Accounting Separation and Publication of Financial Information by Maltapost plc.

Decision Notice

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1 Introduction

The Malta Communications Authority has been designated with the responsibility of regulating the Postal Sector under the Postal Services Act (Cap 254) with effect from 1 June 2003.

Legal Notice 296 of 2004 designates Maltapost plc as a universal service provider with an obligation to provide all the universal services required by or under the Postal Services Act.

One of the main pillars of the Regulatory Framework for Postal Services is the establishment of principles governing transparency of accounts, in order to ensure transparency and non-discrimination in tariffs. This is achieved through the implementation of cost accounting systems and accounting separation within the Postal Services operating environment.

This Decision establishes the framework under which Maltapost plc as the Universal Service provider shall prepare separated accounts.

This Decision deals exclusively with the preparation and submission of annual Regulatory Accounts. The MCA shall continue liaising with Maltapost in relation to other work streams such as the establishment of an RPI-X price control mechanism. Separated financial and cost accounting information can be requested from Maltapost plc on an *ad hoc* basis, as may be necessary from time to time in relation to other regulatory obligations.

2 Regulatory Accounts

The regulatory accounts shall be based on the audited statutory financial statements of the regulated business. They shall be used by the MCA to monitor and measure the performance of the regulated entity and also to support the price control process. The three fundamental priorities underpinning the requirement to prepare regulatory accounts by Maltapost plc are as follows:

- Service Performance
- Price Control
- Competition

Regulatory accounting issues can be considered under the following headings:

1. Accounting Separation
    a) Legislation
    b) Categories
    c) Other Compliance
    d) Cost Allocation
    e) Practical Issues
2. Audit
3. Publication of Regulatory Accounts

3 Accounting Separation

3.1 Legislation

Article 23 and the Third Schedule of the Postal Services Act of Malta requires:

1. The Universal Service Provider to maintain separate accounts within its cost accounting systems, for each of the services within the reserved area on the one hand and the non – reserved area on the other.

    a. Accounts for the non-reserved area shall clearly distinguish between services which are part of the universal service and services which are not,

    b. Such internal accounting systems shall operate on the basis of consistently applied and objectively justifiable cost accounting principles.

2. Costs shall be allocated to each of the reserved and non-reserved area services respectively in the following manner:

    a. Costs which can be directly attributed to a particular service/business segment,

    b. Common costs, i.e. costs that cannot be directly attributed to a particular service, shall be allocated as follows:

        - Whenever possible, common costs shall be allocated on the basis of direct analysis of the origin of the costs themselves,

        - When direct analysis is not possible, common cost categories shall be allocated on the basis of an indirect linkage to another comparable cost category or group of comparable cost categories for which a direct assignment or allocation is possible,

        - In the absence of either a direct or indirect measure of cost allocation, the cost category shall be allocated pro rata to the total of all other allocated costs.

3. Other cost accounting systems may be applied if they are compatible with the cost accounting principles established in this Decision and which have been approved in writing by the Malta Communications Authority,

4. The compliance of the Universal Service Provider (USP) to these cost accounting systems shall be verified annually by a competent body which is independent of the Universal Service Provider,

5. The MCA shall keep available information on the cost accounting systems applied by the Universal Service Provider,

6. The Authority may request the Universal Service Provider (USP) to provide, in confidence, detailed cost accounting and financial information as required by the Postal Services Act.

3.2 Categories

The Separated Accounts should be segmented on the basis of the following categories which collectively comprise the postal services provided by the Universal Service Provider:

- Services in the reserved area,

- Services in the non-reserved area, which are part of the universal postal service,

- Non-reserved services, which are not part of the universal postal service.

The Regulatory Accounts should also be separated to show:

- Non-postal activities.

3.3 Other Compliance

The Postal Services Act states that "The universal service provider shall comply with one of the cost accounting systems described in paragraphs 1 and 2 which shall be verified by auditors independent of the provider and the expense of such auditors shall be paid by the provider. The provider shall publish a statement concerning compliance in two daily newspapers at least once every calendar year"[1].

