Australian Competition & Consumer Commission

Assessing cross-subsidy in Australia Post

April 2015

ISBN 978 1 922145 49 9

Australian Competition and Consumer Commission
23 Marcus Clarke Street, Canberra, Australian Capital Territory, 2601

Important notice

The information in this publication is for general guidance only. It does not constitute legal or other professional advice, and should not be relied on as a statement of the law in any jurisdiction. Because it is intended only as a general guide, it may contain generalisations. You should obtain professional advice if you have any specific concern.

The ACCC has made every reasonable effort to provide current and accurate information, but it does not make any guarantees regarding the accuracy, currency or completeness of that information.

Parties who wish to re-publish or otherwise use the information in this publication must check this information for currency and accuracy prior to publication. This should be done prior to each publication edition, as ACCC guidance and relevant transitional legislation frequently change. Any queries parties have should be addressed to the Director, Corporate Communications, ACCC, GPO Box 3131, Canberra ACT 2601, or publishing.unit@accc.gov.au.

ACCC_04/15_971

www.accc.gov.au

Contents

Glossary

ACCC	Australian Competition and Consumer Commission
APCA	*Australian Postal Corporation Act 1989*
attributable cost	costs that are part of a pool of common costs identifiable to a particular service by a separable cause-and-effect relationship
Australia Post	Australian Postal Corporation
cross-subsidy	a cross-subsidy occurs where profits from the supply of a service are used to cover a loss incurred in the supply of another service
CCA	*Competition and Consumer Act 2010* (formerly *Trade Practices Act 1974*)
direct cost	costs that are solely associated with a particular service and so are incremental to providing that service
fully distributed cost	the sum of direct, attributable and unattributable costs allocated to the particular service or group of services
incremental cost	the additional cost incurred by producing a good or service (in addition to the other goods the firm produces)
non-reserved services	services not subject to Australia Post's statutory monopoly (i.e. generally, services it provides in competition with other businesses)
PreSort letters	Australia Post's PreSort letter service is a bulk mail service that provides discounted prices for business customers that barcode and sort their letters prior to lodgement
RAF	regulatory accounting framework
record-keeping rule (RKR)	a requirement by the ACCC that Australia Post keep certain records
regulatory accounts	the statement of financial performance, statement of capital employed, statement of movements in non-current asset values, statement of WACC and statement of service group usage required by the RKRs to be provided by Australia Post to the ACCC
reserved services	postal services reserved to Australia Post under the APCA legislation (i.e. no other entity can provide these services)
segment	For the purpose of compliance with the ACCC's regulatory accounting framework, Australia Post combines service groups into broader 'segments'. Australia Post's segments in 2013–14, were Mail (reserved and non-reserved), Parcels and StarTrack, Retail and Other services
service group	the service groups defined in Schedule 1 of the RKR information provided by Australia Post (for example, Financial services is a service group)
stand-alone cost	the cost of producing each output or service in isolation
unattributable cost	a cost that is part of a pool of common costs but is not readily identifiable (in whole or part) to any particular service by a separable cause-and-effect relationship
UPU	Universal Postal Union
WACC	weighted average cost of capital

Key findings

- The ACCC has a number of postal regulatory responsibilities including assessing proposals for price increases for the basic postage rate. However this report deals only with the ACCC's role in assessing cross-subsidy by Australia Post.
- The ACCC uses regulatory accounts submitted by Australia Post to conduct economic tests to assess whether Australia Post is using revenue from its monopoly letter service to cross-subsidise those services it provides in competition with other businesses.
- Any cross-subsidy by Australia Post from its reserved (statutory monopoly) services to its non-reserved services would be a concern because Australia Post could damage competition in other markets by the use of its legislated monopoly.
- The ACCC's cross-subsidy testing has found that Australia Post is not using profits from its monopoly reserved letter services to unfairly compete in other markets.
- The ACCC is satisfied that Australia Post's monopoly letter services were not a source of subsidy in 2013–14. Instead, reserved services were a potential recipient of subsidy. The level of cost recovery of reserved services has been declining together with letter volumes over time. In 2013–14 Australia Post's monopoly letter services were unable to recover its costs.
- However the source of any subsidy to Australia Post's reserved services is not clear. Australia Post's non-reserved services (as a whole) in 2013–14 were neither the recipient nor source of a subsidy.
- In all previous years which the ACCC has monitored cross-subsidy non-reserved services have been a source or a potential source of subsidy.
- In 2013–14, no specific non-reserved service or group of services was a definite source of subsidy.
- In 2013–14, Australia Post's overall revenues were lower than its costs, after taking into account capital costs. This is only the second time Australia Post has been unable to recover its full costs since the ACCC started monitoring for cross-subsidy in 2004–05.

1. Introduction

The ACCC has a role under the *Australian Postal Corporation Act 1989* (APCA) to assess whether Australia Post is cross-subsidising its non-reserved services (generally, services it provides in competition with others) with revenues from its reserved (statutory monopoly) services. This would be a concern because Australia Post could damage competition in competitive markets by the use of its legislated monopoly.[1]

To undertake its cross-subsidy assessment, the ACCC relies on information provided by Australia Post in its regulatory accounts. The regulatory accounts provide detailed revenue and cost information disaggregated by defined service groups. For example:

- Direct costs are solely associated with a particular service (for example, cost of goods sold can be directly attributed to products sold in Australia Post's retail stores). Due to the shared and labour-intensive nature of Australia Post's operations, it has very few direct cost items relating to specific mail services.
- Attributable costs items are part of a pool of common costs that are identifiable to a particular service by a separable cause-and-effect relationship. For example, the labour costs associated with processing and delivering letters can be described as attributable.
- Unattributable costs are part of a pool of common costs but are not readily identifiable to any particular service. For example, costs associated with senior management and central support functions such as finance and corporate affairs are classified as unattributable costs.

The regulatory accounts must be prepared by Australia Post in accordance with an ACCC record keeping rule (RKR). The regulatory accounts are reviewed by an independent auditor who audits Australia Post's compliance with the RKR and Australian Auditing Standards.

Australia Post allocates revenues, costs, and assets between service groups using its cost allocation methodology (CAM). The ACCC does not formally review Australia Post's CAM as part of its annual cross-subsidy assessment process.

In undertaking this cross-subsidy analysis, the ACCC has adjusted the regulatory accounts submitted by Australia Post to allow for a return on capital. The ACCC believes a return on capital is a legitimate cost to business. Accordingly the conclusions and cross-subsidy tests results in this report are presented on a capital-adjusted basis, unless otherwise noted. However, as discussed in appendix A, cost figures presented in this report do not include a return on capital. This approach allows readers to reconcile the figures presented with Australia Post's annual report, and recognises Australia Post's claim of confidentiality over its weighted average cost of capital (WACC) and its components.

The remainder of this report is structured as follows:

- Section 2 provides an overview of Australia Post and the ACCC's roles in the regulation of postal services
- Section 3 outlines the ACCC's framework for monitoring for cross-subsidy
- Section 4 sets out the results of the ACCC's cross-subsidy analysis for 2013–14
- Section 5 presents the ACCC's conclusions.

Appendix A outlines Australia Post's cost allocation methods and accounting policies.

