
From: Parsons, Andrew [GRO]
Sent: Mon 13/10/2014 1:50:32 PM (UTC)
To: Belinda Crowe [GRO]
Cc: Patrick Bourke [GRO]; Tom Wechsler [GRO]; Angela Van-Den-Bogerd [GRO]; [GRO] Rod Ismay [GRO]
Subject: RE: Errors that arise between Post Office and its clients and others [BD-4A.FID20472253]
Attachment: _DOC_29547133(1)_Suspense Account II.DOCX

All

Please find attached a draft response to Second Sight on the Suspense Account question for your comments.

Rod, as background – SS have responded to our original SA note in the email from Ron below. I've therefore prepared the attached paper which hopefully explains the SA in more detail. Would you mind reviewing and sending through any comments? If I've completely missed the point, please say.

Kind regards
Andy

Andrew Parsons
Managing Associate
for and on behalf of Bond Dickinson LLP

Bond Dickinson

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From: Belinda Crowe [GRO]
Sent: 01 October 2014 17:21
To: Parsons, Andrew
Cc: Patrick Bourke; Chris Aujard; Tom Wechsler; Belinda Crowe; Angela Van-Den-Bogerd
Subject: FW: FW: Errors that arise between Post Office and its clients and others

Andy,

Please see below from Ron. This is his action to write to use setting out the question he wants answering in relation to suspense accounts. We need to do a response for Chris and I suggest we should have done so by the next face to face. Could you please have a go at the first draft? My initial take is that SS still have not understood the points we have made or the way that POL's accounting system works. However the only substantive comment I have to make at the moment is that in relation to the point:

We hope that this email clarifies why we have asked for sight of the Credit entries, derived from Suspense Accounts, that have eventually been written off to the credit of Post Office's P&L Account. We are NOT interested in seeing the DEBIT entries and certainly not any NET entries, only the CREDIT entries. Perhaps

you could arrange for us to be given sight of the aggregates of the individual Credit entries for the years 2010 and 2011 and the details of the individual Credit entries that make up those aggregates? The years 2010 and 2011 would cover at least some of the cases with which we are dealing.

I do not think it is appropriate to provide this source data as it is not for second sight to trawl through a set of spread sheets and try to identify what they think might be relevant. We will, however, investigate the cases as they arise.

Best wishes
Belinda

Belinda Crowe
148 Old Street, LONDON, EC1V 9HQ

GRO

Postline:

GRO

GRO

GRO

From: Ron Warmington GRO

Sent: 01 October 2014 16:20

To: Chris Aujard; Belinda Crowe

Cc: mediation GRO rjw GRO

Subject: RE: FW: Errors that arise between Post Office and its clients and others

Belinda: Tony had asked me to send a follow-up message to Chris about Suspense Accounts and it may be that he'd like a copy of this email uploaded to Huddle and added - perhaps at AOB - to tomorrow's Call Agenda, though it would, in my view, be better addressed at the next face-to-face, once Chris has had a chance to decide on Post Office's next steps.

Chris:

As requested in the 16 September face-to-face WG Meeting, here is an updated request in regard to SUSPENSE ACCOUNTS.

We have prepared this follow-up email after studying your 29 July 2014 Response Paper (also attached for ease of reference).

Just to recap: The Key Control Question that we posed in our 18 June email was: **"Could any Subpostmasters have been charged by Post Office for amounts that became incorporated in suspense account balances that were subsequently taken into profit by Post Office or by any of its Counterparty Companies, or that remain as credit balances on the Balance Sheet of Post**

Office or of any of its Counterparty Companies?"

As mentioned in that 16 September WG Meeting, our intention and hope was that this question would provoke a simple Yes or No answer: Either Subpostmasters (perhaps including some of the Applicants to the Scheme) HAVE paid in funds, in response to TC Invoices (or by settling to cash or by settling centrally shortages that had appeared in their branch's books) where those TC Invoices/shortages arose as a result of transactional discrepancies that also resulted in credit entries in Post Office's (or any of its clients') Suspense Accounts... or that has never happened.

