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## CEO's Report – January 2015

### 1. Introduction to this month's Board and overall strategic priorities

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- We start the new calendar year on firm foundations as we accelerate our turnaround plans. At the heart of this is the work to reshape the business and reduce our cost base. Thanks to the efforts of staff across the organisation, we're now only £13k from our target to find £60m of in-year savings in 2014/15. We also secured agreement to work together with Unite on Business Transformation. And over Christmas the team reached an agreement with the CWU on Supply Chain pay – without prolonged industrial action – and critically agreed a way forward to minimise compulsory redundancy.
- I am pleased to welcome our new CFO, Alisdair Cameron, and Jane MacLeod, General Counsel, both of whom will be part of the new strategic Group Executive which I am introducing from the 1<sup>st</sup> February. This will be complemented by the Executive Team to help me lead the business with clearer accountabilities and to ensure effective decision making at pace. I am also reviewing our executive governance arrangements to better align with our focus on becoming a commercially sustainable business.

#### **Key issues for discussion at this Board:**

- We have three substantive topics for discussion at this Board meeting:
- Firstly, Al will lead an initial discussion on **budget and targets for next year**. Building on the business transformation discussion at the Board in November, we have developed next year's budget with the goal of maintaining the headline operating profit year-on-year, by improving profitability at the same rate at which subsidy is declining. The paper highlights areas where we expect income growth and the expectations of a continuing focus on cost reduction.
- The related paper on the **three-year operating plan** extends the discussion beyond 2015/16 and sets out a proposal to establish a stronger framework for medium-term financial and strategic planning. This is intended to help the business manage its flightpath to commercial sustainability through quarterly reviews by the Group Executive, and to strengthen the culture of financial management across the business. The paper provides an interim update on financial projections which will be further refined ahead of the Board Away Day in June.
- Secondly, I have asked Lesley and Al to provide a paper updating the Board on progress implementing our **IT strategy**. The Board has previously agreed a strategy to transition the business away from its disparate legacy IT systems to a more secure platform, which will meet the evolving needs of our customers and agents and, critically, reduce and variabilise our IT cost base. The paper summarises progress to date and the forward work plan, as well as the significant risks to delivery. Lesley will describe how we are mitigating the risk specifically around exiting Fujitsu as an incumbent supplier as we procure the new Front Office IT platform. The paper also draws out the actions we are taking to improve governance of IT change and integration with the wider business transformation programme.
- Finally, we will be discussing a draft **risk appetite statement** for the business. The statement is an integral part of work to develop our risk management capability to become compliant with the risk elements of the UK Corporate Governance Code by the

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end of this financial year. The various statements attempt to capture our risk tolerances across a range of dimensions and have been refined following very helpful discussions at both the ExCo and ARC. Work is now in hand to embed the statement into business decision making. The ARC approved the statement for discussion and formal adoption by the Board. If adopted, it is proposed that the Board review the statement bi-annually in the first year, and subsequently on an annual basis as part of our normal business cycle.

**2. Commercial and business performance overview**

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**Overall performance**

- As the CFO's Performance Report sets out in detail, December trading was below forecast but showed an improvement on the same period last year. Net income was adverse to budget across all pillars but the focus on cost reduction meant operating profit in the month was favourable to budget, reducing the overall shortfall for the year to date.
- Our focus is now on securing the EBITDAS target of £99m over the next ten weeks. We held a Teamtalk event with the SLT on the 13<sup>th</sup> January to brief them on the latest financial performance and galvanise them and their teams to rise to this challenge.

**Mails initiatives**

- Mails income in Period 9 was £1m ahead of last year, driven by the extra day's trading in Christmas week and supported by the Christmas marketing campaign and Christmas Makers out in branches. In the same period, our Home Shopping Returns grew by 21% over the previous year, reflecting the general growth in on-line sales. It is worth noting that for the same period average on-line retail sales grew by 13%<sup>1</sup> showing that Post Office (with Royal Mail) is gaining a higher share of the returns market than its competitors.
- The focus is now in growing income through Q4. This includes more targeted training for Post Offices who are a part of the guiding coalition by identifying and training poorer performing colleagues in the bottom 1,000 branches. We are also evaluating options for a Q4 Mails campaign to maximise the impact of the small parcel price promotion.

