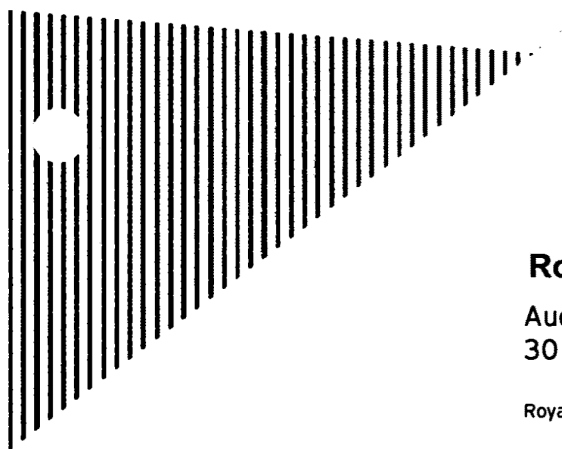


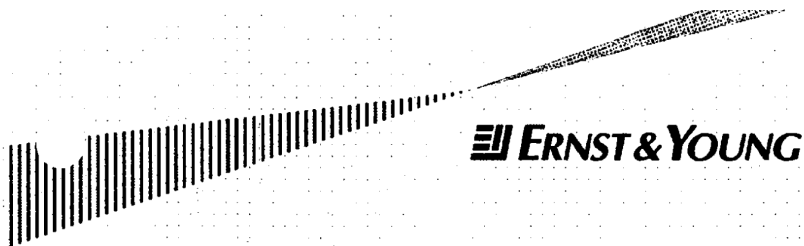


Royal Mail Holdings plc

Audit results report for the year ended
30 March 2008

Royal Mail reference: ARC(08)16

7 May 2008



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Members of the Audit and Risk Committee

Audit results report for the year ended 30 March 2008

We are pleased to attach our Audit Results Report for the forthcoming meeting of the Audit and Risk Committee. The purpose of this report is to provide an update on the status of our audit prior to the Group's preliminary announcement on 8 May 2008. Our report also provides our conclusions on the key areas highlighted in our Audit Planning Report and on other matters that have arisen during the audit. We have included our observations in relation to controls insofar as they impact the scope of our audit work and we also present our preliminary release letter and confirm our independence from Royal Mail Holdings plc.

We welcome the opportunity to discuss this report with you on 7 May 2008.

Yours sincerely,
For and on behalf of Ernst & Young LLP

GRO

Alison Duncan
Ernst & Young

United Kingdom

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OVERVIEW

Overview

The proposed publication of an unaudited preliminary announcement of the Group's results on 8 May requires our audit to be at an advanced stage at that date. We have therefore accelerated our audit procedures to ensure that the primary statements and all notes to the accounts that tie directly to these statements will be completed by 7 May. Following the preliminary announcement, we will focus our work on narrative disclosures and 'front end' statements such as the directors' report and remuneration report, prior to finalisation and signing of the accounts in the week commencing 19 May.

The ability to accelerate the publication of the Group's annual results is supported by a strong financial statement close process, including P11 hard close audit, that was well executed by the business unit and Group finance teams. Our agreed audit approach of highlighting and discussing issues at Period 11 has facilitated resolution by the time of our year end audit visit.

We confirm that we have received full co-operation from the Royal Mail teams with whom we work and to the best of our knowledge we have received all information necessary to enable us to complete our audit.