1 For example, a monopolist is able to sustainably maintain prices below cost in related markets using profits from its monopoly services. In such a situation, customers that use the monopoly services are charged higher prices that contain a subsidy for the customers that use the monopolist's competitive services. This may result in economically inefficient over-consumption of non-reserved services, and may also negatively affect the competitiveness of the non-reserved service market. Additionally, in such a situation an economic inefficiency arises because prices for the monopoly services are, on the whole, at higher than competitive levels.

2. Background

The ACCC has a number of postal regulatory responsibilities including assessing price increases in the 70 cent basic postage rate. However this report deals only with the ACCC's role in assessing cross-subsidy by Australia Post.

This report presents the results of the ACCC's analysis of Australia Post's regulatory accounts for the 2013–14 financial year in order to determine whether Australia Post cross-subsidised its contestable services with revenue from its monopoly letter services.

The ACCC was given this role in 2004 in response to complaints by competitors that Australia Post was damaging competition by cross-subsidising its contestable services with revenues from its reserved services.[2] In June 2004 the APCA was amended to provide for the ACCC to issue a RKR that would 'enable the ACCC to scrutinise whether or not Australia Post is cross-subsidising from reserved services to the services it provides in competition with others'.[3]

The ACCC issues reports on its assessment of cross-subsidy in Australia Post on an annual basis. This is the 10th of these reports.

This section provides an overview of Australia Post's obligations in providing postal services and the ACCC's role in the regulation of postal services.

2.1 Australia Post's functions and obligations

Australia Post is the government-owned provider of postal services in Australia.

At the end of 2013–14, Australia Post employed approximately 36 900[4] people and operated 4417 retail outlets.[5] In 2013–14 Australia Post delivered mail to 11.3 million Australian addresses with 98.8 per cent of these receiving letter delivery five days a week.[6]

The APCA requires that Australia Post:

- as far as is practicable, perform its functions in a manner consistent with sound commercial practice[7]
- meet certain community service obligations (outlined below)[8]
- perform its functions in a way consistent with general government policy and any directions given by the Minister.[9]

Australia Post has a community service obligation to supply a letter service. The purpose of the letter service is to carry, by physical means, letters within Australia and between Australia and places outside Australia.

For letters that are standard postal articles, Australia Post must make the letter service available at a single uniform rate of postage for carriage within Australia. In recognition of the social importance of the letter service, Australia Post must ensure that:

- the letter service is reasonably accessible to all people on an equitable basis, wherever they reside or carry on business
- the performance standards of the letter service reasonably meet the social, industrial and commercial needs of the Australian community.

---

2 A situation where a monopolist is able to cross-subsidise its competitive services by revenues from its monopoly services may damage competition in the markets in which it competes, because the monopolist is able to sustainably maintain prices in those markets below cost, using profits from its monopoly services. This situation also means that prices for the monopoly services are, on the whole, at higher than competitive levels.

3 Explanatory memorandum for the Postal Services Legislation Amendment Bill 2003, p. 40. Section 50H(2) of the APCA provides the ACCC with authority to require Australia Post to keep certain records about its reserved services.

4 Australia Post annual report 2013–14 p. 35. Refer http://auspost.com.au/media/documents/Australia_Post_Annual_Report_2013-14.pdf

5 Australia Post annual report 2013–14 p. 139.

6 Australia Post annual report 2013–14 p. 22.

7 Section 26 of the APCA.

8 Section 27 of the APCA.

9 Section 28 of the APCA.

2.2 Services 'reserved' to Australia Post

In recognition of its community service obligations, Australia Post has a general monopoly in the carriage and delivery of letters within Australia, subject to some specific exemptions.[10]

The services covered by this monopoly are generally referred to as 'reserved services'. They extend to:

- the collection within Australia of letters for delivery within Australia
- the delivery of letters within Australia.

The term 'letters' has a meaning that is wider than its general usage—the APCA defines 'letter' as meaning any form of written communication that is directed to a particular person or a particular address.[11]

Australia Post also has the exclusive right to issue postage stamps within Australia.

As noted above, the monopoly in relation to reserved services is subject to a number of exceptions, which are detailed in s. 30 of the APCA. Some of these include:

- the carriage of a letter weighing more than 250 grams
- the carriage of a letter relating to goods that is sent and delivered with the goods
- the carriage of a newspaper, magazine, book, catalogue or leaflet, whether or not directed to a particular person or address and whether or not enclosed in any sort of cover
- the carriage of a letter otherwise than for reward
- the carriage of a letter on behalf of a foreign country under a convention
- the carriage of a letter within Australia for a charge or fee that is at least four times the then rate of postage for the carriage within Australia of a standard postal article by ordinary post.

2.3 ACCC role in the regulation of postal services

The ACCC has three key roles in the regulation of postal services under the *Competition and Consumer Act 2010* (CCA) and the APCA. This report deals only with one of these roles, under which the ACCC has the power to issue record keeping rules (RKRs) requiring Australia Post to keep certain records.[12]

The ACCC also has two other roles under the CCA and the APCA:

- assessing proposed price increases of Australia Post's notified[13] services under Part VIIA of the CCA
- inquiring into certain disputes regarding the terms and conditions on which Australia Post supplies its bulk mail services.[14]

2.4 Record-keeping rule powers

In March 2005 the ACCC issued an RKR that established a regulatory accounting framework (RAF) for Australia Post. In accordance with this RKR, Australia Post has submitted regulatory accounts to the ACCC for each financial year from 2004–05. The primary purpose of the RAF is to allow the ACCC to assess whether Australia Post is cross-subsidising from its reserved services to the services it provides in competition with others.

The rationale for this is that a situation where a monopolist is able to cross-subsidise its contestable services by revenues from its monopoly services may damage competition in the markets in which it competes, because the monopolist is able to sustainably maintain prices in those markets below cost using profits from its monopoly services. In such a situation, customers that use the monopoly services are charged

10 Section 27 of the APCA.

11 Section 3 of the APCA.

12 Section 50H of the APCA.

13 In 2011, the Australian Government limited prices surveillance of Australia Post letter services from all reserved services to certain letter services reserved to Australia Post. For example, the 70 cent basic postage rate (BPR) and other Ordinary letter services remain 'notified' and thus subject to price notification requirements. The other services currently reserved to Australia Post are no longer notified. Refer *Price Notification Declaration (Australia Post Letter Services) (No. 2) 2011.*

14 Regulations made under section 32B of the APCA allow the ACCC to inquire into disputes about the terms and conditions, including price of access to Australia Post's bulk mail services.

higher prices that contain a subsidy for the customers that use the monopolist's competitive services. This may result in economically inefficient over-consumption of non-reserved services, and may also negatively affect the competitiveness of the non-reserved service market. Additionally, in such a situation an economic inefficiency arises because prices for the monopoly services are, on the whole, at higher than competitive levels.

The ACCC may prepare and publish reports—or may be directed by the Minister to prepare and publish reports—analysing information provided to it under the RKRs.[15] Such reports may include information that Australia Post claims is commercial-in-confidence if:

- the ACCC is not satisfied that the claim is justified, or
- the ACCC considers it in the public interest to publish the information.[16]

15 Sections 50I and 50J of the APCA.

16 Sections 50K of the APCA.

3. Framework for monitoring for cross-subsidy

The term 'cross-subsidy' is often used to refer to any case where the profit from providing one service is used to cover a loss incurred in providing another service.