**FS initiatives**

- Banking services continue to perform well and the ongoing positive publicity is helping raising awareness of our services. Another round table with Vince Cable and the banking community has been scheduled at the end of January, providing a further opportunity to discuss how we might expand our partner banking offer on a basis which is commercially sustainable for the Post Office.
- All preparations to launch the Post Office Money Brand have now been successfully completed. Branch literature is using the new brand and the Post Office Money website has gone live ([www.postofficemoney.co.uk](http://www.postofficemoney.co.uk)). At the end of January the nationwide PR campaign will ramp up and the first TV ad will air on February 1st. The new brand is being supported in the business with a renewed focus on learning and development through the launch of the Post Office Money Academy in mid-January.

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<sup>1</sup> Source: IMRG, [analysis of UK online retail?](#)

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- Savings negotiations have now been successfully completed with the Bank of Ireland, which is a helpful underpin for the next financial year.
- POMS, the wholly owned Post Office subsidiary focussing on the sourcing and administration of insurance products was launched on January 1st and started trading successfully.

**3. Other issues and updates**

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**Industrial Relations**

- The CWU's Postal Executive endorsed the 'negotiators' agreement' struck on the 23rd December and put the deal to a ballot of its members in early January. The result of the ballot was a resounding 93.3% 'YES' vote, on a turnout of 64.4%.
- This means that the long-running dispute is now formally settled and we will not need to negotiate on pay in Supply Chain & Admin until shortly before April 2017. More importantly, this confirms the CWU's co-operation on Business Transformation, which has continued apace since the New Year.
- The deal which was agreed with the CWU remained within the mandate agreed with the Board even with the final minor concessions. Four small changes were made in the discussions:
  - an enhancement for short service to VR terms for this exercise only;
  - a lump sum payment of £1,500 paid to staff in Supply Chain after headcount reductions and roster pattern/staffing changes in place;
  - Temporary restitution of RMG reps onto Supply Chain until the end of March (Neil had withdrawn their access from 18<sup>th</sup> Dec) on the basis they help implant the changes and that CWU now enters into a proper and full review of the working relationship we have with them and funding we provide by April;
  - the consultation process has been adjusted to allow for a further 28 days to consider any surplus staff that still exist at the end of a 90 day period if this is required (may be the case in a few cases). But it is acknowledged that we will make staff redundant at the end of that further 28 days i.e. no non-time bound surplus.
- Neil Hayward and the IR team have now started a review of the CWU's union Facility Time, in line with the IR Strategy approved by the Board last year. The aim is to improve relations between our two organisations and to reduce the cost of facility time to the business. The team presented their proposals to CWU Representatives in Bournemouth on 14<sup>th</sup> January and aim to have a new framework agreed by April 2015. Ideally this will be agreed, but we reserve the right to introduce a new framework unilaterally if we cannot get co-operation. Our parallel review with Unite is on track to conclude with an agreement by the end of January.

**Office move to Finsbury Dials**

- Significant work has been undertaken over the last 6 months as we prepare to move out of 148 Old Street. The project remains on track to complete to agreed timescales within the agreed budget, with savings being made on furniture and fit-out costs.

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- The Network Transformation team moves to its new site in Clapham with the first official operational day scheduled to be 23 February. The remainder of our colleagues will move from 148 Old Street to Finsbury Dials in a phased sequence between 9 March and 27 March 2015.
- The focus is now shifting from logistics to staff engagement, and we will begin weekly communication to ensure colleagues are prepared for the move and ready to embrace new ways of working to help us become more agile, collaborative and ultimately more effective. The new ways of working include hot-desking, remote working and greater use of technology and we will draw from lessons built up from the trials over the last 6 months.

**Government Services**

- PayPoint have challenged DWP on the use of the Front Office Counter Services (FOCS) Framework Agreement. They have claimed it is an inappropriate contracting vehicle for POca, on the basis that FOCS does not cater for Banking Services. PayPoint have not challenged the award itself. This has led to a delay in DWP signing the new POca contract with POL.
- DWP have made a “robust” response to the PayPoint challenge and assured us this presents a delay to the process rather than a serious challenge. BIS colleagues share this view and have shared advice from the EU Commission confirming they regard FOCS as a suitable contract vehicle for POca. This risk from a delay is that the £9.8m additional POca revenue negotiated as part of the BAFO for 2014-15 may be at risk. Currently we regard this risk as low but are monitoring the situation daily.
- DWP officials have indicated they expect to enter into formal discussions on the Call-Off Agreement later in January, confirming their intention to continue using the FOCS Call Off Agreement process.