Significant audit and accounting issues

See pages 3 to 16

The following significant items were discussed and agreed with management:

- ▶ The going concern basis for RMG and RMH has been confirmed
- ▶ An update on our going concern review for POL will be given at the Audit and Risk Committee ('ARC') meeting. Retention, or otherwise, of the emphasis of matter paragraph in our POL audit report to be determined
- ▶ The key actuarial assumptions used in determining the pension deficit are within acceptable ranges
- ▶ We concur with amounts accrued for regulatory compensation and other penalties at March 2008
- ▶ Severance and non-severance provisions are appropriately stated
- ▶ We agree with the accounting treatment for ColleagueShares and with the disclosure of the costs as exceptional
- ▶ Accruals made for management bonuses, together with the UK and GLS LTIP schemes are appropriate with reasonable judgments applied. Government approval of certain UK targets is outstanding
- ▶ The impairment of Project Breakthrough has been made in accordance with accounting standards and the disclosure of the costs as exceptional is in accordance with Group accounting policies
- ▶ Following the Project Speedy management fraud at GLS Italy, extended audit procedures have not highlighted any manipulation of the financial statements. We concur with amounts accrued for potential costs
- ▶ The corporate taxation charge is appropriate and a prudent methodology has been used to calculate the deferred tax position. Significant increase in deferred tax asset recognised reflects future pension benefits offset by a reduction in tax rate
- ▶ The non EU revenue related VAT accrual is appropriate. Work on the VAT accrual for miscoding exposures is ongoing and a verbal update will be given at the ARC meeting
- ▶ Other areas where we agree with management's accounting treatments are: the REIMS accrual, the classification of vehicle leases, the treatment of Black Eagle costs and the capitalisation of POL broadband modem costs

OVERVIEW

Control themes and observations

The key internal control findings arising from our audit work are:

See pages 17 to 22

- ▶ No material control exceptions noted from our work on the Royal Mail Group revenue and payroll processes
- ▶ Changes in audit approach were required following exceptions noted in the IT general control environment and POL payroll process
- ▶ Improvements are required in the indirect tax process to support the VAT returns and partial exemption calculations
- ▶ A summary of our controls observations, update on prior year management letter agreed actions and 2008 challenges are set out on pages 17 to 22
- ▶ Detailed control observations and recommendations of a 'housekeeping' nature are being discussed with management and will be reported in our management letter

Scope update and status of the audit

We undertook our audit in accordance with the scope set out in our engagement letter, our September 2007 Audit Planning Report and our March 2008 Audit Update Report.

See pages 23-24

We have finished our audit procedures at the business units and the Group audit is substantially complete. Key matters outstanding include detailed narrative disclosures and 'front end' statements and reports.

Summary of audit differences

See page 24

- ▶ There are no unadjusted audit differences above our reporting threshold of £1.0m

Our opinions and confirmations

See pages 24-32

- ▶ We anticipate providing the directors with our consent letter, on the unaudited preliminary announcement, on 8 May 2008 (refer to Appendix B)
- ▶ We anticipate issuing an unqualified audit opinion on the consolidated Royal Mail Holdings plc Group accounts for the year ended 30 March 2008
- ▶ We confirm that there have been no changes in our assessment of our independence since our report dated March 2008
- ▶ We confirm that our fees for non-audit services during 2007-08 have been reviewed to ensure we have maintained our independence as your auditor

SIGNIFICANT AUDIT AND ACCOUNTING ISSUES

Significant audit and accounting issues

Set out in this section are those key audit findings discussed with local and Group management during the P11 hard close and final audits.

In order to provide clear opinions on the issues that matter most, we have introduced our own assessment of the subjectivity involved in determining the accounting treatment used in preparing the financial statements to provide an indication of the level of risk involved. In addition, we provide our assessment of where judgments and estimates determined by management fall in a range of possible outcomes. The bases for our assessments are outlined below:

Description of criteria

Level of subjectivity

This applies only to significant estimates and indicates the level of subjectivity in the estimate as well as the reliability of the underlying data used to develop the estimate.

Ratings applied to each criteria

High - Estimate involves significant judgment and is made with little verifiable historical experience, current trend information or market and industry comparative information.

Medium - Estimate still involves some judgment and is made with verifiable historical experience, current trend information, or market industry comparative information.

Low - Estimate involves limited judgment and is made with verifiable historical experience, current trend information, or market industry comparative information.

