



**Royal Mail Group Ltd**

**Regulatory Financial Statements  
2010-11**

**Audited financial information**

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## Royal Mail Group Ltd

### How these statements reconcile to the Royal Mail Holdings plc financial statements

The Royal Mail Holdings plc financial statements comprise four segments as shown in the table below (also included on page 2 of the Royal Mail Holdings plc Annual Report and Financial Statements 2010-11):

Business unit	External Revenue		Operating profit/(loss) after modernisation costs	
	2010-11 £m	2009-10 £m	2010-11 £m	2009-10 £m
UKLPI	6,857	6,978	(120)	20
Post Office Limited	776	838	21	33
General Logistics Systems	1,485	1,487	118	112
Other	38	46	20	15
Group	9,156	9,349	39	180

Source: Royal Mail Holdings plc Group Annual Report and financial Statements 2010-11

The regulated business is within the UK Letters, Parcels and International (UKLPI) business unit and where relevant the regulatory financial statements are reconciled to the UKLPI reported results in the Royal Mail Holdings plc financial statements, as shown above for 2010-11 external revenues and operating profit/(loss) after modernisation costs.

### Licence requirements

Royal Mail Group Ltd is required, originally under Condition 14 of the Licence granted by Postcomm on 23 March 2001, and as amended under Condition 15 of the Licence dated 25 May 2006 (as updated on 13 February, 14 May, 8 June and 22 December 2009), to provide regulatory financial statements.

The regulatory financial statements are based on the statutory financial statements of Royal Mail Group Ltd for the 52 week period ending 27 March 2011, on which the auditor has expressed an unqualified opinion.

The revenues, costs, assets, liabilities and cash flow effects of non-letter services and subsidiaries, associates and other undertakings (primarily operating outside the UK), have been agreed with Postcomm as being outside of the scope of regulation. Consequently, the main focus in the regulatory financial statements is on the UK operations of the Group mails operations, particularly those that form the USO and Price Control.

The format of the regulatory financial statements is agreed with Postcomm on an annual basis, and where appropriate there are enhancements or exclusions from the Licence requirements to provide readers with information that both Royal Mail and Postcomm believe is more relevant and useful.

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## The USO

The USO is the Universal Service Obligation required under the terms of the Licence granted to Royal Mail Group Ltd as provider of a universal postal service in the UK.

The USO is formally defined in the Licence by product. The key products categorised as USO are set out in Condition 2 (3) (a) of the Licence.

Historically, revenue generated from the USO services (£2,873m in 2010-11) has been insufficient to cover the 'stand alone' cost of the USO operations (£5,098m - £6,389m 2010-11), and these have, in part, been financed by Royal Mail providing other services, which make use of the USO network, and which provide a positive contribution to the common costs of the USO.

It should be noted that the costs attributed to the USO in these accounts (£2,713m before exceptional items) are those allocated to the USO products using an Activity Based Costing methodology, which spreads daily collection and delivery common costs across all services using the network, and therefore the USO profit does not reflect the true underlying economic/stand alone cost of providing the USO.

## Accounting records

The organisation, management and accounting structures of Royal Mail do not align with the Services defined in Condition 15(2)(a) of the Licence as shown on page 14. In addition, an inherent feature of the postal industry is the use of common resources to provide services and products. Royal Mail does not maintain separate ledgers for each of the Services. As a consequence, processes have been developed and estimates have been applied in determining the assignment of costs and revenues to products.

This means that the records are not those that would exist if each of the Services was carried on by a separate business as required by paragraph 2(b) of Condition 15 and accordingly are not such that if each of the separate Services was carried on by a separate company incorporated under the Companies Act 1985 each of those companies would comply with subsections 221(1) and (2) of that Act.

This is consistent with the records supporting the production of previous regulatory financial statements.

## Methodology

The methodology adopted in preparing these financial statements has been documented in "An overview of the principles and methodologies used in preparing regulatory financial statements for 2011". This methodology was developed following discussions with Postcomm. The methodology and approaches used to create these regulatory financial statements are not intended to establish precedents for future regulatory financial statements.

Royal Mail continues to review and improve its approach and methodologies.

# Royal Mail Group Ltd

## Income Statement

	A	B	C	D=B+C	E	F=A+D-E	G	H	I=F+G+H	J	K=I+J
					Less	Sub Total	Add back	Add	Sub Total		Total
	USO Total	Price Controlled non-USO products excluding Access	Downstream Access	Total Price Controlled non-USO products	USO Non-Price Control products	Total Price Control products	USO Non-Price Control products	Other Letter products	Total Mails	Non-mails activities within UKLPI and other adjustments	UKLPI total <sup>1</sup>
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Revenue	2,873	1,374	1,108	2,482	170	5,185	170	977	6,332	553	6,885
Operating costs	(2,713)	(1,440)	(1,177)	(2,617)	(232)	(5,098)	(232)	(1,059)	(6,389)	(424)	(6,813)
People costs (Note 3)	(1,625)	(1,042)	(932)	(1,974)	(161)	(3,438)	(161)	(655)	(4,254)	(305)	(4,559)
Depreciation, amortisation and impairment	(82)	(35)	(28)	(63)	(8)	(137)	(8)	(25)	(170)	(82)	(252)
Net operating charges	(1,006)	(363)	(217)	(580)	(63)	(1,523)	(63)	(379)	(1,965)	(37)	(2,002)
Operating profit/(loss) before exceptional items	160	(66)	(69)	(135)	(62)	87	(62)	(82)	(57)	129	72
Modernisation Costs - operating exceptional items:											
ColleagueShare scheme	26	17	15	32	3	55	3	11	69	-	69
Other	(94)	(58)	(51)	(109)	(9)	(194)	(9)	(37)	(240)	(21)	(261)
Operating (loss)/profit after modernisation costs	92	(107)	(105)	(212)	(68)	(52)	(68)	(108)	(228)	108	(120)
Other operating exceptional items:											
ColleagueShare scheme	-	-	-	-	-	-	-	-	-	-	-
Other	(15)	(5)	(3)	(8)	(1)	(22)	(1)	(7)	(30)	(18)	(48)
Operating (loss)/profit	77	(112)	(108)	(220)	(69)	(74)	(69)	(115)	(258)	90	(168)
<b>Volumes (excluding unaddressed)</b>	5,012	3,742	7,064	10,806	414	15,404	414	1,509	17,327	63	17,390
<b>Total Volumes</b>	5,012	3,742	7,064	10,806	414	15,404	414	4,690	20,508	63	20,571

