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Performance Audit

Australia Post’s Efficiency in Delivering Reserved Letter Services

Australian Postal Corporation

Department of Communications and the Arts

Department of Finance

Australian National Audit Office

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28 September 2017

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken an independent cross entity performance audit in the Australian Postal Corporation, the Department of Communications and the Arts and the Department of Finance titled *Australia Post's Efficiency in Delivering Reserved Letter Services.* The audit was conducted in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit to the Parliament.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's website—http://www.anao.gov.au.

Yours sincerely

Grant Hehir
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office (ANAO). The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits, financial statement audits and assurance reviews of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Australian Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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Summary and recommendations

Background

1. The Australian Postal Corporation (Australia Post) is a Government Business Enterprise (GBE), which provides a regulated monopoly service for letter delivery. It also provides parcel delivery and other related services on a commercial basis. In relation to its letter delivery business, Australia Post is required to meet Community Service Obligations (CSOs); together with other regulations relating to price, frequency, reliability and accessibility for the community; as well as international obligations–these are collectively referred to in this report as Australia Post's obligations.[1] Letter delivery services are classified as either reserved or non-reserved. Reserved services broadly capture the letter services.

2. Nearly three decades have passed since the current regulatory framework relating to Australia Post's letter delivery service was first established. In that time, fundamental changes have occurred both to patterns of consumer demand for communications technology, as well as the depth and breadth of access to communications infrastructure across Australia.

3. The consequent reduction in demand for letter services has reduced Australia Post's profitability. At the same time, the rise in e-commerce has increased demand for parcel delivery services. Over time, this has led to the profitable, commercial side of Australia Post's business funding the losses from the declining letters business. The overall reduction in enterprise profitability has also reduced the dividends paid to Australia Post's sole shareholder—the Australian Government.

4. In response to these developments, aspects of the regulations relating to the CSOs have been changed, and a number of price increases to the Basic Postal Rate for letter services have been notified. Together, these changes have allowed Australia Post to reduce the losses being sustained by the letters delivery service and return the enterprise to profitability. In addition, Australia Post has implemented strategies to increase the efficiency with which it meets its CSOs. However, given the outlook for letter volumes, these measures are only likely to provide a temporary solution.

5. The Australian Government is the sole owner of Australia Post, represented by the Minister for Finance and the Minister for Communications and the Arts (together, the 'Shareholder Ministers'). In carrying out their governance responsibilities, the Shareholder Ministers are supported by their respective departments.

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1 Australia Post's Community Service Obligations are detailed in s.27 of the *Australian Postal Corporation Act 1979* (the APC Act), and requires Australia Post to provide a letters service. The APC Act (division 1A) also provides for performance standards to be made by regulation. These relate to the frequency, speed and accuracy of mail delivery; as well as the availability of street posting boxes and post offices. While the performance standards apply to some letter services they do not necessarily apply to all letter services. Further, the performance standards also cover items that are not part of the letter service (e.g. the provision of retail outlets is to enable persons to purchase Australia Post products and services). Australia Post also has obligations in relation to the delivery of international mail pursuant to the Universal Postal Union (UPU).

Audit objective and criteria

6. The objective of the audit was to examine whether the Australian Postal Corporation (Australia Post) is meeting its obligations efficiently and the effectiveness of Commonwealth shareholders in monitoring value for money.[2] To form a conclusion against the audit objective, the following criteria were adopted:

- Has Australia Post implemented strategies to improve the efficiency of meeting its obligations?
- Is Australia Post meeting its obligations efficiently?
- Do the Departments of Finance, and Communications and the Arts, effectively monitor the ongoing costs and benefits of meeting the obligations?

Conclusion

7. Australia Post has developed strategies to improve the efficiency with which it meets its obligations. It has not, however, improved its efficiency in its letters business as quickly as its international counterparts. The Department of Finance (Finance) and the Department of Communications and the Arts (Communications) provide briefing to their respective Ministers on Australia Post's performance, but greater transparency is required regarding the costs and benefits of the obligations, the distribution of those costs and benefits within the Australian community, and the longer-term strategy for Australia Post's business model.

8. Australia Post's strategies to improve its efficiency have focussed on process optimisation and automation along with labour force flexibility, all with the objective of improving labour productivity. Australia Post has been relatively slow in developing and implementing some of these strategies. In particular, Australia Post has not fully implemented its strategies to improve labour productivity, which were to be a key driver of the planned efficiency improvements.

9. Australia Post has improved its efficiency over time, however these improvements have been relatively slow compared to its international peers, particularly in relation to its management of operating costs.

10. While Australia Post monitors and evaluates the efficiency with which it meets its obligations, there would be scope for Australia Post to provide its shareholder with more strategic information on the long-term sustainability of the letters business; changes in Australia Post's performance over time; and the assumptions driving key forecasts that underpin the enterprise valuation.

11. The dual shareholding arrangements that underpin many Commonwealth Government Business Enterprises (GBEs) are intended to ensure that the public policy objectives delivered by the GBE are balanced by an appropriate focus on financial performance. The guidance underpinning the governance arrangements for GBEs does not distinguish between the roles of

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2 The Auditor-General may only conduct a performance audit of a Government Business Enterprise on request by the Joint Committee of Public Accounts and Audit (JCPAA) – *Auditor-General Act 1997* s.17. The JCPAA requested a performance audit of Australia Post in October 2016.

Finance, and that of the relevant portfolio entity (in this case, Communications) as advisers to their respective ministers.

12. Finance and Communications have established regular monitoring and reporting mechanisms in their capacity as advisers to the Shareholder Ministers. The departments have also advised Government on the forecast decline in the letter delivery service. This advice supported major changes that were introduced in 2016, and informed the identification of the need for further change. The advice by the departments has typically focussed on the net profitability of Australia Post as a whole and on conservative cost estimates of the CSOs. The entities' advice has not directly addressed the impact of reserved letter delivery service on Australia Post's competitive market activities. In addition, Communications, in its role as the lead policy agency, has not advised its Minister on the benefits provided by the CSOs, or the distribution of those benefits within the community. Consequently, the advice has provided the department's respective ministers with an incomplete picture of the costs and benefits of the CSOs.

13. Generating stakeholder support for policy change, particularly in the context of the current framework of the CSOs, is a lengthy process, and it can be a number of years from developing a proposal through to its implementation. Developing and testing proposals for more fundamental reforms of Australia Post's business model may take considerably longer. The current regulations underpinning the CSOs have a 'sunsetting' date of April 2019. This represents an opportunity for Finance and Communications to re-evaluate the CSOs, and Australia Post's role in delivering them, into the future.

Supporting findings

Australia Post's strategies to improve the efficiency of meeting its obligations

14. Australia Post has identified strategies to improve its efficiency in delivering its reserved letters services, having regard to the regulatory and practical constraints faced by its business, and the need to generate support for policy changes impacting on the CSOs. These strategies have focused on reducing labour costs, through such means as process optimisation, automation, and reducing the number of penalty shifts worked. In addition, Australia Post has sought to better utilise its fixed delivery network to grow revenue from existing sources and develop new sources of revenue. However, there would be scope to assess the costs and benefits of providing letters infrastructure over and above the requirements of the CSOs.

15. The strategies adopted by Australia Post to pursue changes to service standards, increase processing efficiency and reduce costs are comparable to postal agencies in other jurisdictions that are facing similar challenges. Australia Post commenced its implementation of these strategies later than its international peers, partly due to challenges in generating the impetus for change. The high fixed costs for operating Australia Post's delivery network, combined with the long implementation times, have highlighted the need to take a strategic, long-term view and to generate stakeholder support well in advance.

16. Australia Post is yet to realise many of its planned efficiency improvements. Australia Post's workforce profile, combined with its decisions relating to workforce management, have created challenges in implementing, and realising the benefits of, strategies to improve efficiency, particularly in relation to penalty hours and overall staff numbers.

Australia Post’s efficiency in meeting its obligations

17. Australia Post has not performed as well as its international peers in managing its operating costs, both across its business as a whole and in relation to its letters business. Australia Post has improved its efficiency over time, however these improvements have been relatively slow compared to its international peers, including those that also operate under the constraints of government ownership.

18. Australia Post monitors and evaluates the efficiency with which it meets its obligations. However, there would be scope for Australia Post to provide its shareholder with a more strategic view of the long-term sustainability of the letters business, Australia Post’s performance in respect of reserved services over time, and the impact of the key assumptions underpinning the longer-term enterprise valuation.

Monitoring the costs and benefits of the obligations

19. The roles of Finance and Communications with respect to Australia Post are defined under the Commonwealth GBE Governance and Oversight Guidelines (the Guidelines). The Guidelines confer identical responsibilities for strategic control and oversight of GBEs upon the Portfolio Minister and the Finance Minister (together, the Shareholder Ministers). Consistent with this framework, Finance and Communications have largely taken a joint approach to supporting the governance roles of their respective ministers.

20. Previous changes to the GBE governance arrangements recognised the inherent tension between the role of GBEs as vehicles to deliver Government policy objectives and the Government’s intention that GBEs operate under a commercial framework, with a strong focus on efficiency and financial performance. These changes saw the establishment of the current dual shareholding arrangements, whereby the Government’s interest as both shareholder and policymaker were represented by the Finance Minister, and the relevant portfolio minister, respectively. These reforms also saw the establishment of a GBE unit within the Department of Finance.

21. Accordingly, while the joint briefing approach taken by Finance and Communications may be appropriate in the context of ongoing governance and oversight of Australia Post’s operations, it is unlikely to realise the intent of having dual Shareholder Ministers, particularly in relation to the longer-term, strategic reforms that will be required to ensure the sustainability of Australia Post’s business model.

22. Finance and Communications have recently strengthened their engagement with Australia Post with a view to providing their respective Shareholder Ministers with greater transparency regarding Australia Post’s strategic direction, major initiatives, financial projections, and the assumptions driving these. Finance’s analysis of the financial performance of Australia Post has, however, tended to be largely based on Australia Post’s own financial reporting, and focused on the performance of the enterprise as a whole, as opposed to the ongoing sustainability of the letter delivery service. While there is some evidence that shareholder entities have briefed their ministers in broad terms on Australia Post’s progress in realising efficiencies from its ongoing strategies, recent changes have been implemented to deepen the analysis and briefing.

23. The departments have supported policy changes which have temporarily arrested the impact of declining mail volumes. However, the letters business is anticipated to return to a loss-making position in the short-term. The timeframes required to effect policy change, together with the projected further declines in letters volumes, emphasise the need for further and more substantial policy changes in the immediate future.

24. The Department of Communications and the Arts, in its capacity as policy adviser, has examined benefits of the CSOs in general terms, but not with sufficient granularity to gain a complete understanding as to whom those benefits accrue or the value of those benefits in light of increasing access to communications technologies.

Recommendations

Recommendation no. 1

Paragraph 2.48

Australia Post should identify and address the impediments to improving the efficiency of its letters service, including implementing, and realising the benefits of, its efficiency strategies.

Australian Postal Corporation's response: Agreed, with qualifications.

Recommendation no. 2

Paragraph 3.27

Australia Post should improve its monitoring and evaluation to:

(a) facilitate greater shareholder visibility regarding the key assumptions underpinning the longer-term sustainability of the business model underpinning reserved services;

(b) facilitate monitoring and reporting of trends over time, including in relation to implementation and benefits realisation of key efficiency strategies; and

(c) examine performance against relevant benchmarks.

Australian Postal Corporation's response:

(a) Agreed, with qualifications.

(b) Agreed.

(c) Agreed, with qualifications.

Recommendation no. 3

Paragraph 4.16

The Department of Finance should review the GBE guidelines to ensure they give effect to the original policy intention of the dual ministerial shareholding arrangements.

Department of Finance's response: The Department of Finance did not state whether it agrees or disagrees with the recommendation.

Recommendation no. 4

Paragraph 4.61

The Departments of Finance, and Communications and the Arts, consistent with their respective portfolio responsibilities, should:

(a) provide their respective Shareholder Ministers with greater transparency over the total costs and benefits of the obligations and the distribution of those costs and benefits within the Australian community;

(b) review the approach to funding the delivery of the community service obligations through Australia Post's increasing involvement in competitive markets; and

(c) review the policy framework relating to Australia Post's Community Service Obligations in the context of the Australian Government's broader commitment to providing access to communications infrastructure.

Department of Finance's response: The Department of Finance did not state whether it agrees or disagrees with the recommendation.

Department of Communications and the Arts' response: The Department of Communications and the Arts did not state whether it agrees or disagrees with the recommendation.

Summary of entity responses

25. The Australian Postal Corporation's, the Department of Finance's and the Department of Communications and the Arts' summary responses to the proposed report are provided below, with full responses at Appendix 1.

Australia Post

Australia Post is a large, complex and challenging business with a rich history of serving the entire Australian community. Since 2010, we have been implementing a wide-ranging transformation program, called "Future Ready", in response to the digital disruption of our traditional core business (the letters service). This transformation program has involved investing heavily in our parcels business to secure market share as online shopping has been growing in Australia. This strategy has enabled Australia Post to maintain its nationwide community-based networks and, importantly, provide ongoing and meaningful jobs for the dedicated employees who wish to continue working in our business.

It is of paramount importance to Australia Post that we manage the decline of the community's use of the letters service in a purposeful and orderly way, while also continuing to deliver against the Community Service Obligations and Prescribed Performance Standards that have been set by our Shareholder (the Commonwealth Government). The ongoing decline in letter volumes and revenue will continue to present significant challenges to Australia Post's operations and financial performance. For this reason, we are committed to working closely with our Shareholder and other stakeholders to explore options to ensure the ongoing financial viability of the letters service. We will continue to track and report our progress against the targets contained in the 2015 business case that was developed for the Reform our Letters Service (RoLS) program. We are proud of our progress in realising benefits thus far, but we recognise there will be a need for ongoing review and improvement as the community's use of the letters service continues to decline.

Department of Finance

Finance accepts the recommendations in the report, and has commented on particular recommendations.

Department of Communications and the Arts

The Department notes the ANAO's findings that the Department has managed its responsibilities as a Shareholder Department by establishing regular monitoring and reporting mechanisms, with a strong focus on informing Ministers on the financial performance of Australia Post. We also note the finding that Shareholder Departments have strengthened engagement with Australia Post to provide greater transparency to Shareholder Ministers on Australia Post's strategic direction, major initiatives and financial projections.

Recommendation 4 is noted. Shareholder Departments are working with Australia Post to update the method by which the cost of the CSOs is calculated. Australia Post is providing Shareholder Departments with data to allow a better understanding of the value of and distribution of the benefits of the CSOs.

Audit findings

1. Background

Introduction

1.1 The Australian Postal Corporation (Australia Post), is an Australian Government Business Enterprise (GBE) incorporated and operated under the *Australian Postal Corporation Act 1989* (APC Act).

1.2 Australia Post provides both regulated and non-regulated services. The regulated services (primarily reserved letter services) require Australia Post to deliver letters, in accordance with prescribed performance standards, in relation to domestic and international mail.[3] The non-regulated (or commercial) services include parcels, retail outlets and digital communications. Australia Post competes with other businesses in the provision of these non-regulated services. Australia Post delivers its services through an integrated postal network with significant shared costs between its regulated and non-regulated services.

Government Business Enterprises

1.3 Governments may become involved in commercial activities due to the inability of the private sector to deliver the required products or services; a preference for natural monopolies to be owned and operated by Government; or the desire to fulfil a community service obligation (CSO).[4] CSOs arise either when a government requires a public enterprise to carry out activities which it would not elect to do on a commercial basis—which the government does not require other businesses in the public or private sectors to undertake—or which it would only do commercially at higher prices. CSOs are one means of achieving identified policy objectives. Australia Post is subject to CSOs in respect of ordinary letters services (discussed below at paragraph 1.9).

1.4 Government service providers are often commercialised with the objective of increasing the efficiency and effectiveness with which its resources are used. The intention is for these GBEs to be governed within an institutional framework that allows them to focus on the efficiency with which they meet their service delivery requirements. In the context of Australia Post, commercialisation was seen as being a necessary and fundamental pre-condition to improvements in efficiency, placing it on a more commercial footing, bringing it more into line with private sector competitors and subjecting it to the disciplines of the marketplace.[5]

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3 Australia Post's Community Service Obligations are detailed in s.27 of the *Australian Postal Corporation Act 1979* (the APC Act), and requires Australia Post to provide a letters service. The APC Act (division 1A) also provides for performance standards to be made by regulation. These relate to the frequency, speed and accuracy of mail delivery; as well as the availability of street posting boxes and post offices. While the performance standards apply to some letter services they do not necessarily apply to all letter services. Further, the performance standards also cover items that are not part of the letter service (e.g. the provision of retail outlets is to enable persons to purchase Australia Post products and services). Australia Post also has obligations in relation to the delivery of international mail pursuant to the Universal Postal Union (UPU).

4 Department of the Parliamentary Library, Government Business Enterprises and Public Accountability through Parliament, Research Paper No. 18 1999–2000, (2001) Department of the Parliamentary Library.

5 House of Representatives, Australian Postal Corporation Bill 1989, Second Reading Speech, (1989).

1.5 However, Australia Post's status as a Government-owned, regulated monopoly—at least in so far as its reserved services is concerned—means that the incentives associated with competitive markets, and the disciplines associated with raising equity from the market, are more difficult to replicate. Consequently, Australia Post's obligations to act commercially sit alongside its obligations to meet its community service and other government obligations, including directions by the Minister, government policies and international conventions.[6]

Ministerial oversight and governance

1.6 Although GBEs often have a legal existence that is independent of government, they are subject to governance and reporting frameworks set out both in their respective enabling legislation as well as broader legislation and rules governing the management of GBEs. Australia Post is a self-funded entity with the Australian Government its sole owner, represented by the Minister for Finance, and the Minister for Communications and the Arts (together, the 'Shareholder Ministers'). The principle functions of Australia Post under the APC Act are to supply postal services within Australia, and between Australia and places outside Australia.

1.7 While the Australia Post Board and the corporation's management are responsible for day-to-day operation, certain key decisions and significant events must be notified to the Shareholder Ministers.[7]

1.8 The Department of Finance (Finance) and Department of Communications and the Arts (Communications), as the principal advisers to the Shareholder Ministers, develop policies relating to postal services, and monitor Australia Post's compliance with the APC Act and the Commonwealth Government Business Enterprise Governance and Oversight Guidelines[8] (the Guidelines). Finance provides oversight and governance through its role in overseeing GBEs. Communications has a dual role as the chief policy advisor and shareholder.

Community Service Obligations (CSOs)

1.9 As noted above, Australia Post is subject to regulation in terms of the service levels provided for its reserved letter services, but not in respect of the other commercial activities it undertakes in competitive markets. The CSOs are set out in section 27 of the APC Act, and require Australia Post to supply a letters service at a uniform rate within Australia for standard postal articles; ensuring that the service is reasonably accessible to all Australians; and meets the social, industrial and commercial needs to the Australian community. Detailed performance standards covering frequency, accuracy, speed of delivery and accessibility of retail outlets and mail boxes are prescribed in the *Australian Postal Corporation (Performance Standards) Regulations 1998* (the APC Regulations).[9] These are set out in Table 1.1.

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6 *Australian Postal Corporation Act 1989* ss.25–28.

7 Refer to Chapter 4 and Appendix 2 of this report for more discussion.

8 Department of Finance, Resource Management Guide No. 126 – Commonwealth Government Business Enterprise Governance and Oversight Guidelines, August 2015, available from <http://www.finance.gov.au/resource-management/governance/gbe/>.

9 The Auditor-General for Australia is required to audit and report to the Minister each financial year on the extent to which Australia Post has met the prescribed performance standards that were in force – *Australian Postal Corporation Act 1989*, s.28D.

Table 1.1: Australia Post's Community Service Obligations

Performance standard			2015–16 performance
Lodgement			
10 000 street posting boxes			15 357
Delivery timetables[a]	**Priority**	**Regular**	
Delivery within a State			
Metro to metro	Next business day	3 business days	Maintained
Same/adjacent country to country	Next business day	3 business days	Maintained
All else	2 business days	4 business days	Maintained
Delivery between States			
Metro to metro	2 business days	5 business days	Maintained
Country to metro	3 business days	6 business days	Maintained
Metro to country	3 business days	6 business days	Maintained
Between country areas	4 business days	7 business days	Maintained
On-time delivery			
94.0 per cent of reserved services letters			96.2 per cent
Access[b]			
4 000 retail outlets			4 392
2 500 retail outlets in rural and remote areas			2 551
Retail outlets located so that: Metropolitan areas – at least 90 per cent of residences within 2.5km of an outlet Non-metropolitan areas – at least 85 per cent of residences within 7.5km of an outlet			 93.6 per cent 88.8 per cent
Delivery frequency[c]			
98.0 per cent of delivery points to receive five days a week			98.8 per cent
99.7 per cent of delivery points to receive deliveries no less than twice a week			99.9 per cent

Note a: Regulation 6.
Note b: Regulation 9.
Note c: Regulation 5.

1.10 The cost of maintaining the letters network to meet the CSOs is largely determined by the formulation of the CSOs as they relate to network coverage, density and delivery frequency.

1.11 Aspects of Australia Post's letters service are also subject to price regulation. The reserved letters service is a 'notified service' under Part VIIA of the *Competition and Consumer Act 2010* and is regulated by the Australian Competition and Consumer Commission (ACCC). Australia Post must notify the ACCC if it proposes to increase the price of these services. The ACCC assesses notified price increases on the basis of whether they will lead to an over-recovery of Australia Post's costs for its letters services.[10]

1.12 Australia Post also has obligations with respect to the exchange of international mail arising from Australia's participation in the Universal Postal Union (UPU), of which it has been a member since 1907.[11] The UPU obligations require Australia Post to deliver inbound international mail on terms no less favourable than those applied to comparable items in the domestic service, increased by the time normally required for customs clearance. Consequently, changes to the CSOs can have a significant impact on the cost to Australia Post of meeting the international obligations. Australia Post receives remuneration for providing these services from the designated operators for member countries of the UPU for delivering inbound international mail based on provisions set out by UPU treaties, but these payments do not recover the cost of service delivery. This net shortfall is understood to currently be in excess of $50m per annum[12], which is partly accounted for in the methodology by which Australia Post quantifies its losses from the letters service.