Assessment of management's judgments and accounting treatment

		Range		
This measurement provides an indication of where in the range of possible acceptable outcomes the estimate has been recorded.	The estimate/treatment is within the lower range of acceptable outcomes resulting in a less conservative treatment.	L	M	H
	The evaluation of any estimate or treatment being in the upper (more conservative) or lower range (less conservative) of acceptable outcomes does not imply the estimate/treatment is not in accordance with GAAP, or the preferred accounting has not been given to the estimate/treatment or that the estimate should move to the mid range immediately.	L	M	H
	The estimate/treatment is within the upper range of acceptable outcomes resulting in a more conservative treatment.	L	M	H

SIGNIFICANT AUDIT AND ACCOUNTING ISSUES

Issues dashboard

The following 'dashboard' summarises the significant audit and accounting issues outlined in this report. It seeks to provide the ARC with an overview of the subjectivity involved and our assessment of where the accounting treatment falls within a range of acceptable outcomes.

Audit and accounting issue	Level of subjectivity	EY Assessment			Page reference
Funding					
▶ RMG & RMH	N/a	N/a			5
▶ POL	N/a	N/a			6
Pensions	High	L	M	H	6
Regulatory compensation and other penalties					
▶ Bulk compensation	High	L	M	H	7
▶ Other penalties	Low	L	M	H	8
Provisions					
▶ Severance	Low	L	M	H	9
▶ Non-severance	Medium	L	M	H	10
ColleagueShare	High	L	M	H	10
LTIP					
▶ UK	Low	L	M	H	11
▶ GLS	Low	L	M	H	11
Project Breakthrough	Low	L	M	H	12
Project Speedy	Low	L	M	H	12
Corporate tax	Medium	L	M	H	13
VAT					
▶ Non EU revenue related accrual	Low	L	M	H	15
▶ Accrual for miscoding exposures	High	Audit ongoing			15
Other issues					
▶ REIMS	Low	L	M	H	16
▶ Vehicle leases	Low	L	M	H	16
▶ Black Eagle costs	Low	L	M	H	16
▶ POL broadband costs	Low	L	M	H	16

SIGNIFICANT AUDIT AND ACCOUNTING ISSUES

Going concern**RMG & RMH**

We have reviewed the funding analysis prepared by management and presented in the Briefing Book. We note that the cash flow forecasts are based on an updated Strategic Plan that has been approved by the Board, but not yet by Government. Below is a reconciliation to the funding analysis previously presented:

Headroom reconciliation	2008-09 £m	2009-10 £m	2010-11 £m
March brought forward	627	457	354
Opening funds improvement	449	406	88
Free cash flow movements	-43	-318	-81
Risk changes	180	181	6
Management actions	-197	-176	54
March carry forward	1016	550	421

Opening funds improvement

The improvement is mainly due to delayed capital expenditure relating to the Transformation case. As the capital is spent this improvement is reduced.

Free cash flow movement

The changes are due to:

- ▶ Benefits from the pay deal
- ▶ Benefits from pension reform
- ▶ Modelling the impact of declining revenue
- ▶ Ongoing delays in capital expenditure

Risk changes

The improvement to 'Risks' is due to a significant portion of the previously noted revenue risk being modelled into the free cash flow numbers. Management has assumed within the new Risk numbers that the market will decline by around 8% over 4 years.

In addition, management has identified a risk that Royal Mail will not be allowed to benefit from the pension changes and will be required to pass these on to the pension trustees.

Management actions

The main changes relate to:

- ▶ More accurate information relating to the stakeholder dividend which has resulted in lower amounts being recognised
- ▶ No management action recognised in the updated analysis relating to slowing down investment. Previously this accounted for £98m in 2008-09
- ▶ No risk amount for fines and compensation associated with Industrial Action. In the previous analysis there was a downside of £200m in 2008-09

We also note that the management actions are not exhaustive and further actions such as the disposal of GLS could be taken, if necessary.

