Australian Competition & Consumer Commission

Assessing cross-subsidy in Australia Post 2009–10

An ACCC report

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

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Glossary

ACCC	Australian Competition and Consumer Commission
AIFRS	Australian Equivalents to International Financial Reporting Standards
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	the supply of one group of services at a loss made up by the profits on the supply of (an)other group(s) of services
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 that Australia Post provides in competition with other entities
RAF	regulatory accounting framework
record-keeping rule (RKR)	a requirement by the ACCC that Australia Post keep certain records that relate to any of the ACCC's regulatory roles
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 APCA legislation (i.e. no other entity can provide these services)
service group	the service groups defined in Schedule 1 of the RKR information provided by Australia Post
stand-alone cost	the cost of producing each output 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 is required to determine, using Australia Post's regulatory accounts, whether Australia Post cross-subsidised its non-reserved services with revenue from its reserved services.
  - Reserved services are those services in which Australia Post has a statutory monopoly; non-reserved services are services not subject to Australia Post's statutory monopoly (i.e. generally, services it provides in competition with other businesses).
- The ACCC is satisfied that Australia Post's reserved services, at an aggregate level, were not a source of subsidy for its non-reserved services. The total revenue earned by reserved services was less than the total of reserved services direct and attributable costs.
- In particular, revenue from small ordinary letters, small PreSort letters and large PreSort letters (on a capital-adjusted basis) was not sufficient to recover the direct and attributable costs of providing the respective services in 2009–10. In the case of small ordinary letters (on a capital-adjusted basis), this has been the case in each year for which the ACCC has monitored cross-subsidy (with the exception of 2004–05).
- Revenue from Australia Post's non-reserved services (as a whole) in 2009–10 was greater than the lower bound estimate of the stand-alone cost of providing non-reserved services. The ACCC is therefore satisfied that non-reserved services (as a whole) did not receive a subsidy; rather, on the whole, they were a potential source of subsidy for reserved services in 2009–10.
- Individually, logistics services (a non-reserved service group) received a subsidy in 2009–10 from other non-reserved services. Logistics services has been the recipient of a subsidy in each year for which the ACCC has monitored cross-subsidy (since 2004–05). The subsidy to logistics services had increased substantially in 2008–09 but reduced to pre–2008–09 levels in 2009–10.
- Two other non-reserved service groups may also have received a subsidy from the (other) non-reserved services in 2009–10—international inward letters and international inward parcels. Revenue from these service groups was not sufficient to fully recover the direct and attributable costs of providing those services.

1 Introduction

In addition to administering the *Competition and Consumer Act 2010* (CCA), the Australian Competition and Consumer Commission (ACCC) has some specific responsibilities under the *Australian Postal Corporation Act 1989* (APCA) in the regulation of postal services.

Assessing proposed price increases for Australia Post's reserved services is conducted under the CCA, while the ACCC's responsibilities under the APCA include monitoring for the presence of cross-subsidies between Australia Post's reserved and non-reserved services, and inquiring into certain disputes regarding the terms and conditions under which Australia Post supplies bulk mail services.

This report presents the results of the ACCC's analysis of Australia Post's regulatory accounts for the 2009–10 financial year to determine whether it cross-subsidised its non-reserved services with revenue from its reserved services.

Information that is considered to be confidential to Australia Post is not disclosed in this report. Such exclusions are indicated by '**[information removed]**' in the text, or '✂' in tables.

The remainder of this report is structured as follows:

- Section 2 provides an overview of the ACCC's roles in the regulation of postal services.
- Section 3 outlines the ACCC's framework for monitoring for cross-subsidy.
- Section 4 outlines Australia Post's cost allocation methods and accounting policies.
- Section 5 sets out the results of the ACCC's cross-subsidy analysis for 2009–10.
- Section 6 presents the ACCC's conclusions.

2 Background

This report presents the results of the ACCC's analysis of Australia Post's regulatory accounts for the 2009–10 financial year to determine whether it cross-subsidised its non-reserved services with revenue from its reserved services. Reserved services are those services in which Australia Post has a statutory monopoly; non-reserved services are services it provides in competition with other businesses.

The ACCC was given this role in 2004 in response to complaints by competitors that Australia Post was cross-subsidising its competitive services with revenues from its reserved services. In June 2004 the APCA was amended to provide for the ACCC to issue a Record Keeping Rule (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'.[1]

The ACCC issues reports on its assessment of cross-subsidy in Australia Post on an annual basis.

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 2009–10, it employed approximately 34 500 employees and operated around 4 400 retail outlets. In 2009–10 Australia Post delivered 5.1 billion items of mail to 10.7 million Australian addresses, and served around a million customers in its retail outlets each business day. It reported a post-tax net profit of $89.5 million (an operating profit before tax of $103 million), representing a return of 3.8 per cent on average operating assets and a return of 2.1 per cent on revenue.[2]

The APCA requires that:

- Australia Post must, as far as is practicable, perform its functions in a manner consistent with sound commercial practice[3]
- Australia Post is required to meet certain community service obligations (outlined below)[4]
- Australia Post must perform its functions in a way consistent with general government policy and any directions given by the minister.[5]

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.

2.2. 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.

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.

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

2 Australia Post, *Annual report 2009–10*, pp. 7, 9, 11, 13, 14.

3 Section 26 of the APCA.

4 Section 27 of the APCA.

5 Section 28 of the APCA.

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.[6]

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 section 30 of the APCA. 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[7]
- 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 responsibilities in the regulation of postal services. These responsibilities are contained in the CCA and the APCA. They can be summarised as:

- Monitoring for cross-subsidy between Australia Post's reserved and non-reserved services
- assessing proposed price increases of Australia Post's reserved services
- inquiring into certain disputes regarding the terms and conditions on which Australia Post supplies its bulk mail services.

This report deals only with the first of these roles—monitoring for cross-subsidy between reserved and non-reserved services.

2.4. Record-keeping rule powers

To assist in fulfilling its role in postal regulation, the ACCC can issue RKRs to Australia Post that require Australia Post to keep specified records and provide them to the ACCC. One major intention was to enable the ACCC to scrutinise whether or not Australia Post is cross-subsidising from its reserved services to the services it provides in competition with others.

In March 2005 the ACCC issued an RKR that established a regulatory accounting framework (RAF) for Australia Post. The primary purpose of the RAF is to allow the ACCC to monitor for the presence of cross-subsidy. In accordance with this RKR, Australia Post has submitted regulatory accounts to the ACCC for each financial year starting from 2004–05.

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.[8] 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.[9]

The principles applied by the ACCC when considering whether to publicly disclose information that Australia Post claims is confidential are outlined in the ACCC publication *Principles for the public disclosure of record-keeping rule information provided by Australia Post*, which is available from the ACCC website.

6 Section 3 of the APCA.

7 Whilst not strictly a 'reserved service' as defined in the APCA, Australia Post has been nominated by the Government to fulfil its obligations under the Universal Postal Union Convention, including the delivery of incoming international letters. Thus, Australia Post is the only operator able to carry international inward mail under 250 grams. The statutory monopoly does not apply to items weighing more than 250 grams. However, for the purpose of Australia Post's 2009–10 Regulatory Accounts, all international inward mail is being classified as non-reserved.

8 Sections 50I and 50J of the APCA.

9 Section 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. However, a more formal definition of cross-subsidy that has developed in the economic literature comprises two tests:

- A service (or combination of services) is a potential source of subsidy if the revenue generated by that service (or combination of services) is greater than the stand-alone cost of the service. Whether such a service is an actual source of subsidy depends on if the second test is satisfied. That is, revenue greater than stand-alone cost is not, of itself, evidence of a cross-subsidy—the firm may simply be making economic (or excess) profit; and
- Another service (or combination of services) provided by the same enterprise is the recipient of a subsidy if the revenue generated by that service (or combination of services) is not sufficient to cover the incremental cost of providing it.