1.13 In this report, the term 'obligations' is used to collectively describe Australia Post's responsibilities with respect to its CSOs, the prescribed performance standards, as well as its international obligations under the UPU.

Implications for Australia Post's business model

1.14 The losses incurred by Australia Post in meeting its CSOs are expected to increase as letter volumes continue to decline (Figure 1.4). In contrast, Australia Post's revenues from its commercial operations in the parcels sector continue to grow. In its Annual Report 2016, Australia Post estimated letter volumes had declined by 43 per cent since 2008–09. The losses that Australia Post incurred in meeting its CSOs as set out in section 27 of the APC Act were estimated to be $183 million in 2016, as shown in Figure 1.2.

1.15 The decline in letter volumes is expected to increase as digitisation accelerates. Given the current framework for delivery of the CSOs, this is expected to have a significant impact on Australia Post's overall enterprise performance.

1.16 The significant decline in historical letter volumes are reflected in the following figures on Australia Post's profitability, CSO costs and dividends between the 2008–09 and 2016–17 financial years. In particular:

- In 2009–10, Australia Post's profitability was significantly affected by the slowdown in global economic activity and the restructuring costs associated with the Future Ready Program (Figure 1.1). Dividend payments are based on net profit from the previous year, so there is a consequential reduction in dividends paid in 2010–11 (Figure 1.3).

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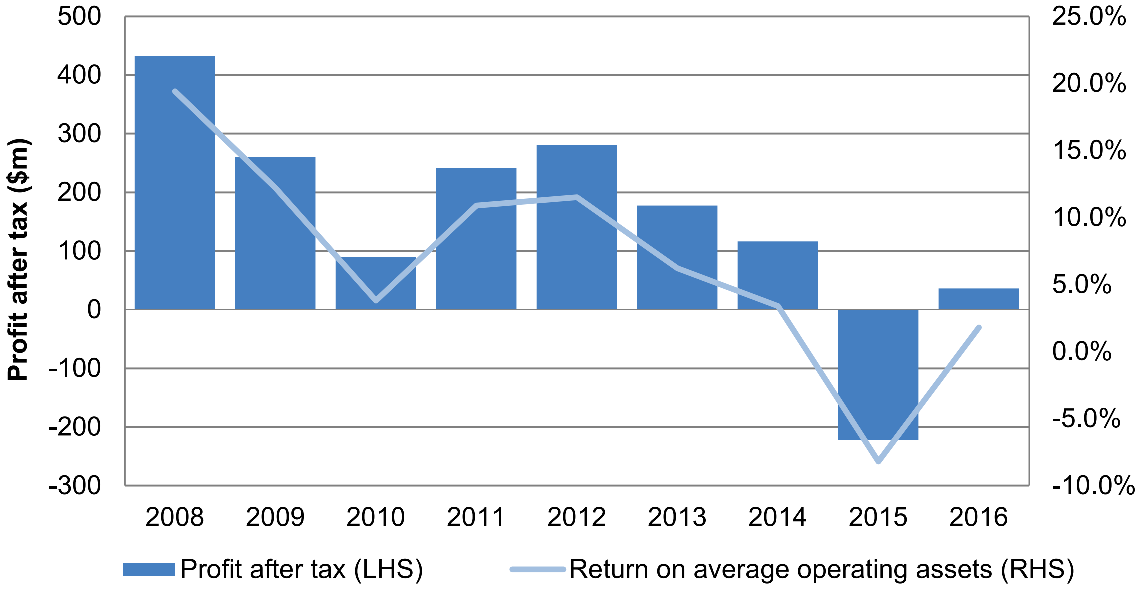
10 For notified products, the ACCC must assess the proposed price increases for Australia Post's notified Reserved Services under sections 95X and 95Z of the *Competition and Consumer Act 2010.* The ACCC does not set the actual price and can only choose to not object; or object to a proposed price increase if it considers that the prices will exceed efficient costs (including an appropriate rate of return). The notified price then indirectly sets the baseline for Australia Post's negotiation of other prices with customers. Notified services represent around 15 per cent of Australia Post's volume of items delivered (that is, letters and parcels).

11 Section 28(c) of the APC Act requires Australia Post to fulfil the obligations of the Australian Government in respect of any convention governing mail.

12 This loss includes parcels weighing less than 2 kilograms.

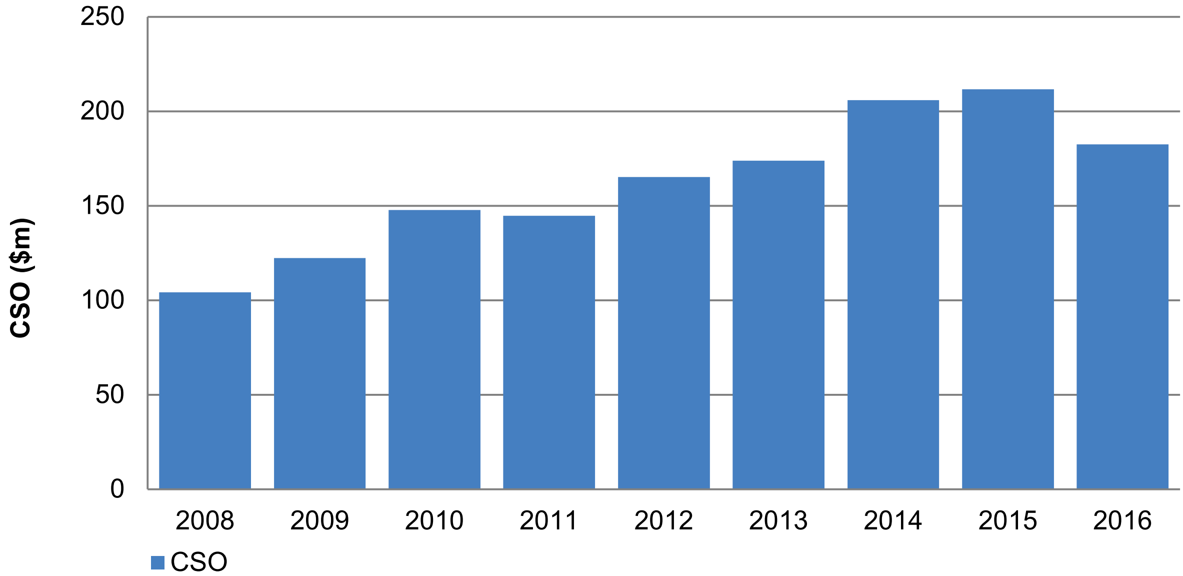
- In 2014–15, the decline in letters contributed to a net loss after tax of $222 million (Figure 1.1)

Figure 1.1: Australia Post's profitability 2008–2016



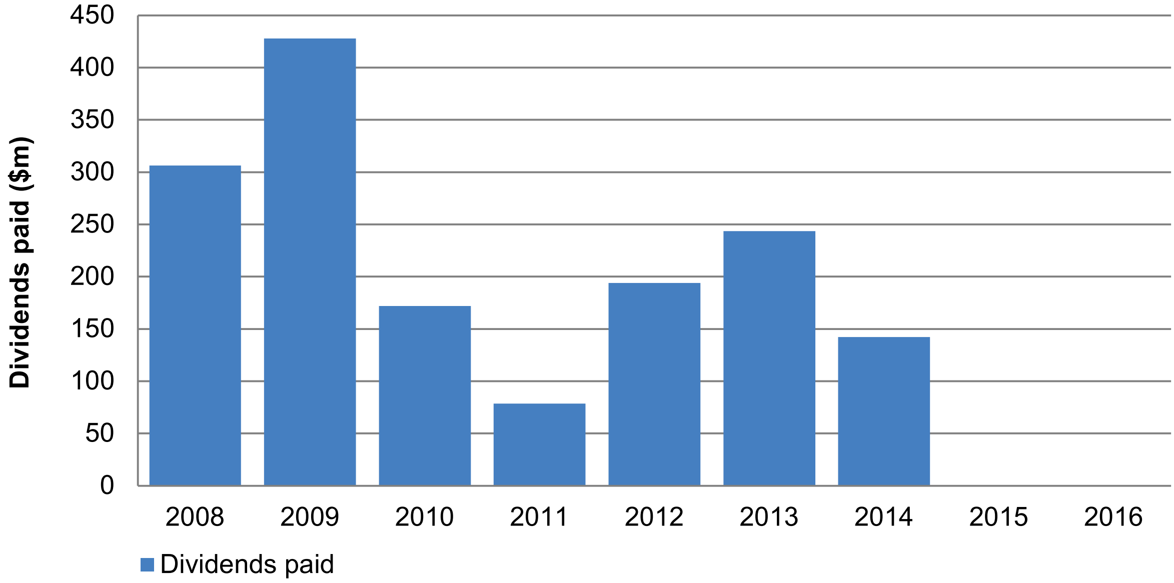
Source: ANAO analysis based on Australia Post Annual Reports.

Figure 1.2: Australia Post's Community Service Obligation costs 2008–2016



Source: ANAO analysis based on Australia Post annual reports.

Figure 1.3: Australia Post's dividend payments 2008–2016

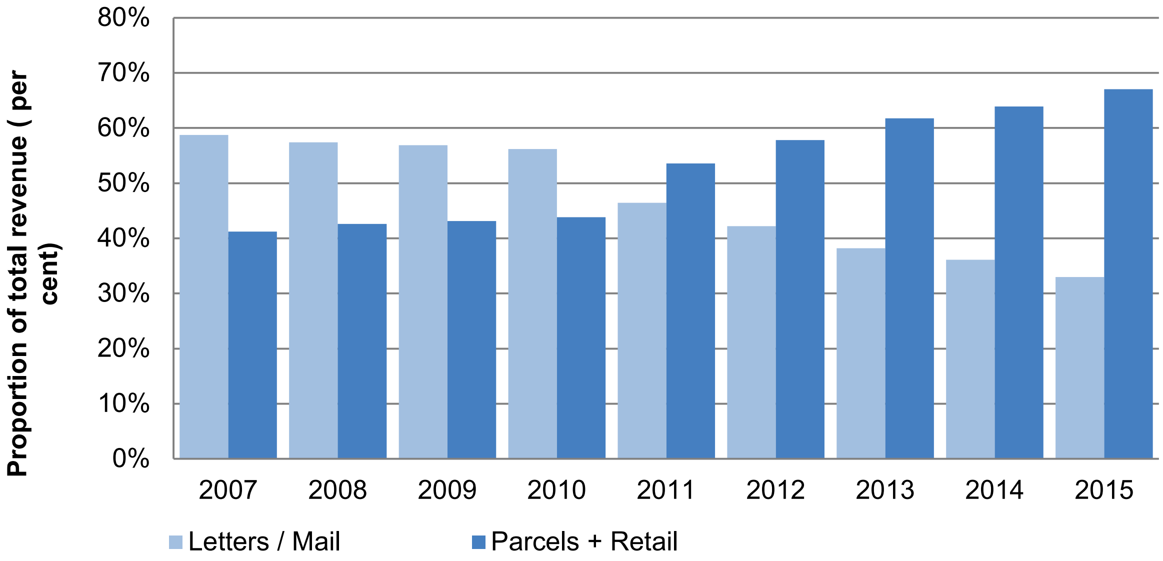


Source: ANAO analysis based on Australia Post annual reports.

1.17 The decline in letter volumes has resulted in the revenue share of Australia Post's letter services segment falling from 59 per cent of total revenues in 2007, to 34 per cent in 2015.[13] In contrast, the relative size of the competitive business (that is, the parcels and logistics, and retail and agency services) has grown from 41 per cent of total revenues in 2007 to 66 per cent in 2015. This reflects the significant growth in the parcels business (inclusive of acquisitions), which between 2007 and 2013 had a compound annual average growth rate of 13 per cent per annum, growing from $1.2 billion in 2007 to $3.2 billion in 2015 (Figure 1.4).

13 Total revenue excludes unallocated items. In 2016, the Mail Services and Retail & Agency Services segments were combined to reflect the nature of the postal business and data for separate segments is not available from Australia Post's *Annual Report 2016*.

Figure 1.4: Australia Post's revenues—proportion of letters vs parcels 2007–2015



Source: ANAO analysis based on Australia Post Annual Reports. This relies on the financial statements in the segment reporting which were impacted by a number of business organisational restructures during this period. Changes have been reflected in the segment notes in the year of the change and comparatives restated to provide a comparative basis.

1.18 The majority of letters delivered by Australia Post are those sent by businesses and governments. Australia Post does not have any specific data on private consumers however it estimates that private consumers generate approximately 3 per cent of addressed letter volumes. This is based on analysis of stamp sales (which is around 10 per cent of addressed letter volumes).[14] In addition, the rate of change in the volume of letters sent by individuals has fallen proportionally much faster than the rate of change in the volume of letters sent by businesses and governments (by 57 per cent and 27 per cent respectively between 2008 and 2016).

1.19 The prescribed performance standards (Table 1.1) are set to expire in April 2019. Public consultation on the development of the new prescribed performance standards is expected to be undertaken during 2018.

Audit approach

1.20 The objective of the audit was to examine whether the Australian Postal Corporation is meeting its obligations efficiently; and the effectiveness of Commonwealth shareholders in monitoring value for money.[15]

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14 Australia Post does not record data on letters sent by individuals or any measure of 'personal mail' volumes so the total volume of stamp sales has been used as a proxy for letters sent by individuals (as opposed to sent by businesses or governments), given the majority of stamps are used for this purpose, according to Australia Post.

15 The Auditor-General may only conduct a performance audit of a Government Business Enterprise on request by the Joint Committee of Public Accounts and Audit (JCPAA)—*Auditor-General Act 1997* s.17. The request to undertake a performance audit of Australia Post was received in October 2016.

1.21 To form a conclusion against the audit objective, the following high level criteria were adopted:

- Has the Australian Postal Corporation implemented strategies to improve the efficiency of meeting its obligations?
- Is the Australian Postal Corporation meeting its obligations efficiently?
- Do the Departments of Finance, and Communications and the Arts, effectively monitor the ongoing costs and benefits of meeting the obligations?

1.22 The audit methodology included reviewing:

- Australia Post's Executive Board papers, corporate plans, and financial reports;
- price notifications by Australia Post to the ACCC, relating to the Basic Postal Rate;
- reports examining Australia Post's efficiency and performance, including benchmarking against international comparators; and
- ministerial correspondence and other advice provided by Finance, and Communications.

1.23 Discussions were also held with relevant staff in Australia Post, Finance and Communications.

1.24 The audit was conducted in accordance with the ANAO Auditing Standards at a cost to the ANAO of approximately $599 851.

1.25 The team members for this audit were Andrew Rodrigues and EY–Infrastructure Advisory.

2. Australia Post's strategies to improve the efficiency of meeting its obligations

Areas examined

The ANAO examined whether Australia Post has developed and implemented strategies to improve the efficiency with which it meets its Community Service Obligations (CSOs).

Conclusion

Australia Post's strategies to improve its efficiency have focussed on process optimisation and automation along with labour force flexibility, all with the objective of improving labour productivity.

Australia Post has been relatively slow in developing and implementing some of these strategies. In particular, Australia Post has not fully implemented its strategies to improve labour productivity, which were to be a key driver of the planned efficiency improvements.

Area for improvement

The ANAO made one recommendation to Australia Post aimed at addressing the delays in implementing, and realising the benefits of, its strategies to improve the efficiency of its reserved services.

Is Australia Post developing strategies to improve its performance in meeting its obligations?

Australia Post has identified strategies to improve its efficiency in delivering its reserved letters services, having regard to the regulatory and practical constraints faced by its business, and the need to generate support for policy changes impacting on the CSOs. These strategies have focused on reducing labour costs, through such means as process optimisation, automation, and reducing the number of penalty shifts worked. In addition, Australia Post has sought to better utilise its fixed delivery network to grow revenue from existing sources and develop new sources of revenue. However, there would be scope to assess the costs and benefits of providing letters infrastructure over and above the requirements of the CSOs.

Opportunities to improve efficiency

2.1 In competitive markets, firms can enhance their efficiency by reducing costs for a given output; increasing output for given cost; more closely matching output and pricing to demand; and ensuring that their business can adapt to changing market conditions.

2.2 As a GBE, Australia Post is required to operate efficiently, price efficiently and earn a commercial rate of return.[16] As noted in Chapter 1, Australia Post's letters delivery service is a

16 Department of Finance, Resource Management Guide No. 126, Commonwealth Government Business Enterprise Governance and Oversight Guidelines (2015) [accessed 1 June 2017] http://www.finance.gov.au/sites/default/files/RMG-126 per cent20GBE per cent20Guidelines.pdf.

regulated monopoly. Consequently, Australia Post faces a number of regulatory, commercial and practical constraints on its delivery of its letters service. These are detailed in Box 1.

Box 1: Factors shaping Australia Post's corporate strategies

- **Service standards**: The frequency, accuracy and accessibility of Australia Post's mail service and network is regulated under section 28C of the *Australian Postal Corporation Act 1989* and associated regulations. Together, these regulations prescribe much of the CSOs that Australia Post must meet in delivering its reserved letters service.
- **Price**: The majority of Australia Post's products and services to meet its obligations—including the reserved letters service—are subject to price notification requirements.[a] While Australia Post has secured price increases through the notification process, this framework, combined with the fact that Australia Post cannot price discriminate and charge cost reflective prices to all customers[b], constrains Australia Post's ability to set efficient prices.
- **Revenues**: For most goods and services, the demand for the goods is responsive to the price (normal goods). In such cases, firms have an opportunity to set their prices to maximise total revenue. While, the majority of letter volumes are relatively price inelastic[c], prices are also regulated, which makes it more difficult to increase prices sufficiently to offset the falls in letter volumes since 2008.
- **Postal delivery network**: Australia Post's reserved letters service is delivered through a large and geographically dispersed network, with low customer and mail density. Consequently, reforms to the network, including changes to processes and deployment of capital, must be carefully planned and are often implemented over lengthy timeframes. Reforms to the network also require a clear understanding, well in advance, of any changes to requirements under the CSOs.
- **Organisational cost structure**: The majority of the operating expenses that Australia Post incurs to meet its obligations are through providing a physical postal network to meet the obligations and prescribed performance standards. Australia Post estimates physical mail network costs to be largely fixed (in the sense that the cost of operating the network is not closely related to the volumes of mail moving through it) at around 89 per cent of the mail network's total costs[d], primarily driven by the CSOs. The majority of Australia Post's costs in operating its network, in turn, are driven by labour costs[e], which Australia Post estimates at 68 per cent of total expenditure at an enterprise level.
- **Workforce composition**: Australia Post's workforce is largely comprised of full-time, permanent employees, with a low natural attrition-rate (see paragraph 2.34). Australia Post has also committed to not undertake any forced redundancies at the award level for employees affected by the Reform our Letters Service program.

Note a: For notified products, the Australian Competition and Consumer Commission must assess the proposed price increases for Australia Post's notified Reserved Services under sections 95X and 95Z of the *Competition and Consumer Act 2010.* Notified services represent around 15 per cent of Australia Post's volume of items delivered (that is, letters and parcels). The ACCC can object to any price increases proposed by Australia Post if it considers that the prices will exceed efficient costs (including an appropriate rate of return). The notified price then indirectly sets the baseline for Australia Post's negotiation of other prices with customers.

Note b: Australia Post must charge a single uniform rate of postage for its letter service within Australia under section 27(3) of the *Australian Postal Corporation Act 1989*.

Note c: Australia Post advised that 'transactional' mail is relatively inelastic, and is the dominant volume segment. Volumes for promotional mail, which accounts for around 20 per cent of total letter volumes, are more responsive to changes in price.

Note d: Australia Post, Reform our Letter Service: Detailed Design Blueprint Effective 15 July 2014

Note e: People-related costs comprise costs related to staff labour, contract labour, corporate superannuation entitlements, licensees and contractors used for mail delivery services. This is discussed further at paragraph 2.32.

2.3 These factors have imposed some constraints on Australia Post's ability, in the short-run, to determine its revenues, output, or quality (in terms of service standards) for its reserved letters business, and therefore to improve the efficiency with which it meets its obligations.

Australia Post's strategies and programs to improve its efficiency

2.4 Given its cost base and regulatory obligations, Australia Post advised that its strategies, objectives and supporting programs to improve its efficiency in meeting its obligations have been shaped by a strong focus on building stakeholder support for major changes to its letters business. Key strategies, objectives and supporting programs are outlined at Table 2.1:

Table 2.1: Australia Post's strategies and programs to improve efficiency

Strategy/Program	Date	Description
Future Ready	2010	Future Ready was designed to reshape the enterprise to meet the challenges and opportunities presented to it, and to bring a stronger commercial focus. Its strategic objectives were to manage the decline of the regulated letters business; grow the non-regulated business and manage customers through the change; and support Australia Post's staff, partners and the community during the process.
Post People First	2013	Key workforce enterprise strategy designed to support career mobility and development by ensuring that staff have access to available jobs within Australia Post.
Reform of our Letter Services (RoLS)	2015	Key program designed to reform the letters delivery service in response to declining letter volumes.
Our Part of Tomorrow	2015	Our Part of Tomorrow was designed to improve Australia Post's customer focus, with a focus on digital and online markets. Its strategic objectives include: running the current business efficiently; implementing Australia Post's reform program; accelerating Australia Post's future in eCommerce delivery; and designing and scaling future eCommerce services.

Note: Further detail on the timing of Australia Post's key strategies is included at Appendix 3.

2.5 Broadly, Australia Post's strategies in respect of its letters service have focussed on:

- process optimisation particularly to increase labour flexibility and reduce costs;
- process automation to use better technology to reduce costs;
- obtaining better utilisation of its delivery network;
- obtaining regulatory approvals to increase the price of its regulated letters products; and
- contributing to the policy discussion on modifying the prescribed performance standards it is required to meet.