SIGNIFICANT AUDIT AND ACCOUNTING ISSUES

Funding covenants

Management has prepared covenant calculations for the 12 months to March 2008, September 2008 and March 2009 for both the Senior Debt and GLS facility. The calculations, which incorporate the forecast numbers included in the updated Strategic Plan, indicate sufficient headroom on each financial ratio covenant. Management has been unable to perform the covenant calculations at September 2009 as the 2009-10 forecast is only available in annualised form.

We have performed sensitivity analysis on the covenant calculations by considering the 2008-09 'Risks' as included in Table 1 of the RMG Latest Funding Analysis included in the March 2008 Briefing Book. The 'sensitised' calculations indicate that there would be no breach in the covenants in 2008-09.

We have also prepared high level covenant calculations for 2009-10 incorporating the updated Strategic Plan forecast and the downside Risks for this period. The analysis highlights a breach in the covenants should the downside Risks materialise. However we acknowledge that the calculation does not take into consideration the potential management actions.

We suggest that the future covenant compliance position is regularly monitored to provide management with sufficient time to identify and implement any actions necessary.

Going concern conclusion

We concur with the directors' conclusion that both the RMH Group and RMG accounts should continue to be prepared on a going concern basis.

POL

The key change in the assessment of going concern from prior years has been the funding arrangements agreed with government on 16 May 2007, the subsequent receipt of funds, and the agreement to extend the £1.15bn working capital facility from 2010 to 2011 on 18 April 2008.

At the time of writing this report, POL management are updating their headroom analysis incorporating the fund flows from both the financing outlined above and from the 5 year Strategic Plan. We have requested that the cash flow forecasts are overlaid with risk sensitivities so that a range of potential scenarios can be considered.

On reviewing this data, and particularly in view of the funding package agreed with government, we will need to consider whether it is appropriate to retain the emphasis of matter paragraph included within our audit report on the POL statutory accounts since 2004-05. Our Professional Standards Panel, which was consulted on the initial modification of our audit report, is due to meet on the 6 May, and we will provide confirmation of our conclusions at the ARC meeting on 7 May.

Pensions

Level of subjectivity	EY assessment		
High	L	M	H

Royal Mail has recognised a liability of £2.9bn on its balance sheet at March 2008 (March 2007: £5.0bn) in respect of its net pension liability in accordance with IAS 19 'Employee Benefits'. This amount comprises £23.9bn scheme assets offset by £26.8bn of defined benefit obligation.

SIGNIFICANT AUDIT AND ACCOUNTING ISSUES

During the year, following consultation with its actuaries, Royal Mail has updated its assumptions used in the measurement of the defined benefit obligation. These updated assumptions have led to a decrease in the obligation of £1.8bn, with the asset value increasing by £0.3bn.

We have reviewed the key financial assumptions underpinning the valuation, with input from EY pension specialists where appropriate. We have also discussed and reviewed the methodology used in preparing the assumptions with the Group's actuaries. The assumptions have been prepared on a consistent basis with previous years, with adjustments made for current market conditions.

In our opinion, Royal Mail has used appropriate assumptions which are consistent with those applied by UK plc in valuing the quantum of their pension obligation in accordance with the measurement criteria set out in IAS 19. All of the assumptions fall within an acceptable range and we have the following observations:

	2007-08	2006-07	EY View
Salary increase rate	4.6%	4.1%	Middle of range
Pensions in payment increase rate	3.6%	3.1%	Prudent end of range
Deferred pension increase rate	3.6%	3.1%	Middle of range
Discount rate	6.5%	5.3%	Optimistic end of range
Price inflation	3.6%	3.1%	Prudent end of range
Return on assets	6.8%	7.0%	Middle of range

We note that the pension obligation is extremely sensitive to small changes in the assumptions, with a 0.1% change in the discount rate leading to a change in obligation of approximately £450m. We are working with management to ensure that the financial statements contain appropriate disclosure in relation to this sensitivity.