The incremental cost of a service is defined as the additional cost incurred by producing that service (in addition to the other services the firm produces). Another way of considering incremental cost is to ask what costs would be avoided, in the long run, if the service were no longer offered. If the revenue from each service is at least as great as the incremental cost of that service, no cross-subsidy exists.

If a service is the recipient of a subsidy, identifying the source of subsidy requires identifying which service (if any) has revenues greater than the stand-alone cost of providing the service. The stand-alone cost of a service is the cost of producing that service in isolation.

There may be more than one source of subsidy. For example, if reserved services revenue is greater than the stand-alone cost of reserved services and non-reserved revenue is greater than the stand-alone cost of non-reserved services, both reserved and non-reserved services are possible sources of subsidy. Where there are multiple sources of subsidy, it is impossible to determine which particular group of services provides the subsidy or what each group's contribution to the subsidy is.

Alternatively, if revenue from reserved services is less than the stand-alone cost of providing these services, there can be no cross-subsidy from reserved to non-reserved services. In this case, even if a non-reserved service is the recipient of a subsidy, there must be an alternative non-reserved source of subsidy, or Australia Post's regulatory accounts indicate that the company is operating at an economic loss.

In monitoring for the presence of cross-subsidies from the monopoly reserved services to the competitive 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.

The ACCC considers that Australia Post would 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.[10]

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.

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

3.1. Accounting data used in testing

Australia Post is required by the RAF to provide revenue and cost information (regulatory accounts) disaggregated by 19 defined service groups and reported as direct, attributable or unattributable account items.

Direct account items are account items that 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. Due to the nature of Australia Post's operations, it has very few direct account items relating to its mail services. As a result, most of these revenues and costs are attributed to the various letter services according to an activity-based allocation methodology.

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 a relevant, reliable and verifiable factor such as relative use.

3.1.1. Incremental cost test

Costs that are direct to a particular service group will be incremental to that service group as they are 'solely associated with a particular service group' and would therefore be avoided if that service group were no longer offered.

A cost that is attributable to a number of service groups is incremental to that combination of service groups (if that combination of service groups were no longer offered, the cost would be avoided) and may be incremental to a particular individual service group in that combination—the extent to which it is incremental to a particular individual service group depends on the extent to which Australia Post can avoid these costs by not providing that service group.

It follows that where revenue is less than direct costs, the service group is the recipient of a subsidy. Where revenue is sufficient to cover the direct costs, but less than the sum of direct and attributable costs, the service group may be the recipient of a subsidy. Whether the service is actually the recipient of a subsidy in such a case depends on the extent to which the costs attributable to the service are incremental to that service––that is, the extent to which they would be avoided if the service were no longer provided.

3.1.2. Stand-alone cost test

The stand-alone cost of a service (or group of services) typically lies between the sum of direct, attributable and unattributable costs (that is, the fully distributed costs) allocated to the particular service (or group of services) and the sum of direct and attributable costs for that service (or group of services) plus all of the company's unattributable costs.

This approach establishes fully distributed costs as a lower bound of stand-alone cost, and fully distributed costs plus all unattributable costs allocated to other services as an upper bound of stand-alone cost for any given service or group of services. However, this approach will only be valid if the direct costs and attributable costs are an accurate reflection of the incremental costs of the group of services concerned. Whether this is the case will depend on the particular circumstances, so some care is necessary in interpreting these 'lower' and 'upper' bounds.

In Australia Post's case, it appears likely that fully distributed cost may underestimate stand-alone cost in some cases. This is especially so for reserved services, because of the large proportion of attributable and unattributable costs common to more than one 'letters' service group. For example, the labour cost associated with the delivery of letters is largely driven by the number of delivery points and the frequency of delivery rather than by the number of letters delivered. If non-reserved letters services were no longer offered by Australia Post, this would be unlikely to significantly reduce Australia Post's labour cost associated with outdoor delivery.

Also, the reasonableness of the upper bound appears to increase as the number of service groups included in the test increases. That is, adding all unattributable costs to one individual service group is likely to significantly overestimate the stand-alone cost of providing that service. However, when adding all unattributable costs to a larger group of services, the amount of the overestimation is likely to reduce.

If revenue is above the upper bound of stand-alone cost, that particular service (or group of services) is a potential source of subsidy. Whether it is an actual source of subsidy depends on whether or not the revenue from another service (or group of services) is below the incremental cost of providing that service (or group of services). That is, finding that revenue is greater than stand-alone cost is not sufficient to identify a cross-subsidy—it may be that Australia Post is simply earning positive economic profit.

3.1.3. Fully distributed cost test

While the ACCC's analysis is primarily concerned with the economic cost concepts of incremental and stand-alone costs (as proxied by accounting data), fully distributed cost is also reported. Although not strictly relevant to determining the existence of cross-subsidy, fully distributed costs are compared with revenue to show whether each of the service groups is, in addition to meeting its estimated incremental cost, also meeting Australia Post's allocation of common costs.

The fully distributed cost test is more stringent than the incremental cost test described above, because it requires revenue to be sufficient to recover the incremental cost (proxied by the sum of direct and attributable costs) of providing the service and Australia Post's allocation of common (unattributable) costs.

Fully distributed cost can also be considered a lower bound for stand-alone cost.

3.2. Accounting for a return on capital

In conducting the tests described above, the ACCC used a 'capital-adjusted' statement of financial performance.[11] The ACCC has previously stated that it believes a return on capital is a legitimate cost to business.[12] 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 generally change whether services pass or fail; it only changes the amount by which they pass or fail.

While results of cross-subsidy tests presented in this report are on a capital-adjusted basis, cost 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.

3.3. Monitoring cross-subsidy over time

The RKR requires Australia Post to keep records and provide them to the ACCC on an annual basis. However, this 'static' reporting ignores the fact that costs incurred in one period may be recovered from revenue earned in another period. That is, while the ACCC's analysis is based on annual accounting records, and can show that a particular service received a subsidy in any given period, such a service may not receive a subsidy over time, and a long-run consideration is preferable. Further analysis of key trends and changes over time is set out in Table 2 and section 5.1.

11 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 19 service groups.

12 ACCC, *Issues raised during consultation: Record-keeping rules establishing a regulatory accounting framework for Australia Post*, March 2005 (published on the ACCC website), p. 3.

4 Accounting policies and cost allocation

The method of allocating costs to service groups will affect the results of any cross-subsidy assessment, while accounting policies will impact on how any cross-subsidy may be reported. Currently, Australia Post's 2009–10 regulatory accounts have been prepared based on financial data consistent with Australian Equivalents to International Financial Accounting Standards (AIFRS)[13], and Australia Post allocates revenues, costs, and assets between service groups using its activity-based allocation model.

4.1. Cost allocation

In its assessment of Australia Post's 2008 price notification, the ACCC engaged WIK Consult to assess Australia Post's cost allocation methodology. In its report, WIK Consult expressed some concerns about Australia Post's methodology. In light of these concerns, the ACCC decided that Australia Post's cost allocation methodology required a comprehensive review before Australia Post provided the ACCC with any further price notifications.