We have to say that, having read your 29 July Paper, we are still not at all clear whether Post Office's answer to the 18 June email Key Control Question was "Yes" or "No". Indeed there are only two sentences in the Paper that are truly relevant to the question posed: those are the two sentences, on page three, that say: *"It is acknowledged that Post Office has a suspense account for discrepancies between Horizon records and client records"* and: *"These discrepancies are held for 3 years for investigation before being released to Post Office's profit and loss account"*.

At the risk of complicating the simple Key Control Question, perhaps we need to elaborate a little and explain better what we are concerned about:

First of all, our Working Group's Chairman himself posed a question which we hope we correctly recall as: *"Could a Surplus in one branch be offset by a Shortfall in another?"*. We are now extending that question by adding: *"Could a Surplus that is booked into a Suspense Account in Post Office (or in the books of one of its clients) be offset by a past, current or future Shortfall in any branch?"*. This focuses attention, as we mentioned in the 16 September WG Meeting, only onto the CREDIT ENTRIES in those Suspense Accounts. The backdrop here is that Credit entries in Post Office's Suspense Accounts can only have arisen where:

1. Transactional errors and delays have occurred, such that an entry's offsetting Debit may have been initially passed to another Account in Post Office's own books (e.g. a debit to an Account that hits Post Office's Profit and Loss Account or its Balance Sheet, such as an amount that has been received but where, in due course, that amount will, or may have to be,

debited to another Post Office General Ledger Account);

2. Amounts that have been received by Post Office, and are due to Post Office, but which are unidentified, so it is not (or it is not immediately) clear to which Account that sum should be credited, though there is certainty that it is money due to Post Office, rather than to one of its clients or to one of its branches;
3. Amounts that have been received by Post Office, but may not be due to Post Office (for example the amount may be due to be paid to one of Post Office's clients or to one of its branches) but where it is not, or not yet, clear who should be paid.

It is pretty obvious that we are not in the least bit concerned about situation Types 1 and 2 above. It is situation Type 3 that is our focus here. In the case of those credits to Post Office's Suspense Accounts, the possibility exists that the amount that has been received was money that should have been remitted to a Post Office client or to one of Post Office's branches. This could, for example, be money (whether received from HMRC, from Royal Mail, from the DWP, or from another Post Office 'client') that has been wrongly processed as a result of an error by a branch customer, by a branch employee, by Post Office itself or by a Post Office client. When that happens, the incoming funds may well be meant to offset a TC Invoice that was issued, either in some earlier Trading Period or is yet to be issued, to a branch. In the event that the incoming funds are not properly recognised and allocated, there exists the possibility that, instead of reimbursing the branch that has been negatively impacted by the earlier error (or by the resultant TC Invoice), Post Office instead (and in error) passes the funds to the credit of its own Profit and Loss Account as a 'write-back' (perhaps three years later when that Suspense Account is, as it were, 'tidied up'). Does it not also follow, just as Tony has suggested, that it might be possible that a Debit entry in a Suspense Account could have been the result of an error that, having generated a Surplus in a branch, has been retained by that branch's Subpostmaster? The result: One branch keeps the Surplus that has generated the Debit entry into Post Office's Suspense Account, while another suffers a Shortfall that OUGHT to have been offset by that Debit.

Having dealt with that, the same possibility has to apply to Suspense Accounts

maintained by Post Office's client companies. In ordinary commerce, where two companies transact with one another, there always exists the possibility that one company will either incorrectly charge, or pay, an amount to the other (e.g. an amount of £91.00 due gets paid as £19.00, etc.). This will sometimes lead to amounts being posted to Suspense Accounts and, in simple terms, the party that ends up writing off the balance of its Suspense Account to the debit side of its P&L Account loses, while the other party gains. In Post Office's Business Model, when such situations arise, Post Office debits or credits its branch (by means of the TC Process so fully described in the 29 July Paper) so that the onus to prove the counterparty wrong then falls on the shoulders of the impacted branch's Subpostmaster. This is of greatest concern to us in regard to ATM-related and Lottery-related TC Invoices. In the case of the former, the only way that a Subpostmaster (and many of the Scheme's Applicants) can dispute a TC Invoice that has been initiated as a result of Bank of Ireland challenging the Horizon figures is to rely on an ATM print-out produced by the Bank of Ireland's own ATM/system.