Each of these is discussed below.

Changes to service standards

2.6 Australia Post has recognised that two key drivers of the losses it has sustained in meeting the CSOs have been the formulation of the CSOs themselves; and the ongoing decline in letters volumes. Australia Post has put forward changes to the CSOs to reduce the losses from its regulated letters business. Australia Post's key enterprise strategy from 2010–2014 was embodied in 'Future Ready', which was developed partly in response to declining letters volumes, which by 2008 were gathering momentum. This program ultimately led to the introduction of the RoLS program in 2014.

2.7 As part of this process, Australia Post made a number of representations to Government during 2013 and 2014, to build the case for more comprehensive changes to the reserved letter services. These included the:

- 2013–14—2016–17 Corporate Plan;
- Postal Services Review; and
- Advice Paper to the Departments of Finance, and Communications and the Arts.

2.8 Australia Post's international obligations are also an important driver of its costs. As noted at paragraph 1.12, the Universal Postal Union (UPU) convention requires Australia Post to deliver inbound international mail on terms no less favourable than those applied to comparable items in the domestic service, increased by the time normally required for customs clearance. Australia Post works closely with the Department of Communications and the Arts (Communications) to manage its international obligations as a designated party under the UPU Convention. These obligations are the subject of lengthy multilateral negotiations, the main focus of which is to increase the level of Australia Post's cost-recovery with regards to its international mail activities (that is, covering inbound and outbound international mail). In addition to the UPU, Australia Post consults with its international peers through regular forums such as Kahala to exchange insights and information[17], executive field trips and internal monitoring of movements of international pricing and volume trends.

2.9 The outcomes in this regard are predominantly a function of the prescribed performance standards and cost recovery (that is, prices) applying to the domestic network. Domestic postage prices are not the only factor in determining cost recovery under the UPU; the framework for determining remuneration under the UPU also involves a formula for converting postage rates, as well as a 'price cap' on remuneration.[18] However, supporting change to its domestic letters delivery obligations is one of the key ways Australia Post can manage the cost of meeting its obligations under the UPU.

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17 Kahala is a selection of international postal agencies from Australia, Canada, China, France, Hong Kong, Japan, Korea, Spain, Thailand, the UK and the USA. It seeks to promote customer choice and improve service options for postal express and package services.

18 The net loss to Australia Post from its obligations under the UPU is understood to currently be in excess of $50m per annum. This is likely to be a bigger issue for Australia Post compared to its international peers due to the Australia's larger geographic area and lower customer/mail density.

Securing price increases

2.10 In respect of Australia Post's 'notified services' (including much of the letters business) the Australian Competition and Consumer Commission (ACCC) assesses whether the proposed prices will exceed efficient costs (including an appropriate rate of return).

2.11 During the period from 2010–15, Australia Post sought and obtained regulatory approval for three increases to the Basic Postage Rate (55 cents to 60 cents; 60 cents to 70 cents; 70 cents to $1.00[19]) to improve the rate of cost recovery of its letters business. Notwithstanding these increases, prices still did not fully recover the costs of providing the services. Because demand for reserved letters services is relatively inelastic to price[20], additional price increases in the Basic Postage Rate have increased total revenue and increased the financial performance of the letters business. However the ability to continually do this would be influenced by regulatory constraints, community expectations, and Australia Post's objective of generating broad stakeholder support for its proposed changes.

2.12 During this period, Australia Post also negotiated a reduction of ACCC price oversight for 'PreSort'[21] mail in October 2011, which better enabled Australia Post to set more commercial and cost reflective prices for these products.

Leveraging the delivery network

2.13 As noted in Chapter 1, aspects of Australia Post's delivery network are shared across both its letter and parcel delivery services. Accordingly, Australia Post's strategies for increasing the efficiency of its letters delivery service have included pursuing economies of scale and scope across its delivery network. These strategies include:

- initiating the program to build our Future Parcels Network;
- launching the MyPost Digital Mailbox;
- acquiring StarTrack, Mail Call, MailPlus and SecurePay; and
- enhancing the retail network (with Superstores, 24/7 zones, Self-service terminals).

2.14 These strategies all seek to improve efficiency by utilising Australia Post's network infrastructure to generate new sources of revenue or generate additional revenue from existing sources by: increasing network capacity to handle more mail (Future Parcels Network); bringing new revenue streams (MyPost Digital Mailbox, acquisitions) and attracting new customers; and increasing the average spend of existing customers (enhancing the retail network).

2.15 In April 2017, Australia Post announced its intention to merge its parcels, and letters and mail networks to form a new eCommerce Delivery Team. The aim of the merger was to streamline

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19 In 2015, Australia Post also sought and obtained approval to introduce a new two-speed letter delivery timetable which allows an extra two business days for delivery of regular mail to enable greater flexibility and cost efficiency in its letter processing and delivery operations.

20 Australia Post, Supporting Information to Australia Post's Price Notification, November 2015, p. 8.

21 PreSort mail is a type of bulk mail used for the delivery of large volumes of barcoded articles. Pre-sort mail is still indirectly affected by the Basic Postal Rate (BPR). There is also separate regulatory oversight of pre-sort mail via s.32B of the *Australian Postal Corporation Act 1989* (which relates to Bulk Mail disputes). Australia Post also advised that pre-sort customers also use the BPR as a reference for their price expectations in negotiations.

shared functions and costs to improve productivity, and to increase employment mobility for staff between businesses to increase labour utilisation. The merger builds on other efficiency initiatives to increase network utilisation such as using the letters and mail network to deliver small parcels, which commenced in 2013 for parcels up to two kilograms. Australia Post has shifted its strategic focus to an enterprise strategy called 'Our Part of Tomorrow', which commenced in 2015. Key objectives relevant to the efficiency of the letters business include:

- increasing successful first-time delivery;
- continuing the move to day-time processing shifts, away from night-time or overtime shifts; and
- installing world-class processing machines, with higher processing speeds and lower error rates.

2.16 Looking forward, Australia Post continues to consider the options to align the process and delivery systems and costs to declining volumes, including options relating to:

- product offering—further slowing down the regular product and price increases;
- further automation of mail handling and consolidation of the network;
- further adapting delivery modes; and
- leveraging new machine and information technology across the supply chain.

2.17 Australia Post still exceeds the levels of service required by the legislated performance standards in respect of the number of street posting boxes (more than 50 per cent above target) and the number of retail outlets (almost 10 per cent above). Australia Post has advised that services provided above the CSOs, and the cost/benefit analysis of these services, is largely driven by community expectations and population growth, including providing new services for growing areas, and the challenges in reducing services in declining demographic areas—particularly rural and remote areas.

2.18 The number of additional posting boxes over and above the legislated standards is significant (for example, 5 357 posting boxes above the standards in 2016–17), which may impose additional costs, notwithstanding post boxes can be used to provide non-reserved services (for example, delivery of some parcels).

Reducing labour costs

2.19 As noted earlier, the majority of Australia Post's costs in maintaining its letters network are fixed, in the sense that the cost of maintaining the delivery network capable of meeting the CSOs is not significantly impacted by the volumes of mail moving through the network. The most significant cost of maintaining the network is labour costs.

2.20 Consequently, Australia Post's key strategies to reduce its network costs have focussed on investments in the network infrastructure to optimise and automate processes; reducing the frequency of deliveries (while still meeting its obligations); enhancing workforce flexibility; consolidation of mail processing and delivery; and extending processing shifts through using a longer day time processing window, which enabled an increase in the volume of mail that was automated and also provided opportunities to reduce the number of hours worked at penalty rates. Together, these strategies are intended to deliver savings in labour costs through increased processing efficiency. The total savings from the network and labour force optimisation strategies under RoLs were anticipated to deliver a total of $339 million in savings, which in cost terms would be equivalent to an FTE reduction of nearly 3 500. This would represent around 22 per cent of total labour costs for the reserved letters service workforce.

2.21 In the context of agreeing changes to the reserved letters service delivery framework, Australia Post decided not to seek forced redundancies at the Award level for employees affected by the RoLS program. Australia Post subsequently reflected that decision in its Enterprise Bargaining Agreement, which is current until August 2020. Therefore, actual reductions in staff numbers, relating to the reserved letters network pursuant to the RoLS reform program, were to be achieved through voluntary redundancies.

Table 2.2: Reform our Letters Service—network and labour force optimisation strategies

Process	Description	Projected savings 2018–19 ($m)
Automation impacts in delivery	New machines at major mail centres will automate sorting of mail and reduce sorting times and associated labour costs.	128
Implementing the National Delivery Model (NDM)	Under the NDM, regular mail will be delivered every second weekday (as opposed to every weekday), reducing the time and cost of outdoor delivery rounds.	53
Increasing automation in Mail Centres	Investment in new machines will reduce manual work effort, reduce number of required operators per machine and improve throughput rates.	52
Shift alignment in delivery	This will drive savings by increasing the number of non-penalty shifts worked.	45
Renegotiating contract terms	Renegotiation of terms for delivery contractors is expected on more favourable terms for Australia Post.	33
Shift alignment in processing	This will drive savings by increasing the number of non-penalty shifts worked, with all regular mail to be processed during the day.[a]	18
Consolidating processing of regular mail	Consolidation of mail processing activities will reduce the number of Mail Centres from 15 to 4.	4
Consolidating Delivery Centres	Consolidation of Delivery Centres into existing sites to allow disposal of surplus centres.	2
Vehicle optimisation	Optimisation of vehicle selection for delivery rounds based on conditions, terrain and density (for example, using electric bicycles).	3
Street Posting Box optimisation:	Aligning the Street Posting Box clearance time (that is, cut-off times) with mail centre processing windows.	0.6
TOTAL		**339**

Note a: The projected saving from shift alignment in processing is targeted to have been achieved by the end of the 2016–17 financial year. The remaining figures in the ROLS blueprint document are cumulative savings over the four years, targeted to be achieved by the end of the 2018–19 financial year.

Source: Australia Post, 2014, Reform our Letters Service - Detailed Design Blueprint, p. 73, 111.

2.22 The total costs of the network reforms from the RoLS program, including transition, implementation and capital costs, as well as anticipated redundancy incentives, is estimated at $278 million.[22]

Other relevant corporate programs

2.23 A number of other, often broader, programs have been progressing simultaneously with the RoLS program. These include:

- Australia Post's Post People First (PP1st) program, which is designed to support career mobility and development within Australia Post;
- work to support the ongoing commercial viability of the licensed post offices (LPOs), and through them the delivery network; and
- property portfolio rationalisations, which are ongoing.

Are Australia Post's strategies comparable with relevant international postal agencies?

The strategies adopted by Australia Post to pursue changes to service standards, increase processing efficiency and reduce costs are comparable to postal agencies in other jurisdictions that are facing similar challenges. Australia Post commenced its implementation of these strategies later than its international peers, partly due to challenges in generating the impetus for change. The high fixed costs for operating Australia Post's delivery network, combined with the long implementation times, have highlighted the need to take a strategic, long-term view and to generate stakeholder support well in advance.

International comparisons

2.24 There have been several benchmarking reviews of Australia Post's performance in delivering its letters delivery service undertaken previously, which provide some evidence that Australia Post has improved the efficiency of meeting its obligations over time.

2.25 The two key reviews were undertaken by Economic Insights (on three separate occasions)[23] and WIK-Consult.[24]

2.26 Economic Insights benchmarked Australia Post's efficiency against six other countries based on Total Factor Productivity (production of output produced relative to inputs used) and Partial Factor Productivity (inputs of labour, operating expenditure and capital expenditure) parameters and found that the:

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22 Total costs are comprised of $211 of capex investment, $54m of implementation costs and $13m of transition costs.

23 Economic Insights, *Measuring the Allocation of Australia Post's Reserved Service Productivity Dividend*, 6 July 2009; Economic Insights, 'Australia Post's Aggregate and Reserved Service Productivity – 2012 update', 19 April 2012; and Economic Insights, *'International Benchmarking of Postal Service Productivity'*, 8 May 2012.

24 WIK-Consult, November 2015, *'Review of Australia Post Efficiency program in light of an international benchmark'.*

- results of the 2009 Productivity Report showed that most of the benefits from Australia Post's reserved service productivity improvements over the past 12 years have been passed on to consumers in the form of real price reductions.
- 2012 Benchmarking Report concluded that for the unadjusted Total Factor Productivity results, Australia Post ranked second out of its peers.
- 2012 Productivity Report found that Australia Post Total Factor Productivity indexes have outperformed the market sector multifactor productivity over the last 15 years.

2.27 WIK-Consult found that:

- Australia Post's efficiency in letter operations has lagged behind its international peers, with relatively poor performance in respect of efficiency improvements and cost savings between 2008–2014.
- Australia Post's modernisation program, which will continue until 2018–19, envisaged savings that were conservative in light of international best practice, but ambitious in light of Australia Post's past performance.
- Falling letters volumes are common to postal operators around the world, and given these operators are typically already some years ahead of the experience in Australia (in terms of when major letter transformation programs were implemented—between four and nine years before Australia Post's RoLS program), there is scope to learn from their strategies and approaches.
- There were additional opportunities for Australia Post to increase efficiency and achieve substantial cost savings.
- Flexibility in work place arrangements are crucial to achieving the above outcomes.

2.28 Australia Post acknowledges that it has been relatively slow in adopting automation strategies to improve the efficiency of meeting its obligations. In most other countries the major letter transformation programs began in the 2005–10 period, while Australia Post commenced its RoLS program in 2014. However, Australia Post has also expressed the view that:

(a) Transformations to the postal network were best made in conjunction with changes to the prescribed performance standards underpinning the CSOs, the latter of which required Government agreement. Designing and gaining support for these reforms took two and a half years, and there were significant stakeholder challenges in building consensus around the need for significant change.

(b) The fall in letter volumes had been relatively slower in Australia compared to some other countries, at least up to the point when the recent changes were developed.

(c) Australia Post's network has some unusual features (for example, the small number of key mail centres) when compared to most of the countries that Australia was benchmarked against, and a customer base with relatively lower customer and mail density, and thus it is difficult to make static and absolute comparisons of efficiency across postal agencies; and

(d) Australia Post had limited capital at its disposal, particularly given the financial performance of its letter delivery service, and decided to focus more on growing the parcels business to offset the decline in the letters business.

2.29 As noted in Chapter 1, Australia Post's options to increase the efficiency of its letters delivery service are impacted by the prescribed performance standards underpinning the CSOs. This is not unique to Australia. Further, the relatively late peak in letters volumes in Australia compared with overseas represented an opportunity for Australia Post to learn from the experience overseas. In particular:

(a) Changes to postal services in Australia requires engagement with numerous stakeholders, including: a heavily unionised workforce in a challenging workplace relations environment; rural and remote stakeholders; and licensed post offices. While changing postal services does have inherent challenges, it has been a highly sensitive issue in many countries. Many comparable postal agencies have managed to build support for the necessary changes more quickly. In most other countries, the major letter transformation programs began in the period from 2005–10, while Australia Post commenced its RoLS program in 2014.[25]

(b) The later, more modest fall in letter volumes in Australia compared to some countries may have reduced the urgency of Australia Post's actions, but overseas experience also signalled the likely outlook in respect of volumes (which has largely been proven to be correct) and could have encouraged Australia Post to respond sooner.

(c) The unusual features of network (for example, low customer and mail density, the small number of key mail centres) did pose challenges, but other countries with similar networks undertook modernisation sooner. Differences in the operating environment faced by Australia Post compared with its international peers make static and absolute comparisons of efficiency difficult. That said, the WIK report draws its conclusions based on a qualitative assessment of where Australia Post sits on the modernisation path and the trend in operating cost performance over the recent past (that is, it compares the operating cost efficiency improvements each postal agency has made).

(d) A decision to pursue a growth strategy in the parcels delivery service would not of itself preclude a stronger focus on improving the efficiency of reserved letter services—indeed, a number of postal agencies internationally have done both. In addition, the business cases presented to Australia Post's Executive Board supporting the investments in network optimisation have invariably shown very positive prospective returns on investment, including after accounting for potential voluntary redundancy payments in some cases.

2.30 The high proportion of fixed costs incurred by Australia Post in maintaining its reserved services delivery network, as well as the long implementation times required to implement changes to the network, highlight the need to take a strategic, long-term view of potential change, and to generate stakeholder support for those changes well in advance. Moreover, these changes were supported by positive internal rates of return.

25 WIK-Consult, November 2015, *'Review of Australia Post Efficiency program in light of an international benchmark'.*

Has Australia Post implemented its strategies effectively?

Australia Post is yet to realise many of its planned efficiency improvements. Australia Post's workforce profile, combined with its decisions relating to workforce management, have created challenges in implementing, and realising the benefits of, strategies to improve efficiency, particularly in relation to penalty hours and overall staff numbers.

2.31 As outlined earlier, Australia Post's cost base for meeting its obligations is largely determined by the requirements of the CSOs, rather than the volume of mail flowing through the network.[26] The majority of the network costs are shared between the reserved and non-reserved services. For example, 96 per cent of reserved services costs are 'attributable costs' rather than direct costs.[27]

2.32 The overwhelming majority of the costs of operating Australia Post's delivery network are comprised of labour costs which make up around 70–80 per cent of total costs for reserved services. Consequently, the ability of Australia Post to realise its efficiency improvements has depended on its ability to deliver the labour cost reductions envisaged in its corporate strategies. The primary strategy to address issues associated with efficiency of reserved services being the RoLS program, which was designed to achieve reductions in costs.

2.33 In addition, Australia Post's implementation of its strategies have been impacted by:

- the composition of Australia Post's workforce; and
- Australia Post's workforce management policies.

Australia Post's workforce

2.34 Australia Post's workforce has:

- a significant proportion of permanent and full-time employees, with the majority of employees contracted under the Enterprise Bargaining Agreement and its terms and conditions;
- an average age of 50 years old in the Letters and Mail Network with high average tenure (16 years) and low levels of turnover; and
- historically had a low reliance on voluntary redundancies which made up 2.2 per cent of staff exits between 2014–15 and 2017–18, compared to natural attritions (voluntary retirements and other staff separations) which accounted for 16.1 per cent of total staff departures.

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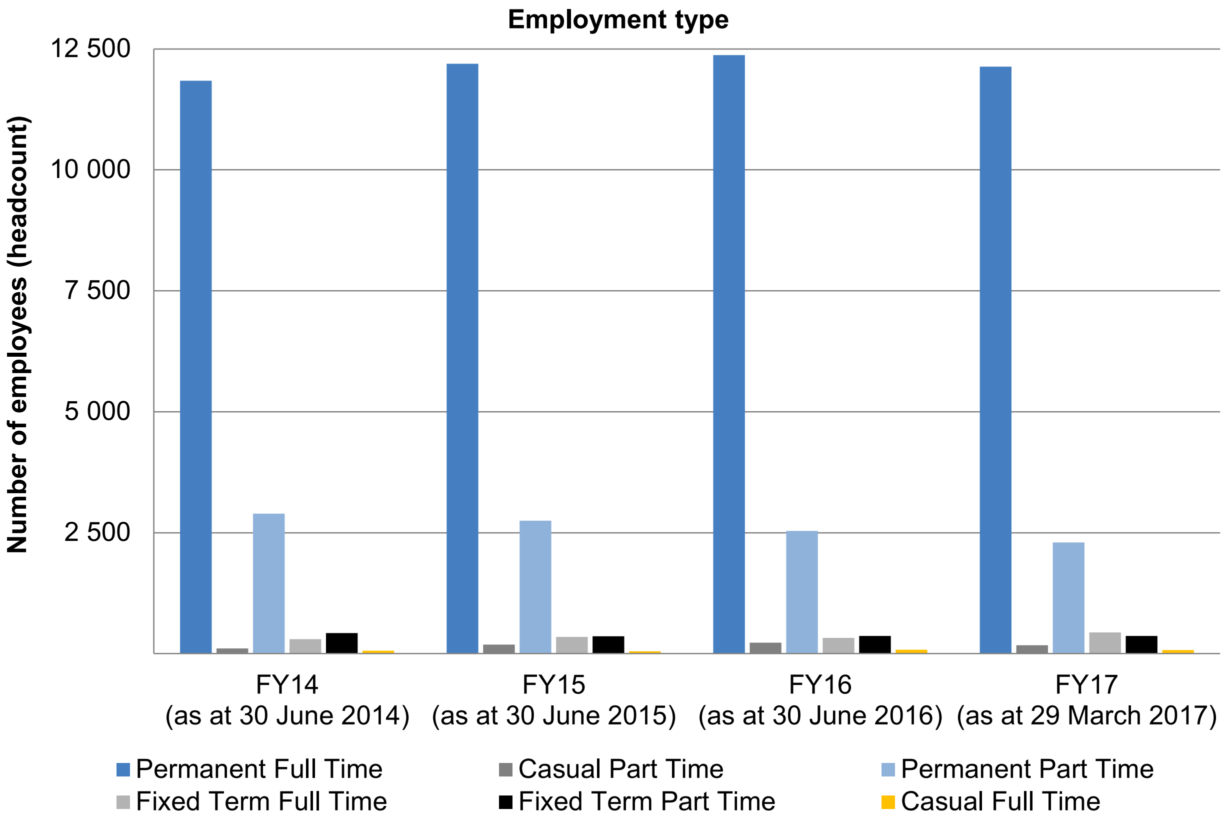
26 Australia Post estimates physical mail network costs to be largely fixed at around 89 per cent of total costs. Sourced from Australia Post, Reform our Letter Service: Detailed Design Blueprint Effective 15 July 2014.

27 WIK Consult estimated that 66 per cent of Australia's total costs classified as 'attributable costs'. WIK-Consult, 'Review of Australia Post Cost Allocation Methodology – Final Report'. Attributable costs are those that are shared across the reserved and non-reserved services, and apportioned to the reserved services business based on volumes.