The ACCC commenced its review of Australia Post's cost allocation methodology in late 2008 and completed the review in June 2009. The objective of the cost allocation review was to improve the transparency of Australia Post's methodology. The ACCC considered three assessment principles:

- ensuring there is sufficient information on and explanation of Australia Post's methodology at each stage of allocation—in order for the ACCC to be able to 'replicate' the results of Australia Post's methodology
- assessing whether the allocation procedures are consistent over time
- assessing whether the methodology is internally consistent—that is, there is consistency between Australia Post's descriptions of the allocation process and its allocation methodology, and consistency and traceability of cost allocation to different products.

As a result of the ACCC's review, there has been an improvement in the transparency of Australia Post's regulatory accounts, and Australia Post has also addressed a number of the ACCC's concerns about the application of its activity-based cost allocation methodology. In its July 2009 report assessing cross-subsidy in Australia Post for 2007–08, the ACCC noted that it was now satisfied with Australia Post's method of activity-based cost allocation.[14]

In assessing Australia Post's 2010 price notification, the ACCC stated that an environment of declining demand for letter services raises more fundamental questions as to the appropriate approach to the pricing of Australia Post's reserved services, and expressed concern about maintaining—for the purposes of pricing reserved services—a pure activity-based cost allocation methodology in such an environment.[15] The ACCC considered that should volumes continue to decline at rates commensurate with those forecast by Australia Post, then the approach to determining the appropriate contribution to shared costs by reserved services would need to be examined prior to any further price notifications by Australia Post.[16] This may have an impact on future ACCC cross-subsidy assessments.

13 Australia Post, *Annual report 2009–10*, p. 11. Companies and entities that prepare financial reports under the *Corporations Act 2001* have been required to comply with AIFRS for financial years commencing on or after 1 January 2005.

14 ACCC, *Assessing cross-subsidy in Australia Post 2007–08*, July 2009, p. 9.

15 ACCC, final decision, Australian Postal Corporation 2010 price notification, May 2010, p. 4.

16 ACCC, final decision, Australian Postal Corporation 2010 price notification, May 2010, p. 4.

4.2. 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 2008–09 regulatory accounts and the 2009–10 regulatory accounts.

4.2.1. Weighted Average Cost of Capital (WACC)

Risk-free and cost of debt parameters

The risk-free rate and the cost of debt were estimated at the start of the year, rather than the end, of the relevant period as measured in the 2008–09 RKR submission.

For consistency with the ACCC's practice of taking an average of rates over a slightly longer period than one day to smooth out any volatility, Australia Post has agreed to use the period of 10 business days ending 30 June 2009 for interest rate settings.

The same 10 day period will apply to both the cost of debt and the risk-free rate.

Risk-Free Rate

The 10-year Commonwealth bond rate has been adopted.

Cost of debt

Australia Post's actual interest rates are floating rates reset each six months. Rates are set at 23 March and 23 September each year and then held constant until the next reset.

There is no need to take an average of the two 2009 reset rates to give a notional average rate for 30 June 2009. In practice, the reset rates comprise the 180 day bank bill rate plus a fixed borrowing margin of 66 basis points. These rates are available daily, and allow determination of a smoothed actual rate for the 10 business days ending 30 June 2009.

For that 10 day period the average bill rate was 3.32 per cent, and the 66 basis points borrowing margin implies an actual cost of (rounded) 4.0 per cent.

The short term risk-free instrument most applicable is a short term Treasury note. For that period, the return on the average Treasury note rate closest to the bill rate duration was 3.06 per cent. This was a 3-month rate, as no 6-month note rates were published by the Reserve Bank for that 10 day period. However, earlier in June 2009 and in July 2009, the margin of the 6-month note over the 3-month note was about 10 basis points, giving an implied 6-month Treasury note rate for the 10 days selected of 3.10–3.15 per cent. This would indicate a Post borrowing premium over that risk-free rate of about 90 basis points, and this has been added to the 10-year Commonwealth bond rate for that period to give a benchmark cost of debt for the same period.

4.2.2. Inward International Mail

The ACCC has advised Australia Post that its view is that all inward international mail is non-reserved (previously Australia Post had been reporting mail weighing under 250 grams as 'reserved').

Australia Post has made the necessary adjustments to reflect inward international mail carried under the UPU convention as a non-reserved service in its Regulatory Accounts.

While international inward mail is not strictly 'reserved' under the APCA (because it falls under the exception under section 30 of the Act), Australia Post has been nominated by the Government to fulfil its obligations under the UPU convention, which includes delivery of incoming international letters.

Thus, Australia Post is the only operator able to carry international inward mail under 250 grams.[17] The statutory monopoly does not apply to items weighing more than 250 grams. However, for the purpose of Australia Post's 2009–10 Regulatory Accounts, all international inward mail is being classified as non-reserved.

17 Australia Post's statutory monopoly for reserved services still restricts anyone from providing this service because the only mail items that are exempt need to be carried on behalf of a foreign country under a convention.

5 Analysis of Australia Post's 2009–10 accounts

This Section sets out the results of the ACCC's analysis of Australia Post's regulatory accounts for 2009–10.

As noted in Section 3, 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 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. However, a lower WACC, such as that used in the ACCC's decision on the 2010 price notification, does not have a material effect on the cross-subsidy tests in this report. Accordingly, it is not necessary for the ACCC to determine a precise WACC for current purposes.

Similarly, the test results are generally robust whether or not the capital adjustment occurs (i.e. the capital adjustment only affects the size of the pass/fail result).[18]

Despite use of the capital-adjusted costs in testing, the ACCC is not reporting the capital-adjusted cost data, due to Australia Post's claim of confidentiality over the information contained in the statement of capital employed. Accordingly, all costs in this report are reported on a non-capital adjusted basis and are reconcilable to Australia Post's annual report.

In 2009–10, Australia Post incurred $150 million of restructuring costs associated with the Future Ready program, which significantly affected Australia Post's Statutory Accounts. The ACCC, in conducting its cross-subsidy assessment, considered the impact of these costs, and found that its overall conclusions (that Australia Post's reserved services were not a source of subsidy for its non-reserved services) would not be impacted by these costs. The costs included in this report include the restructuring costs.

The cross-subsidy test results for 2009–10 for all 19 service groups is presented in Table 1. Comparison of 2009–10 results with past results is presented in Table 2.[19]

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18 There are five exceptions to this general finding. One service (large reserved PreSort letters) passes the direct and attributable cost test without a capital adjustment, but fails once a capital adjustment is made. Four services (large non-reserved PreSort letters, courier services, retail, and other services) pass the fully distributable cost test without a capital adjustment, and fail once a capital adjustment is made.

19 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 2009–10 (available on the ACCC website) for details of changes to accounting policies over time.

