required outcome of account mapping in the record keeping rules and allow Australia Post to specify the form of the account mapping through the annual approval of the regulatory accounting procedures manual.

The record keeping rules no longer specify the form that the account mapping must take; rather, the required outcome is specified.

14. Audit procedures

Australia Post comments:

> The audit must adhere to full audit standards. Note that it appears that the ACCC has the right to reject an audit even if it follows all rules, even if it has determined (under clause 26) who the auditor will be.
>
> Post strongly considers that the auditor be the [Australian National Audit Office] ANAO or its delegate consistent with existing Government requirements. Otherwise, Post might find itself paying twice for the same audit work.
>
> Consideration needs to be given to whether it is workable for an auditor to owe a duty of care both to Post and to the Commission

Australia Post also considers the reserve audit powers to be unreasonable 'in view of Post being subject to audit by ANAO'.

The Post Office Agents Association supports the use of ANAO for auditing requirements. It is also concerned that the process of external audit could lead to the release of commercial in confidence information.

14.1 Comment

The ACCC expects that, in the ordinary course of events, the ANAO or its delegate will be an acceptable auditor.

Any auditor of information provided under the record keeping rules will be bound to protect the confidentiality of information it audits.

Australia Post has indicated it no longer has any objection to the audit provisions.

The record keeping rules retain this requirement.

15. Regulatory accounting procedures manual

Australia Post's public submission indicated that it believed the requirements of the regulatory accounting procedures manual were excessive and that the manual should only have to meet the ACCC's *reasonable* expectations (not its expectations as the draft record keeping rules required).

15.1 Comment

The manual will set out the procedures to be followed by Australia Post in preparing the regulatory accounts. The ACCC's expectations for the manual are likely to be that it ensures the keeping of satisfactory regulatory accounts, and that it adequately explains how those accounts are derived.

However, ‘expectations’ has the potential to be subjective and changing ‘expectations’ to ‘reasonable expectations’ does not necessarily reduce this subjectivity. It may be more appropriate to replace ‘expectations with ‘reasonable requirements’. The ACCC’s reasonable requirements will be determined by reference to the actual reporting requirements.

Australia Post has indicated that it no longer has an issue with the provision of the Regulatory Account Procedures Manual.

The record keeping rules bow require Australia Post to liaise with the ACCC to ensure that the manual meets its reasonable requirements, rather than its expectations.

16. Statement of movements in non-current asset values

Rule 16 of the draft record keeping rules required the preparation of a statement showing the source of changes in aggregate values of non-current asset classes with assets allocated to reserved and non-reserved services.

Australia Post’s public submission stated that the completion of this statement would be onerous and that it was not clear how this material will be used by the ACCC to make conclusions on cross-subsidy. It also advised that it was not possible to produce some of the information required to complete this statement.

16.1 Comment

Asset values form an input into the development of capital adjusted statement of financial performance. Accordingly, understanding the source of movements in asset values is necessary to understand those statements.

In subsequent consultation, Australia Post has suggested a revised format of this statement that meets the ACCC’s requirements.

The requirements of the Statement of Movement in Non-Current Asset Values has been amended to reflect Australia Post’s revised format.

17. The Finance Minister’s Orders

Sub-rule 9(1) of the draft record keeping rules required Australia Post to comply with Australian Accounting Standards ‘except where approved by the ACCC, or if these Rules specifically mandate otherwise’.

Australia Post submitted that sub-rule 9(1) should be amended to reflect the overriding role of the Finance Minister's Orders in Australia Post's statutory accounting process.

The record keeping rules now acknowledge the role of the Finance Ministers Orders.

18. Changes to accounting standards and policies

Sub-rule 9(2) and 9(3) of the draft record keeping rules required:

> (2) Australia Post must advise the Commission of any material changes to its accounting principles or policies, and the rationale for such changes.
>
> (3) Australia Post must provide the Commission with details concerning the impact any changes under sub rule (2) have on the Reports.

Australia Post's public submission stated that this was an excessive requirement and requested a more manageable policy that limits the reporting to service group revenues or expenses where particular impact is material.

18.1 Comment

The intention of these requirements is to ensure the ACCC is informed of material changes to the accounting principles and policies that Australia Post uses to prepare the regulatory accounts and to ensure that it understands the impact of such changes.

The record keeping rules retain this requirement.

19. Disaggregation and deconsolidation of Group Statutory Accounts

Rule 10 of the draft record keeping rules required that the regulatory accounts be prepared by deconsolidating and disaggregating Australia Post's group statutory accounts. Australia Post made a number of comments about practical difficulties of the process proposed by this rule in its public submission.

19.1 Comment

The intention of this requirement was to ensure that the regulatory accounts are reconciled to Australia Post's Group Statutory Accounts.

The record keeping rules have been amended to better reflect this intention.

20. Statement of WACC

The draft record keeping rules did not require Australia Post to submit, as part of the regulatory accounts, a statement of its weighted average cost of capital (WACC).

The ACCC had intended to engage a consultant to estimate Australia Post's WACC and apply this to the value of capital employed for each service group to determine the 'cost of capital' that Australia Post's accounting records do not contain.

20.1 Comment

Australia Post requested that this requirement be added to the record keeping rules to allow it input into the ACCC's estimation of Australia Post's WACC.

The record keeping rules now require that Australia Post submit a statement of WACC.

21. Statement of service group usage

Australia Post's public submission stated that, other than for mail volumes, the reason for volume data was not clear. Australia Post also noted that in some cases, due to diverse products being grouped together the data could not be used to calculate averages and that in some cases the measures prescribed would not be meaningful at all.

21.1 Comment

Usage data is useful for allowing the calculation of average costs and revenues; however, where the service groups are composed of a variety of services, or where the usage data prescribed by the draft record keeping rules does not accurately reflect the level of use throughout the reporting period this will not be the case.

The record keeping rules now require usage data be supplied for all mail related 'service groups' and where the usage measures provide a reasonable indication of usage throughout the reporting period.

22. Other changes

In addition to the changes discussed in this document, a number of minor drafting changes have been made to the draft record keeping rules. These changes are intended to improve the clarity of the record keeping rule requirements.