

Royal Mail Holdings Audit & Risk Committee

**Quarterly Report
September to October 2006
draft**

November 2006

Internal Audit & Risk Management (IA&RM)



Royal Mail - CONFIDENTIAL

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Distribution

Bob Wigley, Non Executive Director, Chair
John Neill, Non Executive Director
Baroness Prosser, Non Executive Director
Helen Weir, Non Executive Director

Royal Mail Group Executive Team

1. Executive Summary

Introduction

This report assists the Audit & Risk Committee (ARC) and Royal Mail Management in discharging their responsibility to assess risks and monitor the effectiveness of Royal Mail's risk management and control environment. It summarises Internal Audit and Risk management (IA&RM) activity and findings from September to October 2006 and presents the results of a variety of risk and control measures including the results from half year Risk and Control Self Assessment exercise.

IA&RM Activity for the Period

IA&RM issued 8 reports in the period, listed at Appendix A. Of these, assurance/risk ratings were applied in 5 cases as follows: 1 was rated as "satisfactory" and 4 were rated as "some improvement required" or "low risk". Appendix C provides an explanation of what the ratings mean. The key report findings are presented in Section 2. Summarised below are findings on key assignments:

1 – The review of Downstream Access (DSA) Contract Compliance was rated as 'Some Improvement Required' with a **Medium** risk at Group level. The review was undertaken at 8 Mail Centres. Key processes have been established to enable the RM Letters Operations and Wholesale teams to prevent, monitor and report instances of customers failing to comply with contractual terms and conditions. Some important aspects of these processes however are not being deployed by the business: a key revenue protection check (J Tools) was not completed in 6 out of the 8 Mail Centres; inconsistent gatehouse checks allowed unauthorised drivers to enter RM sites and at unauthorised times in all 8 of the Mail Centres; unit prices used, when adjustments to customer mail volumes was necessary, were based on averages rather than agreed actual prices; and instances of customer non-compliance were not being escalated by the sites to central control to enable onward reporting to customers. This results in a loss of revenue and increased operational costs. Since the report was issued, 4 of the 30 agreed actions have been completed, and none are overdue.

2 – The review of the People Partnering project – Royal Mail Group (RMG) has issued an Official Journal of the European Union (OJEU) notice indicating their intention to enter into a contract for the provision of Human Resources (HR) processing capability. This includes HR services and an integrated HR system which currently costs approximately £80m per annum representing over 200,000 payees and 500,000 pension scheme members. IA&RM were asked to support the business and have helped identify potential risks for each of the four stages of the project in addition to providing advice and techniques to assist in the recording and treatment of these risks. The most significant risks currently facing the project in the first stage (the selection of an appropriate partner), are: Royal Mail Group (RMG) does not have a clear understanding of its specific requirements; no solution is able to meet the business requirements in full; there are inadequate supporting processes to effectively manage the project; and there is lack of clarity around the respective scopes of the People Partnering project and the Time & Resource Management System project. Each of the above has agreed planned mitigating actions which, if fully executed, will reduce the level of risk for the first stage to **Low**. 6 of the 17 agreed actions have currently been completed, considerable work is in progress to address the remaining actions, and none are overdue.

3 – The review of Performance Management – Although the review indicated that some improvement was required, we assess that there is a **Low** impact at Group level. There was evidence of performance management at all operational levels. Areas were monitoring actual results, determining root causes of failure against target and implementing action plans. However only 3 of the 8 areas reviewed utilised the nationally developed unit scorecards. These formats, although broadly reflecting agreed national measures, were found to have certain omissions or changes to agreed target definitions, and resulted largely from a lack of clarity as to whether the use of the national scorecards is mandatory and a view from area teams that local scorecards better suited requirements. Full deployment and consistent use of national scorecards may be useful in driving further improvements – this is a decision for the business. Network are not covered in the existing performance management process, however work to integrate Network is underway. All actions are currently being completed to agreed timescale.

1. Executive Summary

Overall Perspectives on Risk and Control Environment

An analysis of our findings and available business data regarding the risk and control environment gives these perspectives:

Half Yearly Risk and Control Self-Assessment (RCSA). Section 3.1 provides a summary of half year RCSA process. The RCSA exercise is designed to identify 'bottom-up' risks and provide assurance for the business on key controls using a rolling programme of testing. No new risks were reported for consideration to date that exceed the threshold for group reporting of £20m impact and 30% likelihood over a three year period.

Of the vital few controls (VFC) tested this quarter, two were reported as 'Major Control Weaknesses' as follows:

- the self audit process for Operations Service Standards in RML. Both IA&RM and the Compliance & Audit Specification (CAS) team (who perform independent audits in operational units) found that the self assessments could not be wholly relied upon.
- front line Customer Service in Parcelforce Worldwide. Recent customer surveys have reported low scores. In response new training and information systems are being rolled out for completion by March 2007.

Assessments from specialists in key areas. Section 3.2 presents a summary of some indicators used by the business to assess controls. Areas that have broadly shown improvement include protection of information and mail. Operational compliance is broadly unchanged, with protection of staff, physical security and revenue showing some deterioration.

The implications for the business are customer satisfaction, addressing quality of service failures, capturing all revenues and internal reporting. The business works with affected units to develop action plans to address identified weaknesses and is also reviewing the standards set to ensure that they are appropriate.

