

**Actions resulting from the audit of the cost accounting system of CTT -
Correios de Portugal, SA - financial year 2016**

Whereas:

- (i) the audit report on the 2016 results of the cost accounting system (CAS) of CTT - Correios de Portugal, SA (CTT), prepared by Grant Thornton & Associados, SROC, Lda (Grant Thornton); and
- (ii) the comments submitted by CTT, as part of the hearing procedure of interested parties on the draft decision regarding the audit of the 2016 results of the CTT CAS,

the Management Board of the National Communications Authority (ANACOM), in the exercise of the duties conferred upon it by Article 8 (1) (h) and (i), Article 9 (1) (a), (g), (h), (i), (l), (n) and (o) and Article 26 (1) (b), all of its Charter, as approved by Decree-Law 39/2015, of 16 March, pursuant to Article 16 (4) of the Postal Act (Law 17/2012 of 26 April, as amended) and Basic Act XIII of the Basic acts of concession of the universal postal service, as approved by Decree-Law 160/2013, of 19 November, decided:

1. to approve the “Report on the prior hearing of interested parties on the draft decision on the 2016 audit of the results of the CTT - Correios de Portugal, SA cost accounting system”, which forms an integral part of this decision;
2. to approve the notification of the CTT to restate the results of its CAS for 2016 and 2017, with a view to their compliance with the guiding principles of the CAS and other applicable legal and regulatory provisions, enabling ANACOM, after the auditing of such results, and if applicable, to issue of the respective Declaration of Conformity, granting CTT a period of:
 - a) 40 working days to submit to this Authority the restated results for the 2016 financial year from its CAS; and,
 - b) 60 working days to submit to this Authority the restated results for the 2017 financial year from its CAS.

This reformulation of the results of the CTT's CAS should take into account the following aspects:

i) Segregation of postal, banking and/or other activities

The provision of business activities unrelated to postal activities at post offices ("CTT Stores") requires appropriate separation between the postal activity and the other activities, and under no circumstances should expenses consumed and/or used by non-postal activities be passed on to postal products and services, as a result of which the resources shared by these activities should be appropriately allocated to each of these activities, in particular in accordance with the principle of causality.

In this regard, and during the audit of the results of CTT's 2016 CAS, the acceptance of expenditure types were identified (e.g. personnel expenses, depreciation and amortisation, capital cost, rents and leases, insurance, taxes and fees, coproperty charges, water, electricity, consumables, etc.) that were shared between the postal activity (CTT, SA) and the banking activity (Banco CTT, SA), for which it is considered appropriate to establish a rule for sharing expenditure between them, bearing in mind that these activities are carried out by separate and related legal entities.

However, it should be noted that this restatement aims to establish the sharing of these expenditures between different legal entities that use the same infrastructure for the pursuance of their activities, and does not preclude continuing to allocate these same expenses to products and/or services, within the scope of the CTT's CAS, based on the criteria currently in use.

It should also be remembered that, during the audit of the 2015 results of the CTT's CAS, ANACOM had already signalled this concern.

Therefore, and notwithstanding the future identification of other shared expenditure items, or other affiliated companies using resources at CTT post offices or other infrastructure, which may also be considered significant, the 2016 results of the CAS, and consequently those of 2017, should be restated within the previously defined time frames in order to comply with the guiding principles of the CAS, in particular the method of distributing expenditure according to the activities that consume them (cost centre), so that the

expenditure shared between postal activities, banking activities and/or other activities are correctly identified and subsequently allocated in accordance with the following criteria.

In this regard, and for the purposes of this ANACOM decision, it should be clarified that, broadly speaking, postal activity should be understood as the range of postal and non-postal services provided by CTT, SA at post offices prior to launch of Banco CTT, these being activities that therefore incorporate not only traditional postal services, but all the other services that CTT, SA has been providing over recent years under a drive aimed at diversifying and optimising post offices (e.g. merchandising, financial services, payment services, etc.).

1) Proportion of area allocated (m²) to each activity at CTT Stores

Regarding the range of expenditure mentioned above, it is possible to identify a set of categories (e.g. depreciation/amortisation and rents/leases, among others) the occurrence of which tends to vary according to the space occupied (m²) in the development of the respective activity, be it postal (CTT, SA), banking (Banco CTT, SA) and/or any other activity provided by a separate legal entity.

This means that for these categories, and in any activity, the amount incurred with these expenditures tends to vary depending on the area occupied.

Given that both postal and banking activities, respectively carried out by CTT, SA and Banco CTT, SA (or another separate legal entity), are based on a physical retail network that would, in isolation, imply the acquisition and/or rental of physical space, these expenditures (e.g. depreciation and amortisation and/or rents and leases) tend to vary depending on the space (m²) purchased and/or leased.

Additionally, there is also a whole array of expenditures (e.g. insurance, cleaning, taxes, coproperty charges, etc.) which also tend to vary depending on the area used.