We also consider it possible that cheque-processing may also result in entries to Post Office's Suspense Accounts. In that context, here is a quote (paragraphs 14.12. e and f) from Post Office's Reply to our Briefing Report Part Two:

14.12. e. If a replacement cheque is not forthcoming, the relevant client organisation (i.e. the product supplier, say Bank of Ireland, Environment Agency, etc.) is informed that the payment for that particular transaction has not been received and the transaction is reversed where possible. By reversing the transaction the loss to Post Office is avoided.

14.12. f. Alternatively, if Post Office is unable to identify the customer details, the relevant client organisation may be asked to try to contact the customer directly for payment. By payment being made direct from the customer to the client the loss to Post Office is avoided.

In both those paragraphs, the phrase "the loss to Post Office is avoided" refers, of course, to the avoidance of any loss to Post Office itself, rather than the avoidance of any loss to its agent, the Subpostmaster, though the avoidance of a loss to Post Office ought also to mean the avoidance of a loss to the Subpostmaster. The point here is that, in the event that a loss really is avoided (particularly as described in 14.12. f above, where the branch's customer makes a

new payment directly to Post Office's client, then the branch needs to be made whole by being sent a TC Credit Note to offset the earlier-sent, and earlier-accepted, TC Invoice.

Post Office has seen an example of this having happened in the Peter Holloway case (see Case M082 CQR, paragraph 3.25 of which is quoted below... see NOTE) where one of one of Mr Holloway's branch's customers seemingly wrote out a cheque, payable to HMRC, that bounced, resulting in his branch being sent a TC Invoice by Post Office. The customer later seems to have sent a new payment directly to HMRC and yet, Holloway says, he was never reimbursed by Post Office for that original TC Invoice. Clearly, Post Office should, in that case, have sent the branch a TC Credit Note to offset the TC Invoice that it had earlier sent to the branch when the customer's cheque had bounced.

It follows that, during the time that any loss appears likely to become real (i.e. until such time as an incoming credit, for example from a Post Office's client, removes the risk of loss to Post Office) then that amount has probably already been nullified by Post Office having sent a TC Invoice to the branch. Later (perhaps months later), in the event that the loss is averted, such as by the arrival of a credit from the client, then Post Office should send out a TC Credit Note to the already-impacted branch. If, as it seems was the case in M082, that fails to happen, then there is a credit floating around that has to go somewhere. We need to be confident that generally, and specifically in regard to case M082, such 'floating' credit entries do not find their way either into a Post Office Suspense Account or into the Suspense Account of one of Post Office's clients (in the M082 case, HMRC) and later become subsumed into a perhaps quite small net debit or credit entry into Post Office's P&L Account, or into one of Post Office's client's P&L Accounts.

We hope that this email clarifies why we have asked for sight of the Credit entries, derived from Suspense Accounts, that have eventually been written off to the credit of Post Office's P&L Account. We are NOT interested in seeing the DEBIT entries and certainly not any NET entries, only the CREDIT entries. Perhaps you could arrange for us to be given sight of the aggregates of the individual Credit entries for the years 2010 and 2011 and the details of the individual Credit entries that make up those aggregates? The years 2010 and 2011 would cover at least some of the cases with which we are dealing.

I do realise we are raising here rather complex ACCOUNTING and OPERATIONAL, rather than LEGAL, issues so, if you think it would be helpful for us to meet with someone from Post Office's Accounting Team in order to make sure we all understand each other, then we'd be happy to do that.

NOTE:

M082 (Peter Holloway)

CQR: 3.25: "A customer had attempted to pay an Inland Revenue bill. The transaction was processed and the customer left the branch. The cheque later bounced and Mr Holloway was left with a difference. Mr Holloway notes that the individual paid HMRC and then he had to settle the difference". We take the "he" here to mean Mr Holloway.