Assessing the business response to agreed actions. Section 3.3 provides a summary of the number of outstanding and overdue actions resulting from IA&RM reviews. While the number of actions agreed has increased recently, the number overdue is decreasing. Furthermore, of those overdue, the majority (83%) are medium risk, with only 17% being high risk. This implies that the business has an improved focus on addressing identified control weaknesses.

Revenue Controls. Section 3.4 focuses on the topic of Revenue, and gives an overview of aspects of revenue reviewed by IA&RM over the last 6 months, covering approximately 62% of RM Letters revenue. In the reviews for Revenue Protection (RP) and Mails Verification (MV), issues identified included adherence to processes, integrity of the risk model, and effectiveness of performance against standards. The measurement of the Stamp & Meter revenue gap continues to show a worsening position, with the gap now standing at 10.2% (equivalent to £239m revenue), the highest for 2 years.

As has previously been reported, the implications for the business are that account revenues are not being thoroughly and comprehensively monitored, and therefore the business is not being paid in full for the services provided. The Stamp & Meter revenue gap is a symptom of the quality and integrity of source stamp and meter data, namely operational traffic volumes, Mails Characteristic Survey (MCS) results, average unit revenue prices, and the recording of revenue.

Release 1 of the Online Business Account (OBA) Programme has deployed a new system for RP and MV to use, namely SAP QM. This model has improved the weaknesses identified in the IA&RM reviews and actual revenue recovered is increasing. Traffic Performance Managers are working with the National Traffic compliance team to review the measurement of traffic and MCS across operational sites.

2. Key IA&RM Activity in Period

2.1. Review of Downstream Access (DSA) Contract Compliance

BACKGROUND: Under Condition 9 of the Licence granted by the Postal Services Commission (PostComm) to Royal Mail (RM), other postal operators and customers can access RM's postal facilities. Under these arrangements, Downstream Access (DSA) customers deliver mail to the inward Mail Centre (MC) for onward processing by RM Letters. It is a condition of RM's licence that mail received under an access contract is treated in the same way as that from RM's own customers (Condition 11). As a result, operating procedures have been developed to ensure consistent treatment. In 2005/06, RM delivered 1.1bn items of mail under access arrangements, with volumes forecast to grow to 3bn in 2006/07.

OBJECTIVE: The overall objective of the review was to assess whether RM is providing services to DSA customers in accordance with their contract and that such services are being provided in a non-discriminatory way. Specifically, to ensure that: for all DSA customers, an agreed contract was in place; the pre-advice (volume forecast) was received in accordance with contract terms; access to RM premises and handover of mail was in accordance with the contract terms and RM procedures; mail received was checked in accordance with RM procedures; mail was processed in accordance with contract terms and RM procedures; returns, missorts and redirections of DSA mail were processed in accordance with the contract terms and RM procedures; the actual volume of mail processed was billed and charges were made in accordance with contract terms; non-compliant practices at every level were escalated centrally and necessary action was taken, including communication to the customer; and customer feedback was handled in accordance with contract terms and RM procedures.

AREA CONTROL ENVIRONMENT: Some Improvement Required. The access and revenue protection (RP) processes are inconsistently deployed. Key management information to assess levels of compliance to contract terms by RM and customers is not complete.

GROUP IMPACT: Medium. The Group is exposed to a medium level of risk if the actions identified in this report are not implemented. Loss of revenue and increased operational costs are incurred due to non-compliance with RM stated procedures.

CONCLUSION: The review was undertaken at 8 Mail Centres. Key processes have been established to enable the RM Letters Operations and Wholesale teams to prevent, monitor and report instances of customers failing to comply with contractual terms and conditions. Some important aspects of these processes however are not being deployed by the business: a key revenue protection check (J Tools) was not completed in 6 out of the 8 Mail Centres; inconsistent gatehouse checks allowed unauthorised drivers to enter RM sites and at unauthorised times in all 8 of the Mail Centres; unit prices used, when adjustments to customer mail volumes was necessary, were based on averages rather than agreed actual prices; and instances of customer non-compliance were not being escalated by the sites to central control to enable onward reporting to customers. This potentially results in a loss of revenue and increased operational costs.

UPDATE: Four of the scheduled actions are fully complete. The remaining actions are very heavily focused on providing additional training on existing processes, and new recording and monitoring processes to identify non compliance.

Importance	No of actions	Completed	By Dec 06	By Mar 07	By Jun 07	By Sep 07	By Dec 07	By Mar 08
High	8	4		4				
Medium	22	0	4	14	4			

2. Key IA&RM Activity in Period

2.2. People Partnering

BACKGROUND: In June 2006 Royal Mail Group (RMG) issued an Official Journal of the European Union (OJEU) notice indicating the intention to enter into a contract for the provision of Human Resources (HR) processing capability, including HR services and an integrated HR system. The objective of the People Partnering project is to identify and enter into contractual terms with a partner that provides for: enhanced capability to run end-to-end HR processes; the financing, building, implementation and operation of an HR system to replace 18 legacy systems; employee and manager "self-serve" functionality; and provision of knowledge and skills that will enable managers and team leaders to obtain the maximum benefit from the system. All business units except GLS and RoMEC are impacted, representing over 200,000 payees and 500,000 pension scheme members. There are four stages to the Partnering Project namely (1) selection of appropriate partnering arrangements (i.e. partner, technical solution and the partner's commercial proposition), (2) effective contract negotiation, (3) successful implementation and (4) sustaining benefits. These are supported by effective project management. The current plan anticipates that a partnering contract will be in place by December 2007.