The regulatory accounts should also:

- Include the auditors' verification statement,

- Comprise a profit and loss account, and, unless the MCA agrees otherwise in writing, a balance sheet, and explanatory notes, including the accounting policies adopted,

- Explain the licence and regulatory requirements relating to accounting separation,

[1] Postal Services Act , Third Schedule, Article 23, para 4

- Include information about the cost allocation methodologies used to proceed from the accounting records to the regulatory statements noting the key drivers of cost allocation,

- Show the reconciliation with the statutory accounts,

- Show prior year figures (with the exception of year 1),

- Details of significant changes that have an impact on the financial statements and prior year restatements shall be disclosed,

- Split the licensed services category which are part of a universal postal service to show 0 to100g separately,

- Provide a separate Profit and Loss account for each service category falling within the Universal Postal Service Obligation (USO) e.g. Letters separated from parcels,

- Cost and revenue data attributable to each service within the USO should be separately identified,

- Be supported by accounting and financial records maintained for a period of six years in case of documents outside the scope of the Companies Act.

As a general principle, the regulatory accounts should include and disclose relevant supporting information, which would assist users to understand the basis of preparation and presentation of the accounts.

Other issues might be relevant in addition to the licence or in the subsidiary legislation:

- The Licensee should prepare annual statutory accounts in accordance with International Financial Reporting Standards and the Maltese Companies Act 1995 and should have these audited by competent independent auditors and published in accordance with the Third Schedule (Article 23) of the Postal Services Act,

- The Licensee should ensure (to the extent possible by its accounting and financial records) that any related person or agent of the Licensee through whom the Licensee provides a Universal Postal Service or any part of such a service, provides the necessary capillarity of information required for the preparation of management accounts.

The new draft Licence requires the Universal Service Provider to publish annually audited financial statements in accordance with the Companies Act 1995 and International Financial Reporting Standards. The separated accounts should be prepared in accordance with International Financial Reporting Standards insofar as they are relevant, the principal limitation being that the presentation of the Regulatory Accounts by necessity will not correspond to the way in which statutory accounting records are structured and presented.

3.4 Cost Allocation

The Postal Services Act establishes the method of cost allocation as follows:

Costs shall be allocated to each of the reserved and the non-reserved services respectively in the following manner:

a) Costs which can be directly allocated to a particular service shall be so assigned:

   Direct costs are those costs that can be directly and unambiguously related to a service or product and which are recorded against the relevant product or service in the operator's accounting system.

b) Common costs, that is, costs that cannot be directly assigned to a particular service, shall be allocated as follows:

   - Whenever possible, common costs shall be allocated on the basis of direct analysis of the origin of the costs themselves:

     Directly attributable costs are also directly and unambiguously related to a service or product but they are not recorded in the financial accounts against the product or service to which they relate.

   - When direct analysis is not possible, common cost categories shall be allocated on the basis of an indirect linkage to another comparable cost category or group of comparable cost categories for which a direct assignment or allocation is possible:

     Indirectly attributable costs are those costs that can be related to a service or product on a non-arbitrary basis based on the relationship of the costs to direct and directly attributable costs. Such costs are allocated to the relevant service or product using an appropriate cost driver (e.g. usage of shared facilities).

   - In the absence of either direct or indirect measures of cost allocation, the cost category shall be allocated pro rata to the total of all other allocated costs.

     Unattributable costs are those costs for which no direct or indirect method of apportionment can be identified. It is therefore not possible to allocate these costs to products and services on a non-arbitrary basis. These costs are likely to be of the character of 'corporate overheads'.

The most practical approach in the short term is therefore to introduce a cost accounting system based on fully allocated costs on a historic cost basis ("FAC (Historic)").

3.5 Practical issues

Practical issues relating to this Decision are considered as follows:

- General Guidance,
- Regulatory Profit and Loss,
- Regulatory Balance Sheet.

General Guidance

The Postal Services Act establishes rules for determining the assignment of costs to individual products. The cost accounting methodology can become rather complex to develop and manage, and therefore, with the objective of ensuring reasonable consistency, the system would need to be documented and agreed to between Maltapost plc and the MCA. Continuous improvements to the methodology and data accuracy within the system can be achieved over time and therefore ongoing consultations between the MCA and Maltapost would need to take place to ensure consonance with best practice.