**Sparrow [DN: checking this with Belinda]**

- We have now completed investigations for all of the 106 cases which remain in the Scheme. To date, we have found no evidence, nor has any been provided by either an Applicant or Second Sight, of either faults with the Horizon system or unsafe convictions, and no convictions have been appealed.
- Since last summer we have followed the strategy, agreed with the Board, of operating within the Working Group Terms of Reference whilst taking a less submissive approach. This has, not unexpectedly, resulted in a concerted attempt by JFSA to apply pressure to Post Office to mediate all cases where Second Sight so recommend. Having failed to persuade the Chair of the Working Group that Second Sight alone should determine whether a case should be submitted for mediation, JFSA has enlisted the support of MPs and the media in an attempt to pressurise Post Office into mediating all cases.
- Media interest to date has been limited and is only being closely followed by a very limited number of journalists. Similarly, the story has failed to find any depth of traction with the majority of MPs. We will maintain our communications strategy focussing on providing a measured and proportionate response to key audiences on the central allegation of faults within the Horizon system.
- The Board sub-committee met on the 12th and agreed **XXX (more submissive approach, as well as work to consider wider options?)**

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- We have been invited to a hearing of the BIS Select Committee on the 3rd February, which will be an opportunity to state our case for the formal record. Chris Aujard will provide a verbal update on Sparrow at the Board meeting.

**4. Update on key change programmes**

*We have started to transition to the new roadmap, with some additional programmes now reporting through to the Transformation Committee. This is in order to ensure clear, integrated governance of all Transformational change activity.*

**a) Crown Transformation Programme**

**Status overview:** Most programme targets are being met. 14 to 19 branches will not be franchised under CTP as no suitable partners can be secured. The P&L run rate at March 2015 is forecast to be £2M - £3M loss with a commitment provided to the Board that P&L break even run rate will be achieved by September 2015. The range of mitigating actions to address current P&L income shortfall of £7M are being progressed and are due to mitigate majority of shortfall.

Programme KPIs:	YTD			2014/15 FY	
	Target	Actual	Period	Target	Forecast
P&L run rate	-£6.7m	-£11.7m	Q2	£0m	-£2m to -£3m
Number of branches transformed	287	287	Q3	292	302
Number of branches franchised	70	45	Q3	70	51-56
Customer satisfaction in transformed branches	85%	82%	Q3	85%	85%
Queue time satisfaction	85%	85%	Q3	85%	85%

**Key milestones ahead:**

Milestone	Target date	Current status
All retained branches transformed	By end March 15	On schedule (currently ahead of plan)
70 franchises live	By end July 15	On track to deliver 56. 14 will be retained and not franchised under CTP
518 Self Service Kiosks rolled out	By end Mar 15	On schedule

**b) Network Transformation Programme**

**Status overview:** The programme remains ahead of target for both contracts signed (+396) and branch openings (+330) which gives confidence of achieving the year-end target. In year status is therefore green but overall the programme remains amber due to challenges finding replacements for leavers. Agreeing and communicating a coherent strategy for managing the cliff is a critical activity to be finalised in the spring, with implementation in June 2015. Operator satisfaction, customer satisfaction, opening times and cost reduction targets are all ahead of target and forecast to over achieve year end targets.