The changes in the Plan benefits for future service that come into force from 1 April 2008 have no impact on the deficit recorded at March 2008. However, these changes will be considered by the Group's actuaries in future fund measurements.

Regulatory compensation and other penalties

At March 2008, Royal Mail has accrued a total of £60.4m (March 2007: £44.2m) for regulatory compensation and fines. The most significant items are £35.0m in respect of potential bulk compensation following the impact of the industrial action on Quality of Service during the year and £12.8m in respect of an EU challenge to government funding in 2001.

Bulk compensation	Level of subjectivity	EY assessment
	High	L M H

Industrial action in Q2 and Q3 had a significant impact on the Group's ability to achieve its Quality of Service targets.

As a result, Royal Mail has submitted an interim application to Postcomm to waive payment of Q2 compensation to bulk mail customers. Non-binding feedback has been received from Postcomm stating that they are minded to agree with Royal Mail's request, although there will be no formal decision until late May 2008. A similar application for Q3, when the nature of the industrial action had a greater impact on Quality of Service, will also be submitted.

SIGNIFICANT AUDIT AND ACCOUNTING ISSUES

Notwithstanding the tone of the current communication, management has assessed that Postcomm will levy a compensation payment to respond to stakeholder concerns and representations. Postcomm's track record of instructing compensation payments and levying fines alongside its decision to hold a public forum, which will hear from customers, competitors and other stakeholders are in management's view, indicators that an exposure is probable. A £35m accrual has been recognised at March 2008, which is management's best estimate of the compensation payout.

Given the level of subjectivity and judgment involved in determining the amount to be accrued, we have understood and validated the potential range of liability, reviewed correspondence with Postcomm and challenged management's assumptions. We are satisfied that the recognition of a liability is appropriate and that £35m is management's best estimate of the compensation exposure. We will obtain a specific representation from management in relation to this item,

Other penalties**Level of subjectivity EY assessment**

Low	L	M	H
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The EU has launched legal proceedings against the UK Government in relation to funding packages agreed with Royal Mail in 2001, 2003 and 2007.

Following correspondence between the EU and the UK Government during the year, it has become clear that the EU will find against the UK government in relation to the GLS loan in 2001. Any penalty levied will in turn be passed on to Royal Mail. Based on interpretation of the benefit of this arrangement enjoyed by Royal Mail, management believes the penalty will be either £5m or £12.8m, and have accrued for the larger amount, which has been booked as interest.

The Government has sought and received professional advice that the funding for 2003 and 2007 is in compliance with the Market Economy Investor Principle ('MEIP'), and therefore was agreed with appropriate terms and conditions. On this basis no amount has been accrued in relation to this challenge.

We have reviewed the correspondence and challenged management's assumptions and agree that the amount booked is appropriate.

In relation to the remaining fines and compensation accruals, we are satisfied that they are correctly stated.

SIGNIFICANT AUDIT AND ACCOUNTING ISSUES

Provisions

The table below summarises the utilisation, charges and reclassification of provisions by major project. Overall, the Group continues to manage its provisions appropriately.

	Provision at Mar 07 £m	Charges/ reclass £m	Utilised £m	Provision at Mar 08 £m
Severance Provision				
Royal Mail				
▶ HWDC	21.0	2.6	(0.9)	22.7
▶ Other mail projects	43.7	92.5	(84.5)	51.7
POL	1.4	189.2	(47.2)	143.4
Others (incl. PFWW, Group Functions and pension)	7.6	18.3	(11.2)	14.7
Total severance provisions	73.7	302.6	(143.8)	232.5
Non-severance provision				
Property	33.1	(7.0)	(5.0)	21.1
ColleagueShares	-	116.0	-	116.0
POL	3.3	62.3	(27.4)	38.2
Others	0.3	4.7	(1.2)	3.8
Total non-severance provisions	36.7	176.0	(33.6)	179.1
Total Provisions	110.4	478.6	(177.4)	411.6