### Income Statement 2009-10 (Restated)

					Less	Sub Total	Add back	Add	Sub Total		Total
	USO Total	Price Controlled non-USO products excluding Access	Downstream Access <sup>1</sup>	Total Price Controlled non-USO products	USO Non-Price Control products	Total Price Control products	USO Non-Price Control products	Other Letter products	Total Mails	Non-mails activities within UKLPI and other adjustments	UKLPI total <sup>2</sup>
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Revenue	3,045	1,543	969	2,512	181	5,376	181	931	6,488	519	7,007
Operating costs	(2,903)	(1,598)	(1,067)	(2,665)	(233)	(5,335)	(233)	(841)	(6,409)	(393)	(6,802)
People costs	(1,758)	(1,150)	(844)	(1,994)	(157)	(3,595)	(157)	(505)	(4,257)	(311)	(4,568)
Depreciation, amortisation and impairment	(80)	(34)	(22)	(56)	(8)	(128)	(8)	(18)	(154)	(88)	(242)
Net operating charges	(1,065)	(414)	(201)	(615)	(68)	(1,612)	(68)	(318)	(1,998)	6	(1,992)
Operating profit/(loss) before exceptional items	142	(55)	(98)	(153)	(52)	41	(52)	90	79	126	205
Modernisation Costs - operating exceptional items:											
ColleagueShare scheme	(15)	(11)	(8)	(19)	(1)	(33)	(1)	(5)	(39)	(1)	(40)
Other	(58)	(37)	(27)	(64)	(5)	(117)	(5)	(16)	(138)	(7)	(145)
Operating (loss)/profit after modernisation costs	69	(103)	(133)	(236)	(58)	(109)	(58)	69	(98)	118	20
Other operating exceptional items:											
ColleagueShare scheme	-	-	-	-	-	-	-	-	-	-	-
Other	-	-	-	-	-	-	-	-	-	5	5
Operating (loss)/profit	69	(103)	(133)	(236)	(58)	(109)	(58)	69	(98)	123	25
<b>Volumes (excluding unaddressed)</b>	5,670	4,456	6,355	10,811	398	16,083	398	1,599	18,080	55	18,135
<b>Total Volumes</b>	5,670	4,456	6,355	10,811	398	16,083	398	4,431	20,912	55	20,967

<sup>1</sup> The total described above as UK Letters & Parcels and International is reconciled to the Royal Mail Group Ltd financial statements in Note 1 on page 14.

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### Balance Sheet

	A	B	C	D=B+C	E	F=A+D-E	G	H	I=F+G+H	J	K=I+J
					Less	Sub Total	Add back	Add	Sub Total		Total
	USO Total	Price Controlled non USO products excluding Access	Downstream Access	Total Price Controlled non-USO products	USO Non-Price Control products	Total Price Control products	USO Non-Price Control products	Other Letter products	Total Mails	Non-mails activities within UKLPI and other adjustments	UKLPI total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
<b>Fixed assets</b>	500	214	171	385	49	836	49	153	1,038	500	1,538
<b>Working capital</b>	(160)	(77)	(62)	(139)	(9)	(290)	(9)	(55)	(354)	(31)	(385)
<b>Pension creditor</b>	(1,563)	(1,002)	(896)	(1,898)	(155)	(3,306)	(155)	(630)	(4,091)	(293)	(4,384)
<b>Provisions</b>	(93)	(60)	(53)	(113)	(9)	(197)	(9)	(38)	(244)	(17)	(261)
<b>Finance Leases</b>	(80)	(34)	(27)	(61)	(8)	(133)	(8)	(24)	(165)	(80)	(245)
<b>Internal funding account</b>	(1,206)	(640)	(523)	(1,163)	(103)	(2,266)	(103)	(472)	(2,841)	(189)	(3,030)
<b>NET LIABILITIES March 2011</b>	(2,602)	(1,599)	(1,390)	(2,989)	(235)	(5,356)	(235)	(1,066)	(6,657)	(110)	(6,767)
<b>NET LIABILITIES March 2010</b>	(3,794)	(2,403)	(1,711)	(4,114)	(293)	(7,615)	(293)	(1,148)	(9,056)	(181)	(9,237)

The value of fixed assets on the balance sheet is reported at historic cost whereas the regulatory asset base (RAB) takes into account the impact of the RPI and includes intangible assets. This is the first time the regulatory balance sheet has been disclosed the audited financial statements.