Second Sight's preliminary notes, in regard to this part of the CQR, said:

"This might be a Post Office Suspense Account Issue if the customer paid HMRC in another way (i.e. after his first cheque had bounced)... in which case, Post Office's reimbursement to HMRC (offset by a TC Invoice that Post Office will have presumably have issued to the branch) would later be repaid to Post Office by its client HMRC (which would, by then, have been paid by the taxpayer/customer) in which case Post Office should have then issued a TC Credit Note to the branch. Did Post Office do that? If Post Office did NOT do that, then HMRC's payment back to Post Office might well have found its way into a Post Office Suspense Account and later been written back to the credit of Post Office's P&L Account when it cleared down its Suspense Account".

Best regards,

Ron Warmington CFE, FCA

Director

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GRO

From: Ron Warmington; GRO
Sent: Wednesday, June 18, 2014 2:45 PM
To: 'Chris Aujard'
Cc: mediation; GRO
Subject: RE: FW: Errors that arise between POL and its clients and others

Chris:

As promised in Monday's Working Group Meeting, the purpose of this email is to state, hopefully more clearly previously, the question that we are asking in regard to the reconciliation and writing off of differences.

The key question that we are trying to address here is: **Could any Subpostmasters have been charged by POL for amounts that became incorporated in suspense account balances that were subsequently taken into profit by POL or by any of its Counterparty Companies, or that remain as credit balances on the Balance Sheet of POL or of any of its Counterparty Companies?**

First of all, what do we mean by "POL and its Counterparty Companies?". We are referring here to Companies or other Entities which POL deals with in regard to products and services delivered at or through its branches. We have seen POL refer to these Companies as its 'Clients'. These will include, for example:

- Royal Mail
- Camelot
- DVLA
- The TV Licensing Body
- Banks such as Alliance & Leicester/Santander and others, including the Bank of Ireland
- A large number of Utility Companies
- Other Government Departments
- ... and possibly hundreds of others

How can differences arise?: Taking say the London Electricity Board (LEB) as an example, if a branch has processed in a day £1,000 worth of customers' electricity bills, that branch will have accounted for those payments through Horizon and POL will then owe the LEB £1,000 and will settle that sum. If one of the bills (let's say one for £90) was paid by cash but the actual bill was not or

could not later for some reason be processed (we have several examples of this happening) then the LEB will not record that customer's bill as having been paid even though the branch took the customer's cash. It follows that, at that point, the customer is down by £90 and the branch is up by £90. All other things being equal, the branch would have shown a £90 surplus on the day if the bill payment failed to be processed through Horizon at the counter, or would be in balance if the bill payment failed at a later stage.

In the event that the bill payment process failed at the branch counter, POL will have overpaid LEB by the £90 that its branch will, in effect, have 'overcharged' the customer. The LEB will then (hopefully) tell POL that it has been overpaid by £90 and will credit POL's account in its books with that amount. When that happens then, at that point, POL (Central) and the LEB are all square but the branch still has its £90 surplus and the customer's bill remains unpaid. POL will then try to re-process the customer's bill and, when it succeeds in doing so, will need to charge the branch the £90 cost of doing that... and of course pay the LEB £90 in settlement.

POL will balance its central books by offsetting that £90 that it has paid to the LEB by sending a Transaction Correction ('TC'), in the sum of £90, to the branch. When that TC is accepted by the branch, it will have the effect of increasing, by £90, the amount of cash that the branch is then meant to have in its tills. All four parties (The LEB; POL; the branch; and the branch's customer) are then all square and, in effect, the branch's £90 surplus has been removed.

The opposite effect occurs when a customer's bill does get recorded as paid, but the non-cash payment (e.g. where a credit or debit card, rather than cash, is used as the method of payment) does not hit the customer's bank account. We have seen many examples of this happening, particularly when power or telecommunications interrupts prevent one side of a transaction from going through, but the other side does go through (the two 'sides' being the bill payment and the LiNK payment).