Accordingly, it is understood that the expenditures directly associated with CTT Stores, in which postal, banking and/or other activities are carried out, and related to:

- a) depreciation and amortisation, and the related cost of capital, of property, plant and equipment;
- b) rents and leases of property, plant and equipment;
- c) maintenance and repair of property, plant and equipment;
- d) insurance of property, plant and equipment;
- e) coproperty charges;
- f) taxes and fees (e.g. Municipal Property Tax (IMI), sanitation fee); and,
- g) cleaning and surveillance,

must be properly segregated between postal activities (CTT, SA) and the others (Banco CTT, SA and/or others) according to the space used (m²) for each activity, which is considered to correspond to the area specifically designated for that activity (postal, banking and/or other activity), plus a proportion of the common area, corresponding to the proportion of specific areas identified above.

This cost sharing between the different legal entities that jointly use this infrastructure (post offices) should take into account the date from which that activity began at the post office, whether in 2016 or in 2017, whenever this has not started at the beginning of the respective financial year.

In this regard, and in order to apply the aforementioned apportionment rule, the CTT should carry out the current measurement of the aforementioned areas, i.e.:

- a) The effective area occupied by the CTT, SA (front-office and back-office) for the provision of their postal and non-postal services, which shall include: i) the area corresponding to the counters used to provide the service; ii) the area used by the operator (including support areas); iii) the area occupied by customers at each counter, which shall measure 1.5 m² per counter, considered reasonable for adequate service, safeguarding the necessary confidentiality; and iv) the display areas;
- b) The effective area occupied by each of the separate legal entities (front-office and back-office) for the provision of their respective activities, which shall include: i) the specific area for the provision of the respective activity; ii) the

area corresponding to dedicated counters (if any) for the provision of the service; iii) the area used by the operator (including support areas); iv) the area occupied by customers at each counter, which shall measure 1.5 m² per dedicated counter, which is deemed to be reasonable for adequate service, safeguarding the necessary confidentiality; and iv) the display areas specifically used by the separate legal entities in the pursuance of their activities;

- c) The remaining area of the post office that has not been accounted for under subdivisions a) and b) above (including mixed service counters) shall be distributed among the different legal entities operating at the respective post office, in proportion to the areas that previously were allocated to them; and,
- d) The information obtained in relation to the areas mentioned under subdivisions a) to c) above shall result from measurements taken at the post offices at which services are provided by any legal entity other than CTT, SA, and this information may be audited at a later date and validated by this Authority, if deemed appropriate.

Additionally, and for expenditure related to the provision of services (e.g. cleaning, insurance, surveillance and security, maintenance and repair) in the event that such provision is associated with a service covered by a single contract, and not with a CTT Store in particular, or in duly substantiated cases where, consequently, due to an insufficient breakdown information, it is impossible to specifically allocate it to a specific location (CTT Store), a *pro rata* methodology may be adopted by reference to the total area of the CTT Stores, for estimation of the proportion of expenditure that will correspond to each activity (postal, banking and/or other activities).

Where it proves impossible to perform the aforementioned measurements in due time in order for them to be used in the restatement of the results of the CTT's 2016 and 2017 results of the CAS, namely due to a lack of detailed information, ANACOM believes that, in the absence of a better indicator, at post offices where activities are performed by separate legal entities (Banco CTT, SA and/or another legal entity), as it is a point of access to two or more separate commercial service networks, the

aforementioned expenditures should be divided equally, taking into account the number of legal entities operating at that establishment.

2) Proportion of expenses allocated to each activity (postal, banking and/or other)

However, there are cases where the principle of causality will not be adequately reflected by the allocation of certain resources to each activity according the area occupied (m²), where CTT Stores are shared by different distinct legal entities (CTT, SA, Banco CTT, SA and/or others).

An example of this the sharing of expenditure between activities related to:

- a) depreciation and amortisation, and the respective capital cost, of property, plant and equipment;
- b) rents and leases of property, plant and equipment;
- c) maintenance and repair of property, plant and equipment;
- d) utilities (e.g. water, electricity); and,
- e) consumables (e.g. ink and toner cartridges, paper, miscellaneous office supplies, etc.).

In this regard, ANACOM believes that, in relation to the expenditure allocated to each of the CTT Stores at which, in 2016 and/or 2017, the provision of commercial activities by different legal entities (CTT, SA, Banco CTT, SA and/or others) took place, explicit account must always be taken of the months of actual activity in 2016 and 2017, respectively, and should be apportioned according to:

- a) the resources actually employed in each of these activities (postal, banking and/or other), where management information exists regarding this consumption, which should be auditable; and,

- b) where the criterion mentioned in the preceding paragraph cannot be met, the proportion of personnel expenses allocated to each of the respective legal entities (CTT, SA, Banco CTT, SA and/or others) in each of the respective years should be used, where this represents a reasonable proxy for the consumption of those same resources, or on the basis of a driver that is deemed more appropriate.

Therefore, the CTT shall carry out a prior analysis of which activities benefit and/or consume them, as well as which driver best suits their correct apportionment. All necessary information should be kept that will allow an audit of the breakdown criteria used, at a later date, both with regard to the allocated values and the ratios considered and their respective justifications.