Programme KPIs	YTD (P9)		2014/15 FY	
	Target	Actual	Target	Forecast
Contract signed (cumulative)	4,226	4,622	4,800	4,800
Branches Open (cumulative)	3,248	3,579	3,708	3,850
Customer Satisfaction (all branches)	90%	98%	90%	96%
Operator Satisfaction	70%	78%	70%	75%
Average increase in opening hours	40%	70%	40%	66%

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Cost reduction (in-year cumulative)	1,323k	2,089k	2,500k	3,600k
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**Key milestones ahead:**

Milestone	Target date	Current status
4,800 contracts signed	End March 15	At risk, but mitigations in place
3,708 converted branches open	End March 15	On schedule (currently ahead of plan)
Complete first evaluation of guided leavers process	End Sept 14	Complete
Start cliff preparation work	End Oct 14	Discussions started
Updated Business Case	End of Feb 15	On track
Transitional locals – Final Tranche	End of Feb 15	On track
Cliff management – POL Board paper	End of Jan 15	On track
Cliff communications to Postmasters	End of May 15	On track

**c) 'Win in Mails'**

**Status overview:** Royal Mail negotiations remain a critical dependency, and RMG are currently unwilling to make any additional investment in access points over and above the current value of the MDA.

Ivy volumes remain extremely low despite the marketing and communications efforts. This is due to the dispersed nature of the access points, difficulties in including communications in parcels from upstream retail clients and the limited product range. Full details are provided to the Board in the separate Winning in Mails update paper.

Programme KPIs	End December		2014/15 FY	
	Target	Actual	Target	Forecast
New access points	157	158	400	157
Average transaction volume per site	10		30	

**Key milestones ahead:**

Milestone	Target date	Current status
135 access points live	End Sep 14	Completed
400 access points live	End Mar 15	At risk. Recommendation not to proceed with IVY 400 submitted to transformation committee.
Technical solution agreed with PO and RMG	Oct 14	Completed
RMG agreement on final solution and commercials	End Mar 15	At risk
NFSP Full agreement on ND & Cliff / proceed with no agreement (post-election)	May 15	At risk
Mails Trials Partner Contracts Signed	Mar 15	On track
Mails Trials (e.g. regional flood) Independents Contracts signed	April 15	On track
Begin Mails Trials Roll-out	May 15	On track
McColl's Full contract signed	Sep 15	On track
Begin Roll-out BillPay/ePos	Nov 15	On track

**d) Business Transformation (Transition to Delivery)**

**Status overview:** The programme is in a transition phase to establish the foundations and governance to commence delivery from April 2015. TMO Design and operation, Change Resourcing Strategy and Partner Sourcing Strategy are all due to complete by the end of January. An update on the actions raised at the November Board is presented in the parallel paper.

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**Transition Phase Key milestones ahead:**

Milestone	Target date	Current status
Current state assessment complete	End July 14	Complete
Draft Target Operating Model	End Sep 14	Complete
Complete Transformation Blueprint	End Nov 14	Complete
End design phase	End Nov 14	Complete
Governance bodies operational	End Feb 15	On track
Transformation Management Office (TMO) operational	End Mar 15	On track
Delivery programmes operational	End Mar 15	On track
Assess Success Criteria	End Mar 15	On track

**e) Separation**

**Status overview:** The programme is on track to deliver against the revised MSA deadlines. As at the end of Dec 145 (of 352) sites have now been fully separated from Royal Mail onto the Post Office IT Network. The remaining sites are planned to migrate through Q1 2015. The Contact Centre is separated and work is continuing to provide operational support.

Programme KPIs	YTD (P9)		Full programme	
	Target	Actual	Target	Forecast
Separation of IT systems	143	143	256	256
Separation of Business Services	120	120	131	131
Finance – headcount reduction	27.5	27.5	27.5	27.5

NB The team will also be monitoring the number of post-launch incidents for the newly separated systems such as Finance and HR.

**Key milestones ahead:**

Milestone	Target date	Current status
Facilities Management separation	1 Oct 14	Completed
Grapevine separation	1 Oct 14	Completed
eBusiness Migration	En of Feb	On track
HR Common Components separated	End Apr 15	Slipped by two months
BT on boarding to ATOS helpdesk complete	End Mar 15	Slipped by a month
Networks site migration end	Apr 15	On track

**f) IT Transformation**

**Status overview:** The Back Office tower procurement is currently paused whilst we test the plan for accelerating the outsourcing of back office functions, as part of wider business transformation activity. There is a high risk that Fujitsu performance will deteriorate as they are in exit mode, and mitigating actions are being deployed. Key procurement milestones for both the Front Office and Network Towers are due over the next month.