In monitoring for the presence of cross-subsidies from the monopoly reserved services to the contestable non-reserved services, the ACCC seeks to identify whether the revenue from any non-reserved service group is less than the incremental cost of providing that service group and whether the revenue generated by reserved services is greater than the stand-alone cost of providing them.

As discussed in section 3.1 below, in assessing Australia Post's regulatory accounts for the presence of cross-subsidy, the ACCC relies on accounting proxies for economic stand-alone and incremental costs.

The assessment of whether a cross-subsidy occurs is independent of the question of the efficiency of Australia Post's costs, which the ACCC has historically considered as part of its price notification assessments.

3.1 Economic vs accounting costs

The ACCC considers that Australia Post would be likely to incur significant compliance costs if it were required to keep financial records on the economic cost concepts of stand-alone and incremental costs. Such a requirement would entail devising new estimates of costs, revenues and assets on a different basis to the one Australia Post currently uses to keep its accounting records.[17]

Accordingly, the incremental and stand-alone costs referred to in this report are based on accounting data and provide a proxy for what the true economic incremental or stand-alone costs may be. The cost proxies used by Australia Post are direct, attributable and unattributable costs:

- **direct account items** are solely associated with a particular service and will be incremental to providing that service
- **attributable account** items are part of a pool of common account items that are identifiable to a particular service by a separable cause-and-effect relationship
- **unattributable account items** are part of a pool of common account items but are not readily identifiable (in whole or part) to any particular service by a separable cause-and-effect relationship.

These cost proxies are described in more detail in appendix A.1.

3.2 Testing for cross-subsidy

Cross-subsidies occur when one group of users pay for more than the costs of the services they receive, and the surplus is used to offset the cost of services provided to other users. They may occur as an unintended result of the chosen charging mechanism or deliberately for example to pursue equity or social policy objectives.

Cross-subsidies between different processes or different users may permanently disadvantage one group relative to another. Those who pay the subsidy may restrict their use of the product, reducing desirable consumption that would have taken place if products were appropriately priced. Conversely, those who receive a subsidy may be encouraged to use too much of the product.

The rationale for the ACCC's role in assessing cross-subsidy in Australia Post is that it may use cross-subsidies from its legislated monopoly in the provision of letter services to damage competition in competitive markets. In such a situation, customers that use the monopoly services would be charged higher prices that contain a subsidy for the customers that use the monopolist's competitive services. This may result in economically inefficient over-consumption of non-reserved services, and may also negatively affect the competitiveness of the non-reserved service market.

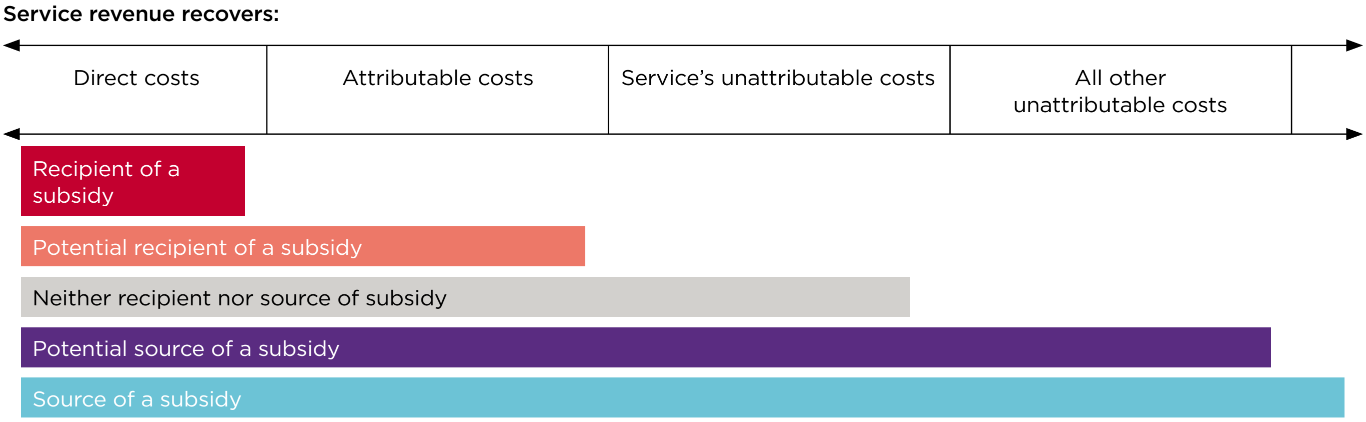
17 ACCC, *Regulation impact statement, record keeping rules for establishing a regulatory accounting framework for Australia Post*, March 2005, p. 6.

The formal definition of cross-subsidy that has developed in the economic literature comprises two tests that compare a service's revenues to different cost concepts:[18]

- the stand-alone cost test for whether a service is a **source** of cross-subsidy:
  - The stand-alone costs are defined as the costs that an efficient competitor would incur in providing just that service or group of services.
  - In testing Australia Post's regulatory accounts for cross-subsidy, the lower bound of the stand-alone cost test is assumed to be the service's fully distributed cost. Where the service's revenue exceeds fully distributed cost (i.e. the sum of the service's direct, attributable and unattributable costs), it may be a source of subsidy.
  - The upper bound of the stand-alone cost test is assumed to be the sum of the service's direct and attributable costs, and the total of all of Australia Post's unattributable costs. Where the service's revenue is above this upper bound, it is a definite source of subsidy.
- the incremental cost test for whether a service is a **recipient** of cross-subsidy:
  - Incremental costs are the additional costs incurred by the monopolist in providing just that service or group of services. Another way of considering incremental cost is to ask 'what costs would be avoided, in the long run, if the service was no longer offered?'
  - In respect of testing Australia Post's regulatory accounts for cross-subsidy, where revenue is less than direct costs, the service is a recipient of a subsidy. This is the lower bound of the incremental cost test.
  - Where revenue is sufficient to cover the direct costs, but less than the sum of direct and attributable costs, the service group is assumed to be a possible recipient of a subsidy. This is the upper bound of the incremental cost test.

The range of possible cross-subsidy results is presented graphically at chart 3.1.

Chart 3.1 Range of possible cross-subsidy results



Further details about how the ACCC applies these cross-subsidy tests is outlined in the document titled 'ACCC tests for assessing cross-subsidy in Australia Post' which is available on the ACCC website at http://www.accc.gov.au/publications/assessing-cross-subsidy-in-australia-post.

18 GR Faulhaber, 'Cross-subsidization: pricing in public enterprises', American Economic Review, 65(5), December, 1975, pp. 966–77.

4. Analysis of Australia Post's 2013–14 accounts

This section sets out the results of the ACCC's analysis of Australia Post's regulatory accounts for 2013–14. Australia Post's current business structure has four business groups:

- Mail: The collection, processing and distribution of mail items, digital communications and associated services. This is comprised of:
  - reserved mail—the collection, processing and distribution of domestic letters defined as reserved by the APCA
  - non-reserved mail—the processing and distribution of non-reserved domestic letter services
- Parcels and StarTrack: The processing and distribution of parcel and express products, international mail services along with freight forwarding operations.
- Retail: Provision of postal products and services, agency services, mail boxes and bags, financial services and other retail merchandise, principally philatelic, stationery, telephony, greeting cards, gifts and souvenirs.
- Other services: This includes services that are incidental to Australia Post's core products and services, principally those which generate rental income, license fees, and other miscellaneous amounts.