Severance

Level of subjectivity EY assessment

Low	L	M	H
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Heathrow Worldwide Distribution Centre ('HWDC')

The project for consolidating international mail sorting from mail centres across the country to HWDC commenced in 2003 and is ongoing through a revised timetable of change, with further delays experienced as a result of the industrial action during 2007-08. The most recent updated plans indicate that significant migration is scheduled to occur during the remainder of 2008.

Despite the ongoing delays, management remains committed to full operation of the HWDC facility and we are satisfied that the provision at March 2008 continues to meet the recognition criteria of IAS 37.

Other mail projects

The provisions in relation to other mail projects reflect actions being undertaken as part of the transformation plan. Significant components of this provision are delivery best practice (£23.7m) and the relocation of Reading and Oxford mail centre traffic to Thames Valley (£12.5m). We are satisfied that these amounts have been appropriately recognised and applied, and that the year end balance is correctly stated.

POL restructuring

At March 2008, POL has recorded restructuring provisions in relation to the Post Office branch closure programme and the transfer of a number of branches to WH Smith shops.

SIGNIFICANT AUDIT AND ACCOUNTING ISSUES

The branch closure programme relates to approximately 2,500 Post Offices, for which government funding of £313m was received. Agreement has also been reached to transfer 70 existing Post Office branches to WH Smith shops located in the same area.

Formal plans were established during the first half of the year for both programmes and at that point a provision was booked for the expected costs of the related severance and closure costs. The majority of the provision, £129m, relates to severance and the remaining £38m relates to non-severance costs associated with closing the branches such as decommissioning costs.

POL has also booked severance provisions during the year in relation to other ongoing restructuring programmes (£14m). We have reviewed the detail of the provisions and the supporting evidence and concur that they correctly reflect liabilities at March 2008.

Other

The main component of the 'Other' severance provisions is £7.7m in relation to the Group Technology review. Redundancies were announced during the current year and assessment centres held prior to the year end to identify the individuals who would remain in the business.

Non-severance

Level of subjectivity	EY assessment		
Medium	L	M	H

Property

At March 2008, the Group is carrying a provision of £21.1m (March 2007: £33.1m) in relation to ongoing onerous property leases. The provision has decreased during the year following the payment of ongoing lease amounts, combined with the sale or rental of a number of buildings. The methodology in calculating the provision remains consistent with previous years and we have reviewed and challenged the estimates and assumptions. We concur that the provision remains appropriate.

Other

The most significant other non-severance provisions relate to POL and ColleagueShares. The details of the POL provisions are included in the severance section above. The ColleagueShares detail is included below.

ColleagueShares

Level of subjectivity	EY assessment		
High	L	M	H

During the year an amount of £116m has been booked in relation to the ColleagueShare phantom share incentive scheme.

The estimation of the provision in the current year involves a number of judgmental assumptions, and adjustments to the provision are probable over the period of the scheme as more accurate information is obtained and the liability is trued-up. The key assumptions driving the provision are the number of ColleagueShares to be paid out in four and five years' time, the rate of leavers, the discount rate, and the value of each ColleagueShare at the date of payment. We have reviewed the ColleagueShare model and identified some differences in assumptions used in terms of discounting calculations and inclusion of future

SIGNIFICANT AUDIT AND ACCOUNTING ISSUES

joiners, among others. However, the net impact of these judgmental differences is not material, and we are satisfied that the provision is correctly stated.

Stakeholder dividends

At March 2008, the Group has accrued £161m reflecting management's intention to pay the maximum possible payment of £800 per employee, although both the targets for Group profit and local business unit targets have not yet been approved by the Government. The calculation supporting the accrual is appropriate and we will obtain a specific representation from management on their intention to pay out the full £800 per employee.