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## Cash Flow Statement

	A	B	C	D=B+C	E	F=A+D-E	G	H	I=F+G+H	J	K=I+J
				Less	Sub Total	Add back	Add	Sub Total		Total	
	USO Total	Price Controlled non-USO products excluding Access	Downstream Access	Total Price Controlled non-USO products	USO Non-Price Control products	Total Price Control products	USO Non-Price Control products	Other Letter products	Total Mails	Non-mails activities within UKLPI and other adjustments	UKLPI total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
<b>Operating profit/(loss) before exceptional items</b>	160	(66)	(69)	(135)	(62)	87	(62)	(82)	(57)	129	72
<b>Add back non-cash costs</b>											
Depreciation, amortisation and impairment	82	35	28	63	8	137	8	25	170	82	252
Pension charge	151	97	86	183	15	319	15	61	395	28	423
Share of profit of JVs and associates	-	-	-	-	-	-	-	-	-	1	1
<b>Operating earnings before non-cash costs</b>	393	66	45	111	(39)	543	(39)	4	508	240	748
<b>Less cash outflows</b>											
Purchase of property, plant and equipment	(53)	(39)	(53)	(92)	(4)	(141)	(4)	(32)	(177)	(31)	(208)
Proceeds from disposal of property, plant and equipment	2	1	-	1	-	3	-	1	4	153	157
Purchase of intangibles and Fixed asset investments	(17)	(12)	(17)	(29)	(1)	(45)	(1)	(10)	(56)	(3)	(59)
Pension cash contributions											
Ongoing	(159)	(102)	(91)	(193)	(16)	(336)	(16)	(64)	(416)	(30)	(446)
Deficit	(101)	(65)	(57)	(122)	(10)	(213)	(10)	(41)	(264)	(18)	(282)
<b>Cash (outflow)/inflow from operating and investing activities</b>	65	(151)	(173)	(324)	(70)	(189)	(70)	(142)	(401)	311	(90)
Exceptional items											
Restructuring											(140)
ColleagueShare											(95)
Exceptional cash flow	(84)	(54)	(48)	(102)	(8)	(177)	(8)	(34)	(219)	(16)	(235)
<b>Cash (outflow)/inflow after exceptional items 2010-11</b>	(19)	(205)	(221)	(426)	(78)	(366)	(78)	(176)	(620)	295	(325)
<b>Cash (outflow)/inflow after exceptional items 2009-10</b>	(103)	(238)	(232)	(471)	(70)	(504)	(70)	(3)	(577)	163	(414)

The cash flow statement does not reflect the entirety of the cash flows relating to the regulated business, most notably in working capital. It does not therefore compare to the reported free cash flow in the Royal Mail Holdings plc financial statements. This is the first time the regulatory cash flow has been disclosed the audited financial statements.

The basis of allocations across the regulatory services are detail on page 12.

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## Regulatory accounting principles and basis of preparation

### A. General

These regulatory financial statements are based on the financial records of the business and the income statement reconciled to operating profit within the Royal Mail Group Ltd financial statements on which the auditor has expressed an unqualified opinion. These statements have been prepared in accordance with the accounting policies set out on pages 15 to 20 of the Royal Mail Group Ltd financial statements unless otherwise stated.

The financial year ends on the last Sunday in March, and accordingly these financial statements cover the 52 week period ended 27 March 2011.

The revenues and costs of non-letter services and subsidiaries, associates and other undertakings (primarily operating outside the UK), have been agreed with Postcomm as being outside the scope of regulation.

Activity and cost driver information is used to assign costs to products; these product costs and revenues are then aggregated into the appropriate Services.

These statements have been prepared adopting the following principles:

- Principles as documented in “An overview of the principles and methodologies used in preparing regulatory financial statements for 2011”; and
- Accounting Policies for the income statement consistent with International Financial Reporting Standards. In so far as they impact upon the regulatory financial statements, the UK GAAP based Accounting Policies used in the audited financial statements of Royal Mail Group Ltd are consistent with IFRS.

In cases of conflict the principles as documented in “An overview of the principles and methodologies used in preparing regulatory financial statements for 2011” prevail.

### B. Income statements

#### (i) General principles

The income statements for the Services have been prepared by applying activity based costing methods and principles to the financial records of the business to assign costs. The resultant statements present the fully allocated costs of products covered by the Licence.

Costs and revenues have been directly attributed to products as far as practicable. Common operational costs that cannot be directly assigned are attributed to the products equitably using an activity based costing system. Overhead costs are allocated to products using the Equi-Proportional Mark Up (EPMU) methodology i.e. in proportion to each product's attributable cost. One-off operating costs have been charged to business units where appropriate. In line with activity based costing approaches, estimates and judgements are required and have been applied in order to comply with the requirements of the Licence.

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### **(ii) Revenue**

Revenue is defined as turnover plus internal income for core services. Revenue is assigned directly to the appropriate product, with the exception of stamp and meter revenue. Account traffic revenue is sourced from the billing systems.

Stamp and meter revenue is assigned to Royal Mail products by applying a statistical analysis of mail stream characteristics. Special Delivery stamp and meter revenue is calculated from the volumes recorded by the proof of delivery system.

### **(iii) Operating costs**

Accommodation and vehicle costs relating to operational postal activities have been included within operating costs in the regulatory financial statements. For the purposes of the regulatory financial statements, depreciation, amortisation and impairment, and people costs have been separately identified.