Figure 2.1 Australia Post staffing composition (full time equivalent)



Source: ANAO analysis based on Australia Post data.

Workforce management policies

2.35 The original Postal Service Optimisation business case underpinning RoLS envisaged a cost of $122 million and a reduction in staffing numbers of 1 417. The original announcement of Government policy to support the reforms did not rule out involuntary redundancies to meet the efficiency objectives of the reform program. However, in March 2015, the (then) Managing Director of Australia Post made a commitment that Australia Post 'would not force redundancy on our people who are directly impacted by operational changes.' The Managing Director made the commitment in the interests of minimising potential disruptions across the business as a whole (including through any industrial action); as well as minimising any negative impacts on key stakeholder groups, including its employees. However, this commitment was not the subject of formal prior approval from the shareholders; from the Board; or formal consideration at executive management level.

2.36 At the time, Australia Post had taken the view that securing broad stakeholder support would be necessary to underpin the changes required as part of the RoLS program. Australia Post considered its commitment—regarding redundancies arising from operational changes – was necessary to achieve this outcome.

2.37 In early May 2015, Australia Post's Board endorsed the commitment to no forced redundancies at the Award level for staff affected by the RoLS program. This was subsequently confirmed nearly a year later, in March 2016, when the Government issued its Statement of

Expectations (SOE) to Australia Post, which reiterated the commitment to no forced redundancies for the life of the reform for award-level employees impacted by the reforms.[28]

2.38 Australia Post's decision not to use forced redundancies in implementing RoLS informed key workforce management programs, including its redeployment program, retraining and employee support, the approach to enterprise bargaining and its engagement with the key labour unions.

Shift alignment

2.39 A significant focus of the RoLS program is to decrease the number of hours worked at penalty rates in distribution centres by reducing the number of employees working night shifts. The 2016–17 to 2019–20 Corporate Plan notes that the shift alignment process has been successful. Australia Post has noted that shift realignment, together with the introduction of a 'priority' and 'regular' letters service from January 2016, is a significant step in securing savings in the longer term and providing a longer processing window, which Australia Post anticipates will allow greater levels of automation in the near future. However, there is no evidence to show that this initiative has materially reduced the number of penalty hours worked, or achieved the intended cost reductions.

Case study: Dandenong Letters Centre

The Dandenong Letters Centre (DLC) was analysed by the ANAO for two pay runs in the four years from 2014–17 to compare ordinary rates with overtime and penalty rates before, during and after the shift alignment process. The analysis considered the proportion of time that employees spent working at ordinary rates, overtime rates (for example, overtime 1.5 times, overtime 2.0 times) and penalty rates (for example, public holiday rates, shift penalty at double time) on average.

The analysis shows:

- The proportion of time spent working penalty shifts compared to time working at ordinary pay rates has increased in this period, from 17 per cent in 2014 to 19 per cent in 2017; and
- The proportion of time spent working overtime compared to time working at ordinary pay rates has increased in this period, from 8 per cent in 2014 to 10 per cent in 2017.

Whilst there is no material decrease in the proportion of overtime and penalty hours to normal hours, it is noted that based on the ANAO's analysis there has been a 3 per cent ($184 639) cost saving at DLC between 2014 and 2017. Staff numbers reduced by 25 per cent (239 employees) from 2014 to 2017. However significant increases in overtime costs incurred by existing staff offset a large portion of the reductions in base salaries.

28 Commonwealth Government, 'Australian Postal Corporation: Government Statement of Expectations', 15 March 2016

Original labour cost savings targets – Reform Our Letters Service (RoLS)

2.40 The original target for the RoLS program was documented in the 2014 *Reform our Letters Service- Detailed Design Blueprint.* This targeted:

(a) headcount reductions of 3 178 by FY19; and

(b) savings of $339 million by FY19.

Subsequent revisions to labour cost savings targets

2.41 The target was subsequently revised in 2015 following further validation of the Blueprint. The key points were:

- management[29] subsequently revised these savings down to $306 million; and
- while there were no specific headcount reductions planned (as the cost program was based on FTEs) the expectation was between 2 500 and 3 000 reductions in FTE as a letters only strategy.

2.42 The reasons for the revision away from the Blueprint are as follows:

- ***Slower declines in letter volumes than expected*** – the RoLS blueprint assumed letter declines would occur more quickly than what materialised and Australia Post decided it needed more staff (~200 FTE) to deliver the higher volumes than originally estimated (delivered letter volumes are 7.5 per cent higher than the BCG detailed design and FY18 Draft Corporate plan levels are 11 per cent higher (or ~200 FTEs)).
- ***Change in strategy since Blueprint*** – the RoLS blueprint did not allow for a broader strategy of taking small packets from 'piece rate delivery contractors' and associated cost reductions there, and giving those packets to postal delivery officers (PDOs) to deliver – so more PDOs were required given the slight shift in strategy since the original Blueprint.
- ***Update in assumptions about reform*** – the blueprint assumed regulatory change would occur six months earlier than it eventually did; and that machines could be procured and implemented 12 months earlier than is occurring.
- ***Blueprint was not an implementation plan*** – the Blueprint was a detailed consulting piece of strategic work, and not a detailed implementation plan. The higher revenue and adjusted cost savings of $306m have formed part of the past two corporate plans.

Current status

2.43 The current status is as follows:

- In aggregate, Australia Post is planning total reductions of 2 526 by the end of FY19.
- As at 30 June 2017, total workforce reductions have been 826, achieved through Australia Post's voluntary redundancy program.
- The Corporate Plan assumes further reductions of 1 700 by the end of FY19.

29 Australia Post's General Manager, Superannuation and Enterprise Projects, indicated that this change was not approved by the Board, but that the Board is aware of the delays in achieving the efficiencies.

- Australia Post expects that 1 500 of the 1 700 reductions (or 88 per cent of these reductions) will rely on voluntary redundancies.

2.44 Australia Post advised:

- It expects the offers to accelerate as greater automation of processing is brought online, with the majority of savings realised in the 2017-18 and 2018-19 financial years.
- It has identified the list of roles expected to become redundant over time, and has a dedicated team managing systems, processes and capabilities to deal with redeployment, retraining and redundancy, as part of its ongoing program to support the implementation of RoLS.
- Delivery of its voluntary redundancy program is being managed at the local facility level by each local Human Resources Business Partner.

2.45 Australia Post also provides quarterly updates to its Board which includes reporting on the total number of workers in the letters business; the number of staff redeployments; the number of departures through voluntary redundancies and natural attrition; and the number of employees transitioning from night shift to day shift in letter processing centres.

2.46 However, the Board reporting reviewed by the ANAO in the course of this audit does not provide a clear comparison of the progress in achieved FTE (or equivalent cost) reductions against those originally envisaged in the RoLS Blueprint, or as revised by subsequent business cases. In addition, the RoLS Program Control Board Status Report—which notes the progress of network reforms, which form the prerequisite for the planned labour cost reductions—notes that implementation timelines and benefits are unlikely to be achieved as planned due to key business assumptions, risks, and programs of work at enterprise level.

2.47 If Australia Post is able to execute its plans to reduce labour costs, then the savings targeted in the 2015 revision would be achieved. However, these costs reductions rely on the successful and timely implementation of a large-scale voluntary redundancy program. Progress to date does not provide evidence that such a large-scale redundancy program can be implemented in the targeted timeframes.

Recommendation no.1

2.48 Australia Post should identify and address the impediments to improving the efficiency of its letters service, including implementing, and realising the benefits of, its efficiency strategies.

Australian Postal Corporation response: Agreed, with qualifications

2.49 *Agreed, with the qualification that the net benefits (considering both cost-out and revenue received) are on track when measured against the 2015 Reform our Letters Service (RoLS) business case. Achieving efficiencies has been impacted by the letter volume mix; the letters automation schedule; the growth in delivery points; and the higher than forecast volume of parcels that is being delivered by our letters network (posties).*

Closure of the defined benefit scheme

2.50 Australia Post has also undertaken business-wide reforms that have impacted on the costs of delivering the reserved letters service. Australia Post estimates that the closure of the Australia Post defined benefit scheme (the APSS) to new members from July 2012 has provided cumulative, net benefits of $73m as at July 2017.[30]

2.51 The Federal Court heard the Communication Workers Union's (CWU) challenge to the cessation of Average Weekly Ordinary Time Earnings (AWOTE) indexing for APSS members' super salaries from 20–24 March 2017. If the indexation of superannuation salaries is fully reinstated, a past service cost to reflect the defined benefit obligation would need to be recognised in the Profit and Loss Statement and this would be similar to the benefit of $117 million in 2015. This case is currently in progress.

30 These benefits are estimated based on the cumulative reduction in superannuation expenses as a result of closing the scheme (totalling $345m, from financial year 2011-12 to 2016-17, inclusive) offset by defined contributions made to other employees nominated funds since 2012.

3. Australia Post's efficiency in meeting its obligations

Areas examined

The ANAO examined whether Australia Post is meeting its obligations efficiently.

Conclusion

Australia Post has improved its efficiency over time, however these improvements have been relatively slow compared to its international peers, particularly in relation to its management of operating costs.

While Australia Post monitors and evaluates the efficiency with which it meets its obligations, there would be scope for Australia Post to provide its shareholder with more strategic information on the long-term sustainability of the letters business; changes in Australia Post's performance over time; and the assumptions driving key forecasts that underpin the enterprise valuation.

Area for improvement

The ANAO made one recommendation to Australia Post, aimed improving its shareholder reporting.

Is Australia Post's performance comparable with relevant international postal agencies?

Australia Post has not performed as well as its international peers in managing its operating costs, both across its business as a whole and in relation to its letters business. Australia Post has improved its efficiency over time, however these improvements have been relatively slow compared to its international peers, including those that also operate under the constraints of government ownership.

3.1 The ANAO benchmarked the historical cost performance of Australia Post against five international postal agencies from 2008–09 to assess how each operator has improved efficiency over that period.[31] The analysis used publicly available information for each postal operator's letters service, including operating expenses, revenues and volumes relating to letters services, and overall mail volumes (that is, including parcels).

3.2 There were some constraints on this analysis based on the level of detail provided in the publicly available data, particularly as postal operators typically operate shared cost networks (that is, between letters and parcels). In addition, the operating environment for international mail carriers is constantly changing, including:

- policy changes affecting the obligations of each entity that have occurred at different times, which includes government policies and accounting standards; and

31 The international postal agencies against which Australia Post was assessed were those in Canada (Canada Post), New Zealand (NZ Post), the United Kingdom (UK Royal Mail), the Netherlands (Post NL) and Germany (Deutsche Post). The starting point (2008–09) was selected as it was the earliest available year of data for all selected international postal agencies. It also captures the material declines in letter volumes in each country.

- structural changes to mail delivery networks and broader changes in the market, and as a result, changes to cost allocation models and accounting treatments.

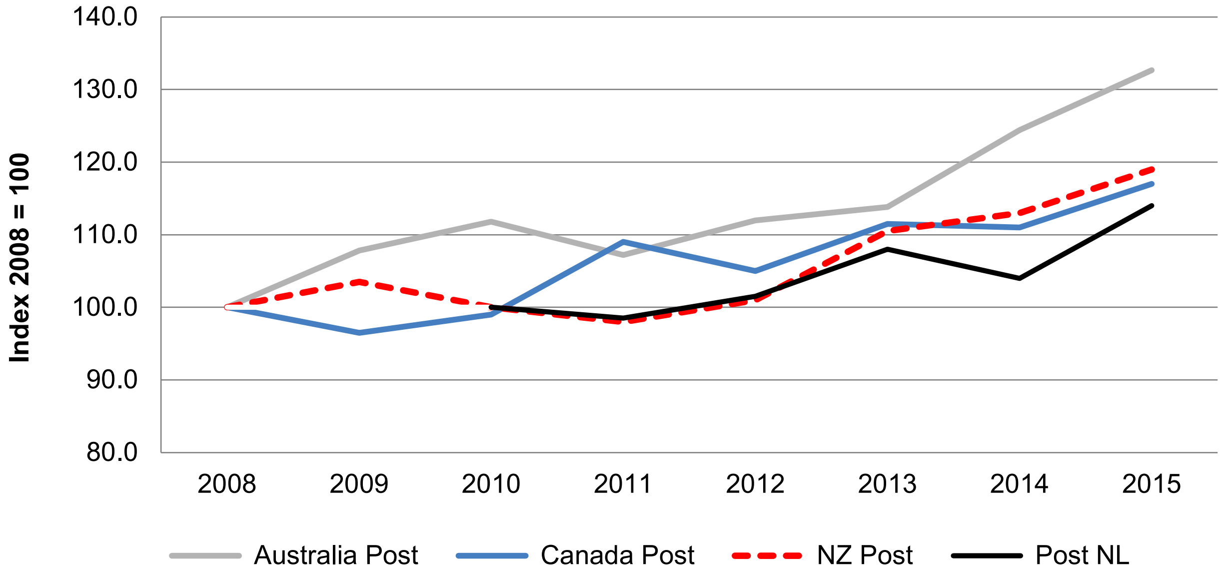
Further detail on the methodological approach is included at Appendix 5.

3.3 Notwithstanding these methodological challenges, the benchmarking approach can provide insights into the relative efficiency of each postal agency by focusing on how each agency's performance has changed over time relative to its own starting point. The key findings are shown in the following figures.

Operating expenses per letter delivered

3.4 Figure 3.1 shows letter delivery service expenses[32] per unit (that is, per letter) delivered between 2008 and 2015 for Australia Post, Canada Post, New Zealand Post (NZ Post) and Post Netherlands (Post NL).[33]

Figure 3.1 Letters operating expenses per unit delivered 2008–15



Note: In 2013-14, Australia Post experienced an increase in operating expenses due to a change in accounting standards for defined benefit superannuation funds. The impact on Letters operating costs equal to $56m in 2013-14 and $31m in 2014-15.

Note: In January 2016, Australia Post introduced a two-speed letter delivery timetable which allowed an extra two business days for delivery of regular mail to enable greater flexibility and cost efficiency in its letter processing and delivery operations, which resulted in a reduction in operating expenses.

Source: ANAO analysis based on annual reports, except for Australia Post which has been sourced from the Record Keeping Schedules which is not publicly available.

32 Letters operating expenses are the costs incurred in undertaking local obligations in delivering letter services. Data for some postal agencies may include international mail.

33 The countries presented in this chart are the only international postal agencies where comparable information could be obtained from publicly available information for the relevant time period. Note that sufficiently granular data on the letters service was only available for Post NL going back to FY2010

3.5 Figure 3.5 shows that between the 2008-09 and 2015-16 financial years, letter delivery service operating expenses per unit delivered:

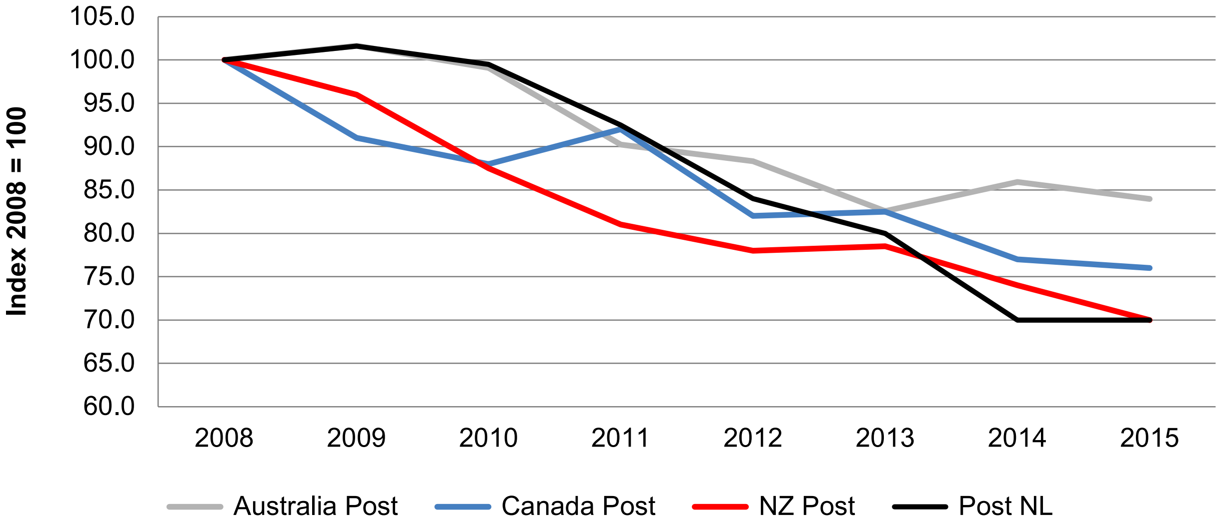
- increased by 33 per cent in Australia[34];
- increased by 17 per cent in Canada;
- increased by 19 per cent in New Zealand; and
- increased by 14 per cent in the Netherlands from 2010–2015.

3.6 All countries examined are currently experiencing declines in letter volumes, albeit at different rates. Since 2008, the decline in Australia Post's reserved letter volumes (-31 per cent) has been equivalent to Canada (-31 per cent) but smaller than the declines in New Zealand (-39 per cent) and the Netherlands (-49 per cent). However, even taking into account the decline in letter volumes, Australia Post's operating expenses per unit delivered have increased at a higher rate than its counterparts.

Operating expenses per letter delivery point

3.7 Given the variability in letter volumes and the nature of the costs of providing letter delivery services, the number of delivery points provides a more stable basis for comparing the trends in operating costs (see Figure 3.2).[35]

Figure 3.2 Letters operating expenses per delivery point, 2008–15



Note: In 2013-14, Australia Post experienced an increase in operating expenses due to a change in accounting standards for defined benefit superannuation funds. The impact on Letters operating costs equal to $56m in 2013-14 and $31m in 2014-15.

34 The increase in Australia Post's letter delivery operating expenses per unit from 2014–15 was driven by increases in costs related to carriage of mail and other (non-people) costs. These results may also be impacted by changes in accounting methodology during 2013–14 in which Australia Post changed profitability systems resulting in different product costing and general ledger costing accounts.

35 This analysis takes into account increases in the number of delivery points over time. However it does not take into account the location of the new delivery points and the implications for network and customer density etc., which may affect the interpretation of the results. No data was available to account for any impact this might have on costs.

Note: In January 2016, Australia Post introduced a two-speed letter delivery timetable which allowed an extra two business days for delivery of regular mail to enable greater flexibility and cost efficiency in its letter processing and delivery operations, which resulted in a reduction in opex.

Source: ANAO analysis based on annual reports, except for Australia Post which has been sourced from the Record Keeping Schedules which is not publicly available.

3.8 Figure 3.2 shows that between the 2008-09 and 2015-16 financial years, letter delivery service operating expenses per delivery point:

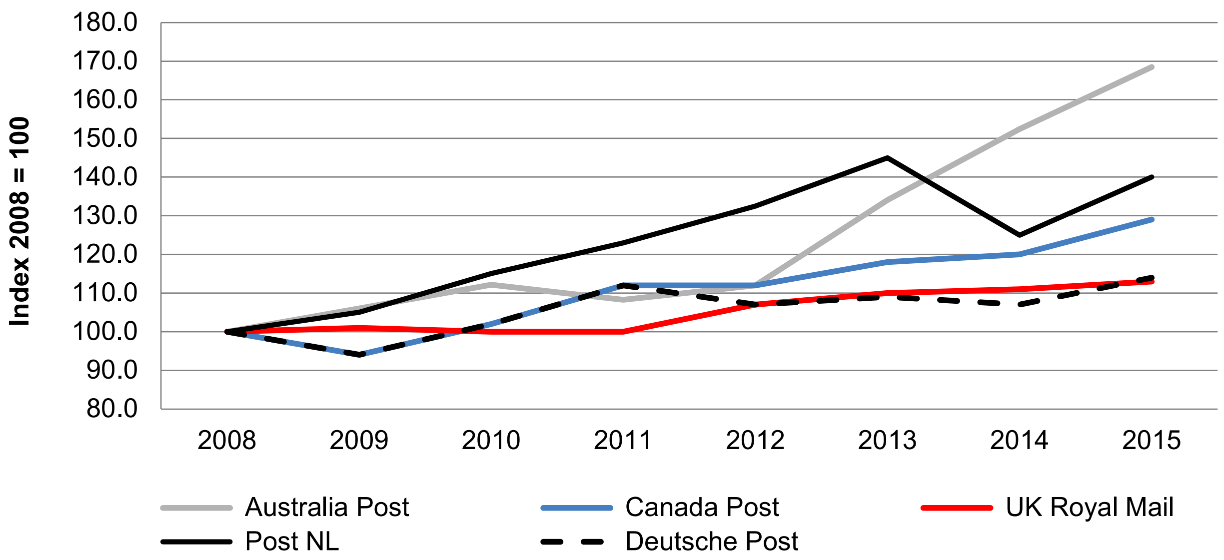
- decreased by 16 per cent in Australia;
- decreased by 24 per cent in Canada;
- decreased by 30 per cent in New Zealand; and
- decreased by 30 per cent in the Netherlands.

Total operating expenses per unit delivered (letters and parcels)

3.9 The following figures show the same analysis of operating expenses per unit delivered and per delivery point for the combined 'mail business' (that is, including letters and parcels services) for Australia Post, Canada Post, Royal Mail, Post NL and Deutsche Post.[36]

3.10 While the focus of this audit is on reserved services (primarily letters), postal operators generally operate a shared cost network with the majority of costs likely to be shared between the letters delivery and parcel delivery services. For example, Australia Post undertakes a significant cost allocation exercise to report costs and revenues in its annual reports for reserved and non-reserved services.

Figure 3.3 Total operating expenses per unit delivered, 2008–15



Note: This figure has not adjusted Australia Post's data for the expenditure and parcel volumes of its StarTrack business, which was acquired in November 2012. Operating expenditure for StarTrack was equal to $638m in 2012-13, $956m in 2013-14 and $1.04bn in 2014-15; with StarTrack's mail volumes of 78.2 million only included from 2014-15.