OBJECTIVE: The three objectives are to: (1) provide an assessment of the risks relating to the current stage of the project, namely selection of appropriate partnering arrangements, and effective project management to the extent that it supports this outcome, together with agreed mitigating actions; (2) identify potential risks to the three future stages; and (3) provide advice and techniques, drawing where appropriate on external sources, to assist in the recording and treatment of risks to current and future stages, such as additional selection criteria and a mechanism to assess the quality of the partnership arrangement.

CONCLUSION: It is recognised that because of the size and complexity of the project, it is inherently high risk. The most significant risks currently facing the project in the first stage (the selection of an appropriate partner), are: Royal Mail Group (RMG) does not have a clear understanding of its specific requirements: if there is a lack of clarity in RMG, potential partners cannot be clear; no solution is able to meet the business requirements in full (this was also noted in an earlier IA&RM report); supporting processes are not adequate to effectively manage the project; and there is lack of clarity around the respective scopes of the People Partnering project and the Time & Resource Management System project. Each of the above has agreed planned mitigating actions, which if fully executed will reduce the level of risk for the first stage to **Low**.

Risks to future project phases may emerge at or in advance of the contract negotiation phase, implementation phase or in sustaining business benefits beyond implementation. External evidence provided by Deloitte shows that cost creep, service deterioration and reduction in innovation are commonplace once contracts are in place. Many of the potential risks at future stages will be mitigated if RMG engages in a genuine partnership, characterised by a collaborative rather than adversarial way of working. However, the outcome of the arrangement is most likely to be a traditional one of customer-supplier. If so, mitigation of future risks is more likely to rely upon effective supplier management underpinned by a strong contractual relationship management.

UPDATE: Six of the agreed actions have been completed with considerable work in progress to address the remaining actions.

Importance	No of actions	Completed	By Dec 06	By Mar 07	By Jun 07	By Sep 07	By Dec 07	By Mar 08
High	8	2	5	1				
Medium	9	4	3	2				

2. Key IA&RM Activity in Period

2.3. Review of Performance Management – Royal Mail Letters

BACKGROUND: Royal Mail (RM) Letters Operations undertakes a performance management process that utilises a series of “scorecards” at area and unit level. The scorecards record performance across a range of shareholder, customer and employee key performance indicators, chosen to support the overall RM Letters business plan. Although comprehensive use of the nationally developed scorecards at unit level was not communicated as mandatory, there is an expectation that any local practices are consistent with the national approach. This includes a full assessment of unit performance against targets at least quarterly, with root cause reasons for failure to achieve targets identified, and remedial activity implemented.

OBJECTIVE: Provide assurance over the robustness of operational performance management procedures. Specifically, to ensure that: performance management procedural guides / tools were readily available, and were understood by operational managers; performance management scorecards were aligned to key business objectives; operational managers complied with performance management monitoring and forecasting requirements; corrective actions were undertaken where performance fell short of target, and performance forecasts were supported by operational activity; and effective escalation procedures existed to identify and remedy continued performance shortfalls. The review included both operational areas and Network units, focusing on performance management activity at area and unit level.

AREA CONTROL ENVIRONMENT : Some Improvement Required. Some area level scorecards had omissions /changes when compared to national targets.

GROUP IMPACT: Low. Although locally developed scorecards were often used in preference to the national versions, there was clear managerial commitment to effective performance management. However, full deployment and consistent use of national scorecards may be useful in driving further improvement, and a business decision is required as to whether use of the scorecards should be mandatory. IA&RM consider the risk of not achieving business objectives through inadequate performance management within operational areas as Low.

CONCLUSION: There was evidence of performance management at all operational levels. Areas were monitoring actual results, determining root causes of failure against target and implementing action plans. The requirement for effective performance management was fully understood by managers and reviews of area and unit performance were being undertaken on a monthly basis, with remedial activity planned or in progress where performance failed target. The use of standard performance measures is seen as a powerful tool to improve business performance at unit, area, and national level.

However only 3 of the 8 areas reviewed utilised the nationally developed unit scorecards. The remaining areas had developed their own scorecard formats. These formats, although broadly reflecting agreed national measures, were found to have certain omissions or changes to agreed target definitions and were dependent upon the direction given by the area senior management team. Use of these locally developed scorecards has resulted largely from a lack of clarity as to whether the use of the national scorecards is mandatory and a view from area teams that local scorecards better suited requirements. Network are not covered in the existing performance management process.

UPDATE: Work to integrate Network within the formal performance management process is underway, and the incorporation of automation related measure(s) in scorecards will improve the alignment to RM Letters business objectives. Performance management guidelines will be updated and will clearly indicate which aspects are mandatory.