While all this is going on, there will be balances, made up of the amounts that have been over or under paid, shown in the LEB's books as under or over paid by POL. POL clears these by issuing TCs to its branches. In the event that this process breaks down, a mismatch will occur such that the amount that LEB shows as due from POL will be different from the amount that POL shows as due to the

LEB. In many companies (clients), this will result in unreconciled balances that are held in suspense accounts and that have, in due course, to be written off to (or written back to) that company's Profit and Loss Account. Those write-offs/write-backs would ordinarily (where there are only TWO parties) occur in one or both companies. In POL's case, there are FOUR parties involved (the Client (in this example the LEB); POL itself; the branch; and the branch's customer). Because POL is acting only as an Agent/Intermediary, those write-offs and write-backs will impact only the three parties other than POL.

In this context, we are aware of a situation where a string of payments were mis-routed to a charity instead of to the intended recipient company. We understand that the cause of this was that part of the POL and client company customer reference fields corrupted the beneficiary sort and account code fields in the outgoing payments.

And what of BoI?: In the case of Bank of Ireland, we know that there have been many instances where the actual amounts loaded into or taken out of ATMs (whether dispensed, removed by theft or lost) is different (sometimes by tens of thousands of pounds) from the figures entered into Horizon by the branch staff. The consequence of these differences is that the BoI's figures (as to how much has been loaded or dispensed) are different from POL's. This gives rise to debit or credit adjusting entries made by BoI in its account with POL. POL deals with those adjustments, in the same way as described above, by sending TCs to those branches that it believes have generated the differences. Again, given the huge volumes and complexity, one would reasonably expect differences and disputes to arise practically every day - and we know they do. One would also expect that, until such time as those disputes are resolved, there will be a mismatch between what POL shows it needs to pay to BoI and what BoI shows POL needs to pay to it. Where such disputes cannot be resolved, one or both parties (POL and BoI) will need to write the difference off to, or write it back into, its Profit and Loss Account. Until such time as the difference is written to the debit or credit of BoI's P&L account, it will reside on BoI's Balance Sheet as an asset or a liability. Once again, we understand that POL will have no unreconciled balances to be written off or written back because all differences are zeroed out by the issuance of TCs to its branches. The point remains, however, that the only check and balance as to the numbers notified by BoI are those carried out in the branches, rather than by POL. Second Sight

regards this as a systemic control weakness.

In our experience, the only time when no differences ever surface in account relationships between entities is when one or both parties are not checking the other party's account entries and simply accepts them as being correct.

Furthermore, what we have experienced is that, when such account relationships remain unverified and unchallenged, errors will remain undetected. We have also found that such situations provide a perfect opportunity for fraud since fraudulent entries will routinely (and predictably) remain undetected and consequently always be absorbed by the victim(s). In this case, since POL is not checking BoI's (or its other clients') entries other than by comparing some of them with the figures that the branches have supplied, the checking/verification/investigation processes that would normally be deployed by the second party (in this case POL) devolve to the third party (POL's branches) and to the fourth party (the branches' customers). We know that branches have little or no investigative abilities or resources so the entire process relies on the accuracy - and integrity - of those first and fourth parties. Put bluntly, were erroneous or possibly even fraudulent entries to be passed by any of those first parties (such as Camelot, Royal Mail, BoI, etc.), the impact would pass straight through POL to the victim branch(es). Similarly, we know that, where customers have benefitted from 'one-sided' transactions, not all of them have admitted to their good fortune. Where such customers have benefitted, the SPMR will, under the current process, in many instances finish up suffering the cost.

Chris, you have twice mentioned, in the above context, that Second Sight is challenging Regulated and Audited Entities and that it is unreasonable or unacceptable for us to do that. Our understanding of your reasoning here is that such entities can and should be trusted to produce accurate data. We absolutely reject that notion. History (and our own experience as External and Internal Auditors; as Bank Directors; and as Corporate/Bank Fraud Investigators) has clearly shown us that Regulated and Audited Entities do not suffer materially less error and fraud (including internal/employee fraud) as Unaudited, Unregulated ones. We therefore reject the suggestion that data emanating from such entities can be so heavily relied upon that there is no need to check it.

So... that brings us back to the Question: **Could any Subpostmasters have been charged by POL for amounts that became incorporated in suspense account**

balances that were subsequently taken into profit by POL or by any of its Counterparty Companies, or that remain as credit balances on the Balance Sheet of POL or of any of its Counterparty Companies?

Best regards,

Ron Warmington

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