### **(iv) Operating exceptional items**

The total operating exceptional items relating to the mails operations are allocated across the regulatory Service columns on the face of the regulatory income statement on a basis appropriate and consistent with the type of cost.

### **(v) Share of post tax profit in associates and joint ventures**

The share of the post tax profit of associated undertakings and joint ventures is recorded at Group level and not assigned to the mails operation. They do not feature in the income statement on page 5.

### **(vi) Net profit on disposal of property, plant and equipment**

Profits and losses on sale of properties are held within a separate property business unit. They are not assigned to the mails operation, and consequently do not feature in the income statement on page 5.

### **(vii) Profit or loss on disposal of businesses**

Profit or loss on disposal of businesses are recorded at Group level and not assigned to the mails operation. They do not feature in the income statement on page 5.

### **(viii) Excluded items**

Postcomm has agreed the items below profit before financing and taxation are excluded from the regulatory financial statements.

### **(ix) Prior year comparatives**

During the year, the Group changed the structure of its internal organisation. Also, the methodology used to measure inland stamped and metered traffic has changed from operational to revenue derived.

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The impact on operating profit after modernisation costs of restating the prior year to reflect the changes is set out below.

	USO £m	Price Controlled £m	Total £m
2009-10 Royal Mail Letters as originally reported	(8)	(165)	(60)
Adjustment for restructure	-	-	80
Adjustment for RDT	77	56	-
2009-10 UKLPI restated	69	(109)	20

### C. Key drivers

#### (i) Income statement

Revenues are primarily driven directly to products by sales account detail or traffic volumes. Resource costs within the ledgers are driven to activities by activity and utilisation analysis. Appropriate drivers are used to assign activity costs to products. Traffic volumes are used as the primary driver of activity costs to sales products, though weighting factors are also applied to differentiate the cost assignment between product types. Products are then analysed into Services.

#### (ii) Traffic volumes

The activity based costing system makes extensive use of traffic volumes to assign costs to products.

Revenue derived methodology has been used as the basis for measuring inland stamped and metered traffic volumes. Export stamp and meter international traffic volumes are derived through sampling. Sampled data is weighted up to give total revenue, weight and items for a period.

Non stamp and meter traffic i.e. "account traffic" volumes for both inland and international products are sourced from billing or track and trace systems.

International import traffic volumes are determined by applying a statistically derived "items per kilo" to the weight of mail received from international postal administrations.

#### (iii) Activity analysis

People costs have been assigned to activities based on an analysis of operational hours and samples of the time spent by staff on specific activities. Whilst Royal Mail believes this provides a fair representation of activities in the operation, it has recognised the potential for improvement.

There are inherent limitations in accurately recording staff time by individual activity. Time is recorded in accordance with Authorised Working Duties ('AWDs'), which set out the duties for staff at each operational site against expected traffic volumes. These are amended by 'pressure' (overtime to cover peak workloads) and 'lapsed' (where duties or

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part of the duties are not undertaken, due to lower workloads) time adjustments each week.

Royal Mail actively reviews the quality of the operationally sourced data that is used to drive costs within its activity based costing system. An ongoing programme of activity in this area is in place.

An initiative to improve both hours and traffic recording within the operations is ongoing.

Other costs have been assigned to activities by the use of appropriate drivers.

### **(iv) Statistical information**

In assigning costs to products and services, Royal Mail makes use of statistically sampled information that is collected from operational sites. This information is used to determine relative weighting factors that allow cost differentials to be generated during the cost assignment process. One of the characteristics sampled is the average size of an item.

Historically, Royal Mail has refreshed this data for the latest sampled information each year, basing measurement on mails characteristic sampling data observations.

### **D. Internal trading and transfer charging**

Royal Mail operates through business units that make use of each other's services in order to take advantage of Group synergies, having regard to the mutual dependencies that exist.

Transfer charges are raised for internal trading and eliminated on consolidation. The elimination is shown in the reconciliation to the Royal Mail Group Ltd results.

Charges made for core services provided by UKLPI to other business units (i.e. Official Mail) are accounted for within revenue, whilst charges incurred by UKLPI for other services such as market rental charges for property, are accounted for within other operating charges.

Internal charges used in the production of the regulatory financial statements have been adjusted to reflect actual cost, which ensures that central functions within the Group do not generate a notional profit or loss. The principal exceptions to this are Post Office Limited charges that are set using a basis of charges reached through a negotiation between the respective businesses, and Royal Mail Estates Limited charges that are at market rates.

### **E. Balance sheet**

The regulatory balance sheet is an allocation of the UKLPI balance sheet (as used for internal management purposes) and does not reflect the entirety of the assets used by the regulated business, most notably, intangible assets. The allocation is purely indicative of proportions of the assets and liabilities within UKLPI that may be assigned to the various regulatory columns. Balances are allocated across the same regulatory services as the income statement as shown below. This methodology has been used for a number of years for the balance sheet and has previously been reported in the unaudited statements supplied to Postcomm.

## Royal Mail Group Ltd

Asset / Liability	Income Statement Heading
Fixed assets	Depreciation charge
Working capital	Revenue
Pension creditor	People costs
Provisions	People costs
Finance Leases	Depreciation charge
Internal funding account	Operating Costs

### F. Cash flow statement

The regulatory cash flow statement is an allocation of balances taken from the regulatory income statement, regulatory balance sheet analysis and internal management reports and does not reflect the entirety of the cash flows relating to the regulated business, most notably in working capital. The allocation is purely indicative of proportions of the cash flow within UKLPI that may be assigned to the various regulatory columns. The columns are the same as the income statement.