Disclosure

The disclosure of these costs as operational exceptional items was agreed and reported to the ARC at its meeting on 6 March 2008.

Long Term Incentive Plans and Bonuses

UK LTIP and bonuses	Level of subjectivity		EY assessment		
	Low		L	M	H

At March 2008, the Group has recorded a liability of £17.9m (March 2007: £42.0m) in relation to the UK Long Term Incentive Plans ('LTIP'). This includes £3.2m for the amended 2005-08 Executive LTIP scheme (March 2007: £42.0m) and £14.5m for the 2007-10 LTIP scheme (March 2007: nil).

In addition to the above, the Group has recorded a liability of £81.1m (March 2007: £74.1m) in relation to management bonuses, based on Group profit and Quality of Service targets.

In calculating the liabilities at March 2008 the most significant assumption that has been made is in relation to the targets for the 2007-10 LTIP scheme and the Board member bonuses. The targets have been approved by the Group Board, but have not yet been approved by the Shareholder Executive.

Our procedures on the calculations have not highlighted any exceptions and we concur that, in the absence of government approval, using Board-approved targets is the most appropriate way for management to estimate the liability at March 2008.

GLS LTIP	Level of subjectivity		EY assessment		
	Low		L	M	H

At March 2008, GLS has recorded a liability of £12.8m (March 2007: £7.0m) in relation to the 2006-08 GLS LTIP scheme.

This is the final year of the 2006-08 scheme and GLS management is entitled to payments under this scheme based on the incremental increase in the value of the GLS business over the three year period. The amount recorded includes two key judgments; an uplift of the bonus pool for organic growth and an additional six months of earnings in relation to the Milan acquisition.

A 20% uplift of the bonus pool has been applied for meeting the organic growth targets. The actual organic growth over the three year period is marginally below the 7% target.

SIGNIFICANT AUDIT AND ACCOUNTING ISSUES

The Milan acquisition occurred halfway through the 2007-08 year. An additional six months of earnings has been included for the six months of the financial year that GLS did not own Milan.

We understand that the Group Remuneration Committee will agree to these assumptions at its May meeting. We are therefore satisfied that the obligation at the year end has been correctly calculated based on the parameters set out in the scheme and the quantum of the provision recorded is management's best estimate of the obligation at March 2008.

Project Breakthrough - Impairment

Level of subjectivity	EY assessment		
Low	L	M	H

Following the decision to terminate the project to create a single parcel management system for PFWW, management has recognised an impairment of £8.0m. The majority of this balance relates to a £5.1m write off of the intangible asset capitalised and for which no future value is anticipated given the issues that arose in relation to the capability of the software supplier and the likely change in scope in any revised track and trace solution. The impairment also includes £2.0m for the cost of exit from the 5 year contract with the supplier TX. Whilst the maximum contractual termination payout is £8.0m, PFWW management believes there is a strong legal case to achieve a much lower settlement. At the time of writing this report, we understand that lawyers for both parties are working on a £2.0m settlement agreement.

We concur with the £8.0m impairment and note that it will be classified as an exceptional item within the Group's operating profit. Given the materiality of this amount to the results of PFWW and to the understanding of the underlying performance of this business segment, we concur that this treatment is in line with the Group's accounting policy for exceptional items.

Project Speedy

Level of subjectivity	EY assessment		
Low	L	M	H

In February 2008 a fraud investigation was initiated by GLS Corporate Management in respect of alleged improper activities by the top management of GLS Italy. Forensic accountants have been engaged to perform a detailed investigation and their work remains in progress. To date a number of items of circumstantial evidence have been discovered. However, it is questionable whether adequate evidence has been gathered to support legal action.

We have extended our audit procedures in Italy by increasing sample sizes and increasing the level of journal entry testing. These procedures, together with those of the forensic accountants, have not highlighted any manipulation of the financial statements.