	No of actions	Completed	By Dec 06	By Mar 07	By Jun 07	By Sep 07	By Dec 07	By Mar 08
High	2	0		2				
Medium	2	0	1	1				

Overall perspective on the Risk and Control Environment

3.1. Risk & Control Self Assessment

The business operates a bi-annual Risk & Control Self Assessment (RCSA) exercise to provide reasonable but not absolute assurance that it is effectively managing its key risks. It includes the results of the business' Vital Few Controls (VFCs) programme as reported by Business Units & Functions (BU/Fs). VFCs cover actions by management to mitigate key inherent business risks as well as controls over core 'business as usual processes'. Separately the business is also required to bi-annually report any new potential risks of Group significance. The corporate threshold for upward reporting is risks of greater than £20m impact and 30% likelihood over a three year period (after taking existing actions and controls into account).

The VFC position as at half year is set out in the table below:

Business Unit or Function	Half Year Vital Few Control Status Report				
	Number of VFCs	Number tested in 06/07	Status of VFC design & deployment (as at last validation)		
			Satisfactory	Minor Weaknesses	Major Weaknesses
Royal Mail Letters	16*	4	7	6	1
Post Office Limited	14	0	7	7	0
Parcelforce Worldwide	12	4	8	3	1
Corporate Functions	tbc				
Technology	6	0	3	3	0
Property Holdings	14	2	11	3	0
Totals					

* Letters have identified three new VFCs in 06/07. The control status of two of these is pending subject to initial testing work.

Areas of major control weakness:

Letters – 'Operations Service Standards'. This follows work by IA&RM which concluded that the control environment around the self audit process was 'Not Satisfactory'. Actions to address this are due for completion by January 2007 and are subject to an electronic solution being developed by CSC.

PFW – 'Front Line Customer Service'. Recent customer surveys have reported low scores. In response, new training and information systems are being rolled out for completion by March 2007.

New/emerging risks of Group significance

At the half year there are currently no new/emerging risks being reported by the business units as meeting the corporate risk threshold. In some cases formal MD sign off is pending and, since this is a dynamic process, there remains the possibility that new/emerging risks could still be escalated to the CRMC and the Group Executive Team in November 2006 for possible inclusion on the Corporate Risk Scorecard.

andrew.lovell:

Activities on Risk and Control Environment in Specialists in Key Risk Areas

A summary of the assessments provided by specialists in key risk areas is presented below. (see Appendix D for further detail)

Assessment Area	Illustrative Indicators		Improving / Deteriorating
Protection of Information	Group	Number of portals lost/stolen	↑ ⇄
	Group	Number of virus attacks to our systems	
Protection of Mail	RML	The number of reported mail items lost	↑
Operational Compliance	RML	Percentage of Offices passing the Compliance & Audit Specification Team's audits	↑ ⇄
	POL	Percentage of Compliance - Regulatory Requirements	↑ ⇄
	POL	Percentage of Compliance - Financial Controls	↑ ⇄
	POL	Percentage of Compliance - Information Security	↑ ⇄
Protection of Cash	POL	Average loss from Post Office Branches audited	↓
	POL	Value of Post Office Network losses resulting from burglary / robbery	↑ ⇄
	POL	Value of Post Office Cash in Transit attack losses	↓
Protection of Staff	RML	The number of attacks on Royal Mail staff	↑
	POL	Percentage of Post Office Ltd robberies where firearms are carried	↓
Physical Security	RML	Percentage of compliance from the physical and procedural audits	⇄
	RML	Percentage of compliance from "Unattended Mail Initiatives" reviews	↓
	RML	Percentage of compliance from "Trojan Horse" visits	↓
Protection of Revenue	RML	Revenue Protection - percentage of risk model samples performed	↓
	RML	Mails Verification - percentage of mandatory and risk model samples performed	↓
	RML	Revenue recovered by Revenue Protection and Mails Verification	↓
	RML	The stamp and meter revenue Gap	↑

The table illustrates the movement in assessment results compared to equivalent period last year. Where no prior year value is available, the arrow is shaded yellow and the movement relates to prior quarter for this year.

The items to highlight are compliance to operational standards particularly in Letters with 49% of Delivery Offices failing, physical security in Operations, and protection of revenue.

Key:

Broadly Improving (Against PY) or stable

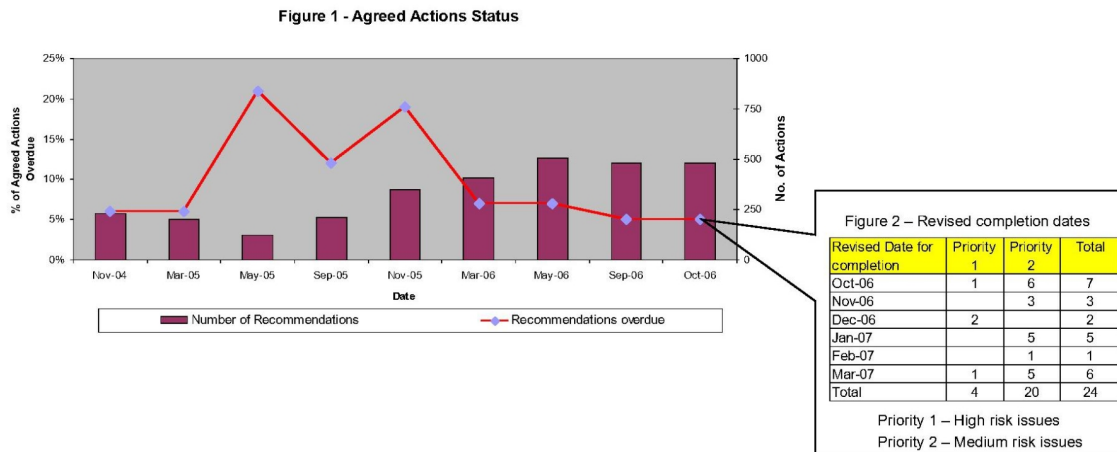
Broadly Deteriorating (Against PY) or continuing concerns

3. Overall Perspectives on Risk and Control Environment

3.3 Assessing Business Response to Agreed Actions

The ARC and the Group Executive Team (GET) have placed emphasis on the Group taking effective action in respect of issues identified in audits and other reviews.