As discussed in appendix A.2, the test results outlined below were performed using capital-adjusted costs—that is, Australia Post's accounting costs were adjusted to include a rate of return on the capital employed for each service group. The ACCC does not endorse Australia Post's proposed WACC either for the purposes of cross-subsidy analysis or for other purposes—such as a price notification. Nor does the ACCC endorse the various input parameters used by Australia Post in its statement of WACC. However, a lower WACC, such as that used in the ACCC's decision on the 2014 price notification, does not affect the ACCC's key finding in this report which is that Australia Post's reserved services were not a source of subsidy for its non-reserved services. Accordingly, it is not necessary for the ACCC to determine a precise WACC for current purposes.

Furthermore, the test results are generally robust whether or not the capital adjustment occurs (i.e. in most cases the capital adjustment only affects the size of the subsidy).

Despite use of the capital-adjusted costs in testing, all dollar cost figures in this report are reported on a non-capital adjusted basis. This approach allows readers to reconcile the figures presented with Australia Post's annual report, and recognises Australia Post's claim of confidentiality over the information contained in the statement of capital employed.

The ACCC has applied the incremental cost test and the stand-alone cost test to each of the service groups, and the broader segments.

The overall conclusion based on Australia Post's regulatory accounts, after taking into account capital costs, is that the non-reserved services did not receive a subsidy from reserved services.

In 2013–14, Australia Post's overall revenues were lower than its costs, after taking into account capital costs. This is only the second time Australia Post has been unable to recover its full costs since the ACCC started monitoring for cross-subsidy in 2004–05.

The level of cost recovery of reserved services has been declining together with letter volumes over time. However, the source of any subsidy to Australia Post's reserved services is not clear. Non-reserved services (as a whole) in 2013–14 were neither the recipient nor source of a subsidy. In all previous years which the ACCC has monitored cross-subsidy non-reserved services have been a source or a potential source of subsidy.

The following table presents the cross-subsidy test results for 2013–14 based on the products and service types specified in Australia Post's 2013–14 regulatory accounts.

Table 1: Results of 2013–14 cross-subsidy tests on a capital adjusted basis

	Is the service group a recipient of a subsidy? (Revenues less than incremental costs)		**Is the service group a source of a subsidy?** (Revenues greater than stand-alone costs)	
	Definitely	**Potentially**	**Definitely**	**Potentially**
	(revenues less than the lower bound of incremental cost: i.e. direct costs)	**(revenues less than the upper bound of incremental cost: i.e. direct and attributable costs)**	**(revenues greater than the upper bound of stand-alone cost: i.e. fully distributed costs plus all other unattributable costs)**	**(revenues greater than the lower bound of stand-alone cost: i.e. fully distributed costs)**
Total reserved mail	**NO**	**YES**	**NO**	**NO**
small letters ordinary	NO	YES	NO	NO
large letters ordinary	NO	YES	NO	NO
small letters pre sort	NO	YES	NO	NO
large letters pre sort	NO	YES	NO	NO
Total non-reserved mail	**NO**	**YES**	**NO**	**NO**
large letters ordinary	NO	NO	NO	YES
large letters pre sort	NO	YES	NO	NO
other letter mail services	NO	YES	NO	NO
other letter associated services	NO	YES	NO	NO
Total parcels and StarTrack[19]	**NO**	**NO**	**NO**	**YES**
international outward letters	NO	NO	NO	YES
international inward letters	NO	YES	NO	NO
domestic parcels	NO	NO	NO	YES
international outward parcels	NO	NO	NO	YES
courier services[20]	YES	YES	NO	NO
international inward parcels	NO	YES	NO	NO
StarTrack International[21]	NO	YES	NO	NO
Total retail services	**NO**	**NO**	**NO**	**YES**
retail	NO	NO	NO	YES
financial services	NO	NO	NO	YES
Total other services	**YES**	**YES**	**NO**	**NO**
Total reserved services	**NO**	**YES**	**NO**	**NO**
Total non-reserved services	**NO**	**NO**	**NO**	**NO**
Total letter services	**NO**	**YES**	**NO**	**NO**
Total non-letter services	**NO**	**NO**	**NO**	**YES**
Total mail services	**NO**	**YES**	**NO**	**NO**
Total non-mail services	**NO**	**NO**	**NO**	**YES**

19 In 2013–14, Australia Post changed the name of this business segment from parcels and express to parcels and StarTrack.

20 The domestic operations of StarTrack (which is a 100 per cent owned subsidiary of Australia Post) are included in Australia Post's 2013–14 Regulatory Accounts under courier services.

21 This service group relates to the provision of supply chain solutions through commercial freight forwarding channels from points of origin overseas for customers shipping goods into Australia. It includes StarTrack's international operation as well as some other logistic services operated by Australia Post.

A time-series of the results of the ACCC's cross-subsidy tests on Australia Post's regulatory account data is presented in table 2.[22] The range of possible cross-subsidy results is presented graphically at chart 3.1.

Table 2: Results of cross-subsidy tests from 2004–05 to 2013–14 on a capital adjusted basis

Service group	2004–05	2005–06	2006–07	2007–08	2008–09	2009–10	2010–11	2011–12	2012–13	2013–14
Total reserved mail	Potential source	Neither	Neither	Neither	Neither	Potential recipient	Potential recipient	Potential recipient	Potential recipient	Potential recipient
Small letters ordinary	Neither	Potential recipient	Potential recipient	Potential recipient	Potential recipient	Potential recipient	Potential recipient	Potential recipient	Potential recipient	Potential recipient
Large letters ordinary	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential recipient
Small letters PreSort	Potential source	Potential source	Potential source	Neither	Neither	Potential recipient	Potential recipient	Potential recipient	Potential recipient	Potential recipient
Large letters PreSort	Potential source	Potential source	Potential source	Potential source	Neither	Potential recipient	Potential recipient	Neither	Potential recipient	Potential recipient
Total non-reserved mail[23]	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential recipient	Potential recipient	Potential recipient
Large letters ordinary	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source
Large letters PreSort	Potential source	Potential source	Potential source	Potential source	Neither	Neither	Neither	Neither	Neither	Potential recipient
International inward letters	Neither	Potential recipient	Potential recipient	Potential recipient	Potential recipient	Potential recipient	Potential recipient	Potential recipient	Potential recipient	Potential recipient
International outward letters	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source
Other letter mail services	Neither	Potential source	Potential source	Potential source	Neither	Neither	Potential recipient	Potential recipient	Potential recipient	Potential recipient
Other letters associated services	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Neither	Potential recipient
Total parcels services	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Source	Source	Potential source
Domestic parcels	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Source	Potential source
International inward parcels	NA	Potential source	Neither	Neither	Potential source	Potential recipient	Potential recipient	Potential recipient	Potential recipient	Potential recipient
International outward parcels	NA	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source
Courier services	NA	Potential source	Potential source	Potential source	Potential source	Neither	Potential source	Potential source	Potential source	Recipient
Logistics	Recipient	Recipient	Recipient	Recipient	Recipient	Recipient	Recipient	Potential source	Potential source	NA
StarTrack International[24]	NA	NA	NA	NA	NA	NA	NA	NA	NA	Potential recipient
Total retail and agency	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Source	Potential source
Retail	Potential source	Potential source	Potential source	Potential source	Potential source	Neither	Potential source	Potential source	Potential source	Potential source
Financial services	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source
Total other services	NA	Potential source	Potential source	Potential recipient	Potential recipient	Neither	Recipient	Recipient	Recipient	Recipient
Total reserved services	Potential source	Neither	Neither	Neither	Neither	Potential recipient	Potential recipient	Potential recipient	Potential recipient	Potential recipient
Total non-reserved services	Source	Source	Source	Source	Source	Potential source	Source	Source	Source	Neither
Total letter services	Source	Potential source	Potential source	Potential source	Neither	Potential recipient	Potential recipient	Potential recipient	Potential recipient	Potential recipient
Total non-letter services	Potential source	Source	Source	Potential source	Potential source	Potential source	Source	Source	Source	Potential source
Total mail services	Source	Source	Source	Source	Source	Neither	Neither	Neither	Neither	Potential recipient
Total non-mail services	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source
TOTAL	Source	Source	Source	Source	Source	Neither	Source	Source	Source	Potential recipient