Table 1 Results of 2009–10 cross-subsidy tests

	Is the service group a potential recipient of a cross-subsidy? (Revenues less then incremental costs)		Is the service group a potential source of a cross-subsidy? (Revenues greater than stand alone costs)	
	Definitely (revenues less than the lower bound of incremental cost: i.e. direct costs)	**Potentially** (revenues less than the upper bound of incremental cost: i.e. direct and attributable costs)	**Definitely** (revenues greater than the upper bound of stand-alone cost: i.e. fully distributed costs plus all other unattributable costs)	**Potentially** (revenues greater than the lower bound of stand-alone cost: i.e. fully distributed costs)
Total reserved letters	NO	YES	NO	NO
Small letters ordinary	NO	YES	NO	NO
Large letters ordinary	NO	NO	NO	YES
Small letters pre sort	NO	YES	NO	NO
Large letters pre sort	NO	YES	NO	NO
Total non-reserved letters	**NO**	**NO**	**NO**	**YES**
Large letters ordinary	NO	NO	NO	YES
Large letters pre sort	NO	NO	NO	NO
International inwards letters[20]	NO	YES	NO	NO
International outwards letters	NO	NO	NO	YES
Other letters mail services	NO	NO	NO	NO
Other letters assoc services	NO	NO	NO	YES
Total parcels / logistics	NO	NO	NO	YES
Domestic parcels	NO	NO	NO	YES
International inwards parcels	NO	YES	NO	NO
International outwards parcels	NO	NO	NO	YES
Courier services	NO	NO	NO	NO
Logistics	YES	YES	NO	NO
Total retail & agency	**NO**	**NO**	**NO**	**YES**
Retail	NO	NO	NO	NO
Financial services	NO	NO	NO	YES
Total other services	**NO**	**NO**	**NO**	**NO**
Total reserved services	**NO**	**YES**	**NO**	**NO**
Total non-reserved services	**NO**	**NO**	**NO**	**YES**
Total letter services	**NO**	**YES**	**NO**	**NO**
Total non-letter services	**NO**	**NO**	**NO**	**YES**
Total mail services	**NO**	**NO**	**NO**	**NO**
Total non-mail services	**NO**	**NO**	**NO**	**YES**

20 Includes letters previously classifies as international reserved letters.

Table 2 Results of cross-subsidy tests from 2004–05 to 2009–10

Service group	2004–05	2005–06	2006–07	2007–08	2008–09	2009–10
Total reserved letters	Potential source	Neither	Neither	Neither	Neither	Potential recipient
Small letters ordinary	Neither	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
Small letters PreSort	Potential source	Potential source	Potential source	Neither	Neither	Potential recipient
Large letters PreSort	Potential source	Potential source	Potential source	Potential source	Neither	Potential recipient
Total non-reserved letters	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source
Large letters ordinary	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
International inward letters[21]	Neither	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
Other letters mail services	Neither	Potential source	Potential source	Potential source	Neither	Neither
Other letters associated services	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source
Total parcels and logistics	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source
Domestic parcels	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source
International inward parcels	NA	Potential source	Neither	Neither	Potential source	Potential recipient
International outward parcels	NA	Potential source	Potential source	Potential source	Potential source	Potential source
Courier services	NA	Potential source	Potential source	Potential source	Potential source	Neither
Logistics	Recipient	Recipient	Recipient	Recipient	Recipient	Recipient
Total retail and agency	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source
Retail	Potential source	Potential source	Potential source	Potential source	Potential source	Neither
Financial services	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
Total reserved services	Potential source	Neither	Neither	Neither	Neither	Source
Total non-reserved services	Source	Source	Source	Source	Source	Potential source
Total letter services	Source	Potential source	Potential source	Potential source	Neither	Potential recipient
Total non-letter services	Potential source	Source	Source	Potential source	Potential source	Potential source
Total letter and parcel services	Source	Source	Source	Source	Source	Neither
Total non-letter and non-parcel services	Potential source	Potential source	Potential source	Potential source	Potential source	Potential source
TOTAL	Source	Source	Source	Source	Source	Neither

LEGEND

Recipient of a subsidy	(red)
Potential recipient of a subsidy	(orange)
Neither recipient nor source of a subsidy	(yellow)
Potential source of a subsidy	(light green)
Source of a subsidy	(green)
Service group did not exist[22]	NA

21 Includes letters previously classified as international reserved letters.

22 In 2004–05 these service groups were combined with other service groups. See previous ACCC cross-subsidy reports for details of changes to service group classifications over time.

5.1. Key trends and changes over time (capital-adjusted basis)

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

Total business

- In 2009–10, Australia Post's overall revenues were less than overall costs, on a capital-adjusted basis. In the prior years, Australia Post's overall revenues were greater than overall costs. A large reason for this was the $150 million of restructuring costs incurred.

Broad business segment

- 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 in 2009–10.
- Non-reserved services have been a source of subsidy for each of the years to 2008–09 inclusive, and a potential source of subsidy in 2009–10.
- Letter services 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 in 2009–10.
- Non-letter services have been a potential source of subsidy in 2004–05 and 2007–08 to 2009–10, and a source of subsidy in 2005–06 to 2006–07.
- Mail services (includes letters and parcels) have been a source of subsidy in 2004–05 to 2008–09, but neither the recipient nor source of a subsidy in 2009–10.
- Non-mail services have been potentially a source of subsidy for each of the years.

Service group category

- Reserved letter services: see 'reserved services' above.
- Non-reserved letter services have been a potential source of subsidy for each of the years.
- Parcels/logistics services have been a potential source of subsidy for each of the years.
- Retail and agency have been a potential source of subsidy for each of the years.
- Other services have been a potential source of subsidy in 2005–06 and 2006–07, a potential recipient of a subsidy in 2007–08 to 2008–09, and neither the recipient nor source of a subsidy in 2009–10.

5.2. Did any service group receive a subsidy in 2009–10?

Revenue for the following services did not recover the direct and attributable costs of providing them, and the services were therefore potentially recipients of a subsidy in 2009–10:

- logistics services (non-reserved)
- international inward letters (non-reserved)[23]
- international inward parcels (non-reserved)
- small ordinary letters (reserved)
- small PreSort letters (reserved)
- large PreSort letters (reserved) (on a capital-adjusted basis only).

Logistics services received of a subsidy in 2009–10, as revenue from this service did not recover the direct costs of providing the service. However, the source of this subsidy was other non-reserved service revenue.

Revenue for each of the remaining services was sufficient to recover direct costs, although not direct and attributable costs. In these circumstances, whether the service is the recipient of a subsidy depends on whether its attributable costs are incremental to that service—that is, whether these costs would have been avoided if the service had no longer been provided. Further information about the attributable costs—that is not readily available—would be required to determine if the service is the recipient of a subsidy.

Small ordinary letters, small PreSort letters, and large PreSort letters are reserved services and so are of limited concern in the context of monitoring cross-subsidy from reserved services to non-reserved services.

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23 Includes letters previously classified as international inward reserved letters.

While not strictly a 'reserved service' as defined in the APCA, Australia Post has been nominated by the Government to fulfil its obligations under the UPU convention, including the delivery of incoming international letters and parcels weighing less than two kilograms. The prices of these items (i.e. letters and parcels weighing less than 2 kg) are effectively capped by the UPU convention, or involve bilateral agreements with other countries, and thus are not a concern in terms of cross-subsidy.[24]

Some analysis of the services that were recipients (or potential recipients) of a subsidy is provided below.

5.2.1. Logistics services

Australia Post's logistics service group includes Post Logistics, a business that offers business customers an end-to-end supply chain capability, from domestic or international manufacturers to consumers.[25]

The services provided by Post Logistics include:

- multi-country consolidation (sourcing products or components from various countries)
- multi-modal international freight forwarding
- destination port and customs services
- electronic order processing
- automated reporting and credit management
- warehousing (in Australia and China)
- inventory management
- kitting
- pick and pack and distribution
- returns management.[26]

In the course of past cross-subsidy assessments, Australia Post provided further information to the ACCC that indicated that logistics profitability was being affected by continuing infrastructure development of the business. Australia Post expected the profitability of logistics services to improve in the future.[27]

In relation to the 2008–09 results, Australia Post stated that it had implemented a number of initiatives that had achieved benefits in 'an extremely difficult trading environment' in logistics services.[28] Australia Post stated that it expected its previous forecasts to remain valid but considered that challenges of a difficult trading environment for logistics services would also remain.[29] **[information removed]**.