Key balances used in the calculation of the cash flow of UKLPI are taken from a number of reports and allocated across the regulatory Services on the basis shown below. This methodology has been used for a number of years for the cash flow and has previously been reported in the unaudited statements supplied to Postcomm

Cash flow heading	Basis of Apportionment
Operating profit/loss before exceptional items	Directly from regulatory income statement
Depreciation, amortisation and impairment	Directly from regulatory income statement
Pension charge	Directly from note 3 to the regulatory income statement
Purchase of property, plant and equipment	Analysis of capital expenditure by pipeline further analysed and apportioned as follows: Processing – based on 100% retail and appropriate percentage of DSA volume Access and Distribution – Based on 100% retail and unaddressed volumes Delivery – based on total volume less international export volumes Other – based on total revenue
Proceeds from disposal of property, plant and equipment	Total of the purchase of property, plant and equipment
Purchase of intangibles and fixed asset investments	Total of the purchase of property, plant and equipment
Pension cash contributions – ongoing and deficit	Same proportion of the Group cash as the UKLPI P/L charge is to the total Group P/L charge, this total is then apportioned across the regulatory services in line with the P/L charge
Exceptional cash flow	Allocated across the regulatory services in line with people costs

## Royal Mail Group Ltd

### Notes to the statements

The following pages contain note information as follows:-

Note 1 - Reconciliation of the regulatory income statement to the Royal Mail Group Ltd audited operating profit/(loss)

Note 2 - 2010-11 Analysis of the USO and other Price Controlled products between Licensed and Non-Licensed services

Note 3 - 2010-11 People costs analysis

Note 4 - Non-mails activities within UKLPI and other adjustments

Note 5 - Mails exceptional items included in operating charges

Note 6 - Royal Mail Group Ltd provisions for liabilities and charges

As agreed with Postcomm comparative information is not required for notes 2 and 3.

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## 1. Reconciliation of the regulatory income statement to the Royal Mail Group Ltd operating profit/(loss)

2010-11									
	Revenue £m	People costs £m	Depreciation and amortisation £m	Other operating charges £m	Operating profit/(loss) before operating exceptional items £m	Modernisation costs - operating exceptional items £m	Operating profit/(loss) after modernisation costs	Other operating exceptional items	Operating (loss)/profit £m
<b>UK Letters &amp; Parcels and International per Regulatory Income Statement (page 5)</b>	<b>6,885</b>	<b>(4,559)</b>	<b>(252)</b>	<b>(2,002)</b>	<b>72</b>	<b>(192)</b>	<b>(120)</b>	<b>(48)</b>	<b>(168)</b>
Other Units	(18)	5	20	(76)	(69)	-	(69)	(5)	(74)
Inter business eliminations and recharges	4	-	-	(4)	-	-	-	-	-
Reclass I/B recharges from income to charges	(8)	-	-	8	-	-	-	-	-
<b>Royal Mail Group Ltd financial statements</b>	<b>6,863</b>	<b>(4,554)</b>	<b>(232)</b>	<b>(2,074)</b>	<b>3</b>	<b>(192)</b>	<b>(189)</b>	<b>(53)</b>	<b>(242)</b>

2009-10 (Restated)									
	Revenue £m	People costs £m	Depreciation and amortisation £m	Other operating charges £m	Operating profit/(loss) before operating exceptional items £m	Modernisation costs - operating exceptional items £m	Operating profit/(loss) after modernisation costs	Other operating exceptional items	Operating (loss)/profit £m
<b>UK Letters &amp; Parcels and International per Regulatory Income Statement (page 5)</b>	<b>7,007</b>	<b>(4,568)</b>	<b>(242)</b>	<b>(1,992)</b>	<b>205</b>	<b>(185)</b>	<b>20</b>	<b>5</b>	<b>25</b>
Other Units	(17)	4	22	(90)	(81)	-	(81)	4	(77)
Inter business eliminations and recharges	4	-	-	(4)	-	-	-	-	-
Reclass I/B recharges from income to charges	(8)	-	-	8	-	-	-	-	-
Rounding	-	-	-	-	-	(1)	(1)	1	-
<b>Royal Mail Group Ltd financial statements</b>	<b>6,986</b>	<b>(4,564)</b>	<b>(220)</b>	<b>(2,078)</b>	<b>124</b>	<b>(186)</b>	<b>(62)</b>	<b>10</b>	<b>(52)</b>

## Royal Mail Group Ltd

### 2. 2010-11 Analysis of the USO and other Price Controlled products between Licensed and Non-Licensed services

	USO Products			Non-USO Price controlled Products, Including Access		
	Licensed 0 - 350g £m	Non- Licensed £m	Total £m	Licensed 0 - 350g £m	Non- Licensed £m	Total £m
Revenue	1,784	1,089	2,873	1,993	489	2,482
Operating Costs	(1,714)	(999)	(2,713)	(1,985)	(632)	(2,617)
People costs (analysed below)	(1,131)	(494)	(1,625)	(1,525)	(449)	(1,974)
Depreciation, amortisation and impairment	(60)	(22)	(82)	(53)	(10)	(63)
Net operating charges	(523)	(483)	(1,006)	(407)	(173)	(580)
Operating (loss)/profit before exceptional items	70	90	160	8	(143)	(135)
Modernisation Costs - operating exceptional items			(68)			(77)
Operating (loss)/profit after modernisation costs	70	90	92	8	(143)	(212)
Other operating exceptional items			(15)			(8)
Operating (loss)/profit	70	90	77	8	(143)	(220)
Volumes (excluding door to door)	4,585	427	5,012	10,121	685	10,806