The MCA shall also agree with Maltapost plc which services will be considered universal services and these will change over time in response to the needs of the users. This is an ongoing process which is presently being addressed as a separate work stream. Therefore, neither the initial identification of products to the universal service nor the methodology of cost allocation used to create the financial statements will be a concrete precedent for future regulatory statements but will be subject to a process of evolution. Some inconsistency can arise because it may not always be possible to adjust prior year results although re-classifications should always be comprehensively noted.

The preparation of separated cost accounting records involves the re-allocation and re-analysis of data and financial records from the financial accounting system to each product category and business segment. The configuration of the internal accounting systems will gradually evolve so that fewer cost re-allocations and sub-analyses are required to produce the regulatory reports.

Regulatory Profit and Loss

Regulatory financial statements are prepared on a fully allocated cost basis where it is suggested that costs are reported across services as Labour, Non-Labour or Depreciation.

Costs and revenues are directly allocated to a service where this is possible. Overheads are apportioned across all products while common costs and revenues that relate to groups of services and cannot be directly assigned to a particular service, are apportioned across those services. One-off operating costs and exceptional items are also charged to business units or assigned to services on an appropriate basis.

Activity-based costing methods which make extensive use of traffic volumes may be used to assign costs to products. Costs are driven to activities by activity and utilisation analysis. E.g. Staff costs including agency labour costs may be assigned to activities based on an analysis of operational hours and samples of the time spent by staff on specific activities. Appropriate cost drivers are used to assign the activity costs to products and services. Postal traffic volumes are the primary driver of costs. Products are then aggregated into the appropriate services.

Revenue is primarily assigned to the appropriate product by sales or traffic volumes, with the principal exception of stamp and franking machine revenue.

Sometimes the peculiarities of a product may require reference to sources such as the volumes recorded by the track and trace system or billing systems.

International traffic volumes may be determined by applying a statistically derived “items per kilo” to the weight of mail carried to international destinations.

Stamp and franking machine revenue may be assigned to products by applying statistical analysis of mail stream characteristics, such as machine and container counting, to stamp and franking machine volumes. Adjustments may be necessary to remove profits and losses on internal services.

There will be items that would not be appropriate or practical to analyse across the services and the MCA may decide that such an item be excluded altogether. E.g.:

- A subsidiary operating outside of Malta;
- Profits and losses on the sale of tangible fixed assets; and more obviously
- Items charged in the statutory financial accounts below “Profit before interest and tax” such as:
    - Interest;
    - Taxation;
    - Equity minority interests;
    - Transfers to dividend reserve.

Regulatory Balance Sheet

The regulatory balance sheet [or cash flow statement] is not a specific requirement of the Postal Services Act although it could be implied. It has value where the capital demands of the USP services is materially different from the Non-USP services and to indicate that the Licensee has adequate financial resources to comply with its obligations under the License. The assignment of assets and liabilities to either USP or Non-USP services must inevitably be indicative at best. At present the preparation of a separated Balance Sheet is not required by the MCA.

4 Audit

4.1 General Requirement

The Postal Services Act requires the Universal Service Provider to engage an auditor [at it's own cost as a license condition] to verify his compliance with the cost accounting systems annually. The auditor addresses his report to the directors and members of the Licensee. The Third Schedule (Article 23), paragraph 4,of the Postal Services Act requires the auditor to be independent of the Universal Service Provider. Paragraph 7 of the Third Schedule requires the audit and subsequent publication of the financial accounts of Universal Service Providers. The auditor's responsibilities should be established both by the licence and by professional guidance. The MCA reserves the right to approve the appointment of the Licensee's auditor for the Regulatory Accounts.

4.2 Appointment of Auditors

Maltapost will appoint auditors to carry out the audit of the Regulatory Accounts and notify the MCA of the appointment. The MCA reserves the right to invite the auditors to discuss procedures to be applied by them in performing the audit or to discuss the auditors' findings following performance of the audit. Where any issues arise requiring clarification the MCA expects that the operator and / or auditors will obtain such clarification regarding the accounting treatment from the MCA.

The MCA reserves the right to request Maltapost to instruct the auditors to perform additional or alternative work to substantiate the statements and assertions contained in the Regulatory Accounts and to further report on this additional work. Finally, the MCA also reserves the right to appoint auditors directly to carry out such further reviews, examinations and audits as it deems necessary should it consider that the submitted accounts fail to provide the required degree of assurance.