Logistics services continued to receive a subsidy (from other non-reserved services) in 2009–10. However, the 2009–10 logistics result compares favourably against the 2008–09 year, in which logistics was negatively affected by substantial impairment charges **[information removed]**.

[/information removed].

24 Australia Post's statutory monopoly still prevents other operators from providing inward international letter services for letters weighing less than 250 grams. No such restriction exists for letters weighing more than 250 grams or for parcels.

25 Australia Post, *Annual report 2009–10*, p. 24.

26 Australia Post, *Annual report 2009–10*, p. 24.

27 Australia Post, letter: Australia Post 2004–05 regulatory accounts, 4 April 2006, pp. 1–2; Australia Post, letter: Australia Post 2006–07 regulatory accounts, 13 February 2008, pp. 1–2; Australia Post, letter: Australia Post 2007–08 regulatory accounts, 2 June 2009, pp. 1–2.

28 Australia Post, letter: Australia Post 2008–09 regulatory accounts, 22 June 2010, p. 2.

29 Australia Post, letter: Australia Post 2008–09 regulatory accounts, 22 June 2010, p. 2.

As part of Australia Post's business restructure, as of July 1 2010, Messenger Post Couriers, along with Post Logistics and its joint ventures (Star Track Express, Australian air Express, Sai Cheng), have formed the Distribution & Express Services strategic business unit. Australia Post has stated in its annual report that these businesses will continue playing an important part in the business-to-consumer (B2C) market, but will also better utilise existing assets, and potentially new ones, to increase Australia Post's share of business-to-business (B2B) distribution and logistics.[30]

On a non-capital-adjusted basis, revenue from logistics services was $✂ million below the direct costs of providing them. The level of the under-recovery of direct costs for logistics services has improved in 2009–10 from $✂ in the previous year (having increased from $✂ million in 2007–08 and $✂ million in 2006–07). Despite the improvement in 2009–10, logistics services has been the recipient of a subsidy each year since the ACCC began monitoring cross-subsidy in 2004–05 (see Table 2).

Direct and fully distributed costs increased from 2004–05 to 2008–09 as a result of Australia Post's infrastructure development for logistics services. Revenue from logistics services grew from 2004–05 to 2007–08 but fell in 2008–09, exacerbating the significant increase in under-recovery of direct costs that began in 2007–08. Revenue continued to decline in 2009–10, however, costs declined at a greater rate than the decline in revenue.

5.2.2. Domestic reserved services

Australia Post's 2009–10 result was significantly impacted by restructuring expenses associated with its FutureReady program and its VOP initiatives. However, the following observations are not impacted by removing the restructuring expenses allocated to these services (only the quantum was affected).

In 2009–10, revenue from small ordinary letters, small PreSort letters and large PreSort letters was below the fully distributed costs of providing these services (by $✂m, $✂m and $✂m respectively on a non-capital-adjusted basis). Further, revenue from these services was below direct and attributable costs on both a capital adjusted and non-capital adjusted basis (except large PreSort letters, which was above direct and attributable costs on a capital unadjusted basis).

- Small ordinary letter services have failed to recover their fully distributable costs since the ACCC began monitoring cross-subsidy in 2004–05. This service did not recover its direct and attributable costs in 2009–10. Revenue from small ordinary letters was below direct and attributable costs on a capital-adjusted basis in 2005–06, 2007–08 and 2008–09, but above direct and attributable costs on a non-capital-adjusted basis in these years. However, the recovery of direct and attributable costs on a non-capital-adjusted basis had been decreasing since the ACCC began monitoring cross-subsidy in 2004–05, and small ordinary letters in 2009–10 substantially under-recovered its direct and attributable costs on this basis also.
- Small PreSort letter services failed to recover their fully distributable costs in 2007–08, 2008–09 and 2009–10. Revenue from small PreSort letters had been above the direct and attributable costs of providing these services from 2004–05 to 2008–09, but in 2009–10 this service group did not recover its direct and attributable costs.
- Recovery of fully distributed costs by large PreSort letter revenues has been decreasing since 2004–05, and in 2009–10 the service also under-recovered its fully distributed cost. This year this service group failed to recover its direct and attributable costs on a capital adjusted basis.

In summary, the ACCC's cross-subsidy analysis shows that small ordinary letter services, small PreSort letter services and large PreSort letter services (the latter on a capital adjusted basis) received a subsidy in 2009–10.

However, being reserved services, these are of limited concern in the context of monitoring cross-subsidy from reserved services to non-reserved services.

5.2.3. International inward letters

On a non-capital-adjusted basis, revenue for international inward letters was $✂ million below direct and attributable costs. Table 2 shows that revenue from international inward letters has been below direct and attributable costs in each year for which the ACCC has monitored cross-subsidy (except 2004–05).

Payment for the delivery of international mail is generally overseen by the UPU under a system known as 'terminal dues'.[31] The terminal dues payable to the destination postal operator are not based on the actual costs incurred

30 Australia Post's 2009-10 Annual Report, p. 25.

31 For the purpose of Australia Post's 2009–10 regulatory accounts, international inward mail is being classified as a non-reserved service: refer to section 4.2: Changes to accounting policy. Prior to 2009–10 international inward letters weighing less than 250 grams had been categorised as reserved. However, Australia Post is the only operator able to carry international inward mail under 250 grams.

in delivering this mail. Rather, the terminal dues rates are capped at a percentage of the basic postage rate and set according to a basket of currencies.

While there was an under-recovery in international inward letters, international outward letters substantially over-recovered its fully distributable costs for each of the years.

International letters as a group—international inward and outward letters—did not recover its direct and attributable costs in 2009–10.

Australia Post has advised that it expects this segment to continue to under-recover its direct and attributable costs in the near future, despite an increase in terminal dues that occurred on 1 January 2011 (which will cut the loss incurred in this segment by $✂ million).[32]

5.2.4. International inward parcels

The inward international parcel segment is made of three quite different product categories, namely:

- Parcels < 2 kg (part of the terminal dues stream with other international inward mail)
- Parcels > 2 kg
- Express (EMS)

On a non-capital-adjusted basis, revenue from the international inward parcels segment was $✂ million below the direct and attributable costs of providing the services.

Australia Post has provided further information to the ACCC explaining why the segment's performance deteriorated in 2009–10 (from 2005–06 the segment had recovered its fully distributable costs, at least on a non-capital adjusted basis).[33]

According to Australia Post, the declining performance was due to a shift in volume-mix towards the Parcels < 2 kg category, which forms part of the terminal dues stream where losses have always been heavy.[34] One of the reasons contributing to the rapid growth in the category is the increase in online ordering. Additionally, Australia Post has explained that the revenue to cost ratio for the segment was adversely impacted by the appreciation of the Australian dollar.[35] Australia Post expects the increased terminal dues rates to increase annual revenue for inward international parcels < 2 kg by around $✂ million, but notes that the performance of the overall segment is dependent on:

- parcel volumes
- the $A/SDR exchange rate
- further changes in volume composition between Parcels < 2 kg, Parcels > 2 kg and EMS
- allocation of domestic delivery costs.[36]

In contrast to international letters, international parcels as a group—international inward and outward parcels—did recover its fully distributable costs in 2009–10.

32 Australia Post, response to ACCC information request, 5 January 2011.

33 Australia Post, response to ACCC information request, 5 January 2011.

34 Australia Post, response to ACCC information request, 5 January 2011.

35 Australia Post, response to ACCC information request, 5 January 2011.

36 Australia Post, response to ACCC information request, 5 January 2011.

5.3. Are reserved services a source of subsidy?

Large ordinary letters was the only reserved service group for which revenue was sufficient to recover fully distributed costs.