3) Proportion of personnel expenses allocated to each activity (postal, bank and/or other)

Where the implementation model of the activity of any other distinct legal entity involves the common use of the post office workers, it is necessary to ensure an appropriate apportionment of personnel expenses among the different separate legal entities (CTT, SA, Banco CTT, SA and/or others), in order to ensure an adequate sharing of the resources consumed and/or used. In this sense, personnel expenses should be allocated to postal (CTT, SA), banking (Banco CTT, SA) and/or other activities, depending on the time spent on the respective provision of services.

Additionally, downtime related to workers providing services to more than one different legal entity should also be appropriately shared among these different entities, and in particular, in order to maintain consistency, the downtime of such workers should be shared between the different legal entities to the same extent as the personnel expenses of the workers concerned were shared, in addition to the downtime resulting from the workers dedicated to them.

In this respect, it should be noted that the CTT, in relation to the apportionment criterion used, should ensure that adequate and duly detailed and justified supporting

documentation is available to enable the auditing, at a later date, of the amounts allocated to each of these legal entities (CTT, SA, Banco CTT, SA and/or others).

As mentioned in point 1 above, where use of the above criteria proves impossible, ANACOM believes that, for the 2016 and 2017 financial years, and in the absence of a better indicator, at CTT Stores where services are provided by a separate legal entity (Banco CTT, SA and/or others), as this constitutes a point of access to two or more distinct commercial service networks, the aforementioned expenditure should be shared equally, taking into account the number of legal entities operating at that establishment.

ii) Calculation and allocation of cost of capital

The analysis of the calculation of the cost of capital carried out within the scope of this audit showed that the use of CTT's market cap in its gearing ratio for beta re-leveraging purposes resulted in a lower cost of capital, around **[Start of confidential information - SCI] [End of confidential information - ECI]** euros.

In view of the need to restate the CTT's 2016 and 2017 results of its CAS due to the situations identified above, it is believed that this situation should also be restated, using CTT's accounting equity instead of its market cap, thus allowing it to meet the understanding of this Authority, which was also reiterated in the methodology defined for the determination of the cost of capital rate for the year 2018, and following years¹.

Additionally, and taking into account the appropriate apportionment of expenses between postal activities and banking activities, as defined in point i) above, the proportion of the capital cost corresponding to the assets whose expenses have been allocated by means of the above-mentioned methodology should also be allocated to the banking activity, on the basis of the apportionment ratio obtained according to the m² used, or the proportion considered, where the former has proved impossible.

¹ <https://www.anacom.pt/render.jsp?contentId=1423147>

iii) Allocation of advertising expenses

In the context of the audit of the CTT's 2016 results of the CAS, a difference of [SCI] [ECI] was identified, which, according to the auditors, results in an understatement of the expenditure allocated through the use of the breakdown criterion for this expenditure item (advertising) and an overvaluation, by the same amount, of common expenditure, as well as generating differences in terms of SU products.

In view of the need to restate the CTT's 2016 and 2017 results of the CAS according to the situations identified above, ANACOM believes that this allocation should be reformulated in the years concerned, and the allocation of these expenses to products and/or services should be based on an allocation criterion that reflects the causality of the occurrence of these same expenditures, and should not thus be allocated as ordinary expenditures.

iv) Non-exclusion of financial expenses

Regarding the identification, in 2016, of financial expenses in the CAS, in the amount of [SCI] [ECI] euros, related to interest paid on financial leasing, and taking into account the need to restate the 2016 and 2017 results by virtue of the situations mentioned above and, in order to comply with ANACOM's determination on this matter, in the restatement to be performed of the results of the CAS, for each of the years mentioned, the total expenditure to be considered in the CAS should exclude the amount of interest on leasing of tangible assets (2016: [SCI] [ECI] euros), thus eliminating the duplication of expenditure in the CAS, as they are remunerated via the cost of capital.

v) Building management policy

Regarding the recognition, as reduced expenses, of capital gains resulting from the sale of properties subsequently leased by the CTT, and notwithstanding the fact that the situation detected in the audit of the 2016 results was not material, given that their allocation was not performed in accordance with the determination issued by ANACOM on this matter, and also taking into account the need, due to the situations identified above, to restate the results of the CAS for the 2016 and 2017 financial years, this

Authority believes that, in the aforementioned financial years, these capital gains should be allocated as recommended by this Authority, i.e. the recognition of capital gains should be allocated to the budget centres to which the expenses incurred for the rental of the respective properties are allocated.

Additionally, considering that the separation of expenses between postal, banking and/or other activities is not in accordance with the guiding principles of the CAS, in particular the principle of causality, ANACOM believes that the CTT should submit to this Authority, within 40 business days, a restatement of the 2016 results of its CAS.

Regarding the 2017 results of its CAS, ANACOM grants an additional 20 working days, which means that the CTT has a total of 60 working days to submit to this Authority a restatement of the results of its CAS for the 2017 financial year.