A summary of the status of agreed actions is outlined in Figure 1 below. It shows that as at October 5% (September: 5%) of the agreed actions due for implementation in the year were overdue at date of this report. Figure 2 details the revised timetable for completion of the 24 outstanding actions, of which 83% are Priority 2 (Medium risk).



3. Overall Perspectives on Risk and Control Environment

3.4 Royal Mail Letters – Revenue Streams and IA&RM Activity

Figure 1 - Analysis of 2005/06 Revenue

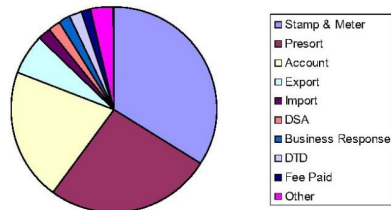


Figure 2 - Analysis Revenue Leakage

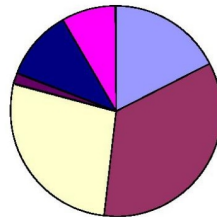


Figure 3 – IA & RM Assignments across RML revenue

Royal Mail Letters Revenue	Auditing Rating	Group Project	% of Revenue	Stamp & Meter	Presort	Account	Export	Import	DSA	Business Reply	DTD	Fee Paid	Other
Proportion of 2005/06 revenue (%)				34	26	21	8	2	2	2	2	1	4
Proportion of Revenue Leakage %				18	34	28		2				10	8
IA&RM assignment			82										
Revenue Management process	SIR	LOW	59										
Deployment of Revenue Protection Processes (See Note 2)	NS	MED	21										
Deployment of Mails Verification Processes (See Note 2)	NS	MED	26										
Review of compliance with the published Royal Mail Credit policy	SAT	LOW	59										
Deployment of Downstream Access operational processes	SIR	MED	2										
Maximising the Contribution from Free Paid Products	-	-	1										
International Mail Revenue protection	NS	MED	8										
Online Business Account	-	ACC	49										

Rating Key SIR - Some Improvement Required

SAT – Satisfactory NS - Not Satisfactory

ACC – Acceptable Med - Medium

The purpose of this section is to give the Committee a “deep dive” into Revenue and revenue losses, including analysis of IA&RM activity in the area last 6 months.

Figure 1 details the RML 2005/06 revenue. The Corporate Risk Analysis published in June 2006 for Revenue Leakage identified sources of revenue leakage totalling £120m (Figure 2). Between February 2006 and August 2006, reviews across processes and projects impacting RML revenue have been completed (Figure 3). These reviews have covered the equivalent of 62% of 2005/06 revenues with a key focus being revenue protection.

Note 1 Stamp & Meter Revenue Management: The 12-month rolling Stamp & Meter revenue gap trend at 30 September 2006 has risen to 10.2% (£239m), the fourth consecutive increase and the highest for 2 years. Work is underway with the Areas to ensure they are providing the same standard of sampling and traffic checks as in prior periods. Investigations into the differences between accounted for revenue and operational traffic volumes is continuing.

Note 2 Protection of Revenue: Revenue recovered by Revenue Protection (RP) was £3.9m for the 5 months ended 31 August 2006 (2005/06: £4.7m). For RP, in period 5, only 22% (target: 75%) of the customers identified by the SAP QM risk model as requiring sampling were sampled, with none of the 68 Mail Centres achieving the target.

Revenue recovered from Mails Verification (MV) was £14.2m for the 6 months ended 30 September 2006 (2005/06: £11.4m). For MV, 92% (target 100%) of all mail received was sampled. Only 76% (target 90%) of the mandatory checks were completed.

Online Business Account (OBA) Programme have deployed a new system for RP and MV (SAP QM) which has much improved the control weaknesses identified in these areas. This new system supports increased targeting of RP and MV resources to the high risk postings. Adherence to the new standards is currently below agreed targets as detailed above. Release 2 of OBA will migrate customers to electronic sales orders which will eliminate approximately 5.5m paper dockets and therefore help reduce revenue leakage.

3. Overall Perspectives on Risk and Control Environment

3.5 Whistleblowing Statistics

The employee disclosure (often called 'Whistleblowing') policy enables employees to raise concerns about inappropriate behaviour (e.g. behaviour linked to criminal activity, fraud, conflicts of interest or health and safety breaches). The Employee Disclosure Policy concerns those occasional situations where a person feels that they are unable to use the standard routes for reporting their concerns without compromising their position or the matter is so serious that it needs escalating to a senior level of management.