All audit work carried out on the Regulatory Accounts, whether by auditors selected and appointed by Maltapost or by the auditors selected and appointed by the MCA shall be at the expense of Maltapost. The auditors will address their report to Maltapost plc and this opinion will be attached to, but will not form part of, the Regulatory Accounts submitted to the MCA.

The auditors will plan and carry out such work as will enable them to report whether or not any matter has come to their attention, from the work carried out by them which causes them to believe that the Accounts do not in all material respects:

i.) Present fairly in accordance with the accounting methodologies that are to be attached to the Accounts, the results and costs incurred by each of the activities disclosed in the Accounts;

ii.) Comply with any relevant decision notices or equivalent documents issued by the Authority; or

iii.) Contain the information specified by these decision notices or equivalent documents as required to be published in the Accounts.

Should any such matters have come to the auditors' attention, these matters should be clearly described in their report together with, where reasonably possible, the potential monetary impact on the results, balance sheet or costs incurred by each of the businesses and activities disclosed in the Accounts, or a statement that the estimation of the potential monetary impact is not reasonably possible to establish.

In addition, the auditors' report is to clearly set out the respective responsibilities of the auditor and the operator and the basis on which the audit has been carried out and the opinion arrived at.

4.3 Auditors' Independence

In June 2002 the European Commission issued Recommendation 2002/590/EC on statutory auditors' independence in the EU. The Recommendation, although not binding, contains a set of high-level principles on this crucial regulatory issue. The main thrust of the Recommendation is that it prohibits auditors from carrying out a statutory audit if the auditors have any relationship with their client that might be perceived to compromise the auditor's independence. This could mean any situations where the auditors provide additional services, other than audits, to the same clients.

The Commission expects the Recommendation to be immediately applied throughout the EU and it may follow with more robust measures. The Recommendation requires statutory auditors to consider, and to document for each audit engagement, any potential risks or threats to their independence, as well as the safeguards for mitigating those risks

Auditors cannot conduct a statutory audit if they have any direct or significant indirect financial interest in the audit client, a close family member working in a management position there, or if they receive an unduly high proportion of their revenue from one client. Also, partners involved in performing audits may not join the audit client before the end of a two-year cooling-off period.

Key audit partners must also "rotate" and avoid being involved in auditing the same client for more than seven years in succession.

4.4 Timetable for the Preparation of Regulatory Accounts

The following is the timeframe that Maltapost plc needs to follow in the preparation of the initial set of regulatory accounts covering a 6-month period, followed by subsequent annual separated financial statements as follows:

1st Interim Accounts (6 months):	**Reported by:**	**1st Full Accounts (12 months):**	**Reported by:**
31-03-2005	31-08-2005	30-09-2005	28-02-2006

Thereafter, the separated regulatory accounts will be provided to the MCA annually and within five months from the year-end to which they relate.

The MCA is positively disposed to accept unaudited interim regulatory accounts insofar as it would appear that these accounts have been properly and correctly produced.

The MCA therefore does not require the first set of interim separated accounts to be audited. The annual regulatory accounts for subsequent periods must however be audited.

5 Publication of Regulatory Accounts

The MCA has considered the issue of the publication of Regulatory Accounts and does not require the publication of the first set of Regulatory Accounts. This position will be reviewed in consultation with Maltapost once the first version of the Regulatory Separated Accounts is produced.

The MCA reserves the right to review its position in light of prevailing circumstances.

Appendix 1 – Template for Separated Accounts

REVENUE

Re-Analysis for Statutory Accounts

	Total per management accounts	Stamps	Parcel post	Terminal dues receivable	Philatelic sales	Courier services	Income on other postal transactions	Income on other non-postal transactions
CMR Bulk posting								
Retail Bulk posting								
DMS Bulk posting								
Total Bulkmail Sales								
Stamps to the public								
Stamp vendors								
Franking Machines/FRAMA								
Total Stamp & Franking Machine Sales								
Business reply service								
Outbound parcels								
Local courier								
Registered Letters (dom & out)								
Other Postage Revenue								
Personalised foreign mail								
Express Int'l - new service								
International Courier								
International Outbound Revenue								
Foreign Letter Post								
EMS Terminal Dues								
Parcels (in)								
Registered Letters (in)								
International Inbound Revenue								
Commission - bill collection								
Commission - Sub post Offices								
Financial Services								
Merchandise								
Other Revenue								
Total Retail Revenue								
Philately								
Total Philatatelic Revenue								
Scanning & archiving								
Billing agency								
Mail house Logistic & other revenue								
Unaddressed Mail								
CPU - Censorship								
Local parcel delivery								
Total Other Revenue								
TOTAL OPERATING REVENUE								