#### People costs analysis

	USO Products			Non-USO Price controlled Products, Including Access		
	Licensed 0 - 350g £m	Non- Licensed £m	Total £m	Licensed 0 - 350g £m	Non- Licensed £m	Total £m
Wages, salaries and social security	(1,026)	(448)	(1,474)	(1,383)	(408)	(1,791)
Pensions	(105)	(46)	(151)	(141)	(42)	(183)
People costs total as above	(1,131)	(494)	(1,625)	(1,524)	(450)	(1,974)

## Royal Mail Group Ltd

### 3. 2010-11 People costs analysis

	USO Total £m	Price Controlled non-USO Products excluding Access £m	Downstream Access £m	Total Price Controlled non-USO Products £m	USO Non Price Control Products £m	Total Price Control Products £m	USO Non Price Control Products £m	Other Letter Products £m	Total Mails £m	Non-mails activities within UKLPI and other adjustments £m	UKLPI total £m
Wages, salaries and social security	(1,474)	(945)	(846)	(1,791)	(146)	(3,119)	(146)	(594)	(3,859)	(277)	(4,136)
Pensions	(151)	(97)	(86)	(183)	(15)	(319)	(15)	(61)	(395)	(28)	(423)
<b>Total People costs</b>	<b>(1,625)</b>	<b>(1,042)</b>	<b>(932)</b>	<b>(1,974)</b>	<b>(161)</b>	<b>(3,438)</b>	<b>(161)</b>	<b>(655)</b>	<b>(4,254)</b>	<b>(305)</b>	<b>(4,559)</b>

## Royal Mail Group Ltd

### 4. Non-mails activities within UK Letters & Parcels and International and other adjustments

Non-mails activities include the Address Management Centre, Customer Management, Royal Mail Specialist Services, Stamps & Collectables and Parcels. Other adjustments relate to the elimination of inter-business activities and reclassifications, where there is different treatment of costs between the statutory and the regulatory financial statements.

<b>2010-11</b>				
	<b>Revenue</b>	<b>People costs</b>	<b>Depreciation, amortisation and impairment</b>	<b>Net operating charges</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Non-mails activities	122	(57)	-	(82)
Interbusiness / Other adjustments	431	(248)	(82)	45
<b>Total</b>	<b>553</b>	<b>(305)</b>	<b>(82)</b>	<b>(37)</b>

<b>2009-10 (Restated)</b>				
	<b>Revenue</b>	<b>People costs</b>	<b>Depreciation, amortisation and impairment</b>	<b>Net operating charges</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Non-mails activities	116	(51)	-	(81)
Interbusiness / Other adjustments	55	(45)	(56)	104
<b>Total</b>	<b>171</b>	<b>(96)</b>	<b>(56)</b>	<b>23</b>

### 5. Mails exceptional items included in operating charges

	<b>2010-11</b>	<b>Restated 2009-10</b>
	<b>£m</b>	<b>£m</b>
Provision for restructuring	(235)	(139)
ColleagueShare scheme	69	(40)
Other exceptional write-offs	(38)	(2)
Non Mails	(36)	
<b>Total</b>	<b>(240)</b>	<b>(181)</b>

The £235m restructuring charge is all employee related costs (2009-10 £139m).

The values shown above are those that have been included within the UKLPI results in the 'Segment information' note in the 2010-11 Royal Mail Holdings plc Annual Report and Financial Statements.

## Royal Mail Group Ltd

### 6. Royal Mail Group Ltd provisions for liabilities and charges

	<b>2010-11</b> <b>£m</b>	<b>Restated</b> <b>2009-10</b> <b>£m</b>
Total provisions for liabilities and charges	253	234

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The provision includes amounts relating to redundancies of £156m (2010 £86m), potential industrial claims of £30m (2010 £nil) and ColleagueShare £2m (2010 £100m), with the balance of £65m (2010 £48m) comprising provisions for estimated exposures resulting from legal claims, onerous contracts and decommissioning.

The amounts charged in other operating costs principally relate to onerous property contracts and estimated exposures resulting from legal claims.

There was a cash utilisation of £129m (2010 £122m) which includes £109m (2010 £107m) of spend relating to exceptional rationalisation, £4m for ColleagueShare leavers (2010 £6m) and £16m (2010 £9m) relating to other costs. There were other non-cash amounts of £46m (2010 £43m) principally relating to transfers from provisions to current payables for amounts due to the pension scheme for redundancies with early retirement.

The majority of provisions are expected to be utilised in 2011-12, except £1m of onerous property contracts expected to be utilised within 3 to 5 years, and a further £2m expected to be utilised over a period greater than 5 years.

The provision for potential industrial claims of £30m is expected to be utilised over a period greater than 5 years except for £3m expected to be utilised within the next financial year.

## Royal Mail Group Ltd

### Statement of responsibilities

Royal Mail Group Ltd is required, as agreed with Postcomm and under Condition 15 of the Licence, to provide regulatory financial statements in respect of each regulatory Service.