Table 3 shows the 2009–10 revenue and cost recovery on a non-capital-adjusted basis for total reserved services in comparison to total non-reserved services (2008–09 is 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 recover their direct and attributable costs. This was the case on both a non-capital-adjusted and a capital-adjusted basis.

In any case, the fully distributed cost of reserved services may underestimate the actual stand-alone cost of providing these services. 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 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

	2008–09 reserved services	2008–09 non-reserved services	2009–10 reserved services	2009–10 non-reserved services
Revenue	1912.2	2994.9	1783.0	3034.1
Direct cost	0.0	625.8	1.2	737.9
Attributable cost	1802.9	1735.4	1850.8	1747.9
Unattributable cost	178.4	207.6	149.4	230.2
Fully distributed cost	1981.4	2568.8	2001.4	2715.9
Revenue less direct cost	1912.2	2369.1	1781.9	2296.2
Revenue less direct and attributable costs	109.2	633.7	(69.0)	548.3
Revenue less fully distributed cost	(69.2)	426.1	(218.4)	318.2
Revenue less fully distributed cost and all other unattributable costs	(276.8)	247.7	(448.6)	168.7

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 2009–10 on a non-capital-adjusted basis for all service groups. All non-reserved service groups earned revenue sufficient to recover the fully distributed costs of providing each respective group of services (revenue from total other services did not recover fully distributed costs on a capital-adjusted basis though). No single non-reserved service group had revenue sufficient to also recover all the unattributable costs allocated to all other services.

Although reserved letter services did not provide a subsidy, it cannot be said with certainty that any other service group was the source of the subsidy to logistics services (or a potential subsidy to international inward letters/parcels). For greater certainty, further information would be required on the extent to which unattributable costs allocated to other service groups represent the stand-alone cost of the service group in question. However, this information is not readily available or necessary for the purposes of the cross-subsidy report.

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

	Reserved letter services	Non-reserved letter services	Parcels and logistics	Retail and financial services	Other services
Revenue	**1783.03**	**874.91**	**1361.67**	**712.04**	**85.46**
Direct cost	1.18	137.49	204.69	353.37	42.31
Attributable cost	1850.84	633.83	896.81	217.19	0.03
Unattributable cost	149.44	61.49	103.75	62.59	2.35
Fully distributed cost	**2001.47**	**832.81**	**1205.25**	**633.16**	**44.69**
Revenue less direct cost	1781.85	737.42	1156.99	358.67	43.14
Revenue less direct and attributable costs	(68.99)	103.59	260.18	141.47	43.11
Revenue less fully distributed cost	(218.43)	42.10	156.43	78.88	40.77
Revenue less fully distributed cost and all other unattributable costs	(448.61)	(276.03)	(119.44)	(238.15)	(336.51)

Total letter services and total mail services

Australia Post may have some degree of market power in non-reserved segment of its letter services due to its ubiquitous collection and distribution networks, despite the fact that it does not have a legislated monopoly in the provision of non-reserved letter services.

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

- total letter services
- total mail services (total letter and total parcel services).

It is important to note here that the 2009–10 results were impacted by significant one-off restructuring costs. Thus, it is difficult to draw conclusions in respect of subsidy from total letter and parcel services in 2009–10.

Table 5 shows that revenue from total (reserved and non-reserved) letter services was below the fully distributed costs of providing these services on a non-capital adjusted basis. On a capital-adjusted basis, revenue from total letter services was not sufficient to recover the direct and attributable costs of providing letter services. Thus, total letter services did not provide a subsidy; indeed, they were a potential recipient of a subsidy from Australia Post's total non-letter services.

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

	Total letter services	Total Non-letter Services
Revenue	2657.95	2159.17
Direct cost	138.67	600.37
Attributable cost	2484.68	1114.03
Unattributable cost	210.93	168.69
Fully distributed cost	2834.27	1883.10
Revenue less direct cost	2519.28	1558.80
Revenue less direct and attributable costs	34.60	444.77
Revenue less fully distributed cost	(176.33)	276.07
Revenue less fully distributed cost and all other unattributable costs	(345.02)	65.14

Table 6 shows that revenue from total letter and total parcel services was also unable to recover the fully distributed costs of providing these services. This was also the case for the services on a capital-adjusted basis.

However, as noted above, the 2009–10 results were impacted by one-off restructuring costs. If not for the restructuring costs, total letters and parcels would have been a source of subsidy (on a non-capital adjusted basis). Thus, it is difficult to draw conclusions in respect of subsidy from total non-letter and non-parcel services to total letter and parcel services in 2009–10.

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	Total non-letter and non-parcel services
Revenue	3764.15	1052.97
Direct cost	157.66	581.38
Attributable cost	3322.37	276.34
Unattributable cost	294.04	85.58
Fully distributed cost	3774.08	943.29
Revenue less direct cost	3606.49	471.59
Revenue less direct and attributable costs	284.11	195.25
Revenue less fully distributed cost	(9.93)	109.67
Revenue less fully distributed cost and all other unattributable costs	(95.51)	(184.37)

6 Conclusion

In 2009–10, Australia Post's reserved services appeared to be the recipient of a subsidy from non-reserved services. The analysis in this report also indicates that, while certain non-reserved services received a subsidy, the source of their subsidy appears to be the other non-reserved services, not reserved services. These results are consistent with those of past ACCC cross-subsidy reports.

Were reserved services a source of subsidy?

Australia Post's regulatory accounts for 2009–10 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 on either a non-capital adjusted or a capital-adjusted basis.

Indeed, in 2009–10, on both a capital and non-capital adjusted basis, Australia Post's reserved services appeared to be the recipient of a subsidy from non-reserved services, because, as a whole, reserved services did not recover their direct and attributable cost.

The non-capital adjusted fully distributed cost is the most stringent test for not being a source of cross-subsidy, in that it is the 'lower bound' of the stand-alone cost estimate. The true stand-alone cost is likely to be higher than this, reflecting that some of the costs allocated to non-reserved services would still be incurred if non-reserved services were not offered.

Because revenue from reserved services was less than the stand-alone cost of providing these services, ACCC is of the view that there is no cross-subsidy from reserved to non-reserved services. In this case, even if a non-reserved service is the recipient of a subsidy, there must be an alternative source of subsidy, or Australia Post is operating at an economic loss.

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

Were non-reserved services a recipient of a subsidy?

Revenue from Australia Post's non-reserved services was greater than the fully distributed cost (lower bound of the stand-alone cost test) but less than the upper bound of the stand-alone cost of providing non-reserved services, on a capital-adjusted basis.[37] Without a capital adjustment, Australia Post's non-reserved services revenue was greater than the upper bound of the stand alone cost test, which means that they appear to be a source of subsidy for Australia Post's reserved services. This has been the case since the ACCC began monitoring cross-subsidy in 2004–05.

Non-reserved services (as a whole) did not receive a subsidy in 2009–10; rather they appear to be a possible source of subsidy.

37 If 'one-off' restructuring costs are removed, Australia Post's non-reserved services revenue would have been greater than the upper bound of the stand alone cost even on a capital-adjusted basis.

Did any service group receive a subsidy?

In respect of individual service groups, revenue from logistics services was less than the direct cost of providing those services in 2009–10. This non-reserved service group has received a subsidy in every year since the ACCC began monitoring cross-subsidy in 2004–05, but the size of the subsidy increased substantially in 2008–09, and decreased in 2009–10.

Five other services may also have received a subsidy in 2009–10. Revenue from international inward letters[38] and parcels (two non-reserved services) was less than the respective direct and attributable costs of providing these services.