Re-Analysis for Regulatory Accounts

	MALTAPOST TOTAL												
	REGULATORY ACCOUNTS											**Excluded Items**	**Total**
	Universal Postal Service Obligation						**Other Non-USO Postal Products**				**Total**		
	Reserved letter products		**Non-reserved**			**Total**				**Total**			
	0 - 100g	**Total**	**Letter Products 100g+**	**Parcels 0 - 20kg**	**Misc. Revenues for non-letter / parcel services**		**Letter Products**	**Parcels 20.1kg+**	**Other Products**				
CMR Bulk posting													
Retail Bulk posting													
DMS Bulk posting													
Total Bulkmail Sales													
Stamps to the public													
Stamp vendors													
Franking Machines/FRAMA													
Total Stamp & Franking Machine Sales													
Business reply service													
Outbound parcels													
Local courier													
Registered Letters (dom & out)													
Other Postage Revenue													
Personalised foreign mail													
Express Int'l - new service													
International Courier													
International Outbound Revenue													
Foreign Letter Post													
EMS Terminal Dues													
Parcels (in)													
Registered Letters (in)													
International Inbound Revenue													
Commission - bill collection													
Commission - Sub post Offices													
Financial Services													
Merchandise													
Other Revenue													
Total Retail Revenue													
Philately													
Total Philatatelic Revenue													
Scanning & archiving													
Billing agency													
Mail house Logistic & other revenue													
Unaddressed Mail													
CPU - Censorship													
Local parcel delivery													
Total Other Revenue													
TOTAL OPERATING REVENUE													

Notes: 1) Other Non-Reserved Products and Excluded Items need not be published separately but may be requested by the MCA if required.
2) The Re-Analysis for Statutory Accounts and Operating Revenue Items may be carried out on a separate sheet which need not be published but may be requested by the MCA if required.

EXPENDITURE

	Re-Analysis for Statutory Accounts							MALTAPOST TOTAL / REGULATORY ACCOUNTS / Universal Postal Service Obligation / Reserved letter products		Non-reserved				Other Non-USO Postal Products						
	Total per management accounts	Direct salaries	Director's salaries	Administrative salaries	non labour costs	Depreciation	Amortisation	0 - 100g	Total	Letter Products 100g+	Parcels 0 - 20kg	Misc. Expenses for non-letter / parcel services	Total	Letter Products	Parcels 20.1kg+	Other Products	Total	Total	Excluded Items	Total
								Re-Analysis for Regulatory Accounts												
Wages & Salaries																				
Pension costs																				
Overtime																				
Provision for leave not consumed																				
Uniforms & safety equipment																				
Staff Training & development																				
Health & Safety																				
Sports & Social club																				
Total Staffing costs																				
Conveyance, handling, etc																				
Terminal Dues payable																				
Motor Vehicle expenses																				
Own Transport use Allowance																				
Production Costs																				
Commission Payable																				
Total Cost of Goods Sold																				
Communication (IT, mob, tel)																				
Water & electricity																				
Rent																				
Postal Licence																				
Advertising & Promotions																				
Travelling & Entertainment																				
Repairs & Maintenance																				
IT Support																				
TSSA - Consultancy																				
Consultancy fees																				
Audit fee																				
Printing & Stationery																				
Office & other admin. Exps																				
Security Services																				
Subscriptions																				
Sponsorships																				
Licences & Fees																				
Director's Remuneration																				
Insurance																				
Total Overhead Costs																				
Depreciation																				
Amortisation																				
Provision for doubtful debts																				
Bank charges																				
Exchange loss/ (gain)																				
Loss on tangible assets																				
Bad debts written off																				
Other income																				
TOTAL																				

Notes: 1) Other Non-Reserved Products and Excluded Items need not be published separately but may be requested by the MCA if required.
2) The Re-Analysis for Statutory Accounts and Operating Expenditure Items may be carried out on a separate sheet which need not be published but may be requested by the MCA if required.