36 This data was not available for NZ Post. Note the results in this section for Deutsche Post are comprised of post (that is, letters), parcels and e-commerce.

Note: In 2013-14, Australia Post experienced an increase in operating expenses due to a change in accounting standards for defined benefit superannuation funds. The impact on total operating costs equal to $176m in 2013-14 and ~$105m in 2014-15.

Note: In January 2016, Australia Post introduced a two-speed letter delivery timetable which allowed an extra two business days for delivery of regular mail to enable greater flexibility and cost efficiency in its letter processing and delivery operations, which resulted in a reduction in operating costs.

Source: ANAO analysis based on annual reports, except for Australia Post which has been sourced from the Record Keeping Schedules which is not publicly available.

3.11 Figure 3.3 shows that between the 2008-09 and 2015-16 financial years, 'total opex' per unit delivered:

- increased by 68 per cent in Australia;
- increased by 29 per cent in Canada;
- increased by 13 per cent in the UK;
- increased by 40 per cent in the Netherlands; and
- increased by 14 per cent in Germany.

3.12 Figure 3.3 also shows Australia Post's total operating expenses per unit increased significantly beginning in 2012–13, with costs increasing by 50 per cent between then and 2014–15. This reflects Australia Post's acquisition of the StarTrack business. If StarTrack's volumes and opex are removed from Australia Post, total opex per unit has increased by an estimated 46 per cent over the same period. This illustrates that Australia Post's operating expenses have been increasing at a higher rate than its international peers.[37] This is also consistent with Figure 3.1 on letters operating expenses per unit delivered.

Total operating expenses per delivery point (letters and parcels)

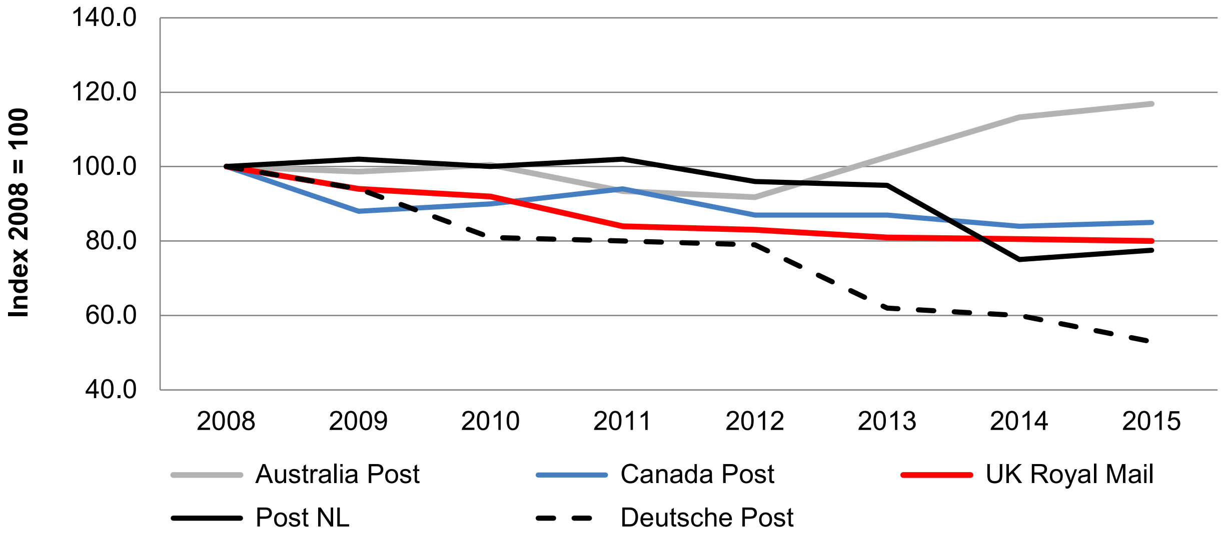
3.13 The following analysis on total operating expenses has been extended to a 'per delivery point' basis.

3.14 Figure 3.4 shows that between the 2008-09 and 2015-16 financial years, total operating expenses per delivery point:

- increased by 17 per cent in Australia, reflecting Australia Post's acquisition of the StarTrack business, with Australia Post the only international postal agency to increase operating expenses on this measure;
- decreased by 15 per cent in Canada;
- decreased by 20 per cent in the UK;
- decreased by 22 per cent in the Netherlands; and
- decreased by 47 per cent in Germany.

37 This analysis has not taken into account any differences in product mix between Australia Post and its international peers due to data limitations. Adjusting for this may affect the results.

Figure 3.4 Total opex per delivery point, 2008–15



Note: This figure has not adjusted Australia Post's data for the expenditure and parcel volumes of its StarTrack business, which was acquired in November 2012. Operating expenditure for StarTrack was equal to $638m in 2012-13, $956m in 2013-14 and $1.04bn in 2014-15.

Note: In 2013-14, Australia Post experienced an increase in operating expenses due to a change in accounting standards for defined benefit superannuation funds. The impact on total operating costs equal to $176m in 2013-14 and ~$105m in 2014-15.

Note: In January 2016, Australia Post introduced a two-speed letter delivery timetable which allowed an extra two business days for delivery of regular mail to enable greater flexibility and cost efficiency in its letter processing and delivery operations, which resulted in a reduction in operating costs.

Source: ANAO analysis based on annual reports, except for Australia Post which has been sourced from the Record Keeping Schedules which is not publicly available.

3.15 These findings suggest that in an environment of declining letter volumes and increasing numbers of delivery points, comparable international postal agencies were more effective than Australia Post in reducing their operating expenses from 2008 to 2015. Removing the effect of StarTrack would see Australia Post's total opex per delivery point decrease by approximately 5 per cent rather than increase by 17 per cent as illustrated in the figure above.

3.16 Given Australia Post's largely fixed cost base, the decline in letters volumes has caused a reduction in efficiency based on the costs per unit delivered—however, even allowing for this reduction in volumes, Australia Post's costs have increased relative to its competitors. On the basis of operating expenses per delivery point, Australia Post has improved its efficiency over time, albeit more slowly than its international peers, including those which also operate under the constraints of government-ownership (that is, Canada Post and NZ Post). Further, Australia Post's performance improvements have been significantly lower than privately-owned international postal agencies (Post NL, UK Royal Mail and Deutsche Post), which have some form of universal service obligations.

3.17 The analysis also supports the view that:

(a) delays in implementing labour productivity strategies, as outlined in Chapter 2, are likely to be a key driver of these outcomes; and

(b) Australia Post's strategies aimed at reducing its costs of meeting the CSOs in their current form are unlikely to ensure the sustainability of the business model over the longer-term, particularly given the expected continued decline in letter volumes.

3.18 Australia Post's Enterprise Valuation model forecasts that Mail Services[38] (which comprises reserved letter services) will achieve a net profit in 2017–18, will begin to experience losses from 2018–19, and is not expected to return to profit.

3.19 Even if Australia Post had been able to achieve the efficiency improvements achieved by its international peers between 2008–15 (for example, Canada Post)[39], this would only have reduced Australia Post's operating expenses by $157 million. Assuming this was Australia Post's 'cost base' for letter delivery services in 2015–16, it would only remain profitable for a further two years and would experience losses from 2020–21 onwards. If Australia Post was able to achieve the greater efficiencies achieved by Post NL[40], this would still mean it would be unprofitable from 2021–22.

Has Australia Post monitored and evaluated its efficiency?

Australia Post monitors and evaluates the efficiency with which it meets its obligations. However, there would be scope for Australia Post to provide its shareholder with a more strategic view of the long-term sustainability of the letters business, Australia Post's performance in respect of reserved services over time, and the impact of the key assumptions underpinning the longer-term enterprise valuation.

3.20 As a monopolist in the provision of letter delivery services, Australia Post is not subject to the incentives associated with competitive markets. In addition, while Australia Post's Board has similar responsibilities and requirements as publicly-listed companies in respect of information disclosure and corporate reporting, its status as a GBE means it does not face the same incentives for efficiency and commercial disciplines that would normally be generated by a private ownership and participation in equity markets. Finally, Australia Post's role in delivering Government policy objectives creates a variety of constraints and conflicting incentives that can be difficult to overcome, particularly in terms of financial performance objectives.

3.21 In this context, it is important that both management and the shareholder have transparent, timely and relevant information on which to assess Australia Post's performance.

3.22 There are a number of activities that Australia Post undertakes to monitor, evaluate and report its performance in meeting its obligations. These activities are undertaken pursuant to regulatory obligations; to support corporate governance and oversight; to inform corporate strategies; and to support pricing and regulatory reform. These measures are outlined in Table 3.1.

38 Mail Services includes all domestic and international letters, and parcels weighing less than 2kg. Reserved letters are a subset of domestic letters.

39 During FY08–15, Canada Post's letter opex per unit delivered declined by 24 per cent (compared to a 16 per cent decline for Australia Post).

40 Post NL's letter opex per unit delivered declined by 30 per cent during FY08–15.

Table 3.1: Performance monitoring and evaluation of Australia Post's letter delivery service

Activity	Description
Shareholder reporting	Australia Post provides regular reports to its shareholder through its annual Corporate Plan, quarterly progress reports (performance tracking), and dividend recommendations. It also provides other updates as appropriate (for example, business proposals above a certain materiality threshold).
Cost modelling of CSOs	Australia Post estimates the financial cost of meeting the CSO in accordance with the methodology in the Commonwealth Government's 1991 guidelines for Australia Post on the costs of providing its CSOs, and reports this in Annual Reports.
External auditing of performance against CSOs	The Australian National Audit Office audits Australia Post's compliance with the prescribed performance standards[a], which cover frequency, accuracy, speed of delivery and accessibility of retail outlets and mail boxes.
Price notifications	Proposed price increases for 'notified' services (a sub-set of reserved letter delivery services) are assessed by the Australian Competition and Consumer Commission (the ACCC) on the basis of whether they exceed the efficient cost of providing that service.
Enterprise Valuation Model	Australia Post's Enterprise Valuation Model provides a long-term valuation of its business, forecasting revenues, costs and profitability for different groups (including reserved letter delivery services) and for the consolidated enterprise. The model adopts the Corporate Plan's assumptions for the life of the plan (usually four years) and then develops its own assumptions beyond this.
Reform our Letters Service	Australia Post undertook a once-off assessment of the current and future letters business; and prospects of efficiency increases to address delivery letters volumes; in the context of developing the business case to support the RoLS program.
Management reporting at Audit and Risk Committee meetings	Management updated the Board of ongoing progress of the RoLS program and other strategies in the Enterprise Portfolio Status discussion papers, presented at Audit & Risk Committee (ARC) meetings. These papers report on the health status of RoLS and all other ongoing significant projects.
Internal benchmarking	Australia Post has commissioned a consultant to benchmark its total factor productivity performance against international peers. This was undertaken in 2012 at an enterprise level and for the reserved services only. In addition to these consultant reports, Australia Post has also undertaken benchmarks of its cost-to-income ratios across the whole business against international comparators.
External reports	External reviews relating to Australia Post's performance include: • WIK-Consult, which assessed Australia Post's operations and reform program in light of international best practice; • Economic Insights benchmarked Australia Post's productivity (Total and Partial Factor Productivity) against six international postal agencies; and • Global Postal Industry Reports are produced annually by the International Post Corporation covering 45 international postal operators (approximately 90 per cent of global postal operating revenue). These reports analyse the performance of each postal operator at the corporate and business unit levels.

Note a: *Australian Postal Corporation (Performance Standards) Regulations 1998.*

3.23 These activities provide some insight into Australia Post's costs, service performance, financial profitability and implementation of strategies. They inform the shareholders' and the Board's assessments of efficiency through: improved corporate governance and oversight; the development of corporate strategies; and support for pricing and regulatory reform.

3.24 The analysis undertaken by Australia Post does have some limitations, in particular:

(a) The analysis does not contain detailed performance benchmarking from an operational cost efficiency perspective (costs per unit of output) and instead considers financial profitability.

(b) The analysis (including benchmarking against international peers) has not been undertaken on a regular basis, which presents challenges in understanding trends in efficiency over time, or Australia Post's progress in achieving efficiencies relative to its international peers.

(c) Australia Post has detailed programs to monitor service level performance (that is, quality of service) within the network for compliance purposes, but these do not include an examination of the costs of providing these services, nor is there a focus on the comparative or relative efficiency of Australia Post's network (for example, comparing the efficiency of mail centres within its own network).

(d) Management reporting of the implementation of the RoLS program does not provide clear information on issues around implementation timelines, or progress in achieving key efficiency outcomes. Monitoring and reporting on the implementation of the RoLS program is generally included in the RoLS Program Control Board Status Report. However, as noted in Chapter 2, the Program Health Dashboard provided as part of the report does not show the overall progress in achieving key efficiency outcomes against the stated objectives nor discuss any issues around implementation timelines.

(e) The modelling to estimate the cost of the CSO is conservative and is likely to understate its true cost. Australia Post currently estimates the cost of delivering against the CSO to be $183 million in 2015–16. However this estimate adopts a relatively strict definition of the cost base, and the more inclusive cost base adopted by Australia Post in developing its corporate plan results in estimates of the CSO of up to $476 million. While this cost estimate is contained in its corporate plan, it is only presented in the commentary and it is not included in any subsequent analysis to identify the implications of these higher costs on the reserved letter services or the enterprise more broadly. This understates the cost of the CSO in the enterprise valuation modelling and relying on this estimate means key decisions—at both the operational level by Australia Post, and at the strategic level by the Government in its capacity as shareholder—will be made on the basis of an incomplete understanding of the potential true costs of the CSOs and the future viability of the letters business.

(f) Australia Post's long-term business valuation modelling depends on a number of assumptions relating to future price increases, labour and accommodation costs. For example, the model adopts the Corporate Plan's assumptions for the life of the plan (that is, usually 4 years) and then develops its own assumptions beyond this. The model's long-term forecast base case assumptions result in a Basic Postal Rate of $1.87 in FY40, almost 100 per cent greater than the current rate. The model is prepared in the context of considerable uncertainty regarding the long term, and adopts assumptions which are optimistic largely because they reflect decisions that have not yet been made and which would require changes in government policy. Moreover, the valuation likely overstates the long-term viability of reserved letter services and the letters business.

3.25 Together, these aspects of the reporting framework tend to understate the need for longer-term, strategic reform of Australia Post's business model.

3.26 Australia Post would be in a better position to estimate the costs of meeting the obligations now and going forward, and to benchmark itself against international postal agencies to help understand its relative efficiency, if it were to improve its monitoring and evaluation activities. This would enhance the effectiveness of existing internal and external governance and oversight mechanisms.

Recommendation no.2

3.27 Australia Post should improve its monitoring and evaluation to:

(a) facilitate greater shareholder visibility regarding the key assumptions underpinning the longer-term sustainability of the business model underpinning reserved services;

(b) facilitate monitoring and reporting of trends over time, including in relation to implementation and benefits realisation of key efficiency strategies; and

(c) examine performance against relevant benchmarks.

Australian Postal Corporation's response:

(a) agreed, with qualifications;

(b) agreed; and

(c) agreed, with qualifications.

3.28 *(a) Agreed, with the qualification that the Government Guidelines for financial modelling should be revised to better reflect the CSO costs in a transformed economic and business environment. We are currently working with the Shareholder on reviewing the methodology.*

3.29 *(c) Agreed, with the qualification that gaining publicly available, reliable data that enables meaningful comparison can be challenging. However, Australia Post will endeavour to provide comparable benchmarking, where possible, and where the commercial cost/benefit scenario makes sense.*

4. Monitoring the costs and benefits of the obligations

Areas examined

The ANAO examined whether the Department of Finance (Finance) and the Department of Communications and the Arts (Communications) effectively support their respective ministers in monitoring the ongoing costs and benefits of Australia Post's obligations.

Conclusion

The dual shareholding arrangements that underpin many Commonwealth Government Business Enterprises (GBEs) are intended to ensure that the public policy objectives delivered by the GBE are balanced by an appropriate focus on financial performance. The guidance underpinning the governance arrangements for GBEs does not distinguish between the roles of Finance, and that of the relevant portfolio entity (in this case, Communications) as advisers to their respective ministers.

Finance and Communications have established regular monitoring and reporting mechanisms in their capacity as advisers to the Shareholder Ministers. The departments have also advised Government on the forecast decline in the letter delivery service. This advice supported major changes that were introduced in 2016, and informed the identification of the need for further change. The advice by the departments has typically focussed on the net profitability of Australia Post as a whole and on conservative cost estimates of the CSOs. The entities' advice has not directly addressed the impact of reserved letter delivery service on Australia Post's competitive market activities. In addition, Communications, in its role as the lead policy agency, has not advised its Minister on the benefits provided by the CSOs, or the distribution of those benefits within the community. Consequently, the advice has provided the department's respective ministers with an incomplete picture of the costs and benefits of the CSOs.

Generating stakeholder support for policy change, particularly in the context of the current framework of the CSOs, is a lengthy process, and it can be a number of years from developing a proposal through to its implementation. Developing and testing proposals for more fundamental reforms of Australia Post's business model may take considerably longer. The current regulations underpinning the CSOs have a 'sunsetting' date of April 2019. This represents an opportunity for Finance and Communications to re-evaluate the CSOs, and Australia Post's role in delivering them, into the future.

Areas for improvement

The ANAO made two recommendations aimed at: ensuring a clearer delineation of the roles and responsibilities of the respective shareholder agencies; and reviewing the ongoing policy rationale for Australia Post's involvement in competitive markets, and providing ministers with greater transparency over the costs and benefits of the CSO and the distribution of those costs and benefits throughout the Australian Community.

Do Finance and Communications have clearly defined roles and responsibilities?

The roles of Finance and Communications with respect to Australia Post are defined under the Commonwealth GBE Governance and Oversight Guidelines (the Guidelines). The Guidelines confer identical responsibilities for strategic control and oversight of GBEs upon the Portfolio Minister and the Finance Minister (together, the Shareholder Ministers). Consistent with this framework, Finance and Communications have largely taken a joint approach to supporting the governance roles of their respective ministers.

Previous changes to the GBE governance arrangements recognised the inherent tension between the role of GBEs as vehicles to deliver Government policy objectives and the Government's intention that GBEs operate under a commercial framework, with a strong focus on efficiency and financial performance. These changes saw the establishment of the current dual shareholding arrangements, whereby the Government's interest as both shareholder and policymaker were represented by the Finance Minister, and the relevant portfolio minister, respectively. These reforms also saw the establishment of a GBE unit within the Department of Finance.

Accordingly, while the joint briefing approach taken by Finance and Communications may be appropriate in the context of ongoing governance and oversight of Australia Post's operations, it is unlikely to realise the intent of having dual Shareholder Ministers, particularly in relation to the longer-term, strategic reforms that will be required to ensure the sustainability of Australia Post's business model.

GBE governance framework

4.1 As noted in Chapter 1, the legislation that established Australia Post recognised the need to ensure that Australia Post: operated as efficiently as possible, on a commercial basis; and was responsive to consumer needs. In commercialising Australia Post, the legislation provided for a new corporate and financial structure, establishment of new planning and accountability mechanisms, modification of major strategic controls and removal of day-to-day ministerial controls. The legislation also set out processes for identifying the costs of the CSOs and how these would be taken into account in fixing financial targets.

4.2 Given the significance of the services provided by Australia Post to the broader economy, the legislation also included obligations to meet the CSOs, together with performance standards and a prices oversight regime. In addition, the legislation provided for accountability requirements including timely presentation of annual reports and financial statements audited by the Auditor-General for Australia; disclosure of the corporate objectives, strategies, policies, operations and performance of Australia Post and its subsidiaries; and prior notification to the Minister of significant changes to business activities.[41]

4.3 Two of these objectives—to operate efficiently and on a commercial basis, but still deliver a CSO in accordance with prescriptive, legislated requirements—create an inherent policy tension in the governance of Australia Post. The tension arises because the formulation of the CSOs

41 House of Representatives, Australian Postal Corporation Bill 1989, Second Reading Speech, (1989).

effectively determines the cost of providing the services and maintaining the letters delivery network; and by extension, plays a critical role in determining the profitability of the enterprise and its shareholder returns.

4.4 This difficulty was acknowledged in the 1997 review conducted by Richard Humphry AO:

> There will be tensions between the interests the Government has in respect of a GBE's CSO delivery role and the interests the Government has as a shareholder in the entity. A simple illustration of this tension is where the Government, in its contracting of the CSO activity to the GBE, would be seeking the outcomes it desires at the lowest cost, whereas from its shareholder perspective the Government would want the GBE to earn an adequate rate of return sufficient to justify the long term retention of its investment in the business.[42]

4.5 The review also noted:

> The requirement that the portfolio Minister balance the shareholder interests in GBEs, with the other relationships that the Government has with its GBEs, places that Minister in an extremely difficult position because of the potential for conflicts of interest. A more transparent arrangement would be to remove the responsibility for the shareholder function from the portfolio Minister altogether. That is, the function could be undertaken by an economic Minister or the Government could appoint a Minister specifically to act as a shareholder in GBEs.[43]

4.6 The Review ultimately recommended that the shareholder role in relation to GBEs be undertaken jointly by the portfolio minister and the Minister for Finance, with the Government having the flexibility to appoint an additional minister as a Shareholder Minister if appropriate. The Government subsequently issued revised GBE Governance Arrangements in June 1997, which implemented recommendations from the review, specifically:

(a) the Commonwealth's ownership interests in GBEs would be represented by the Finance Minister and the relevant portfolio Minister, each to be 'Shareholder Ministers'[44]; and

(b) a GBE unit was established within Finance to provide both Shareholder Ministers with commercially focussed advice on GBEs.

4.7 This dual shareholding arrangement remains in place[45] in recognition of the Government's interests as policymaker and shareholder. However, while the guidelines do note the representation of the Government by both the portfolio minister and the Finance Minister, the obligations of each of those ministers are expressed in identical terms. Consequently, there is no delineation in the roles of each of the agencies in supporting the governance and oversight role of their respective Shareholder Minister with respect to the GBE for which the Minister is responsible.