Royal Mail Group Ltd confirms that the regulatory financial statements have been prepared, after agreeing formats with Postcomm, in accordance with the above requirement and:

1. The statements have been prepared using accounting systems operating on the basis of objectively justifiable cost accounting principles that assign cost and revenue data to the Services;
2. Costs and revenues have been directly attributed to products as far as practicable. Common operational costs that cannot be directly assigned are attributed to the products equitably using an activity based costing system. Overhead costs are allocated to products using the Equi-Proportional Mark Up (EPMU) methodology ie in proportion to each product's attributable cost. In line with activity based costing approaches, estimates are required and have been applied in order to comply with the requirements of the Licence.
3. The regulatory financial statements have been prepared adopting the following principles:
  - Principles as documented in "An overview of the principles and methodologies used in preparing regulatory financial statements for 2011"; and
  - Accounting Policies for the income statement consistent with International Financial Reporting Standards. In so far as they impact the income statement, the UK GAAP based Accounting Policies used in the audited financial statements of Royal Mail Group Ltd for the year ended 27 March 2011 are consistent with IFRS.In cases of conflict the principles as documented in "An overview of the principles and methodologies used in preparing regulatory financial statements for 2011" prevail; and
4. The regulatory financial statements are based on the financial records of the business and have been reconciled to the operating profit within the audited Royal Mail Group Ltd financial statements.

The methodology adopted to produce the regulatory financial statements has been documented in "An overview of the principles and methodologies used in preparing regulatory financial statements for 2011" and in notes A to F on pages 8 to 12. The methodology and approaches used to create these financial statements are not intended to establish precedents for future regulatory financial statements.

Signed on behalf of the Board of Royal Mail Group Ltd.



Matthew Lester

22 July 2011

# Royal Mail Group Ltd

## Independent auditors' report

Independent auditors' report to the Directors of Royal Mail Group Ltd ("the Company") issued as required by Condition 15 of the Licence dated 25 May 2006 (as updated on 13 February, 14 May, 8 June and 22 December 2009) granted by the Postal Services Commission ("Postcomm")

We have audited the Regulatory Financial Statements of the Company for the year ended 27 March 2011 (the "Regulatory Financial Statements") on pages 3 to 18 which include separate statements for the year ended 27 March 2011 for each of the services described within the Licence Condition 15 and agreed with the Regulator and comprise the licence requirements, the income statement, the balance sheet, the cash flow statement, the regulatory accounting principles and basis of preparation and the notes to the statements

These Regulatory Accounts have been prepared in accordance with the "Regulatory accounting principles and basis of preparation" set out on pages 8 to 12, as agreed with Postcomm to meet Condition 15 of the Licence.

This report is made, on the terms of our engagement letter dated 27 October 2010 that have been agreed, solely to the Company's directors, as a body, in order to meet the requirements of Condition 15 of the Licence. Our audit work has been undertaken so that we might state to the Company those matters that we have agreed to state to them in our report, in order to assist the Company to meet its obligation under Condition 15 of the Licence and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's directors as a body, for our audit work, for this report or for the opinions we have formed.

### Respective responsibilities of the Directors and Auditors

As explained more fully in the Statement of Directors' responsibilities as set out on page 19, the directors are responsible for the preparation of the Regulatory Financial Statements as agreed with Postcomm to meet the requirements of Condition 15 of the Licence.

Our responsibility is to audit and express an opinion on the Regulatory Financial Statements in accordance with International Standards on Auditing (UK and Ireland), except as stated in the 'Scope of the audit of the Regulatory Financial Statements' below, and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities' issued by the Institute of Chartered Accountants in England and Wales. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### Scope of the audit of the Regulatory Financial Statements

An audit involves obtaining evidence about the amounts and disclosures in the Regulatory Financial Statements sufficient to give reasonable assurance that the Regulatory Financial Statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the

## Royal Mail Group Ltd

reasonableness of significant accounting estimates made by the directors; and the overall presentation of the Regulatory Financial Statements. In addition, we read all the financial and non-financial information in the Regulatory Financial Statements to identify material inconsistencies with the audited Regulatory Financial Statements. If we become aware of any apparent misstatements or inconsistencies we consider the implications for our report.

We have not assessed whether the accounting policies are appropriate to the circumstances of the Company where these are laid down by Condition 15. Where Condition 15 does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the Regulatory Financial Statements are consistent with those used in the preparation of the statutory financial statements of the company. Furthermore, as the nature, form and content of Regulatory Financial Statements are determined by the Regulator, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK & Ireland).

### **Opinion in respect of paragraph 2(b) of Condition 15 of the Licence**

Although the Company maintains records for each service, many of the group's revenues and costs are not directly identifiable with individual services because of the extent of common assets and services. Therefore the preparation of the Regulatory Financial Statements requires a significant number of apportionments. This means that the records are not those that would exist if each of the Services were to be carried on by separate businesses in accordance with paragraph 2(b) of Condition 15 and accordingly are not such that if each of the separate Services was carried on by a separate company incorporated under the Companies Act 1985 each of those companies would comply with subsections 221(1) and (2) of that Act.

Except as indicated above in our opinion the above records have been maintained to comply with the requirements of paragraph 2 of Condition 15 to the Licence, amended as agreed with Postcomm; and

### **Opinion in respect of paragraph 4(a) of Condition 15 of the Licence**

In our opinion, the Regulatory Financial Statements of the Services for the year ended 27 March 2011, have been properly prepared, in all material respects, in accordance with the "Regulatory accounting principles and basis of preparation" set out on pages 8 to 12 and with the requirements of paragraph 4(a) of Condition 15 of the Licence.