LEGEND

Recipient of a subsidy	
Potential recipient of a subsidy	
Neither recipient nor source of a subsidy	
Potential source of a subsidy	
Source of a subsidy	
Service group did not exist[25]	NA

22 Note that changes to Australia Post's accounting policies over time, in particular the classification of service groups, will impact on comparison of results over time. See ACCC cross-subsidy reports for 2004–05 to 2012–13 (available on the ACCC website) for details of changes to accounting policies over time.

23 Australia Post's 2013–14 regulatory accounts classify international inward and outward letters as a part of 'parcels and StarTrack'. The ACCC's time-series analysis retains the previous classification of these services (non-reserved mail) for easier time-series comparison.

24 This service relates to the provision of supply chain solutions through commercial freight forwarding channels from points of origin overseas for customer shipping goods into Australia. It includes StarTrack's international operation as well as some other logistic services operated by Australia Post.

25 These service groups have now been combined with other service groups. See previous ACCC cross-subsidy reports which available on the ACCC website at http://www.accc.gov.au/regulated-infrastructure/postal-services for details of changes to service group classifications over time.

4.1 Key trends and changes over time

The following section outlines the general trends over the 10 years that the ACCC has been conducting its cross-subsidy analysis.

Total business

- Australia Post's overall revenues were lower than its costs, after taking into account capital costs. The only previous occasion when Australia Post has been unable to recover its full costs since the ACCC started monitoring for cross-subsidy was in 2009–10.[26]

Broad business area

Australia Post's business operation can be categorised into a number of broad areas where there is a similarity of products sold and/or the services provided.

- *Reserved services* have been a potential source of subsidy in 2004–05, neither the recipient nor source of a subsidy from 2005–06 to 2008–09, and a potential recipient of a subsidy from 2009–10 to 2013–14. In general, the cost recovery of reserved services has been declining together with letter volumes.
- *Non-reserved services* have been a source of subsidy from 2004–05 to 2008–09 and from 2010–11 to 2012–13, a potential source of subsidy in 2009–10 and neither the recipient nor source of a subsidy in 2013–14.
- *Letter services* (reserved and non-reserved) as a whole have been a source of subsidy in 2004–05, potentially a source of subsidy from 2005–06 to 2007–08, neither the recipient nor source of a subsidy in 2008–09 and a potential recipient of a subsidy from 2009–10 to 2013–14. Like reserved letters, letter services' cost recovery has followed the trend of overall letter volumes.
- *Non-letter services* as a whole have been a potential source of subsidy in 2004–05, from 2007–08 to 2009–10 and in 2013–14, and a source of subsidy in 2005–06 and 2006–07 and from 2010–11 to 2012–13.
- *Mail services* (includes letters and parcels services) were a potential recipient of subsidy in 2013–14. Mail services were previously a source of subsidy from 2004–05 to 2008–09 and neither the recipient nor source of a subsidy from 2009–10 to 2012–13.
- *Non-mail services* (all services except letters and parcels services) have been potentially a source of subsidy in all years the ACCC has been monitoring cross-subsidy.

Service group

Australia Post has a number of service groups which it reports on in its regulatory accounts. These service groups contain either reserved or non-reserved services.

- *Reserved mail services*: see 'reserved services' above.
- *Non-reserved mail services* segment has been a potential source of subsidy from 2004–05 to 2010–11 but was a potential recipient of subsidy from 2011–12 to 2013–14.
- *Parcels services* segment has been potentially a source of subsidy from 2004–05 to 2010–11 and in 2013–14, and was a definite source of subsidy from 2011–12 to 2012–13. In Australia Post's 2013–14 regulatory accounts its 'logistics services' group was combined with other service groups within the *Parcels services* segment.
- *Retail & agency services* have been a potential source of subsidy in all years the ACCC has been monitoring cross-subsidy with the exception of 2012–13 when it was a source of subsidy.
- *Other services'* segment has been a potential source of subsidy in 2005–06 and 2006–07, a potential recipient of a subsidy in 2007–08 and 2008–09, neither the recipient nor source of a subsidy in 2009–10, and a recipient of a subsidy from 2010–11 to 2013–14.

26 In 2009–10, Australia Post's regulatory accounts were affected by $150 million of restructuring costs.

4.2 Did any service group receive a subsidy in 2013–14?

Revenue for the following services in Australia Post's submitted 2013–14 regulatory accounts did not recover the direct and attributable costs of providing them, and the services were therefore recipients of a subsidy or potential recipients of a subsidy in 2013–14:

- international inward letters (non-reserved) (section 4.2.1)
- international inward parcels (non-reserved) (section 4.2.2)
- large PreSort letters (non-reserved) (section 4.2.3)
- other letter mail services (non-reserved) (section 4.2.4)
- other letter associated services (non-reserved) (section 4.2.5)
- courier services (4.2.6)
- StarTrack International (4.2.7)
- other services (non-reserved) (section 4.2.8)
- small ordinary letters (reserved) (section 4.2.9)
- large ordinary letters (reserved) (section 4.2.9)
- small PreSort letters (reserved) (section 4.2.9)
- large PreSort letters (reserved) (section 4.2.9).

4.2.1 International inward letters (non-reserved)

Payment for the delivery of most international mail is overseen by the Universal Postal Union (UPU) under a system known as 'terminal dues'. The terminal dues payable to the destination postal operator are not based on the actual costs incurred in delivering this mail. Rather, terminal dues remuneration is linked to a formula that uses a percentage of the basic postage rate.

Revenues from international inward letters were below the direct and attributable costs of providing these services in 2013–14. Table 2 also shows that while there was an under-recovery of fully distributed costs in international inward letters, international outward letters over-recovered its fully distributable costs for each of the years the ACCC has been monitoring cross-subsidy.

International letters as a group—international inward and outward letters recovered its fully distributed costs in 2013–14 which is the first time this has occurred since 2004–05.

Australia Post has advised that it expects international inward letters to continue to under-recover its direct and attributable costs. However, new terminal dues which took effect from 1 January 2015 will increase the terminal dues paid to Australia Post.

4.2.2 International inward parcels—(non-reserved)

The inward international parcels service group relates to the receipt, handling, delivery and on-forwarding of inbound international parcels and related mail articles within Australia. For small parcels (i.e. less than 2 kg) the remuneration Australia Post receives for these services is determined by the terminal dues system.

As identified in table 1, revenue from the international inward parcels was below the direct and attributable costs of providing the services in 2013–14.