Table 1 – Number of Whistleblowing reports raised

Type of crime	April	May	June	July	Aug	Sep	Total	Offenders
Mail offences	10	14	13	17	9	10	73	19
Fraud	3	2	5	6	1	1	18	3
Immigration	0	0	0	0	0	1	1	0
Character	0	0	2	0	0	0	2	0
Theft other	0	4	0	3	3	1	11	5
Computer	0	0	0	0	0	0	0	0
Suspicious activity	0	0	3	0	1	0	4	0
Drugs	0	0	1	0	0	0	1	0
Other	1	4	1	0	2	0	8	0
Total	14	24	25	26	16	13	118	27

Table 1 details the cumulative number of Whistleblowing reports raised to 19th September 2006.

The cumulative number of incidents reported (118) are broadly comparable to the corresponding period last year (123). However, the number of incidents reporting mail offences has increased by 16% compared to last year.

All statistics for offenders relate to individuals who have been removed from the Business whether prosecuted or not. The percentage of offenders to reported incidents in 2006/07 is 23% compared to 26% for the financial year 2005/06.

4. Other IA&RM Activity to Support Business Improvement

In the current quarter IA&RM have continued to work proactively to support the business in improving the risk and control environment. Examples include:

Review of Atos Origin (Atos) contract performance data: The current term of the Atos contract expires in July 2007; however, a clause entitles Atos to either enter into an obligatory 2 year extension, if agreed performance criteria are achieved, an optional extension up to 3 years or a 3 month notice period in the event of termination. The review provided assurance that the source(s) of monitoring data were accurate and that reliance could be placed upon the reported performance standards.

End User Computing – Review of the Control Framework of a sample of User Developed Applications: The functionality contained within desktop software enables Royal Mail users to develop fairly sophisticated IT systems (e.g. intranet applications, database products and complex inter-related spreadsheet systems). The output of the review provides the business with a better understanding of the typical levels of controls within these systems, an awareness of the more common areas of weakness and an understanding of the level of risk the business faces in this area. We assess that the risk at Group level is Low.

ACL duplicate payments: Each year RMG makes payments to vendors worth approximately £2.4bn through its accounts payable function. The audit last year used Computer Aided Audit Techniques (CAATs) to electronically scan data downloaded from SAP ESFS for 2003/4 and 2004/5 which identified duplicate payments amounting to £635k, of which £580K has been recovered by Accounts Payable staff. This year, a joint piece of work is being undertaken between IA&RM and Accounts Payable to perform tests on data for 2004/5 and 2005/6.

HR Infinium Data Integrity: Following the review of People & Organisational Development (P&OD) Enterprise IT in January 2006, IA&RM were requested to regularly re-perform data integrity tests on data contained in approximately 180,000 employee records held on the HR Infinium system. CAATs were used to scan data downloaded from HR Infinium, which identified a small number of records that appear to be invalid or require further review. These findings are currently under investigation by Group Technology.

Review of the level of risk embeddedness: In order to improve risk management within the organisation, a review was undertaken to obtain views from senior management and the risk professionals.

5. IA&RM Current and Planned Activity

The table below shows key areas of current and planned IA&RM activity for the remainder of this financial year to provide ARC with a view of likely topics over the year, and the opportunity to assess the extent to which the planned activity remains relevant to current key priorities. The table also highlights those assignments underway or planned and which are of highest potential significance to the Group.

	Assignment	Planning	Fieldwork	Draft	Major Reviews	Target Issue
	Road Transport Directive					Qtr3
	End to end regulation review					Qtr3
	Restrictive Practices					Qtr3
	Health & Safety - Business Unit implementation					Qtr 3
	Mails integrity: Security				Yes	Qtr 3
	Mails integrity: Recruitment Vetting					Qtr 3
	Time Recording Management System (TRMS)					Qtr3
	Strategic projects - Automation				Yes	Qtr3
	Project Breakthrough					Qtr3
	Instant Saver Product Review				Yes	Qtr 3
	Leavers process					Qtr3
	Strategic projects - Walk sequencing				Yes	Qtr3
	Strategic projects - Delivery best practice				Yes	Qtr3
	Group Compliance Framework				Yes	Qtr 3
	Commercial Servicing of Customers					Qtr4
	HWDC Operational					Qtr4
	Traffic Measurement (follow-up)					Qtr4
	PFWW Customer payments					Qtr4
	Sales Tender Process					Qtr4
	Horizon New Generation					Qtr4
	Environmental sustainability					Qtr4