Revenue from three reserved services—small ordinary letters, small PreSort letters and large PreSort letters (on a capital-adjusted basis only)—was less than their respective direct and attributable costs. Revenue from these three 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 not readily available.

However, as these services are either reserved or—in the case of international inward letters and international inward parcels weighing less than 2 kg—not subject to competition, this is not a significant area of concern for the ACCC in respect of potential cross-subsidy from reserved services to non-reserved services.

38 Includes letters previously classified as international inward reserved letters.

Appendix—Regulatory accounting framework information not claimed as confidential

Schedule 1: Service group definitions

Schedule 1(a): Reserved service group descriptions

Service group	Product/service	Description
Small letters ordinary	SL—ordinary—stamped	Small Letters include enveloped mail, lettersheets, prestamped envelopes and unenclosed postcards no larger than 130 mm x 240 mm, no thicker than 5 mm and no heavier than 250 gms.
	SL—clean	Reduced charges for customers who present quantities of correctly machine-addressed small letters.
	SL—ordinary—other	Ordinary Small Letters, where postage has not been paid via a postage stamp (includes payment via charge account and postage meters).
	SL—reply paid	Small Letters within the above definition where the addressee has supplied a 'reply paid' envelope i.e. the addressee is 'paying' the postage. Revenue includes the additional 'fee' for the service.
	SL—local rate	Reduced charges for customers who reside or carry on business in any postcode area serviced by the delivery office and who lodge small letters. Only found in country areas.
Small letters PreSort	SL—regular PreSort	Reduced charges for small letter displaying a Delivery Point Indicator within a four state barcode when presented by the customer in accordance with relevant mailing conditions. Normal delivery standards apply.
	S L—regular charity mail	PreSort Small Letters from organisations that are endorsed as income tax exempt charitable institutions and trust funds for charitable purposes, by the ATO. Normal delivery standards apply.
	SL—off-peak PreSort	Reduced charges for small letter displaying a Delivery Point Indicator within a four state barcode when presented by the customer in accordance with relevant mailing conditions. Delivery standard up to three days longer than Regular.
	S L—off peak charity mail	PreSort Small Letters from organisations that are endorsed as income tax exempt charitable institutions and trust funds for charitable purposes, by the ATO. Delivery standards up to three days longer than Regular.

Service group	Product/service	Description
Large letters ordinary	LL—ordinary—stamped (0–250 g)	Large Letters include enveloped mail, prestamped envelopes and unenclosed postcards that are rectangular in shape, no larger than 260 mm x 360 mm, no thicker than 20 mm, no heavier than 250 gms, not a Small Letter and Postage does not exceed $2.
	LL—ordinary—other (0–250 g)	Ordinary Large Letters, where postage has not been paid via a postage stamp (includes payment via charge account and postage meters).
	LL—clean	Reduced charges for customers who present quantities of correctly machine-addressed large letters.
	LL—reply paid	Large Letters within the above definition where the addressee has supplied a ‘reply paid’ envelope i.e. the addressee is ‘paying’ the postage. Revenue includes the additional ‘fee’ for the service.
	LL—local rate	Reduced charges for customers who reside or carry on business in any postcode area serviced by the delivery office and who lodge large letters. Only found in country areas.
Large letters PreSort	LL—regular PreSort (0–250 g)	Reduced charges for large letter size items under 250 gms displaying a Delivery Point Indicator within a four state barcode when presented by the customer in accordance with relevant mailing conditions. Normal delivery standards apply.
	LL—off-peak PreSort (0–250 g)	Reduced charges for large letter size items under 250 gms displaying a Delivery Point Indicator within a four state barcode when presented by the customer in accordance with relevant mailing conditions. Delivery standard up to three days longer than Regular.

Schedule 1(b): Non-reserved service group descriptions

Service group	Product/service description	Description
Non-reserved large letters ordinary	LL—ordinary (250–500 g)	Large Letters include enveloped mail, prestamped envelopes and unenclosed postcards that are rectangular in shape, no larger than 260 mm x 360 mm, no thicker than 20 mm, no heavier than 500 gms, not a Small Letter and Postage is at least $2.
Non-reserved large letters PreSort	LL—regular PreSort (250–500 g)	Reduced charges to customers who sort their large letters in excess of 250 gms before lodgment and comply with relevant mailing conditions. Normal delivery standards apply.
	LL—off-peak PreSort (250–500 g)	Reduced charges for customers who sort their large letters in excess of 250 gms before lodgment, and comply with relevant mailing conditions. Delayed delivery standards apply.

Service group	Product/service description	Description
Non-reserved international inward letters	non-reserved inward international letter services	'– This service relates to the receipt, handling, delivery and on-forwarding of inbound international letter and related mail articles within Australia. Australia Post receives international incoming mail in two ways: Dispatched to Australia in accordance with the arrangements of the Universal Postal Union (UPU); or transported to Australia as cargo and lodged with Australia Post under the appropriate domestic letter service. – Under the UPU convention, Australia Post has been nominated by the government to fulfil its obligations to deliver incoming international letters exchanged under the convention. Australia Post has the exclusive right to the receipt, handling, delivery and on-forwarding of inbound international letter and related mail articles within Australia to Mail dispatched under the UPU convention.'
International mail (outward)––letters	outward international letter services	All letter and related services lodged in Australia for delivery to overseas addressees, including FX adjustments.
Other non-reserved letter mail services	unaddressed mail	The unaddressed delivery service is the distribution of such items as catalogues, merchandising samples and leaflets to all letterboxes in a certain area.
	periodical publications	Reduced charges for customers who lodge authorised publications and catalogues that are no larger than 260 x 360 x 20mm and up to 1 kg for delivery within Australia.
	registered post fees	Additional fees for service includes optional prepaid envelopes or Registered Post labels or imprints. Also entails insurance cover up to $100.
	express letters	Express Post articles with a weight less than 500 gms and a thickness less than 20 mm.
Other letters associated	forces mail	Mail and parcel services to deployed military units
	mail rooms	The running of customers' internal mail rooms.
	fax post	The acceptance and/or delivery of fax messages to customers without a private fax facility.
	electronic mail services	The production of hard copy documents for mailing to addressees from computer generated data. Covers production costs only i.e. excludes postage which is included in relevant areas above.
	private boxes and bags	The provision by Post of numbered boxes and private mail bags which act as delivery points for customers 'renting' the boxes/bags
	address post	The provision of 'change of address' data to customers wishing to update their mailing lists.

Service group	Product/service description	Description
	redirection fees	The provision of mail redirection service (both short term 'hold' and permanent on-forwarding) for both private individuals and businesses.
Parcels	parcels	All other domestic mail items which do not meet the criteria for letters including items mailed under the 'express' banner excluding express letters.
Courier services	courier services	All courier services including Messenger Post and Express Courier International
Logistics	logistics and fulfilment services	Provision of storage facilities, receipt of orders, picking, packing and despatching of products for both domestic and international customers.
	online delivery	The provision of specialised delivery operations requiring dedicated, specialised vehicles.
	other fulfilment services	Miscellaneous logistics services
Non-reserved international inward parcels	non-reserved inward international parcel services	The carriage and delivery within Australia of incoming international parcels and related services that are outside the scope of reserved service, including FX adjustments.
International mail (outward)—parcels	outward international parcel services	All parcel and related services lodged in Australia for delivery to overseas addresses.
Retail	philatelic	The sale of stamps, related product and coins to the collector market.
	Postpak	The sale of postal packaging and related items
	complementary products	The sale of stationery, cards, communications and other products through retail outlets.
Financial services	transaction services	The provision of financial transactions facilities including money orders, banking services (both personal and business) and the undertaking of passport interviews, and ID&V services.
	other agency	The provision of bill payment and related services.
Other services	other miscellaneous	Other minor items from which revenue is earned.