According to Australia Post, the performance of the service group is dependent on:

- parcel volumes
- the $A/SDR exchange rate
- domestic delivery costs.

Australia Post has advised that the decline in the performance in this service group has been due to a shift in volume mix towards the parcels less than 2 kg category, which forms part of the terminal dues stream. The recent decline in the Australian dollar has negatively impacted volumes in this category.

4.2.3 Large PreSort letters (non-reserved)

This service relates to the collection and delivery of letters which fall within the weight and price definition of an Ordinary Large Letter—non-reserved[27], but where the customer has undertaken a sorting exercise to organise the letters according to pre-defined criteria by Australia Post.

The service was a potential recipient of a subsidy in 2013–14.

4.2.4 Other letter mail services (non-reserved)

The 'other letter mail services' category contains a range of non-reserved letter services, such as Unaddressed Mail and Periodicals.

This service group was a potential recipient of a subsidy in 2013–14. Australia Post has advised that this is due to the fact that, compared to volume, revenue for the service group is proportionally lower as it contains some low unit revenue products such as Unaddressed Mail.

4.2.5 Other letter associated services (non-reserved)

The 'other letter associated services' category contains a range of non-reserved letter services, such as eLetter Solutions, Faxpost, Mailroom Management Services and Mail Holding and Redirection services.

This service group was a potential recipient of a subsidy in 2013–14. Australia Post has advised that this is due to the fact that, compared to volume, revenue for the service group is proportionally lower as it contains some low unit revenue products such as Mail Holding and Redirection Services and Mailroom Management Services.

4.2.6 Courier services (non-reserved)

This includes all Australia Post's courier services including Messenger Post, Express Courier International and the domestic operations of StarTrack. In 2013–14, Australia Post's regulatory accounts included for the first time the full year business operations of StarTrack.[28]

While revenue from 'courier services' was greater than its fully distributed costs on a non-capital-adjusted basis, it was less than just direct costs on a capital-adjusted basis, meaning that 'courier services' received a subsidy in 2013–14 on a capital-adjusted basis. This reflects the fact that this segment carries many assets and thus adjusting for capital had a significant impact on the measure of cost recovery.

4.2.7 StarTrack International (non-reserved)

This service group relates to the provision of supply chain solutions through commercial freight forwarding channels from points of origin overseas for customer shipping goods into Australia. It includes StarTrack's international operations as well as some other logistic services operated by Australia Post.

Revenue from 'StarTrack International' was less than the sum of direct and attributable costs on both a capital-adjusted and non-capital-adjusted basis. Therefore these services were a potential recipient of a subsidy in 2013–14.

Australia Post advised that the low profitability for StarTrack International in 2013–14 was due to the performance of other logistic services classified under StarTrack International category.

4.2.8 Other services (non-reserved)

'Other services' is a category used by Australia Post that relates to non-product-specific operations of Australia Post's business, so there is no direct relationship between revenues, costs, profit and asset allocations. Revenue from 'other services' includes miscellaneous revenue that cannot be attributed to other products, such as property rents, license fees and other revenue such as unclaimed money orders. Costs under 'other services' consist of an allocation of corporate overheads and include property management for external leases. Assets purchased for future use are also included under 'other services'.

---

27 Letters weighing more than 250 grams and that are priced at least four times the basic postage rate are non-reserved services.

28 In November 2012, Australia Post acquired Qantas' interest in StarTrack making Australia Post StarTrack's sole shareholder. Australia Post's 2012–13 regulatory accounts included only a partial year of StarTrack's business operations.

This service was a recipient of a subsidy on both a non-capital and capital-adjusted basis. Australia Post advises that the reason for this is that there was an increase in operational and administration expenses, and costs relating to real estate due to vacant building space not let.

4.2.9 Reserved services

In 2013–14, revenue from each of Australia Post's four reserved letter services was below their respective direct and attributable costs. The individual letter service trends are summarised below.

- Small ordinary letter services have failed to recover their fully distributable costs since the ACCC began monitoring cross-subsidy in 2004–05. Revenue from small ordinary letters was below direct and attributable costs in each of the years from 2005–06 to 2013–14. The recovery of direct and attributable costs has generally been decreasing since the ACCC began monitoring cross-subsidy, which may reflect the decline in letter volumes experienced in recent years.
- While revenue from large ordinary letter revenues was greater than fully distributable costs on a non-capital adjusted basis, it was less than fully distributable costs on a capital adjusted basis, meaning that these services were a potential recipient of subsidy on a capital adjusted basis in 2013–14. In all previous years since the ACCC commenced monitoring cross-subsidy this service has been able to recover its fully distributable costs and has been a potential source of subsidy.
- Small PreSort letter services failed to recover their fully distributable costs in each of the years from 2007–08 to 2013–14. Revenue from small PreSort letters had been above the direct and attributable costs of providing these services from 2004–05 to 2008–09, but from 2009–10 to 2013–14 the service did not recover its direct and attributable costs.
- Large PreSort letter revenues have failed to recover fully distributed costs in each of the years from 2008–09 until 2013–14. In 2009–10, 2010–11, 2012–13 and 2013–14 the service also under-recovered its direct and attributable costs.

In summary, the ACCC's cross-subsidy analysis shows that each of the four reserved letter services potentially received a subsidy in 2013–14. However the ACCC's cross-subsidy assessment is focused on detecting the situation where Australia Post is able to cross-subsidise its contestable services by revenues from its monopoly services. Such a situation may damage competition in the markets in which Australia Post competes, because it is able to maintain prices in those markets below cost. This situation does not arise when the reverse form of cross-subsidy occurs (i.e. where contestable services on the whole appear to be subsidising the monopoly services), or where the business as a whole does not recover all of its costs.

4.3 Are reserved services a source of subsidy?

In 2013–14, on a capital-adjusted basis there were no reserved service groups which were able to recover fully distributed costs, or even their respective direct and attributable costs. The reserved services as a whole did not recover their total direct and attributable costs. Thus, they were not a source of subsidy on a capital-adjusted basis.

Table 3 shows the 2013–14 revenue and cost recovery for total reserved services in comparison to total non-reserved services prior to a capital adjustment (2012–13 revenues and costs are provided for context). In total, revenue from reserved services did not recover the fully distributed costs of providing them. In fact, revenue from reserved services did not even recover their direct and attributable costs, which suggests that the reserved services at an aggregate level were a potential recipient of a subsidy.

The fully distributed cost of reserved services is likely to underestimate the actual stand-alone cost of providing these services. In that case it is necessary to add back some of the unattributable costs that were allocated to non-reserved services (i.e. the unattributable costs that may be incurred by Australia Post whether non-reserved services were provided or not). However, identifying the appropriate amount to be added back is problematic. As discussed in section 3, one approach is to establish an upper bound on the stand-alone cost. This could be done by adding back all the unattributable costs that were allocated to all other services.

Since reserved services revenue was substantially lower than the fully distributed costs of providing reserved services, adding back other unattributable costs will only increase the under-recovery.

Accordingly, the ACCC is satisfied that, on the basis of Australia Post's regulatory accounts, the reserved services were not a source of subsidy.