Appendices

Reports Issued in Period

APPENDIX A

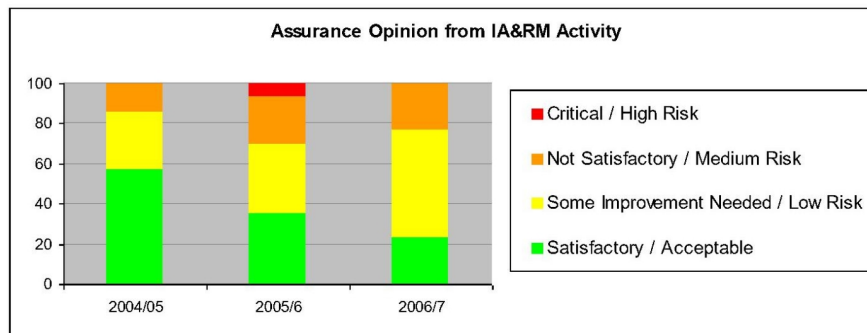
Date	Report No.	Report Title	RM Letters (only)		Other (Incl. Group wide)	
			Audit/Risk Rating	Group Impact	Audit/Risk Rating	Group Impact
Sep-06	06.063	Review of ATOS Contract Performance Data			Satisfactory	Low
Sep-06	06.080	BBC Licence Stamp Withdrawal			N/A	N/A
Sep-06	06.069	Network re-invention			N/A	N/A
Sep-06	06.032	Review of Performance Management	Some improvement req	Low		
Oct-06	06.031	Downstream Access (DSA)	Some improvement req	Medium		
Oct-06	05.038	End User computing			Some improvement req	Low
Oct-06	06.109	HR Infinium Data Integrity			N/A	N/A
Oct-06	06.057	People Partnering: Managing Risks (Rating relates only to the first stage of the project)			Low	N/A

See Appendix C for a definition of ratings used.

Trend in IA&RM Report Ratings

APPENDIX B

The chart below provides a long term comparison of the proportion of ratings issued in each year. Although the proportion of assignments rated satisfactory has decreased since 2004/05 this does not necessarily indicate a worsening in the overall control environment. It reflects the continuing and increased focus of IA&RM on the areas of the Business where risks are considered to be high.



Explanation of Report Ratings Used

APPENDIX C

AUDIT RATINGS				FOLLOW-UP ASSIGNMENTS:		RISK ASSESSMENTS:	
CONTROL ENVIRONMENT:		GROUP IMPACT:		Rating	What it means	Risk assessment	What it means
Area Control Environment Rating	What it means	Group Impact Rating	What it means A separate assessment is performed for the Group impact based on significance to the Business				
Satisfactory	Generally, no or few weaknesses identified	Low	The impact to the Business of any control failure in this area is low. Generally, findings aimed at improving Business Unit processes.	Fully implemented	90%-100% of agreed actions have been completed	Acceptable	Completed and planned actions should reduce any identified risks to an acceptable level
Some improvement required	Matters arising are of sufficient significance to require action, e.g. some policy non-conformance	Medium	At the Group Level of materiality, the risk to the Business is medium. Findings of strategic nature for a Business Unit with an effect on the Group position.	Partially implemented	50%-80% of agreed actions have been completed	Low	Completed and planned actions should reduce most identified risks to an acceptable level
Not satisfactory	Matters arising are of sufficient significance to require immediate action, e.g. widespread non-conformance			Minimal implementation	20%-49% of agreed actions have been completed	Medium	Completed and planned actions should reduce some identified risks to an acceptable level
Critical	Most serious matters, e.g. major system breakdown or threat of breakdown	High	The Group is exposed to a high level of risk. Findings of strategic relevance to the Group.	No Progress	Less than 20% of the agreed actions have been completed	High	Completed and planned actions will not effectively manage significant risk

Evidence from Assessments in Specialist Risk Areas**APPENDIX D**

Information provided by other assurance providers within Royal Mail (RM) can be a very useful in helping to assess the overall level of control in the business. RM is inherently vulnerable to loss of assets, misuse of information and damage to brand and reputation. This is due to the scale and profile of the business, and the nature of the core business processes. The summary provides key assurance providers' information and findings on the key activities cumulative to period 6 (September 2006) unless otherwise indicated. On Audit & Risk Committee request, we also give some information on prosecutions arising from discoveries of wrongdoing.

Group Wide

Protection of Information: Incidents of portal loss/theft in the 6 months ended 30 September 2006 totalled 25 compared with 26 in the same period last year. Mobile phone loss/thefts in the 6 months ended 30 September 2006 numbered 97 (2005/06: 107). In the 6 months ended 30 September 2006 the number of virus attacks to systems are substantially down in comparison with the same period last year, with 703 (2005/06: 4,839) end user virus calls made to the helpdesk; 28,727 (2005/06: 332,713) viruses detected by the server virus guard and 16,731 viruses (2005/06: 120,222) blocked by anti-spam measures.

Taking Action – Prosecutions: In the 6 months ended 30 September 2006 there have been 267 prosecutions (2005/06 full year: 723), both internal and external offenders, of which 220 prosecutions have been successful. Of the successful prosecutions, 73 (33%) resulted in custodial sentence compared with 32% for the full year 2005/06.

Letters

Operational Audits: No central records are held of mandatory operational self-audits. However, a computerised systems is currently being introduced to record the information, but the go live date has been delayed until January 2007. The Compliance & Audit Specification (CAS) Team performs independent audits in operational units to ascertain performance. The following table shows the CAS Team's assessments:

	6 months cumulative to 30 September 2006			
	Pass	Amber pass	Amber Fail	Fail
No of audits	100%	90%-99.9%	85%-89.9%	<84.9%
Mail Centre	28	1	14	3
%		4%	50%	11%
Delivery Office	712	64	296	352
%		9%	42%	49%

Top three impacting Delivery Office questions cumulative to September 2006 were:

1. Are the offices staffing and control mechanisms robust? 52% (370/712 failed)
2. Are all special delivery items processed, delivered and recorded on RMGTT on the day of receipt? 47% (333/712 failed)
3. Was the Delivery Office Daily Report (DODR) made to time and accurately recorded? 16% (117/ 712)

The top three impacting Mail Centre questions cumulative to September 2006 were:

1. Were all collections covered and arrive in the Mail Centre to time? 43% (12/28)
2. Were all checks on presentation and quality undertaken? 43% (12/28)
3. Were all due presentation and segregation standards maintained? 39% (11/28)

Evidence from Assessments in Specialist Risk Areas

APPENDIX D

Letters (continued)

Protection of Mail: Mail loss incidents for Letters and Parcelforce Worldwide total 707 for the 6 months ended 30 September 2006, down 50% compared with the same period last year. The number of items was substantially reduced at 118,637 for the 6 months ended 30 September 2006, down 69% on the corresponding period last year. The four main types of external theft are theft from trolleys (20%), theft from drop off points (16%), theft from vehicles (15%) and theft from cycles (14%). In the 6 months ended 30 September 2006, there have been 195 (2005/06: 217) cases of criminal damage.

Protection of Staff: In the 6 months ended 30 September 2006, 61 people have been injured (3 seriously) in a total of 166 attacks on Royal Mail staff. There were 249 attacks in total for 2005/06, and if this year's trend continues then the total number of attacks will exceeds last year's number.

Security: 92% (92% full year 2005/06) of the offices visited during announced physical and procedural security reviews were compliant in the 5 months ended 31 August 2006. However, only 69% of offices visited in the 6 months ended 30 September 2006 (83% full year 2005/06) as part of the "Trojan Horse" exercise were compliant. "Unattended Mails Initiative" patrols, measuring compliance with delivery and vehicle security procedures, has shown an improvement in cumulative results, with 45% (52% full year 2005/06) of offices being compliant for the 6 months ended 30 September 2006. These results have implications for Mails Integrity.

Evidence from Assessments in Specialist Risk Areas

APPENDIX D

Post Office Limited

Protection of Cash: Network cash losses from burglary/robbery are slightly higher than in previous years with losses to 30 September 2006 totalling £0.74m (2005/06: £0.72m), although the number of incidents in the same period has risen to 259 (2005/06: 236). The percentage of successful attacks (from perpetrator viewpoint) was 16% for burglaries and 47% for robberies. Firearms were carried on 45 (2005/06: 50) occasions, with one firearms discharged in September. Cash in Transit (CIT) attack losses are down in 2006/07 at £0.24m (2005/06: £0.40m), and the number of attacks has reduced by 4%, to 44 (2005/06: 46). Only 64% of the robbery and theft attacks were successful. To date, 14 attacks have caused minor injuries but there have been no instances of major injuries requiring hospital attention.

Financial Reviews:

	5 months ended 31 August 2006	5 months ended 31 August 2005	% LY
No. of Audits	617	756	-18%
No. Branches with loss	418	519	-19%
% Branches with loss	68%	69%	
Cumulative loss £(000's)	2,229	1,622	37%
Average loss £(000's)	5.3	3.1	71%

Financial Reviews: There have been 21 (2005/06: 17) losses greater than £25k, including 3 (2005/06: 2) over £100k. The percentage of branches with acts of dishonesty is 8% (2005/06: 4%), with the value of dishonest acts accounting for 31% (2005/06: 13%) of the total value of losses. Moreover, the percentage of branches with unexplained losses has increased significantly to 72% (2005/06: 40%) accounting for 52% (2005/06: 58%) on the total value of losses.

Compliance Reviews:

	5 months ended 31 August 2006		5 months ended 31 August 2005	
	No. Branches tested YTD	YTD Branch Conformance	No. Branches tested YTD	YTD Branch Conformance
Core Tests	No.	%	No.	%
Regulatory Requirements - Combined	505	90.8	690	85.2
- Anti Money Laundering	504	84.5	690	80.8
- Post Office® financial services	503	94.4	690	88.5
- Travel Insurance On Demand	501	90.6	584	91.1
- Mails Integrity	496	94.9		
- HomePhone	464	81.5		
- Restrictions Policy	306	99.0		
Financial Controls	501	95.8		
Information Security	570	87.2	703	92.7
Procedural Security - Top 10 controls	501	91.8		

Compliance Reviews: The top 3 failing questions for regulatory compliance checks, together with percentage of non compliant branches, were:

1. Copy of the Post Office Home Phone Code of Practice not to hand, 52%
2. Staff unaware of new process for recording customer ID, 20%
3. There were insufficient supplies of P4677 to hand, 16%

The top 3 failing questions for Financial Controls were:

1. Daily payment advice not to hand, 62%
2. Remittances awaiting collection not included in previous night's cash declaration, 21%
3. ONCH not listed accurately and/or cash denominations incorrectly listed, 15%

The top 3 failing questions for Procedural Security were:

1. Hostage policy not known, 32%
2. Cash held on counter exceeded 1 – 1.5 hours usage, 32%
3. CCTV and/or 35mm cameras signage is not prominently displayed, 32%

The top 3 failing questions for Information Security were:

1. PIN and PMMC were not held separately, 26%
2. Obsolete users had not been deleted from the Horizon system, 32%
3. Horizon system user names were not in the correct format, 32%