### **Basis of preparation**

Without modifying our opinion, we draw attention to the fact that These Regulatory Accounts have been prepared in accordance with the "Regulatory accounting principles and basis of preparation" set out on pages 8 to 12, as agreed with Postcomm to meet Condition 15 of the Licence.

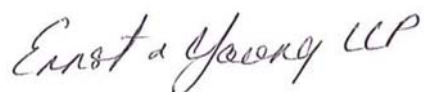
## Royal Mail Group Ltd

The Regulatory Financial Statements are separate from the statutory financial statements of the Company and have not been prepared under the basis of the presentation and disclosure requirements of International Financial Reporting Standards ("IFRS"). Financial information other than that prepared on the basis of IFRS does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006.

### **Other matters**

The nature, form and content of the Regulatory Financial Statements is determined by the Regulator. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the Regulator's purposes. Accordingly we make no such assessment.

Our opinion on the Regulatory Financial Statements is separate from our opinion on the statutory financial statements of the Company for the year ended 27 March 2011 on which we reported on 13 June 2011, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our "Statutory audit") was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.



Ernst & Young LLP  
Statutory Auditors  
London  
22 July 2011

# Royal Mail Group Ltd

## Glossary and explanation of terms

### **£m**

Million pounds sterling.

### **2010-11**

52 week period ending 27 March 2011.

### **2009-10**

52 week period ending 28 March 2010.

### **Account traffic**

Account traffic is the volume of mail associated with customers who pay for postal services on account.

### **Activity based costing (“ABC”)**

Activity based costing is a widely used and accepted method of costing products, services, customers and sales channels based upon the cost of the activities required to produce these outputs. The method identifies the resource consumed by activities and assigns a cost to the resource utilised by each activity. These are aggregated to derive activity costs.

Activity costs are then assigned to outputs, based upon pre defined cost drivers. These cost-drivers provide a measure of the intensity or frequency of an activity demanded by a product or service and reflect a cause and effect relationship.

### **Bulk Mail**

The Bulk Mail definition includes Mailsort, Walksort and Cleanmail products.

### **Business units**

Business units are the separate divisions that make up Royal Mail Group Ltd.

### **Downstream Access**

Customer and other licensed postal operators’ mail, which enters the Royal Mail pipeline after the collection, outward sortation and distribution processes, for subsequent delivery.

### **EC Directive**

A requirement placed upon the postal administrations of all EU member states to produce financial statements in accordance with a prescribed specification.

### **Fully allocated cost (“FAC”)**

The summation of direct and assigned costs for products or services such that no common costs are left unassigned.

### **Group**

The business units that together make up Royal Mail Group Ltd, including UKLPI and Post Office Ltd in the UK.

### **IFRS**

International Financial Reporting Standards.

## Royal Mail Group Ltd

### **iRed**

A wholly owned subsidiary of Royal Mail Group Ltd. iRed Partnership Limited is a document management and printing company.

### **Mail stream characteristics**

The payment method, class and format of mail items.

### **Pipeline**

The sequence of operational processes that is followed by an item of mail. The full pipeline includes collection, sortation/ processing, distribution and delivery.

### **Postal services**

A collective term for the Licensed USO, Non Licensed USO and Other letter products.

### **Postal Services Commission (“Postcomm”)**

The body created under the Postal Services Act 2000 to regulate postal services in the UK.

### **Products**

Products and services offered to customers.

*For a full list of products refer to [www.royalmail.com](http://www.royalmail.com) and select Product A-Z.*

### **PSA**

Postal Services Act 2000.

### **Regulatory financial statements**

The statements, financial statements and reports as expressed in the terms of the Licence which specifically refer to the year ended 27 March 2011 and comparative information for the previous year.

### **Revenue derived traffic**

Volumes where the stamped and metered elements are derived from ledgered revenue using average unit revenues and the Mail Characteristics Survey – a survey of mail types (product stream and content) and volume which is used to derive payment method and class of mail items.

### **Royal Mail**

The business units that collectively deliver the regulatory Services.

### **Royal Mail Estates Limited (RMEsL)**

A wholly owned subsidiary of Royal Mail Group Ltd. RMEsL leases its property fixed assets to Royal Mail Group Ltd under operating leases.

## Royal Mail Group Ltd

### **Royal Mail Group Ltd**

A wholly owned subsidiary of Royal Mail Holdings plc and immediate parent undertaking of Post Office Limited, Royal Mail Estates Limited, and Royal Mail Investments Ltd (which is the immediate parent undertaking of General Logistics Systems International Holdings B.V) for which company financial statements are prepared.

### **Royal Mail Holdings**

Royal Mail Holdings plc.

### **The Licence**

The Licence granted to Royal Mail Group Ltd, by the Postal Services Commission on 23 March 2001, as amended up to 22 December 2009

### **The Services**

The regulatory Services as defined by Postcomm.

### **UK**

United Kingdom.

### **UK GAAP**

UK Generally Accepted Accounting Practice.

### **UK Letters & Parcels and International**

The principal business unit within Royal Mail.

### **Underlying growth**

Volume growth based on revenue derived traffic volumes adjusted for the number of working days in each accounting year.

### **Upstream activities**

Collection, outward sortation and distribution to inward mail centre.

### **USO**

Universal Service Obligation.

### **Wholesale**

The selling of access to the Downstream portion of the Royal Mail network to large bulk mail customers and other licensed postal operators.