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42 Humphry, R. Review of GBE Governance Arrangements (1997) Commonwealth of Australia, p. 17.

43 Humphry, R. Review of GBE Governance Arrangements (1997) Commonwealth of Australia, p. 4.

44 Department of the Parliamentary Library, Government Business Enterprises and Public Accountability through Parliament, Research Paper No. 18 1999-2000, (2001) Department of the Parliamentary Library.

45 Finance's GBE guidelines note 'The Commonwealth's ownership interest is generally represented by two `Shareholder Ministers´. The Shareholder Ministers are the Responsible Minister (that is the Minister responsible for the GBE) and the Finance Minister. The Finance Minister is generally the sole Shareholder Minister for those GBEs within the Finance portfolio.' Department of Finance, *Resource Management Guide No. 126 – Commonwealth Government Business Enterprise Governance and Oversight Guidelines*, August 2015, page 3, available from <http://www.finance.gov.au/resource-management/governance/gbe/>.

Department roles

4.8 As noted in Chapter 1, the Shareholder Ministers and their departments have oversight responsibilities for the operations and functioning of GBEs, including Australia Post. The Australian Government's relationship with GBEs is similar to the relationship between a holding company and its subsidiaries, features of which include:

- a strong interest in the performance and financial returns of the GBE;
- reporting and accountability arrangements that facilitate active oversight by the shareholder;
- action by the shareholder in relation to the strategic direction of its GBEs where it prefers a different direction from the one proposed;
- management autonomy balanced with regular reporting of performance to shareholders; and
- boards that are accountable to shareholders for GBE performance, and shareholders that are accountable to Parliament and the public.

4.9 The *Corporations Act* is the primary regulatory framework for Commonwealth companies. The *Public Governance, Performance and Accountability Act 2013* (Chapter 3) sets out requirements that Commonwealth companies also have to comply with to meet appropriate standards of public sector accountability. Finance maintains a resource management guideline for GBEs on board and corporate governance, financial governance and planning and reporting: RMG-126 Commonwealth GBE governance and oversight guidelines (the GBE Guidelines).[46] Finance and Communications, as the principle advisers to the Shareholder Ministers, develop policy relating to postal services and monitor Australia Post's compliance with the APC Act and the GBE guidelines.

The Department of Communications and the Arts

4.10 The Post and ACMA[47] Branch within Communications has primary responsibility for the shareholder and postal policy functions. It is responsible for advising the Government on how the policy and legislative framework of the Australian postal industry can best meet its objectives. Its key responsibilities are to:

- support the Minister for Communications and the Arts as Shareholder Minister for Australia Post;
- support the department's executive;
- track and prepare briefings on Australia Post's performance and business plans;
- provide business analysis and policy advice in relation to Australia Post and the postal sector;
- analyse and prepare ministerial submissions on Australia Post's corporate plan, progress reports, dividend recommendations and business proposals;

46 Department of Finance, Resource Management Guide No. 126 – Commonwealth Government Business Enterprise Governance and Oversight Guidelines, August 2015, available from <http://www.finance.gov.au/resource-management/governance/gbe/> [accessed 30 June 2017].

47 ACMA refers to the Australian Communications and Media Authority, which is a statutory authority within the Communications portfolio.

- work with Finance on joint Shareholder Ministers' responses;
- liaise with the Australia Post shareholder team on an ongoing basis in relation to any new developments, shareholder briefings and coordination requests; and
- manage Australia Post board appointments.

4.11 Communications also manages the obligations under the UPU. These multilateral negotiations are focussed on increasing the level of cost-recovery with regards to delivering inbound international items over time (discussed at para 1.12).

Department of Finance

4.12 Finance's Government Businesses Branch provides advice to the Australian Government relating to its GBEs and other commercial entities. Its key responsibilities are to:

- provide sound strategic and analytical advice to the Minister for Finance, in particular by engaging with the GBEs, analysing their operations and their financial sustainability, and consulting with stakeholders;
- action the Minister's decisions including communicating objectives; and
- ensure that there is a robust and sound governance framework in place by initiating change and contributing to policy development.[48]

4.13 These processes are described in further detail at Appendix 2.

4.14 As noted above, the GBE Guidelines confer on each of the Shareholder Ministers an identical role in respect of Australia Post's governance, and setting its strategic objectives. Finance has advised that the rationale for this decision was to provide each shareholder with the imperative to act in the best interests of the GBE. The advice reviewed by the ANAO indicated that there were some instances where the Shareholder Departments differed in their approach, however such instances represented the exception rather than the rule.

4.15 Each of the Departments indicated that they work extensively with each other to brief their respective ministers. This joint approach is likely to be effective in relation to routine ministerial governance and oversight, or those instances where there is no disagreement between both Shareholder Ministers. In addition, this approach also provides clarity to GBEs in terms of providing a single consistent view from Government, and reduces the risk that a GBE will be able to exercise 'choice' in which directions to follow to the extent that there are divergent views between Shareholder Ministers. In practice, this has resulted in the majority of issues being resolved at the agency level.

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48 The responsibilities of the Department of Finance's Government Business Oversight branch are described on the Department of Finance's website, available from http://www.finance.gov.au/resource-management/governance/gbe>.

Recommendation no.3

4.16 The Department of Finance should review the GBE guidelines to ensure they give effect to the original policy intention of the dual ministerial shareholding arrangements.

Department of Finance response: The Department of Finance did not state whether it agrees or disagrees with the recommendation.

4.17 *Finance is satisfied that the joint shareholder arrangements implemented for Government Business Enterprises and outlined in the Government Business Enterprises guidelines are appropriate and enable Ministers to fulfil their responsibilities. Finance will regularly review and reassess the effectiveness of its oversight of Government Business Enterprises, and will take the ANAO's report into account in considering changes to arrangements in future.*

Have the departments provided transparency to Shareholder Ministers over the costs of meeting the Community Service Obligations?

Finance and Communications have recently strengthened their engagement with Australia Post with a view to providing their respective Shareholder Ministers with greater transparency regarding Australia Post's strategic direction, major initiatives, financial projections, and the assumptions driving these.

Finance's analysis of the financial performance of Australia Post has, however, tended to be largely based on Australia Post's own financial reporting, and focused on the performance of the enterprise as a whole, as opposed to the ongoing sustainability of the letter delivery service. While there is some evidence that shareholder entities have briefed their ministers in broad terms on Australia Post's progress in realising efficiencies from its ongoing strategies, recent changes have been implemented to deepen the analysis and briefing.

4.18 Australia Post's Shareholder Ministers are tasked with ensuring the long-term sustainability of Australia Post's business model; and monitoring the implementation and effectiveness of changes to date. The Ministers have also been tasked with bringing forward a strategy for further reforms in 2017.

4.19 Briefings by the departments have covered: the overall financial position of the enterprise, and the impact on shareholder returns; Australia Post's costs in meeting the CSO requirements (albeit in line with guidelines established in 1991); and the ultimate risk that these obligations might eventually need to be funded from the Budget. However there has been comparatively little focus on Australia Post's progress in implementing its efficiency strategies; the implications of the evolving business model on competitive neutrality; or the ongoing policy justification for Australia Post's increasing involvement in competitive markets. Each of these is discussed below.

Net financial position

4.20 Quarterly ministerial briefings from both departments focused on the net financial position of Australia Post. These briefings highlighted key aspects of the quarterly reporting by Australia Post to each of the departments.

4.21 Most of the Ministerial Briefings reviewed by the ANAO noted continued deterioration in Australia Post's financial position due to declining letters volumes. This reporting was typically at a high level and in most instances noted the dual nature of Australia Posts performance: the Parcels business was profitable[49] (although facing market challenges), while the letter delivery service was experiencing continued, increasing losses.

4.22 This focus of reporting by departments was on the bottom line results—that is, the profitability of Australia Post as whole and the individual business units. Examination of the changing cost bases of each unit were not considered in detail.

Estimating the costs of the CSO

4.23 Australia Post estimated the cost of the CSO to be $183 million in 2015–16.[50] This estimate was based on the difference between the revenue received and the costs incurred by Australia Post on loss-making mail paths, as prescribed by the Commonwealth Government's 1991 guidelines.[51] Accordingly, this methodology focusses on the incremental or avoidable cost of delivering letters.

4.24 While this approach is on one level technically justifiable, and is the recommended approach[52], it may not be the most useful way of assessing the cost of the obligations, particularly given market circumstances. This approach implicitly assumes that the provision of reserved letter services is the 'marginal' activity, which is underpinned by the other activities of the business. In practice, the obligations require Australia Post to provide a reserved letter delivery service, which creates the opportunity to provide other services (that is, parcels, retail). In other words, the 'causation' flows in the opposite direction to that implicitly assumed in the CSO estimate currently made. The approach may have been more appropriate at the time when the 1991 cost allocation guidelines were produced, as Australia Post was largely a letters and mail business. However, this does not reflect the current market circumstances.

4.25 Further, different assumptions can be made in estimating the cost of the CSO. For example, in its Corporate Plan, Australia Post uses assumptions that result in a more inclusive cost base and more mail paths being deemed as loss making.[53] This results in estimates of the CSO cost of up to $476 million. The assumptions underpinning this estimate are reasonable and more consistent with the stand-alone costs of meeting the obligations.

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49 Both Finance and Communications would provide commentary on the financial performance of Australia Post, stating that whilst the letters business was facing challenges, the Parcels business was relatively successful and overall profitability was improving post reform. Communications also provided commentary on a range of other initiatives such as acquisitions and the delivery other projects and programs.

50 Australia Post, Annual Report 2016, p. 109.

51 Department of Transport and Communications, Guidelines and considerations for Australia Post's study of the costs of providing its Community Service Obligations, 8 July 1991. The guidelines define state that the CSO should be calculated as *"long run avoidable costs less revenue foregone across an end to end mail path"*.

52 Commonwealth of Australia, Australian Government Competitive Neutrality Guidelines for Managers, 2014.

53 This assumes that roadside delivery costs are fully attributed to reserved letter services, the costs of all overhead costs are included and all operational activity costs are avoidable in the long run. However this approach still does not necessarily address the overall level of cost recovery of reserved letter services, as it might be estimated if the business were subject to economic regulation.

4.26 There are several other methodologies in addition to that prescribed in the guidelines for calculating the financial cost of the CSO. These methodologies may provide a more complete picture of the total economic costs of meeting the obligations on a more fully attributed or stand alone cost basis. For example, using a building block type framework similar to that often used by economic regulators, similar to that used by the Australian Competition and Consumer Commission (ACCC) in its price notification role. These may provide higher cost estimates than those derived by Australia Post under the existing guidelines.

4.27 The current CSO cost estimate likely materially understates the relevant cost of meeting the obligations. Consequently, reporting by the departments to their respective Shareholder Ministers may not provide a complete picture of the full costs of meeting the CSOs. As Australia Post does not receive direct Government funding, the true impact of the cost of CSO may not be completely recognised, as reductions in dividend payments to the Government can mask the true extent of the CSO costs. In light of this, transparent and complete costing of the CSO is critical to assess the overall performance of Australia Post.

Focus on efficiency

4.28 As outlined in Chapter 3, the benefits of the RoLS program are unlikely to be realised within the timeframes originally envisaged.

4.29 Requesting more in-depth reports, figures and progress updates from Australia Post may allow the departments to be able to examine the success of this efficiency program better. It should be noted that the departments have begun this process through requesting more detailed information regarding the progress of implementation.

4.30 The departments did not oppose Australia Post's decision to focus on the performing parcels business to offset declines in reserved letter delivery services. The losses in the letters business have reduced the returns to the Australian Government (see Figure 1.3).

4.31 The majority of the advices to Ministers reviewed by the ANAO did not explicitly consider that the losses being generated by the letters business are in effect a taxpayer subsidy to meet the obligations, regardless of the net position of Australia Post.

4.32 Rather, the advice to ministers and internal documents, focused on the future risk of an actual direct subsidy needing to be provided to allow Australia Post to meet its obligations. The documents note a direct cash subsidy would be required, in the event that the net profits in Australia Post's parcel business become insufficient to outweigh the net losses in the letters business.[54]

4.33 The decision by both Australia Post and the departments to focus on the parcels business to underpin the letters business, and the majority of reporting being at an aggregate level, obscured the extent of the declining letters business. Providing greater transparency as to the magnitude and trajectory of the losses may have prompted a stronger focus on Australia Post's progress in implementing its efficiency strategies, and on changing the obligations themselves.

54 It is also important to note that whilst the parcels business provides a subsidy for the letters business, if the costs of the CSO were funded directly through Government appropriations there would be other cost allocation and monitoring costs involved. By allowing this cross subsidisation to occur, these costs are avoided.

Competitive neutrality

4.34 Under the 1995 Competition Principles Agreement (CPA), Australian Governments committed to apply competition principles to government business activities.[55] The agreement sought to eliminate resource allocation distortions arising from public ownership of entities engaged in commercial activities. In addition to advocating the adoption of corporate models of governance, and imposing similar commercial and regulatory constraints as those faced by commercial businesses, one of the CPA's key objectives is to ensure government businesses do not enjoy any net competitive advantage simply as a result of their public sector ownership.[56]

4.35 As noted in Chapter 1, Australia Post operates within an institutional framework that promotes a commercial focus, and requires it to operate efficiently. However, the CSOs bind Australia Post to specific, minimum service requirements. When the CSO was initially established, the letter delivery service was the predominant activity for Australia Post. The Prices Surveillance Authority, and its successor the ACCC, provided oversight to ensure that this then profitable business was not being used to cross-subsidise Australia Post's activities in competitive markets, with the aim of ensuring a level playing field within the market. With the decline of the letter delivery service, this relationship has changed significantly and Australia Post's business model is now focussed on driving the profitable aspects of its service offering, through which it operates in competitive markets; to sustain the ongoing losses in the unprofitable, reserved services business. In addition, while Australia Post does not receive any direct funding from the Government, it does benefit from an implicit Government guarantee. Finally, the losses generated in the letter delivery service have impacted on the overall profitability of Australia Post, however these impacts have been realised in reduced dividends paid to the shareholder over time rather than as a direct expense item in the Budget.

Government involvement in competitive markets

4.36 As noted in Chapter 1, the decline in letters volumes has seen the size of Australia Post's letter delivery services segment fall from 59 per cent in 2007 of total revenues to 34 per cent in 2015.[57] In contrast, the relative size of the competitive business (that is, Parcels & Logistics and Retail & Agency Services) has grown from 41 per cent of total revenues in 2007 to 66 per cent in 2015.

4.37 To facilitate this growth, Australia Post has acquired a number of businesses with the aim of supplementing its own capabilities and supply chains, with the most significant being the acquisition of StarTrack in 2012.[58] Other acquisitions include Mail Call, MailPlus and SecurePay.

4.38 As a result, Australia Post has been able to return to profitability, and avoided the need for any direct Government funding for losses sustained in the letters business. However, the delivery

55 National Competition Council 1998, Compendium of National Competition Policy Agreements, Second Edition, Australian Government Publishing Service, Canberra.

56 Council of Australian Governments 1995 (as amended to 13 April 2007), Competition Principles Agreement, p. 3.

57 Total revenue excludes unallocated items. In 2016, the Mail Services and Retail & Agency Services segments were combined to reflect the nature of the postal business and data for separate segments is not available from Australia Post's Annual Report 2016.

58 Investment in StarTrack was $401m. Sourced from Australia Post, Annual Report 2013, p. 10.

of the CSO, which provided a key justification for Government involvement in the market for postal services, is now a small and declining part of Australia Post's business.

Implicit Government guarantee

4.39 Australia Post is currently rated by Standard and Poors as AA- on an issuer basis (that is, in light of its ownership arrangements) and BBB+ on a stand-alone basis.[59] This means that Australia Post is able to access debt finance at cheaper rates and on more favourable terms than if it was not Government-owned.[60]

4.40 Australia Post does not pay any 'government guarantee levy' on its debt costs to reflect the debt cost advantage it receives from its issuer status (that is, that its credit is ultimately backed by the Government). Indeed, both the letters and parcels businesses of Australia Post benefit from this subsidy. This benefit may be offset by the additional costs incurred by Australia Post in meeting the CSOs.

4.41 The CPA notes that 'Government businesses should not enjoy any *net* competitive advantage simply as a result of their public sector ownership. (emphasis added)"[61] More recently, in discussing competitive neutrality, the Harper Review on Competition Policy asserts that undue advantage may accrue to government owned business enterprises through cheaper debt financing reflecting the lower credit risk of governments.[62] Finance has not undertaken an analysis on what has been the net effect of both the cost burden imposed on Australia Post by the CSOs, combined with the financial benefit flowing from the implicit government guarantee.

Shareholder returns

4.42 The GBE guidelines note an expectation that Australia Post will earn a commercial rate of return, equal to the risk free rate plus a risk premium appropriate to the GBE.[63] However neither the GBE guidelines, nor Finance, specify a particular risk premium to apply for Australia Post. Table 4.1 shows the return on equity and return on assets earned by Australia Post from 2012 to 2016.[64]

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59 S&P Global Ratings, November 2016, *Global Ratings Research Update.*

60 On a stand-alone, benchmark basis, which is how regulated entities are typically assessed, it seems unlikely that reserved letter services would be able to sustain any debt in its capital structure at all absent government subsidies (that is, it would not get a commercial credit rating and would need to be funded entirely by Government).

61 Council of Australian Governments 1995 (as amended to 13 April 2007), Competition Principles Agreement, p. 3.

62 Australian Government, March 2015, *Competition Policy Review Final Report,* p. 255.

63 Department of Finance, Resource Management Guide No. 126 – Commonwealth Government Business Enterprise Governance and Oversight Guidelines, August 2015, page 4, available from <http://www.finance.gov.au/resource-management/governance/gbe/>.

Table 4.1 Australia Post's returns 2012–2016

Process	2012	2013	2014	2015	2016	Average 2012–16
Revenue ($m)	5 126	5 893	6 383	6 374	6 562	**6 077**
Profit before tax ($m)	367	211	103	(352)	41	**74**
Profit after tax ($m)	281	177	116	(222)	36	**78**
Return on equity (per cent)	16.8 per cent	10.5 per cent	6.7 per cent	(14.9 per cent)	2.3 per cent	**4.3 per cent**
Return on average operating assets (per cent)	11.5 per cent	6.2 per cent	3.4 per cent	(8.2 per cent)	1.8 per cent	**2.9 per cent**

Note: Return on equity is calculated as profit (loss) after tax as a percentage of equity. Equity has been adjusted to remove the impact of the Australia Post's net superannuation liability / asset.

Note: Changes to AASB 119 Employee Benefits took effect on 1 July 2013. 2013 has been restated for like-for-like comparison.

Source: Australia Post annual reports.

4.43 These figures reflect the performance of Australia Post's overall business. The shareholder (the Government) does not provide a benchmark rate of return that it expects from Australia Post. However, an indication of the appropriate return can be gained from market data, Australia Post's estimates of its cost of capital and guidance from the Commonwealth Competitive Neutrality Complaints Office:

Table 4.2 Benchmark rates of return

Process	2012
Market data	An independent expert's report on the scheme of arrangement between Toll Holdings Limited and its shareholders in respect of a proposed acquisition concluded that the an appropriate discount rate for Toll is 8 per cent, based on a nominal post-tax cost of equity of 10–11 per cent.
Australia Post's estimates of its cost of capital	Australia Post's most recent estimate of its discount rate was undertaken in 2015, and produced a discount rate (nominal post-tax vanilla Weight Average Cost of Capital) of 8 per cent for the business. This is based on a nominal post-tax cost of equity of 9.6 per cent.[a] This is consistent with its Enterprise Valuation model which assumes a cost of equity of 9.0 per cent.
Commonwealth Competitive Neutrality Complaints Office	The Commonwealth Competitive Neutrality Complaints Office provides a range on nominal pre-tax target returns expressed as a premium over the long term bond rate. It suggests a premium of between 3 per cent to 7 per cent depending on whether the business is low, medium or high risk. Under this approach, businesses in the transport sector are considered to be 'medium risk', which suggests a nominal pre-tax discount rate of 9 per cent and a nominal post-tax cost of equity of 9 per cent.[b]

Note a: Value Adviser Associates, Assessment of WACC Parameters for Australia Post and its Reserved Letters Business as at 23 July 2015, 1 August 2015.

Note b: Commonwealth Competitive Neutrality Complaints Office, Rate of Return Issues, CCNCO Research Paper, December 1998.

4.44 These benchmarks suggest that a nominal post-tax cost of equity for Australia Post's non-reserved services of between 9 per cent and 11 per cent.

4.45 Based on current assumptions in its Corporate Plan 2016–17, Australia Post forecasts a nominal post-tax return on equity[65] of 3.5 per cent in 2017–18, increasing each year to 7.3 per cent in 2020–21, after bearing the costs of the CSO.[66] Australia Post is therefore not achieving its target return on equity. The key implications of this are:

(a) the Government's equity investment in Australia Post is not adding economic value, after bearing the costs of the CSO; and

(b) Australia Post's expectation of delivering below-target returns is dependent on the Government's continued willingness to accept reduced dividend payments.

4.46 Australia's competitive neutrality policy is in the process of being amended as a result of the Competition Policy Review[67] and the Government's acceptance of its key recommendations.[68] The terms of reference of this review will focus on the appropriateness of the current framework, considerations of the policy with regards to start up phases, effectiveness of complaints mechanisms, and whether reporting requirements and government oversight mechanisms are satisfactory.

Have the departments monitored the future implications of Australia Post's business model?

> The departments have supported policy changes which have temporarily arrested the impact of declining mail volumes. However, the letters business is anticipated to return to a loss-making position in the short-term. The timeframes required to effect policy change, together with the projected further declines in letters volumes, emphasise the need for further and more substantial policy changes in the immediate future.

