

## AUDITORS' REPORT ON ANNUAL COST STUDY CONTRIBUTION ANALYSIS

To the Board of Directors

Canada Post Corporation

We have audited the Annual Cost Study Contribution Analysis of Canada Post Corporation for the year ended December 31, 2008, prepared in accordance with the Cost Methodology described in the notes to the Annual Cost Study Contribution Analysis. This financial information is the responsibility of the Corporation's management and has been prepared using Canada Post Corporation segment revenues and expenses contained in note 22 to the audited consolidated financial statements for the year ended December 31, 2008, and other unaudited operational data extracted from Canada Post Corporation's systems. Our responsibility is limited to expressing an opinion, based on our audit, on the financial information resulting from the application of the Cost Methodology.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial information is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial information. An audit also includes assessing the application of the methodology used and significant estimates made by management, as well as evaluating the overall presentation of the financial information.

We did not perform any audit work on the validity of the methodology nor on Canada Post's operational systems and special studies that yield operational data used to allocate costs to products.

In our opinion:

- (a) the Annual Cost Study Contribution Analysis presents fairly, in all material respects, the contribution of services by lines of business and the contribution by exclusive privilege, competitive and concessionary services for the year ended December 31, 2008, in accordance with the Cost Methodology described in the notes to the Annual Cost Study Contribution Analysis, and using Canada Post Corporation segment revenues and expenses contained in note 22 to the audited consolidated financial statements for the year ended December 31, 2008, and other unaudited operational data extracted from Canada Post Corporation's systems; and
- (b) using the Cost Methodology described in the notes, Canada Post Corporation did not cross-subsidize its competitive services group by using revenues protected by exclusive privilege for the year ended December 31, 2008.

*PricewaterhouseCoopers LLP*

Chartered Accountants, Licensed Public Accountants  
Ottawa, Canada  
March 25, 2009

## ANNUAL COST STUDY CONTRIBUTION ANALYSIS

**Canada Post Corporation**

The Annual Cost Study provides costing data that serves as the basis for ensuring that Canada Post Corporation is not competing unfairly by cross-subsidizing its competitive services with revenues from exclusive privilege services.

In conjunction with external experts, Canada Post Corporation maintains a costing methodology based on the principles of long-run incremental costs, which was designed to leverage the structure of an activity-based costing system. Canada Post Corporation applies this methodology each year in its Annual Cost Study for cost attribution purposes.

The methodology, which is summarized in the notes to the Annual Cost Study Contribution Analysis on page 93, recognizes that some costs are caused by the provision of individual services or groups of services while others are common costs of Canada Post Corporation's infrastructure. Approximately 63% of the total non-consolidated costs of Canada Post Corporation are assigned to individual services or groups of services in the Annual Cost Study.

As the Annual Cost Study Contribution Analysis indicates, for the year ended December 31, 2008, the competitive grouping of services generated positive long-run incremental contribution. Under the methodology in the Annual Cost Study, a positive long-run incremental contribution for the competitive grouping of services establishes that this grouping of services has not been cross-subsidized using revenues from exclusive privilege services.

**Annual Cost Study Contribution Analysis**

**Year ended December 31, 2008**

(in millions of dollars)

**I – Long-Run Incremental Contribution of exclusive privilege, competitive, and concessionary services**

	Exclusive Privilege	Competitive	Concessionary	Other	Total
Revenue from operations	\$ 3,794	\$ 1,894	\$ 194	\$ 226	\$ 6,108
Long-run incremental costs	\$ (2,058)	\$ (1,464)	\$ (192)	\$ (132)	\$ (3,846)
<b>Long-run incremental contribution to the fixed costs</b>	<b>\$ 1,736</b> 46%	<b>\$ 430</b> 23%	<b>\$ 2</b> 1%	<b>\$ 94</b> 41%	<b>\$ 2,262</b> 37%
Unallocated fixed costs					\$ (2,242)
<b>Contribution before the under noted items</b>					<b>\$ 20</b>
Investment and other income					\$ 54
Interest and other expense					\$ (8)
<b>Income from the Canada Post segment before income taxes</b>					<b>\$ 66</b>

**II – Long-Run Incremental Contribution by line of business**

	Transaction Mail	Parcels	Direct Marketing	Other	Total
Revenue from operations	\$ 3,234	\$ 1,311	\$ 1,431	\$ 132	\$ 6,108
Long-run incremental costs	\$ (1,652)	\$ (1,087)	\$ (897)	\$ (100)	\$ (3,736)
<b>Long-run incremental contribution to the fixed costs</b>	<b>\$ 1,582</b> 49%	<b>\$ 224</b> 17%	<b>\$ 534</b> 37%	<b>\$ 32</b> 24%	<b>\$ 2,372</b> 39%
Unallocated fixed costs					\$ (2,352)
<b>Contribution before the under noted items</b>					<b>\$ 20</b>
Investment and other income					\$ 54
Interest and other expense					\$ (8)
<b>Income from the Canada Post segment before income taxes</b>					<b>\$ 66</b>

The accompanying notes are an integral part of the Annual Cost Study Contribution Analysis.