Table 3: Reserved and non-reserved services revenues and costs ($million) on a non-capital-adjusted basis

	2012–13 reserved services	2012–13 non-reserved services	2013–14 reserved services	2013–14 non-reserved services
Revenue[29]	1716.5	4096.5	1771.2	4463.4
Direct cost[30]	0.7	1312.5	6.0	1607.9
Attributable cost	1822.4	2131.7	1943.3	2380.2
Unattributable cost	40.8	106.2	64.5	186.9
Fully distributed cost	1863.9	3550.4	2013.8	4175.0
Revenue less direct cost	1715.7	2784.1	1765.2	2885.4
Revenue less direct and attributable costs	(106.6)	652.3	(178.1)	475.2
Revenue less fully distributed cost	(147.4)	546.1	(242.6)	288.3
Revenue less fully distributed cost and all other unattributable costs	(253.7)	505.3	(429.5)	223.8

The ACCC has also applied the stand-alone cost test to other groups of services in order to identify possible sources of subsidy.

Table 4 shows the cost recovery in 2013–14 for all of Australia Post's business segments (prior to a capital adjustment). The 'Parcels and StarTrack' and' Retail services' segments were the only two business segments able to recover their fully distributed costs. The Parcels and StarTrack segment also had, prior to a capital adjustment, revenue sufficient to recover all the unattributable costs allocated to all other services (i.e. it was a source of subsidy).

Table 4: Australia Post's revenues and costs by segment totals ($million) on a non-capital-adjusted basis

	Reserved letter services	Non-reserved mail services	Parcels and StarTrack	Retail services	Other services
Revenue	1771.2	484.3	3094.2	900.0	(15.0)
Direct cost	6.0	131.9	1101.7	340.2	34.2
Attributable cost	1943.3	448.5	1598.6	333.1	–
Unattributable cost	64.5	32.9	76.0	78.0	–
Fully distributed cost	2013.8	613.3	2776.3	751.3	34.2
Revenue less direct cost	1765.2	352.4	1992.5	559.8	(49.2)
Revenue less direct and attributable costs	(178.1)	(96.1)	393.9	226.7	(49.2)
Revenue less fully distributed cost	(242.6)	(129.0)	317.9	148.7	(49.2)
Revenue less fully distributed cost and all other unattributable costs	(429.5)	(347.6)	142.4	(24.8)	(300.7)

29 Australia Post has advised that the major factor contributing to the increase in non-reserved services revenue in 2013–14 relates to the inclusion for the first time of StarTrack's full year business operations in its Regulatory Accounts.

30 Australia Post has advised that the major factor contributing to the increase in non-reserved services direct cost in 2013–14 relates to the inclusion for the first time of StarTrack full year business operations in its Regulatory Accounts.

4.4 Total letter services and total mail services

Although Australia Post does not have a legislated monopoly for non-reserved letter services, it nonetheless has a strong market position in these areas due to its wide-ranging collection and distribution networks.

Accordingly, to identify possible sources of subsidy, the ACCC has applied the stand-alone cost test to:

- total letter services
- total non-letter services
- Table 5 shows that revenue from total (reserved and non-reserved) letter services was less than the direct and attributable costs of providing these services even prior to a capital adjustment. Furthermore letter services appear to be a recipient of a subsidy from Australia Post's total non-letter services, the revenues from which were greater than total non-letter services' fully distributed costs and all other unattributable costs.

Table 5: Letter and non-letter revenues and costs ($million) on a non-capital-adjusted basis

	Total letter services	Total non-letter services
Revenue	2416.6	3818.0
Direct cost	137.9	1476.1
Attributable cost	2540.7	1782.8
Unattributable cost	99.9	151.6
Fully distributed cost	2778.4	3410.4
Revenue less direct cost	2278.7	2341.9
Revenue less direct and attributable costs	(262.0)	559.1
Revenue less fully distributed cost	(361.9)	407.6
Revenue less fully distributed cost and all other unattributable costs	(513.4)	307.7

Table 6 shows that, prior to a capital adjustment, revenue from aggregate letter and parcel services was greater than the direct and attributable costs but less than the fully distributed costs of providing these services. In contrast, revenue from aggregate non-letter and non-parcel services was sufficient to recover fully distributed costs for these services.

When adjusted for the cost of capital, aggregate letter and parcel services were a potential recipient of a subsidy whereas aggregate non-letter and non-parcel services were a potential source of subsidy.

Table 6: Letter and parcel and non-letter and non-parcel revenues and costs ($million) on a non-capital-adjusted basis

	Total letter and total parcel services[31]	Total non-letter and non-parcel services
Revenue	5349.6	884.9
Direct cost	1239.5	374.4
Attributable cost	3990.4	333.1
Unattributable cost	173.4	78.0
Fully distributed cost	5403.4	785.5
Revenue less direct cost	4110.1	510.6
Revenue less direct and attributable costs	119.7	177.5
Revenue less fully distributed cost	(53.7)	99.4
Revenue less fully distributed cost and all other unattributable costs	(131.8)	(74.0)

31 Australia Post's 2013–14 regulatory accounts classify courier services as a part of 'total letter and total parcel services'

5. Conclusion

The ACCC is satisfied that, on the basis of Australia Post's regulatory accounts, its monopoly letter services (as a whole) were not a source of subsidy in 2013–14. Instead, reserved services were a potential recipient of subsidy. The level of cost recovery of reserved services has been declining together with letter volumes over time.

However the source of any subsidy to Australia Post's reserved services is not clear. Australia Post's non-reserved services (as a whole) in 2013–14 were neither the recipient nor source of a subsidy. In all previous years which the ACCC has monitored cross-subsidy non-reserved services have been a source or a potential source of subsidy. In 2013–14, no specific non-reserved service or group of services was a definite source of subsidy.

In 2013–14, Australia Post's overall revenues were lower than its costs, after taking into account capital costs. This is only the second time Australia Post has been unable to recover its full costs since the ACCC started monitoring for cross-subsidy in 2004–05.

5.1 Did reserved services subsidise non-reserved services?

Australia Post's regulatory accounts for 2013–14 do not provide evidence of cross-subsidy from reserved services to non-reserved services.

Revenue from reserved services was not sufficient to cover the lower or upper bound of the stand-alone costs test, which needs to be met for a service to be a potential source of subsidy.

Indeed, in 2013–14 Australia Post's reserved services were a potential recipient of a subsidy, because, as a whole, reserved services did not recover their direct and attributable costs (the upper bound of the incremental cost test) on both a capital and non-capital adjusted basis.

Australia Post's non-reserved services were neither the recipient nor source of a subsidy, on a capital adjusted basis. However, without a capital adjustment, Australia Post's non-reserved services revenue was a source of subsidy for Australia Post's reserved services. In all previous years which the ACCC has monitored cross-subsidy non-reserved services have been a source or a potential source of subsidy on a capital adjusted basis.

The ACCC is therefore satisfied that reserved services were not a source of subsidy.

5.2 Did any service group receive a subsidy?

Two Australia Post services, 'courier services' and 'other services' received a subsidy in 2013–14.

Australia Post's 'courier services' service group includes Messenger Post, Express Courier International and the domestic operations of StarTrack. Revenue from 'courier services' was less than just direct costs on a capital-adjusted basis, meaning that 'courier services' was recipient of a subsidy in 2013–14. When considered on a non-capital-adjusted basis, 'courier services' was not a recipient of a subsidy—it was a possible source of subsidy.

'Other services', a category used by Australia Post that relates to non-product-specific operations of Australia Post's business, received a subsidy in 2013–14, when considered on both a capital-adjusted and non-capital-adjusted basis.