Shareholder implications of meeting the obligations into the future

4.47 Change in this sector is challenging due to the complex stakeholder issues it raises. It is important to consider the shareholder implications in this context.

4.48 The evidence shows that it took 2.5 years to develop and implement the major changes that occurred in 1 January 2016. Flowing from the changes Australia Post reported an enterprise profit for 2015–16 of $36m following a loss in 2014–15 of $222m.

4.49 The evidence shows that three years from now, Australia Post's financial situation will be similar to when these changes were introduced. For example, the Corporate Plan 2016–17 forecasts a net loss of $457m in FY20[69], where mail volumes could have fallen a further 30 per cent.[70] The implication from this is clear: there is a compelling case for detailed consideration of further changes to be occurring now.

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65 Return of equity calculated as Net Profit After Tax divided by average equity.

66 Australia Post, *'Corporate Plan 2016-17'*, p. 61.

67 The Australian Government Competition Policy Review, March 2015.

68 The Australian Government's response to the Competition Policy Review, 2015.

69 Australia Post, *'Corporate Plan 2016–17'*, p. 57.

70 Australia Post, August 2016, *Australia Post Corporate Plan 2016/17–2019/20.* Figure is calculated by measuring the percentage change in mail volumes from the budgeted 2017 to 2020 financial years detailed, p. 42.

Key assumptions driving Australia Post's future outlook

4.50 Forecasts provided by Australia Post in the quarterly reporting and corporate planning processes outlining the declining letter volumes and its associated impact have formed the evidence base that the each of the departments have relied upon to report on future trends. The assumptions underpinning this forecasting have been tested by the departments when they have engaged external consultants to aid their analysis, including the work undertaken by KPMG in its review of the Corporate Planning process in 2016.[71]

4.51 The review found that while the Corporate Plan was conceptually sound, some of the assumptions driving the modelling for the long-term valuation appeared optimistic, particularly those relating to future price increases; the reductions in labour and accommodation costs; and the likely future assistance that would be required by LPOs.

4.52 The review proposed that Communications deepen its engagement with Australia Post by requesting additional information and develop an improved reporting framework (for example, including monthly and quarterly updates).[72]

4.53 The departments have responded to this by:

- strengthening regular engagement with Australia Post including: fortnightly teleconferences on high importance ongoing and emerging issues; making the quarterly meetings and discussion more in-depth and with a stronger strategic focus; and arranging 'deeper dive' briefings on key strategic initiatives[73]; and
- further, Shareholder Ministers wrote to the Chair of Australia Post encouraging a refined Corporate Plan process that would provide more detailed information and analysis of Australia Post's strategic direction, major initiatives and financial projections, together with underlying assumptions. Shareholder Ministers also requested to be provided with a more comprehensive description of risks and proposed mitigation action in future corporate plans.

Has Communications monitored the benefits of the Community Service Obligations?

The Department of Communications and the Arts, in its capacity as policy adviser, has examined benefits of the CSOs in general terms, but not with sufficient granularity to gain a complete understanding as to whom those benefits accrue or the value of those benefits in light of increasing access to communications technologies.

4.54 The Department of Communications and the Arts' analysis of the changing beneficiaries and measurement of benefits of the CSOs have been largely contained within stand-alone pieces of work supporting overall analysis. Examples of this are illustrated below.

71 KPMG, August 2015, *Australia Post Corporate Plan Review.*
72 KPMG, August 2015, *Australia Post Corporate Plan Review.*
73 Correspondence from the Department of Communications.

(a) In May 2014, Boston Consulting Group (BCG) was commissioned by Communications to undertake an assessment of the Postal Services Review, which included a high level analysis of impacts and benefits on Australia Post customers.[74]

(b) The 2015 Regulation Impact Statement prepared by Communications examined benefits through a high level qualitative analysis.[75]

(c) Australia Post undertook a customer survey to assess consumer sentiment with regards to a shift to a three day letter delivery timing, and willingness to pay for a five day service. The beneficiaries were stratified by age (under 30, between 30 and 59, and above 60), income (under $40 000, $40 000–$80 000, $80 000–$150 000, and over $150 000), and location (Metropolitan, Regional, Remote).

(d) A Regional Impact Statement was prepared which identified and attempted to measure different beneficiaries categorised by businesses, not for profit organisations and individuals. This analysis was qualitative in nature.

(e) Communications commissioned a report by Deloitte in January 2015 which undertook a relatively high-level qualitative analysis of the impact of postal changes on various social groups. The focus of the report overwhelmingly was on the costs of the obligations and the proposed changes.[76]

Distribution of benefits

4.55 As outlined in Chapter 1, the benefits associated with Australia Post's provision of a universal letters delivery service in accordance with the CSOs are not evenly distributed throughout the Australian community. In particular, Australia Post's inability to price-discriminate among users means it is not able to impose user chargers that reflect either the differing costs of providing the service, or the value the user might place on them. Universal postage stamp pricing across the country means that customers in densely populated (metropolitan) areas are likely to pay more for sending a letter than the cost that Australia Post incurs in providing this service. Conversely, customers in less densely populated areas (for example, rural and remote areas) are likely to pay less than the actual cost incurred by Australia Post. Consequently, customers in densely populated areas subsidise the cost of providing a letters service in rural and remote areas.

4.56 In addition, the majority of letters delivered by Australia Post are those sent by businesses and governments. Personal letters are estimated (based on volumes of stamped mail) to have made up 10 per cent of Australia Post's total letter volumes in 2016, compared to 16 per cent in 2008.[77] In other words, 90 per cent of the letters that Australia Post collects, processes and delivers are estimated to be for letters sent by businesses and governments (for example, corporate mail). In addition, the rate of change in the volume of letters sent by individuals has fallen proportionally

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74 Boston Consulting Group, *Assessment of Australia Post's Postal Services Review Final Report.* May 2014

75 Department of Communications, (2015) Regulation Impact Statement for proposed reforms to postal regulation, [accessed 26 June 2017] <http://ris.pmc.gov.au/2015/08/28/modernising-australia-post>.

76 Deloitte, January 2015, *Economic advice on regulatory options in the Australian Postal Sector.*

77 Australia Post does not record data on personal mail volumes so the total volume of stamp sales has been used as a proxy for personal mail, given the majority of stamps are used for personal mail, according to Australia Post.

much faster than the rate of change in the volume of letters sent by businesses and governments (by 57 per cent and 27 per cent respectively between 2008 and 2016).

4.57 Therefore, while the CSOs guarantee a minimum level of service for all users, the main senders of mail (and therefore the primary financial beneficiaries of the CSOs) are government and business users.

4.58 Not only are the majority of the benefits of the subsidies received by non-personal letters, amongst personal mail users, only those customers that are paying a price below marginal cost (that is, those in less densely populated areas) effectively receive the benefit of the subsidy.

4.59 Ministerial briefings examined in the course of the audit did not include a detailed analysis of where the majority of the CSO benefits flow, and the rationale for those beneficiaries continuing to receive those CSOs at the cost of a public subsidy. Communications has identified beneficiaries in discrete pieces of work, however this analysis has been at a high-level, and with limited discussion of the changing pattern of mail usage or quantification of the benefits accruing to each category of beneficiary.

4.60 Given the changing composition and narrowing of the user base for regulated letter delivery services, it may be that there are more effective ways of providing support to meet public policy objectives that do not involve using a broad-based CSO. A full examination of the costs and benefits of delivering the CSO would include a detailed consideration of the beneficiaries of the CSOs, the value of those benefits over time, and alternative options for delivering those benefits. This analysis would better inform decisions on whether the CSO remains relevant and fit for purpose, and if not, whether there are alternative policy approaches to adopt.

Recommendation no.4

4.61 The Departments of Finance, and Communications and the Arts, consistent with their respective portfolio responsibilities, should:

(a) provide their respective Shareholder Ministers with greater transparency over the total costs and benefits of the obligations and the distribution of those costs and benefits within the Australian community;

(b) review the approach to funding the delivery of the community service obligations through Australia Post's increasing involvement in competitive markets; and

(c) review the policy framework relating to Australia Post's Community Service Obligations in the context of the Australian Government's broader commitment to providing access to communications infrastructure.

Department of Finance's response: The Department of Finance did not state whether it agrees or disagrees with the recommendation.

4.62 *Finance notes that Shareholder Departments and Australia Post are already undertaking work to improve transparency and reporting on the cost and benefits of Australia Post's Community Service Obligations. Finance notes that changes to the approach to funding the delivery of the Community Service Obligations, or the policy framework relating to Australia Post's Community Service Obligations are a matter for Government. In addition, the Treasury is currently undertaking a review into Competitive Neutrality issues (which includes Community Service Obligations).*

Department of Communications and the Arts' response: The Department of Communications and the Arts did not state whether it agrees or disagrees with the recommendation.

4.63 *The Department of Communications and the Arts notes the recommendation. Shareholder Departments are working with Australia Post to update the method by which the cost of the CSOs is calculated.*

Grant Hehir
Auditor-General

Canberra ACT
28 September 2017

Appendices

Appendix 1 Entity responses

CHRISTINE CORBETT

Acting Managing Director & Group CEO

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8 September 2017

Mr Grant Hehir
Auditor-General for Australia
Australian National Audit Office
GPO Box 707
CANBERRA ACT 2601

Dear Mr Hehir

RE: The ANAO Performance Audit of Australia Post's efficiency in delivering reserved letter services

I am writing on behalf of Australia Post to respond to the Australian National Audit Office's (ANAO) Report on the Performance Audit of Australia Post's efficiency in delivering reserved letter services (the Report).

As a business that is implementing a broad-scale change program in response to digital disruption, we welcome the insights of external organisations, such as the ANAO, regarding the strategies that are required to efficiently manage the decline of the reserved letters service, and how those strategies might be enhanced in the future.

Nonetheless, we believe the Report needs to be read in the broader context of the complex business transformation program that Australia Post has been implementing since 2010 and the unique nature of our business should also be considered when making comparisons with our international postal peers. I have articulated this context and addressed some of the specific issues raised in the Report below.

Business context

In developing the Future Ready business transformation program between 2010 and 2012, Australia Post made a deliberate strategic decision to concentrate on three crucial transformation issues:

- How do we manage the decline of the regulated letters business?
- How do we grow our non-regulated, competitive business areas (especially in parcels) and attract new customers during the change?
- And how are we going to engage our people, our partners and the community in that journey of change?

As we started to sequence our strategic change activities, we came to the view that it was critical to prioritise the investment that we were making in the parcels business, so that we were equipping the business to capitalise on the growth that was starting to occur, at that time, in the Australian online shopping market.

This focus on achieving growth in the Parcels and eCommerce market was driven by our desire to ensure a viable and sustainable future for Australia Post – for the benefit of the Australian community, our Shareholder, our directly employed workforce of ~35,000 people, and the tens of thousands of other Australians who are indirectly employed by Australia Post (especially our Post Office licensees and delivery contractors).

We believe the strategic decision we made to prioritise our investment in the parcels business (and partnering closely with our eCommerce customers) has been vindicated by the strong growth we are now seeing in the eCommerce delivery market. The investments we have made in both the physical capacity of the parcels network and our digital capabilities over the past seven years have strengthened our nationwide delivery network and cemented Australia Post's role in the Australian community for future generations.

Importantly, the growth in the parcels business has enabled us to rebalance our workforce by transferring staff from the declining letters business to work in roles in our expanding parcels business. For some of our people, accepting a voluntary redundancy package was the right decision for them personally and we are proud of the support programs we put in place to enable those individuals to make that decision with confidence. But, for the vast majority of our operational staff, the strategy to focus on growth in parcels and eCommerce provided an opportunity for ongoing and meaningful employment within our business that would not have existed otherwise.

Therefore, the approach that we took in the Future Ready program to prioritise the growth of the parcels business, ultimately became a lever for both engaging our people in the transformation of our business ***and*** also managing the decline of the letters business. An example of how this transformation approach has worked at a practical level is the fact that, today, our Posties deliver 34% of all the parcels that move through our network; whereas back in 2010, our Posties did not deliver parcels at all.

Recommendation #1: Australia Post should identify and address the impediments to improving the efficiency of its letters service, including implementing and realising the benefits of, its efficiency strategies.

Tracking progress of cost efficiency programs and benefit realisation in letters

The Report observes future challenges in achieving targets in the Reform our Letters (RoLs) Program set in the 2015 business case. Australia Post acknowledges that this is a highly complex program and the targets set are a deliberate stretch. When adjusted for volume fluctuations, we are on track to exceed those cost efficiency targets. The net benefit from the RoLS program is forecast to be $2.6 billion over the five years to the end of FY19 (and the net cost efficiency savings from the reform of letters is forecast to be $634 million over this five-year period).

However, it should also be noted that the strategic imperative to manage the decline of the regulated letters business in a sustainable and viable way needs to be examined in real-time to adapt to the changing needs and expectations of multiple stakeholders, including our Shareholder and the wider Australian community. This is particularly important during a period of population growth (resulting in an ever-expanding delivery network) as well as a period of non-linear digital disruption (where year-on-year letter volume declines can fluctuate).

The future – operational innovation to achieve cost efficiencies

As we look to the future, we are confident that our forecasts for benefits and cost efficiencies in the letters service will be achieved, due to the operational innovations that we're currently implementing.

With the installation of new automated letter-sorting machinery in the first quarter of this current financial year (FY17/18), we expect to achieve automation benefits from greater machine efficiency and advanced letter processing. These changes will deliver workforce efficiencies in letter processing, night-sorting and delivery due to a longer day-time processing window that enables an increase in the volume of letters processed via automation and an increase in the volumes that are sequenced for delivery.

Meeting community expectations

Australia Post is well aware that a number of services (particularly the numbers of post offices and street posting boxes) are provided at levels higher than the mandatory requirements of the Prescribed Performance Standards (PPS) set by the Government.

As the report acknowledges, a significant challenge for Australia Post is that as letter volumes decline, the population is increasing. Access to postal services and infrastructure are expected by the Australian community in newly established suburbs. Due to the high fixed-cost nature of the letters business, it is a clear reality that achieving profitability in the letters service will continue to be a challenge as there will be ongoing pressure to expand the network (due to population increases) at a time of ongoing declines in letter volumes and revenues.

With the regulatory changes to the PPS that occurred in January 2016, we successfully introduced a two-speed letter service that gives Australia Post opportunities to achieve cost efficiencies throughout the network. However, as letter volumes continue to decline, at some point in the future there will need to be further regulatory reform. Australia Post is working with the Shareholder on the review of the *Australian Postal Corporation (Performance Standards) Regulations 1998*, which are due to sunset in April 2019. We are also continually engaging with the Australian community to better understand their expectations of the letters service in an era of ongoing letter declines.

Recommendation #2: Australia Post should improve its monitoring and evaluation to:

(a) facilitate greater shareholder visibility regarding the key assumptions underpinning the longer-term sustainability of the business model underpinning reserved services

Revised modelling approach required for assessing CSO costs

Australia Post acknowledges that some of the financial modelling mandated by Government guidelines over 20 years ago should be reviewed to provide a more contemporary view of CSO costs, given the context of dramatic changes in the use of the letters service – especially over the past decade. We do provide regular reporting to our Shareholder according to the guidelines; and we also provide an estimate of those costs using an alternative modelling approach. We are currently working with our Shareholder, and seeking advice from independent economic experts, to review and implement appropriate economic methodologies and financial models to reflect the changed environment and the resulting cost impacts.

Recommendation #2: Australia Post should improve its monitoring and evaluation to:

(b) Facilitate monitoring and reporting of trends over time, including in relation to implementation and benefits realisation of key efficiency strategies; and,

(c) Examine performance against relevant benchmarks.

The limitations of International Benchmarking

Australia Post closely monitors developments and innovations occurring in international postal agencies and, in turn, our overseas counterparts also engage with Australia Post to learn from us. Undertaking benchmarking of international postal service performance is a challenging and complex activity that requires significant investment for it to be meaningful and robust.

The difficulty in making accurate comparisons between nations is due to the differences in:

- local economic environments that drive different changes in costs (particularly labour) and revenue (i.e. Australia's wage environment post-GFC was much stronger than Europe or America);
- governing legislation and community service obligation requirements;
- efficiency baselines, when measuring efficiency of defined time periods;
- mail and customer densities[1]; and,
- the commercial profiles of the postal businesses beyond their core letters business (e.g. the provision of financial services, parcels business, acquisitions and divestments).

[1] As the Economics Insights 2012 benchmarking or postal services indicated, with adjustments for both customer and mail density Australia Post's relative position moved from second to first

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Working with the Universal Postal Union (UPU)

As a net importer of mail, profitability related to international mail is a challenging and complex business to manage for Australia Post. As acknowledged in the Report, price is one element that will help to limit the losses in international mail, but it will not improve cost recovery alone.

Australia Post, with the support of the Department of Communications and the Arts, continues to campaign for better and fairer remuneration policies within the UPU as the payments received are already at the capped level. While there have been some recent positive changes, policy negotiations are complex and protracted as they also form part of the wider trade negotiations of the Australian Government. In summary, there are constraints on Australia Post setting a commercially based price for international mail that are much broader and beyond our control than just the level of the Basic Postage Rate.

Summary

Australia Post will continue to pursue operational change as we seek to achieve efficiencies in the delivery of the nation's letters service. As a complex commercial organisation that has been undertaking broad-scale transformation, we have been managing and sequencing multiple change activities to ensure the best outcomes for the Australian community, our Shareholder and our workforce. We believe it's important to consider the broader context of strategic transformation and stakeholder impacts when reviewing the effectiveness of our recent approach to change.

Once again, I would like to acknowledge the work of the ANAO – and thank your Office for providing independent insights that will contribute to the continuous improvement of our business.

Yours sincerely,

Christine Corbett
Acting Managing Director & Group CEO

Australian Government

Department of Communications and the Arts

Dr Heather Smith PSM

Secretary

Mr Grant Hehir
Auditor-General
Australian National Audit Office
GPO Box 707
CANBERRA ACT 2601

Dear Mr Hehir

Performance Audit: Australia Post's efficiency in delivering reserved letter services

I write in regard to the email of 7 August 2017 from Ms Lisa Rauter of the Australian National Audit Office (ANAO) which provided a copy of the proposed performance Audit Report on *Australia Post's efficiency in delivering reserved letter services.*

I note the ANAO's findings that the Department has managed its responsibilities as a Shareholder Department by establishing regular monitoring and reporting mechanisms, with a strong focus on informing Ministers on the financial performance of Australia Post. I also note the finding that Shareholder Departments have strengthened engagement with Australia Post to provide greater transparency to Shareholder Ministers on Australia Post's strategic direction, major initiatives and financial projections.

There are, however, some issues raised in the proposed report which I would like to draw to your attention.

Role of Shareholder Departments

As noted by the ANAO, Shareholder Departments have strengthened their oversight of Australia Post. This has occurred in the context of rapid change in the postal industry including a 43 per cent decline in Australia Post's letter volumes since 2008. The changes have meant increased Government/taxpayer risks as the sole shareholder of the business.

The Shareholder Departments take a co-ordinated approach with the aim of mitigating these risks. This occurs in the context of each Department's portfolio responsibilities and does not mean that Ministers are presented with identical briefing. Rather, Shareholder Departments will discuss and share their analysis of the relevant issues and then prepare separate advice. When Ministers need to write to Australia Post, we aim to present a single draft joint letter for their consideration. This is done with the objective of providing a clear Government position to Australia Post. If an agreed joint draft letter was not possible, we would draw the issues to Ministerial attention so that they could resolve the matter after

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considering their portfolio/shareholder responsibilities. In our experience, this process works very well.

Focus on financial performance in advice to Ministers

The proposed ANAO report seems to question what you perceive to be a focus on overall financial performance rather than that of individual business units or progress on efficiency initiatives.

The Department maintains that a focus on the overall performance of the business is appropriate given that the main risk to the Government as the sole shareholder is the overall financial sustainability. But you should also note that the Department worked closely with Australia Post during 2015-16 to develop a robust monitoring and reporting framework which is now embodied in quarterly reporting to Government. Shareholder Ministers are regularly updated on the performance of Australia Post's individual business units and progress in implementing efficiencies.

Transparency on the costs and benefits of the CSOs

I note recommendation 4 which is consistent with work that is underway.

Shareholder Departments are working with Australia Post to update the method by which the cost of the CSOs is calculated. Australia Post is providing Shareholder Departments with data to allow analysis and a better understanding of the value of and distribution of the benefits of the CSOs.

As requested, attached is a summary of our response and our formal response to recommendation 4.

Yours sincerely

Heath Smith

Heather Smith
6 September 2017

Summary of Agency response

The Department notes the ANAO's findings that the Department has managed its responsibilities as a Shareholder Department by establishing regular monitoring and reporting mechanisms, with a strong focus on informing Ministers on the financial performance of Australia Post. We also note the finding that Shareholder Departments have strengthened engagement with Australia Post to provide greater transparency to Shareholder Ministers on Australia Post's strategic direction, major initiatives and financial projections.

Recommendation 4 is noted. Shareholder Departments are working with Australia Post to update the method by which the cost of the CSOs is calculated. Australia Post is providing Shareholder Departments with data to allow a better understanding of the value of and distribution of the benefits of the CSOs.

Department's response to report recommendations

Recommendation No.4
The Departments of Finance, and Communications and the Arts, consistent with their respective portfolio responsibilities, should:

a) *provide their respective Shareholder Ministers with greater transparency over the total costs and benefits of the obligations and the distribution of those costs and benefits within the Australian community;*
b) *review the approach to funding the delivery of the community service obligations through Australia Post's increasing involvement in competitive markets; and*
c) *review the policy framework relating to Australia Post's Community Service Obligations in the context of the Australian Government's broader commitment to providing access to communications infrastructure.*

Department's response:

Noted - Shareholder Departments are working with Australia Post to update the method by which the cost of the CSOs is calculated.