Programme KPIs	YTD		Full programme	
	Target	Actual	Target	Forecast
Towers Contracts Awarded	2	2	5	5
3 <sup>rd</sup> parties transitioned to Service Integrator (SI)	90	90	96	96
SI operating model processes accepted	23	23	23	23
Financial savings	£0	£0	£25m	£25m

**Key milestones ahead:**

Milestone	Target date	Current status
Mid-term opportunities kicked off	End Nov 14	On track
B/O contract awarded	Paused pending alignment with Business Transformation	

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F/O ISFT	End Feb 15	On track
Network ISFT	End Feb 15	On track
F/O Contract awarded	End May 15	On track
Network contract awarded	End May 15	On track
EUC service commences	End Mar 15	On track
Network services commences	End Aug 15	On track
F/O service commences	End Jun 16	On track

**g) People & Engagement**

**Status overview:** Wave 1 activity for managers is progressing in line with the plan. A pensions consultation reviewing DC benefits is up and running.

Work is underway to develop a vision for the transformed business which is compelling for our staff, agents and customers. ExCo and SLT interviews are being conducted in January, and an ExCo workshop will be held on January 26th. The project will also form part of an SLT development day on January 30th, and the outcome of this work will be presented to the Board in March ahead of a business-wide launch.

**Key milestones ahead:**

Milestone	Target date	Current status
Making it easy crowd sourcing in place	Complete	Complete
P&E toolkit in place for supporting change	Complete	Complete
Union agreement for new collective framework	End Jan 15	On track
NFSP new org in place	End Mar 15	On track
Serve notice on current IR framework	End Dec 14	On track
Existing IR framework ends	End April 15	On track
Revised incentives & colleague offers in place	End March 15	At risk
Revised performance management process in place	End Apr 15	On track
Sales capability plans agreed / presented to Board	End Jan 15	At risk
Wave 1 complete	End March 15	On track

**h) Titan**

**Status overview:** a soft launch for renewals started from the 19<sup>th</sup> December, with the full POMS launch taking place on the 1st January. There were no significant issues. Some minor issues were identified relating to the average length of handling times and abandonment rates, and extra staff were recruited to mitigate this.

Programme KPIs	YTD (P7 cum.)		Full programme	
	Target	Actual	Target	Forecast
Contractual relationships in place	13	11	13	13
Systems in place	4	4	6	6
Staff in place	5	5	6	6

**Key milestones ahead:**

Milestone	Target date	Current status
POL Board approve POMS plan	Complete	Done
POL Board approve POMS to trade	Complete	Done
FCA authorisation received	Complete	Done
Initial trading (renewals)	Complete	Done
Live for new business	Complete	Done
Strategic system implemented	End Aug 15	Done

**i) Hawk**



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**Status overview:** We are in the final stages of appointing an Independent Expert to progress the negotiation on the Bank's insurance business (Hawk). We remain confident of achieving the year-end deadline.

Milestone	Target date	Current status
Conclude IE valuation	Jan 15	Subject to delay
Seek PO Board approval to proceed	Feb 15	Contingent on valuation being in POL range.
Sign transaction agreements	Mar 15	
Hawk Implementation programme	Dec 15	

**j) Financial Services Investments and Savings Negotiations**

**Status overview:** Negotiations with the Bank of Ireland continue with BoI rejecting Post Office's proposal on investments. The key points under discussion are: the need for market soundings (going to RFP before any commercial arrangements between both parties); agreeing a delivery model; assessing an alternative structure (linked to Hawk) to exclusivity; and contractual control over Investments.

Savings negotiations for 15/16 have been concluded.

Programme KPIs	2015/16	
	Target	Actual
Incremental increase in net Savings revenues	£0 - £12M	£9m
Investments Negotiations	£0.25m	n/a

**Key milestones ahead:**

Milestone	Target date	Current status
Savings negotiation	End of Q3	Complete
Investments negotiation	End of Q4	On track

**k) Financial Services Sales Effectiveness**

**Status overview:** The Post Office Money Academy launched on the 19 January supporting the wider launch of the Post Office Money Brand. This builds on positive initial results received from the hub and spoke pilots.