However, the subsidy to 'courier services' and 'other services' that occurred in 2013–14 is not a significant area of concern for the ACCC because it is not being provided by Australia Post's statutory monopoly services.

Ten other services may also have received a subsidy in 2013–14.

Revenue from these 10 services did recover their respective direct costs. Therefore, to determine whether these services actually received a subsidy requires further analysis of the extent to which the costs attributed to these services represent their incremental costs. The information required to undertake this further analysis is only likely to be obtained by conducting a broader cost review.

Revenue from each of large PreSort letters, international inward letters, international inward parcels, 'other letter mail services', 'other letter associated services' and StarTrack International (all non-reserved services) was less than the respective direct and attributable costs of providing these services.

Revenue from all four reserved services—small ordinary letters, large ordinary letters, small PreSort letters and large PreSort letters—was less than their respective direct and attributable costs.

The ACCC's role in assessing Australia Post's regulatory accounts for evidence of cross-subsidy is aimed at preventing Australia Post from using profits from its statutory monopoly services to harm its competitors in non-reserved services. As such, any cross-subsidy received by reserved services is not a focus for the ACCC in relation to this role because the sources of the subsidy are not services covered by Australia Post's statutory monopoly. International inward letters and international inward parcels weighing less than 250 grams are also not subject to competition because these services are subject to UPU regulation.

Appendix A: Accounting policies and cost allocation

The results of the cross-subsidy assessment will be affected by:

- the method of allocating costs to service groups (section A.1)
- Australia Post's accounting policies (section A.2).

A.1 Cost allocation

The ACCC does not formally review Australia Post's activity-based cost allocation methodology (CAM) as part of its annual cross-subsidy assessment process.

To undertake its cross-subsidy assessment, the ACCC uses information provided by Australia Post in its regulatory accounts, which are required to be prepared in accordance with the ACCC's RKR. Australia Post allocates revenues, costs, and assets between service groups using its CAM.

Australia Post is required by the RAF to provide revenue and cost information (regulatory accounts) disaggregated by defined service groups and reported as direct, attributable or unattributable account items. The regulatory accounts are reviewed by an independent auditor who audits Australia Post's compliance with the RKR and Australian Auditing Standards.

Direct account items are account items that are solely associated with a particular service and will be incremental to providing that service (for example, cost of goods sold can be directly attributed to products sold in Australia Post's retail stores). Due to the shared and labour-intensive nature of Australia Post's operations, it has very few direct account items relating to its mail services (for example, most of the delivery costs would be shared by a number of mail and small parcel services, and are attributed to the product by the cost allocation methodology).

Attributable account items are part of a pool of common account items that are identifiable to a particular service by a separable cause-and-effect relationship. For example, the labour costs associated with processing and delivering letters can be described as attributable, as these costs are attributed to particular mail and parcel services based on their revenues, volumes, and the relative effort of delivery/processing the product.

Unattributable account items are part of a pool of common account items but are not readily identifiable (in whole or part) to any particular service by a separable cause-and-effect relationship. For example, costs associated with senior management and central support functions such as finance and corporate affairs are classified as unattributable items. Unattributable account items are allocated to particular service groups using some factor (such as, for example, relative use).

2014 Review of Australia Post's cost allocation methodology

The ACCC completed a limited review of Australia Post's CAM in the context of its assessment of Australia Post's 2014 price notification. This review focused on the allocation of non-operational (indirect) costs to reserved services. This review did not identify any systematic bias in Australia Post's CAM that would likely lead to a higher allocation of non-operational costs to reserved services.[32]

32 Refer pages 10–13 of the ACCC's decision on Australia Post's 2014 price notification (which can be accessed at http://www.accc.gov.au/system/files/2014%20Australia%20Post%20price%20notification%20decision%20-%20web%20site%20version.pdf) for further details about the ACCC's 2014 review of Australia Post's CAM.

A.2 Australia Post's accounting policies

Australia Post's 2013–14 regulatory accounts have been prepared to be consistent with, and are reconcilable with, the company's annual report. The financial accounts in Australia Post's annual report comply with Australian Accounting Standards.[33]

A.2.1 Accounting for a return on capital

In conducting the tests discussed in Chapter 4 of the report, the ACCC used a 'capital-adjusted' statement of financial performance.[34] The ACCC believes a return on capital is a legitimate cost to business. As part of the ACCC's cross-subsidy assessment the cost of capital is included in the cross-subsidy tests. Accordingly, in seeking to identify the existence of cross-subsidy, it is appropriate to identify and quantify this cost.

The ACCC has applied the tests for cross-subsidy on both a capital-adjusted and a non-capital-adjusted basis and found that the results are generally robust whether capital adjustment is made or not. That is, adding a return on capital as a cost does not in most cases affect whether there is a subsidy, but only the magnitude of the subsidy.

The ACCC does not endorse Australia Post's rate of return on capital (WACC) proposed in its statement of WACC either for the purposes of cross-subsidy analysis or for other purposes—such as a price notification. Nor does the ACCC endorse the various input parameters used by Australia Post in its statement of WACC. The ACCC notes that a lower WACC, such as that used in the ACCC's decision on the 2014 price notification, does not affect the ACCC's key finding in this report which is that Australia Post's reserved services were not a source of subsidy for its non-reserved services.

While the conclusions presented in this report are generally presented on a capital-adjusted basis, dollar figures presented in this report have not been adjusted to reflect a return on capital. This approach allows readers to reconcile the figures presented with Australia Post's annual report, and recognises Australia Post's claim of confidentiality over the capital employed figures.

A.2.2 Changes to accounting policy

As required under the RKRs, Australia Post has provided the ACCC with details of material changes to the accounting policies it implemented between the submission of the 2012–13 regulatory accounts and the 2013–14 regulatory accounts. Although there were no material changes to Australia Post's accounting policies, the structure of the 2013–14 regulatory accounts has been updated to align to Australia Post's current business structure.

Overall the four operating segments in Australia Post's 2013–14 regulatory accounts are similar to the segments contained in the 2012–13 regulatory accounts. The reportable segments are based on aggregated operating segments determined by the similarity of the products sold and/or the services provided.

The four primary operating segments include:

- Mail: The collection, processing and distribution of mail items, digital communications and associated services. This is comprised of:
  - reserved mail—the collection, processing and distribution of domestic letters defined as reserved by the APCA
  - non-reserved mail—the processing and distribution of non-reserved domestic mail services
- Parcels and StarTrack: The processing and distribution of parcel and express products, international mail services along with freight forwarding operations.
- Retail: Provision of postal products and services, agency services, mail boxes and bags, financial services and other retail merchandise, principally philatelic, stationery, telephony, greeting cards, gifts and souvenirs.

33 Australia Post annual report 2013–14, p. 52.

34 The WACC is applied to the value of capital employed for each service group, and this cost of capital is added to the statement of financial performance to derive a 'capital-adjusted' statement of financial performance for each of the service groups.

- Other services: If items of revenue and expense are not allocated to the core operating segments then any associated assets are also not allocated to segments. The following are not allocated to operating segments as they are not considered part of the core operations of any segments:
  - activities incidental to the core product and service offerings, principally those which generate rental income, licence fees and other miscellaneous amounts
  - expenses representing costs that are attributable to unallocated revenues
  - assets include assets under construction, cash and held to maturity investments.