Schedule 3: List of account items for revenues

Account Code	Account Item	Description
3-1	Mail Revenue	All revenue earned from the carriage of mail items (including letters and parcels) including through sale of postage stamps, postage labels, bulk postage and franking machines. (Note: Individual categories of reserved and non-reserved mail will be separated)
3-2	Licence Fees	All revenue earned from licence fees not included in other revenue categories.
3-3	Transaction Fees	All revenue earned from transaction fees not included in other revenue categories.
3-4	Retail Sales	All revenue earned from retail sales not included in other revenue categories.
3-5	Property Rents	All revenue earned from property leasing not included in other revenue categories.
3-6	Other	All other revenue earned not included above.

Schedule 4: List of account items for cost

Account Code	Account Item	Description
4-1	Labour (including Contract Services)	All costs associated with the employment of staff, including wages and salaries, payroll tax, leave and other entitlements, separation and redundancy and workers' compensation. Includes contact staff utilised in Post administered operational areas.
4-2	Motor Vehicle Operating	Costs (excluding depreciation) for the operation of motor vehicles including their maintenance and upgrade.
4-3	Accommodation	Costs (excluding depreciation) for accommodation and property including their maintenance, upgrade and the supply of basic services (i.e. power, water etc).
4-4	Depreciation & Amortisation	A periodic allocation of the historical cost of plant and equipment over the useful life of the asset. Includes a periodic allocation of the value of intangible assets.
4-5	Licensees	All payments made to Licensed Post Offices, including Post points located in non Post retail outlets.
4-6	Carriage of Mail	Payments made to non-Post employees for the carriage and/or delivery of mail.
4-7	Cost of Goods Sold	Cost of purchases for Retail Merchandise, Philatelic Product and Sprintpak.
4-8	International Mail Settlements	Payments made to overseas postal administrations for the transport, processing and delivery of international mail originating in Australia.

Account Code	Account Item	Description
4-9	General Administration	General corporate type costs not already included, including corporate centre, legal, regulatory, accounting and finance, human resources and personnel, and non-product specific research and development. Will include costs from Account Items 4-1, 4-2, 4-
4-10	Other	All other costs not already included.

Schedule 6: List of account items for fixed assets

Account Code	Account Item	Description
NON-CURRENT ASSETS		
6-2-1	**Land and buildings**	
6-2-1-1	Land	All land (including freehold and perpetually renewable leasehold land) owned by Australia Post. Includes land improvements but excludes buildings or other limited-life structures.
6-2-1-2	Buildings	All buildings including those under construction, owned by the company and the associated building alterations.
6-2-1-3	Fit-out	All extensions, structural attachments, improvements; and building plant and equipment such as electric light and power equipment, lifts and air-conditioning which are considered an integral part of the building. Included are improvements on leased buildings.
6-2-2	**Plant and Equipment**	
6-2-2-1	Motor Vehicles	All motor vehicle and related equipment.
6-2-2-2	Mail Handling Plant	All equipment related to the sorting of mail and/or parcels.
6-2-2-3	Other Plant & Equipment	All plant and equipment not already included.
6-2-2-4	Office Equipment	All office and related equipment.
6-2-2-5	Counter Equipment/EPOS	All equipment related to the servicing of customers in retail outlets, including the provision of electronic point-of-sale facilities.
6-2-3	**Other**	
6-2-3-1	Software	Computer software.
6-2-3-2	Intangibles	Identifiable assets having no physical existence, their value being limited by the rights and anticipative benefits that possession confers upon the owner, such as goodwill, trade marks, copyrights, patents, licenses and other assets of a similar nature.
6-2-4	**Assets under Construction**	
6-2-4-1	Assets under Construction	Value of assets under construction.

Schedule 7: Movements in valuation of non-current assets 2009–10

RESERVED	**Notes**			2		5	
	Opening Tyr	Addit.	Retire	Transfer	Revalue	Deprec.	Closing
Land	314.3	0.1	–0.3	–29.6	–0.7	–	283.8
Buildings	252.1	11.2	–1.0	–11.1	5.1	–14.0	242.4
Fitout	16.3	26.0	–0.4	0.9	–	–6.2	36.6
Motor Vehicles	77.8	16.3	–3.6	–9.3	–	–15.3	65.8
Mail Handling Plant	162.8	1.6	–0.2	2.9	–	–23.0	144.1
Other Plant & Equipment	34.8	20.4	–1.4	–12.7	–0.0	–10.9	30.2
Office Equipment	9.2	0.5	–0.4	5.3	–	–1.4	13.1
Counter Equipment/EPOS	7.3	0.2	–0.1	0.0	–	–1.9	5.5
Software	65.7	10.9	–3.9	2.5	–	–22.6	52.6
Intangibles	0.2	–	–	0.2	–	–	0.4
TOTAL RESERVED	**940.6**	**87.3**	**–11.4**	**–51.0**	**4.4**	**–95.3**	**874.5**

NON RESERVED								
		Opening Tyr	Addit.	Retire	Transfer	Revalue	Deprec.	Closing
Land		580.9	2.6	–4.9	29.8	–22.3	–	586.2
Buildings		379.2	11.7	–4.9	15.3	22.4	–20.6	403.0
Fitout		29.4	29.4	–0.4	6.5	–	–11.6	53.2
Motor Vehicles		52.1	7.0	–2.0	8.7	–	–11.0	54.8
Mail Handling Plant		87.4	5.1	–0.4	15.1	–	–15.2	91.9
Other Plant & Equipment		55.1	22.0	–1.5	–9.9	–0.0	–17.0	48.7
Office Equipment		13.4	1.2	–0.4	5.0	–	–1.8	17.4
Counter Equipment/EPOS		11.2	0.4	–0.3	2.0	–	–3.4	9.9
Software		74.3	16.2	–16.9	30.2	–	–34.9	68.9
Intangibles	4	32.0	1.8	–	1.1	–20.5	–2.4	12.0
TOTAL NON RESERVED		**1315.0**	**97.4**	**–31.9**	**103.8**	**–20.5**	**–117.9**	**1346.0**
Land		–	0.0	–	44.1	–9.2	–	34.9
Assets Under Construction	3	–	46.4	–	97.8	–	–	144.2
UNALLOCATED		194.6	46.4	–	–52.7	–9.2	–	179.0
TOTAL FIXED ASSETS	**1**	**2450.2**	**231.1**	**–43.2**	**0.0**	**–25.3**	**–213.2**	**2399.6**

Notes:

Note 1: Movements in Non AM adj are entered as balancing items as only opening and closing balances are provided. Entries are not material.

Note 2: The transfer column includes both transfers of physical assets and movements due to changes in allocations.

Note 3: Assets under Construction are not allocated to Service Groups. Opening balance has been restated as a result of this change.

Note 4: Intangible revaluations relate to the writedown of intangibles

Note 5: Depreciation is obtained from cost as reflected in the ledger.

Schedule 9: Statement of service group usage

Service group	Volume (m)	Description
Total—ordinary small letters	1536.2	Total posted ordinary small letters
Total—PreSort small letters	2016.1	Total posted PreSort small letters
Total—ordinary large letters	182.0	Total posted reserved and non-reserved ordinary large letters
Total—PreSort large letters	142.4	Total posted reserved and non-reserved PreSort large letters