2

Australian Government

Department of Finance

Rosemary Huxtable PSM
Secretary

Our Ref: SEC0014841

Mr Grant Hehir
Auditor-General
Australian National Audit Office
GPO Box 707
Canberra ACT 2601

Dear ~~Mr Hehir~~ Grant

I refer to the Australian National Audit Office's (ANAO's) correspondence dated 7 August 2017, providing the proposed section 19 Audit Report, *Australia Post's efficiency in delivering reserved letter services* (the proposed Report) and seeking the Department of Finance's response.

I thank you for the opportunity to respond to the matters raised in the proposed Report. I understand that whilst my officers received an extract of the Report Preparation Paper in mid-April, the proposed Report has been materially amended. Finance would be happy to discuss the ANAO's views and conclusions outlined in this final report in more detail.

My response to the report is as follows:

Finance accepts the recommendations in the report, and makes the following comments on particular recommendations:

Recommendation 3:

Finance is satisfied that the joint shareholder arrangements implemented for Government Business Enterprises and outlined in the Government Business Enterprises guidelines are appropriate and enable Ministers to fulfil their responsibilities. Finance will regularly review and reassess the effectiveness of its oversight of Government Business Enterprises, and will take the ANAO's report into account in considering changes to arrangements in future.

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Recommendation 4(a):

Finance notes that Shareholder Departments and Australia Post are already undertaking work to improve transparency and reporting on the cost and benefits of Australia Post's Community Service Obligations.

Recommendation 4(b) and 4(c):

Finance notes that changes to the approach to funding the delivery of the Community Service Obligations, or the policy framework relating to Australia Post's Community Service Obligations are a matter for Government. In addition, the Treasury is currently undertaking a review into Competitive Neutrality issues (which includes Community Service Obligations).

Thank you for the opportunity to comment on your report.

Yours sincerely

Rosemary Huxtable

5 September 2017

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Appendix 2 Governance and oversight processes

The key processes undertaken by the Departments of Finance, and Communications and the Arts, are described in the table below.[78]

Regular process	Frequency	Description
Quarterly progress reports (performance tracking)	Quarterly	Australia Post is required to provide progress reports to Shareholder Ministers on quarterly and year to date performance against the Corporate Plan forecasts.[a] Progress reports include detailed analysis of financial and non-financial information and are confidential to Ministers, advisers and the Departments. Following receipt, the Departments usually hold a joint meeting with Australia Post. A Ministerial Submission and joint response letter is then prepared for the Shareholder Ministers. Any response from Shareholder Ministers should be provided within 45 days of receipt[b] of the progress report.
Corporate Plan final review	Annually each September	Australia Post is required to provide a Corporate Plan annually that sets out key priorities and objectives over four financial years.[c] The Corporate Plan is a confidential document not released publicly. It is submitted with a Statement of Corporate Intent (SCI), a publicly available version of the Corporate Plan. Process The Departments are initially briefed by Australia Post on its draft corporate strategy in May (as part of the March quarterly meeting) and have opportunity to provide initial feedback to Australia Post. 1. A draft Corporate Plan and SCI are submitted to Shareholder Ministers by 30 June each year following consideration by Departments. Shareholder Ministers may choose to provide comments and/or approve by 15 August each year. 2. The Departments jointly review the draft Corporate Plan and SCI and request relevant supplementary information from Australia Post. 3. The Departments liaise with their respective budget groups in relation to Australia Post's valuation and dividend profile which are incorporated in the Portfolio Budget Statements and subsequently updated in the Mid-Year Economic and Fiscal Outlook (MYEFO) in November. Ministerial Submission is prepared on the Corporate Plan and SCI. 4. The Shareholder Ministers write to Australia Post with feedback to the draft Corporate Plan and SCI. 5. Australia Post publishes the agreed version of the Corporate Plan and SCI.

78 Department of Communications, February 2017, *Australia Post Shareholder Oversight Procedures Manual.*

Regular process	Frequency	Description
Dividend recommendations	Annually in April and October	Dividend payments are agreed annually between Australia Post's directors and the Shareholder Ministers through the Corporate Plan consultation process. Dividends should be paid in two instalments, an interim dividend (30 April) and a final dividend (30 October). The Shareholder Ministers must formally respond within 45 days[d] to either agree the recommended dividend or direct payment of a different amount. **Process** 1. Australia Post provides an interim and final dividend recommendation to the Shareholder Ministers by February and August each year. 2. Under the APC Act, the Shareholder Ministers must respond within 45 days of receipt of Australia Post's advice, either to approve the interim/final dividend or direct payment of a different amount. 3. The Departments jointly review the dividend recommendation with reference to Australia Post's performance, liquidity and investment requirements and business outlook. 4. A Ministerial Submission and joint response letter is prepared to either agree to the recommended dividend or direct payment of a different amount (any direction must be tabled in Parliament and to date no direction has been issued to Australia Post). 5. The Departments liaise with their respective budget groups in relation to Australia Post's dividend profile which is incorporated in the Portfolio Budget Statements (May) and subsequently updated in MYEFO (November) 6. Australia Post pays the agreed interim (April) and final dividend (October).
Board Appointments	As required	Board members have ultimate responsibility for the performance of Australia Post and are accountable to the Shareholder Ministers. The Minister may nominate a board candidate of their choice or request that the Department conduct an executive search or to engage an external executive recruitment provider.
Business proposals (mergers, acquisitions, divestments)	As required	There is a framework in place under which the Shareholder Ministers must be notified by Australia Post of any 'significant events', including proposals for which Australia Post's exposure exceeds $100 m for core business and $20 m for non-core business activities (either investment or divestment). **Process** 1. Decisions about the commercial operations of the Corporation are ultimately the responsibility of the board, 2. Shareholder Ministers expect that in considering new business ventures, the board will take into account its statutory functions, statutory obligations, investment guidelines and notification requirements. 3. Shareholder Ministers must be notified by Australia Post in relation to any new significant business events or decisions. 4. Departments brief Ministers on any new business proposals, notifications and shareholder briefings.

Note a: Department of Finance, August 2015, *Resource Management Guide No. 126 Commonwealth Government Business Enterprise Governance and Oversight Guidelines*, p. 13.

Note b: Department of Finance, August 2015, *Resource Management Guide No. 126 Commonwealth Government Business Enterprise Governance and Oversight Guidelines*, p. 13.

Note c: Department of Finance, August 2015, *Resource Management Guide No. 126 Commonwealth Government Business Enterprise Governance and Oversight Guidelines*, p. 10 and Sections 35 of the PGPA Act and 16(E) of the PGPA Rule.

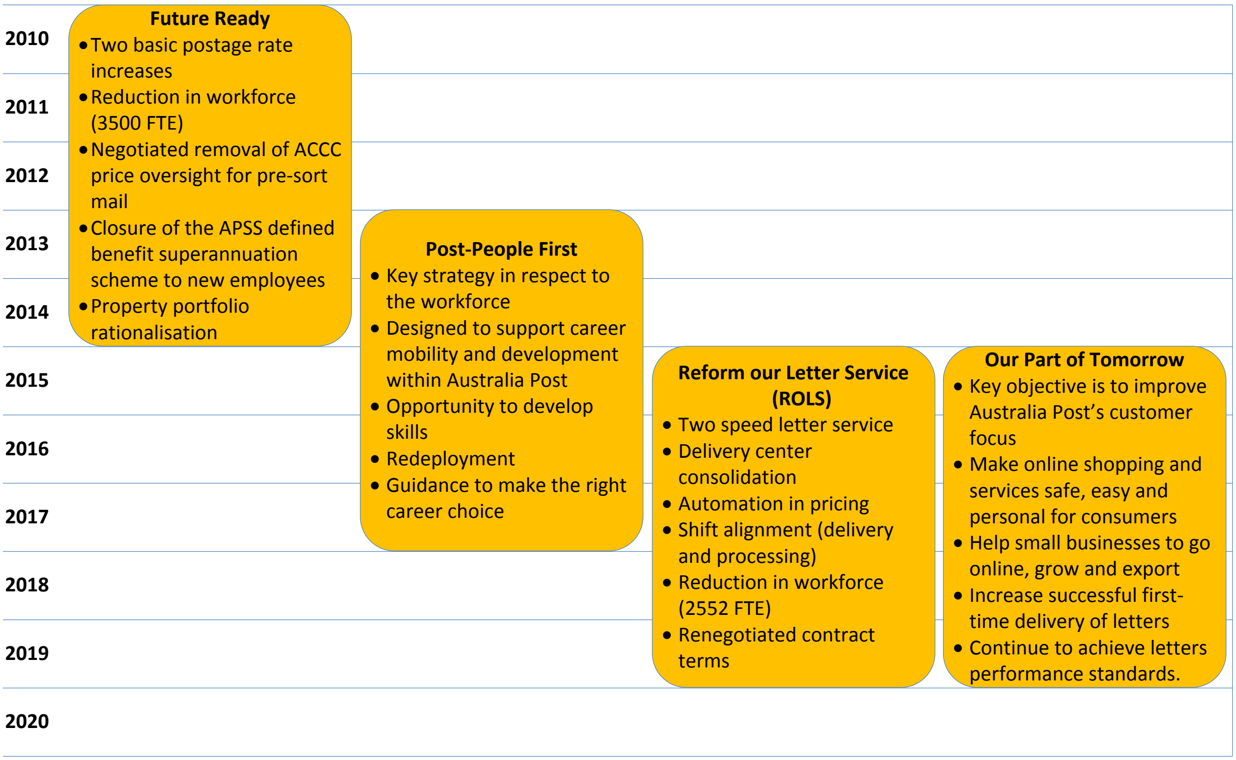
Note d: Department of Finance, August 2015, *Resource Management Guide No. 126 Commonwealth Government Business Enterprise Governance and Oversight Guidelines*, p. 17.

Source: Department of Communications Australia Post Shareholder Oversight Procedures Manual, PGPA Act, APC Act.

Appendix 3 Australia Post's Key Corporate Strategies and support programs

Australia Post's key corporate strategies and support programs are shown in the diagram below. Some of these relate to the letters business only (for example, RoLS, Future Ready) and others relate to the entire organisation (for example, Our Part of Tomorrow, Post People First).

Figure A.1: Key Corporate Strategies and Support Programs



Source: ANAO analysis based on Australia Post strategies.

Future Ready

Australia Post's key enterprise strategy from 2010–2014 was embodied in 'Future Ready', which as the name suggests, was designed to reshape the business to meet the challenges and opportunities presented to it, and to bring a stronger commercial focus. It was therefore developed partly in response to the challenges that were beginning to emerge for the letters business; that is, declines in letter volumes which started in 2008 were gathering momentum.

This program ultimately led to the recognition of the need and the development of the Government reforms to letter services that were introduced in 2016 and the introduction of the RoLS program, which was introduced in 2015.

Post People First

Post People First: Australia Post's key strategy in respect of its workforce is embodied in its Post People First (PP1st) program. It commenced in the 3rd quarter of 2013 and was designed to support career mobility and development within Australia Post by ensuring staff have:

- access to available jobs;

- the opportunity to develop their skills; and
- guidance to help them make the right career choices.

Reform our Letter Services

Australia Post's main program in response to the declines in mail volumes, which builds on the two speed product offer and operational changes. More details are provided in Appendix 4.

Our Part of Tomorrow

As the Future Ready strategy is in implementation phase, Australia Post has shifted its strategic focus to an enterprise strategy called 'Our Part of Tomorrow'. This strategy commenced in 2015.

The key objective of this strategy is to improve Australia Post's customer focus. Key parts of the customer strategy are to:

- make online shopping and services safe, easy and personal for consumers;
- help small businesses go online, grow and export;
- power eCommerce for business customers; and
- power the digitisation of corporations (including mailhouses) and governments, as a substitute to traditional mail services.

In respect of the letters business, the key objectives of 'Our Part of Tomorrow' include:

- increasing successful first-time delivery
- delivering the productivity and efficiency program including RoLS benefits, including:
  - continuing the move to day-time processing shifts, away from night-time or overtime shifts; and
  - installing world-class processing machines, which operate quicker and with fewer errors;
- continuing to achieve its performance standards.

Australia Post is also considering options to align the process and delivery systems and costs to declining volumes and will consider:

(a) product offering—further slowing down the regular product and price increases;

(b) further automation of mail handling and consolidation of the network;

(c) further adapting delivery modes; and

(d) leveraging new machine and information technology across the supply chain.

Formation of eCommerce Delivery Team

In April 2017, Australia Post announced its intention to merge its parcels, and letters and mail networks to form a new eCommerce Delivery Team. The aim of the merger was to streamline shared functions and costs to improve productivity, and to increase employment mobility for staff between businesses to increase labour utilisation. The merger builds on other efficiency initiatives to increase network utilisation such as using the letters and mail network to deliver small parcels, which commenced in 2013 for parcels up to two kilograms.

Appendix 4 RoLS program

The RoLS program was originally justified on the following bases:

Costs

- *Transition costs:* estimated at $13m in total from FY15–FY19. This cost peaks at $8m in FY17, when National Delivery Model (NDM), automation in processing and Delivery Centre (DC) consolidation will all be implemented.
- *Implementation costs:* is approximately $54m over the implementation period of FY15–18 period, with annual costs peaking in FY17. The largest proportion of which is expected to come from automation in processing ($17m), DC consolidation ($13m) and NDM in delivery at ($8m).
- *CAPEX:* is estimated at $211m from FY15–FY18 and is inclusive of a contingency of $17m. This cost peaks in FY16. The bulk of CAPEX cost is driven by automation and mail storage/movement solution with equipment costs making up 65 per cent of total cost ($138m).

Benefits

- The design blueprint estimates total benefits from the network redesign to be $339m for FY18.
- It is evident from the above that the expected return on investment from the RoLS program is very high (that is, capex of $211m to deliver annual savings of $339m by 2018). A number of its other letter business investment cases, show similarly highly attractive prospective returns. Indeed, the ANAO understands that the Board requires business cases in the letters business to have a pay-back period of not more than 5 years, given the outlook for the business.
- The estimated $339m by FY18 in savings is a cumulative figure from the following projects:
  - Automation impacts in delivery: $128m;
  - Implementing the NDM: $53m;
  - Increasing automation in MCs: $52m;
  - Shift alignment in delivery: $45m;
  - Renegotiating contract terms: $33m;
  - shift alignment in processing: $17.8m;
  - Consolidating processing of regular mail: $4m;
  - Consolidating DCs: $2m; and
  - SPB optimisation: $0.6m.

Implications for workforce

- If implemented as described in the RoLS Detailed Design Blueprint, the proposed network changes would result in a cumulative gross headcount reduction of 2 552 FTE by FY17. This breaks down into: 443 FTE in processing; 1 801 FTE in deliver; and 33 in engineering. Further estimated FTE reductions are now 431 in FY18 and 195 in FY19 (that is, cumulative reductions of 2 983 by FY18 and 3 178 by FY19).

- Of the total estimated savings of $339m, approximately 71 per cent ($240m) can be attributed to labour costs, specifically the reduction in FTE headcount:
  - *Automation impacts in delivery:* this project's estimated savings of $128m in FY18 is derived from a gross reduction in headcount of 1 428 FTE.
  - *Implementing the NDM in delivery:* This project's estimated savings of $53m in FY18 is derived from a gross reduction in headcount of 585 FTE.
  - *Increasing automation in MCs:* This project's estimated savings of $52m is driven by reduction in manual work effort and is contributed by a gross reduction in headcount of 763 FTE.
  - *MC consolidation:* This project's net estimated savings of $4m is contributed by a gross reduction in headcount of 161 FTE.
  - *DC consolidation:* The net expected savings of $3m is driven by a mix of reduction in labour and transport costs. The labour savings coming from a gross reduction in headcount of 46 FTE.

The majority of the benefits of the RoLS program are therefore largely dependent on achieving significant reductions in the labour force. The intended 2 983 workforce reduction by FY18 represents approximately 19 per cent of the reserved letter services workforce.

Appendix 5 Efficiency benchmarking methodology

1. To analyse Australia Post's relative efficiency in meeting its obligations, the ANAO undertook a longitudinal analysis of the historical performance of Australia Post against five international postal agencies from FY08 to assess how each operator has improved efficiency over time. The international postal agencies used were those in Canada (Canada Post), New Zealand (NZ Post), the United Kingdom (UK Royal Mail), the Netherlands (Post NL) and Germany (Deutsche Post). FY08 was selected as a starting point as it was the earliest available year of data for all selected international postal agencies. It also captures the material declines in letter volumes in each country.

2. The benchmarking focused on the performance of each postal operator's letters service. However, there were some constraints on this based on the level of granularity in the publicly available data, particularly as postal operators tend to operate a shared cost networks (that is, between letters and parcels).

Data and analysis

3. This analysis only uses publicly available information for the international postal agencies. The following activities were undertaken:

(a) Collected data on operating expenses, revenues and volumes pertaining to letters services and broader mail services (that is, including parcels) from the company annual reports of the international postal agencies.

(b) Supplemented the above with other public information where available (for example, government or regulator reviews).

(c) Developed a historical database of the above information for each of the international postal agencies over the long term.

(d) Verified the outputs with other relevant reports and publicly available sources where available

4. The analysis is subject to the following qualifications:

(a) The period from 2008 to 2015[79] was used for this analysis because these years produce the most complete dataset for all international postal agencies. Prior to this, there are some more significant limitations on the availability of data. In addition, many organisations may have changed reporting systems or data storage platforms which affect the consistency of the way data has been categorised.

(b) The focus is on operating costs per unit of volume or capacity (for example, letter delivered and delivery point) and does not cover profitability.

(c) All findings are expressed as a 'real index' and have been estimated exclusive of inflation and are expressed as an index with FY08 as the base year (that is, equal to 100) to focus on how the performance of the businesses in each country has changed over time in

79 Annual data is presented on a financial year basis, which begins 1 July for New Zealand Post, 1 January for Canada Post, Deutsche Post and Post NL and 1 April for Royal Mail.

percentage terms relative to a historical starting point. All results have also been kept in the country of origin's currency.

(d) The findings of any type of longitudinal analysis are influenced by the starting year so the results should be interpreted taking this into account.

(e) The analysis should be viewed as longitudinal analysis with emphasis on the trends in performance over time, rather than absolute costs or numbers.

(f) Postal agencies generally operate a shared cost network with the majority of its operating costs allocated between various services or products (for example, letters and parcels) for reporting purposes. To address this, the analysis considers the cost performance of the whole enterprise[80], in addition to the letters business in isolation.

Comparability of data

5. The environment in which mail is delivered globally is continually changing and there are factors which influence the comparability of data across countries. The following should be considered in respect of postal agencies in specific countries.

(a) In respect of Australia Post:

- Australia Post implemented a significant change in its approach to cost allocation, moving away from volume as a driver of the allocator for costs in 2015 with the introduction of the new Standard Cost Model. Prior to this, the results may understate the costs that are allocated to Reserved Services, particularly during periods when parcel volumes were increasing significantly. Under the older Full Cost Model, the falling volumes for letters and the increasing volumes for parcels; both tend to allocate costs away from Reserved Services.
- Australia Post acquired StarTrack in FY13 which resulted in a significant increase in opex costs for Non-Reserved Services.
- During FY13, Australia Post changed profitability systems 'in year'. This change resulted in different Product Costing & General Ledger Costing accounts within hierarchies. This should be considered when interpreting the data and in particular the changes in cost allocation from FY13 onwards.
- In 2013, Australia Post started streaming small parcels weighing less than 2 kilograms through the postal network
- Prior to 2011, costs associated with the collection, processing and distribution of international inbound letters and packets (weighing less than 2kg) were included in Reserved Services. These costs are now classified in the parcels segment (that is, Non-Reserved Services).

80 This includes letters, parcels and all other activities.

Benchmarked agencies

In respect of the international postal agencies:

(a) Canada Post

- In 2014 Canada Post introduced Community Mailboxes to streamline internal operations by converting urban households still getting door-to-door delivery to community mailboxes. In their 2015 annual report, Canada Post reported having completed conversions for approx. 830 000 addresses (out of 5m planned). In October 2015 it was announced that the Community Mailbox future deployment was temporarily suspended.[81]
- In 2010 the Canada Post Corporation Act was amended to remove the exclusive privilege on letters intended for delivery outside of Canada and open the market to competition.

(b) New Zealand Post

- In 2014 the Deed of Understanding with the Government for NZ Post was amended to allow a redesign of mail processing and delivery networks which provided for the introduction of alternate day deliveries from 1 July 2015.
- The Christchurch earthquake in 2011 caused a significant increase in costs relating to staff welfare, restoration of business services and remedies of facilities for NZ Post.

(c) UK Royal Mail

- Royal Mail was privatised in October 2013.
- Royal Mail obtained significant deregulation in 2012. In 2011, more than 80 per cent of revenues were subject to direct price regulation. Following the announcement of Ofcom’s new regulatory approach on 27 March 2012, direct price control now affects almost 10 per cent of Royal Mail’s revenues.
- Combined Royal Mail letters and Parcelforce Worldwide to form UKPIL (UK Parcels, International and Letters) in 2010.

(d) Deutsche Post

- There have been significant changes to the postal services market in Europe since 1992 with the full liberalisation of postal markets of countries in turn. The Full Market Opening occurred in Germany in 2008 and the Netherlands in 2009. This occurred in the UK in 2006, outside the period of analysis.

(e) Post NL

- In 2013, the Dutch parliament voted in favour of amending the Dutch Postal Act to cancel Sunday collection and Monday delivery, and the introduction of a significant market power regime, both as of 1 January 2014.

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81 Statement from Canada Post Regarding Community Mailbox Program, 26 October 2015, <https://www.canadapost.ca/web/en/blogs/announcements/details.page?article=2015/10/26/statement_from_canad&cattype=announcements&cat=newsreleases>.

– Whilst all international postal agencies provide letter and parcel services, some agencies have grown the parcels more quickly over the period. The constraints associated with the 8 year time frame should be considered when interpreting this data.

(f) There were some issues obtaining comparable data for the international postal agencies across the relevant years so assumptions were made in some instances to estimate the data.