# NOTES TO ANNUAL COST STUDY CONTRIBUTION ANALYSIS

Year ended December 31, 2008

## 1. General

The Annual Cost Study calculates the long-run incremental contribution from exclusive privilege services, competitive services and concessionary services. The long-run incremental contribution is defined as the revenues from such services, less their long-run incremental cost.

## 2. Cost methodology

- a) **Long-run incremental cost** • The cost methodology employed by Canada Post Corporation measures the long-run incremental cost of individual services and groups of services according to the current operating plan. Long-run incremental cost is the total annual cost caused by the provision of a service.
- b) **Activity-based** • Services provided by Canada Post Corporation are analyzed to determine the various activities involved in their fulfillment. Each activity is then analyzed to determine the causal relationship between the costs of the activity and the services that require the performance of that particular activity. Service volumes or other data are used to attribute those activity costs to services.
- c) **Attribution principles** • The relationship between the cost of resources and the activities performed and between the activities performed and the services delivered are identified using the principles of causality and time horizon. Those activity costs which are incurred because of the provision of a service are attributed to that service. Activity costs which cannot be attributed to the provision of a service but which are common to a specific group of services are attributed at that higher level of aggregation. The remaining business sustaining or common fixed costs are "unallocated fixed costs".
- d) **Source data** • The source of the financial data used to produce the Annual Cost Study results is the Canada Post Corporation general ledger revenues and costs. Operational time, volume and weight/cubage data are used to attribute general ledger costs to activities and activity costs to services. Operational volume data is used to determine revenue by services. Where operational data is not available, an appropriate proxy is used to make the attribution.
- e) **Reconciliation to financial records** • Total revenues and costs considered in the Annual Cost Study are agreed to the total revenues and expenses forming the Canada Post Corporation segment of the audited consolidated financial statements, which have been reported on by another firm of chartered accountants.
- f) **Cross-subsidization test** • Under the Cost Methodology in the Annual Cost Study a positive long-run incremental contribution (revenue exceeds long-run incremental cost) for a line of business, and competitive grouping of services establishes that the grouping of services has not been cross-subsidized using revenues from other services or groups of services.

## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING


Management is responsible for the consolidated financial statements and all other information presented in this Annual Report. The *Financial Administration Act* and regulations require the consolidated financial statements to be prepared in accordance with Canadian generally accepted accounting principles. Where appropriate, the consolidated financial statements include amounts based on management's best estimates and judgments. Financial information presented elsewhere in this Annual Report is consistent with the consolidated financial statements.

In support of its responsibilities, management established a system of internal controls designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable financial information in accordance with the *Financial Administration Act* and regulations, as well as the *Canada Post Corporation Act* and regulations and by-laws of the Corporation. Internal audits examine and evaluate the application of the Corporation's policies and procedures and the adequacy of the system of internal controls.

The Board of Directors has delegated responsibility for oversight of the financial reporting process to the Audit Committee. The Committee acts on behalf of the Board of Directors in fulfilling the Board's responsibilities, which are prescribed by Section 148 of the *Financial Administration Act*. The Audit Committee is entirely constituted of non-executive directors and currently composed of five members who are therefore independent in accordance with the Corporation's standards of independence. The Audit Committee is responsible for reviewing the consolidated financial statements and the Annual Report and for meeting with management, internal auditors and external auditors to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues. The Audit Committee meets not less than four times a year, focusing in particular on the areas of financial reporting, risk management and internal control.

The Board of Directors on the recommendation of the Audit Committee approves the consolidated financial statements.

Canada Post Corporation is a Crown corporation included since 1989 in Part II of Schedule III of the *Financial Administration Act*. The Auditor General of Canada and KPMG LLP were appointed as joint auditors of the Corporation for the year ended December 31, 2008, in accordance with the *Financial Administration Act*. The Auditor General and KPMG LLP audit the consolidated financial statements and report to the Audit Committee of the Board of Directors, as well as the Minister of Transport, Infrastructure and Communities.



President and Chief Executive Officer

March 6, 2009



Chief Financial Officer