**Key milestones ahead:**

Milestone	Target date	Current status
POM Academy Phase 1 launch	Jan 15	On track
POM Academy Phase 2 launch	End Aug 15	TBC
Salesforce Development Web leads	Mid Feb 15	On track
Salesforce Development release 3	End May 15	TBC
Salesforce Development release 3.2	Mid Sept 15	TBC
Technology for Frontline	End March 15	At risk
Hub and Spoke	Mid Feb 15	TBC
Data enablement – PID approved	End Feb 15	On track
Data Enablement – Mortgage Income	End April 15	At risk
Data enablement – FAD codes	TBC	Feasibility stage

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## 5. Market, political and external developments

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- **Retail – Christmas Trading Reports.** In 2014 customers spent £104bn on e-retail, a 14% growth on the previous year. During the Christmas Trading period (2/11 - 27/12) customers spent £21.6bn, an increase of 13% on last year. These rates of growth are being translated into the Home Shopping Returns market which has grown by c8% on last year. Online e-retail now accounts for 24% of retail sales and next year is expected to grow by 12% to £116bn. However, within these numbers are some interesting emerging trends.
  - Whilst the overall Christmas performance is in line with expectation, December trading was only 5% up on last year. This is being linked to the rise of Black Friday which saw 17% of Christmas sales happen in the w/c 23 November, with an estimated £810m being spent on Black Friday (alone the biggest ever day for on line sales).
  - Sales via smartphones and tablet devices recorded a 55% growth on the same period in 2013. £8bn was spent via mobiles this Christmas, compared to £5.1bn last year. 37% of online sales are now made on a mobile device; an estimated 8.9% of total retail sales.
- **City Link entered administration.** The parcel delivery firm, entered administration on Christmas Eve. Administrator Hunter Kelly, of Ernst and Young, said, "City Link Limited has incurred substantial losses over several years. These losses reflect a combination of intense competition in the sector, changing customer and parcel recipient preferences, and difficulties for the company in reducing its cost base."
- **Tesco announces new retail strategy and cost reduction plans to deal with declining sales.** Overall, Tesco sales in Q3 were down 2.9%, a slight improvement on Q2 when sales dropped by 5.4%. Online clothing sales grew by +50% and grocery sales went up 13% over the six weeks leading to Christmas. In response Tesco's new CEO announced the business will close 43 of its unprofitable stores across the UK. Tesco also plans to reduce overheads by 30%, make cuts of £250m, close its final salary staff pension scheme and move its headquarters from Cheshunt, Hertfordshire to Welwyn Garden City. It will further 'remove the fat' by selling Tesco Broadband and Blinkbox to TalkTalk and Dunhumby, the data business behind Tesco Clubcard.
- **BT signals intent for mobile market with exclusive negotiations to buy EE.** BT has decided to pursue negotiations to buy EE for £12.5bn. The sale of the acquisition has raised concerns about the potential control BT will have of Britain's airwaves. Barclay's analysts estimated synergies would be worth £5bn. It is thought BT will use Wi-Fi hotspots, new miniature masts and whole sale deals to use the EE 4G network to undercut rival mobile operators. BT sees negotiations to buy EE as an accelerator for its ambitions in the mobile market and ultimately its quad-play offering.

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**Annex A: Forward Board meetings: overview of the sequencing of discussions on key business strategy issues**

Key agenda items	Description
<b>28<sup>th</sup> January:</b>	
15/16 Budget	Initial discussions on budget, operating plan and targets for next financial year
IT strategy including Fujitsu	Progress update on the IT strategy progress and the relationship with Fujitsu
Cyber Security	Lunch with Tony Smith from the Centre for Protection of National Infrastructure
Risk Appetite	Agree the risk appetite statements and risk rating scores as recommended by the ARC
<b>25<sup>th</sup> March:</b>	
3 year Business plan	Approval of a 3 year business plan
1 year plan and budget	Approval of 1 year operating plan and budget
Scorecard	Approval of 2015/16 scorecard
Business Transformation	Progress update on Business Transformation, cost reduction and run rate for 2015/16
Telephony Strategy	Board update on progress to date and strategic options going forward
<b>21<sup>st</sup> May:</b>	
Annual Report and Accounts	
Performance payments	Approval of STIP and LTIP payments and performance conditions
People and engagement	Roadmap for people and engagement activity for the next 12-18 months
Network update	Network and Channels update including sales capability
Working capital	
Win in Mails	Update on the programme to date and next steps