The employment contracts of both individuals concerned were terminated on 30 April 2008. Management believes that the maximum potential exposure in relation to claims by the individuals is £2.4m and a provision of £1.6m has been established as the best estimate of the amount payable. An additional £0.3m has been accrued in relation to professional fees incurred to date and we concur that these amounts are appropriate.

SIGNIFICANT AUDIT AND ACCOUNTING ISSUES

Corporate tax

Level of subjectivity	EY assessment		
Medium	L	M	H

The Group's tax charge for the period is as follows:

	2007-08	2006-07
Profit before tax	(£77m)	£313.0m
Tax charge/(credit) - income statement	(£212m)	£27.0m
Effective tax rate	N/a	8.6%
Tax (credit)/charge - summary of Group recognised income and expenses (SORIE)	£18m	(£27.0m)
Net total tax credit recognised in year	(£194m)	(£0.0m)
Net effective tax rate	N/a	N/a

Tax credit - income statement

The principle figures affecting the recognition of a £212m tax credit are:

- ▶ A UK current tax credit of (£19m) in respect of payment for losses from joint ventures
- ▶ A foreign tax charge of £29m in respect of GLS
- ▶ A deferred tax credit (UK and overseas) of (£216m)

The deferred tax credit of £216m is made up of the following elements:

- ▶ £246m credit in respect of the reassessment of deferred tax assets for fixed assets, losses and ongoing pension contributions
- ▶ £30m charge reflecting the change in UK and German corporation tax rates

Tax charge - SORIE

The £18m tax charge recorded in the SORIE comprises:

- ▶ Current tax charge of £3m in relation to fair value movements on gilts during the year
- ▶ Deferred tax charge of £15m following the remeasurement of the deferred tax asset recognised in equity on the pension scheme deficit as a result of the decrease in the UK corporation tax rate from 30% to 28% with effect from 1 April 2008

Deferred tax assets**Recognised deferred tax assets**

A deferred tax credit of £216m has been recognised in the year, bringing the total net UK deferred tax asset to £591m at March 2008 (March 2007: £397m). This credit is primarily in respect of deferred tax on ongoing pension liabilities (£125m), fixed assets (£35m), and losses (£33m). The basis of UK deferred tax asset recognition remains prudent and consistent with the approach adopted at March 2007, with the amount recognised being restricted to the tax benefit which is expected to be realised in the next five years based on the information in the Strategic Plan approved by the Board. The key reason for the increase in UK deferred tax asset recognition arises from the significant increase in forecast profits in the updated Strategic Plan over the next five years (particularly in years 4 and 5) mainly as a result of the benefits from the pension reform.

The Group's overall deferred tax asset at March 2008 is £608m. This comprises £591m relating to UK operations and £17m relating to GLS overseas operations.

SIGNIFICANT AUDIT AND ACCOUNTING ISSUES

The rate of UK corporation tax has reduced from 30% to 28% from 1 April 2008. In addition, the combined effective corporate income tax rate in Germany has reduced from 37.8% to 28.6% with effect from 1 January 2008. These rate changes have decreased the size of the Group's balance sheet deferred tax asset by £45m

Unrecognised deferred tax assets

At March 2008, the Group has potential net deferred tax assets of £758m, principally attributable to the actuarial deficiency of the Group pension plan, together with losses carried forward in POL and fixed asset temporary differences in RMG and POL. In view of the uncertainty regarding the availability of suitable future profits, and in accordance with IAS 12 these deferred tax assets have not been recognised at the balance sheet date.

Correspondence with revenue authorities

HMRC are currently updating their risk assessment of large businesses following publication of revised risk assessment guidelines at the end of 2007. We expect that Royal Mail should receive a revised risk assessment/rating shortly. The risk rating awarded will have a significant impact on the resource allocation the Group receives from the tax authorities over the next few years.

A review of HMRC correspondence on open enquiries has been undertaken. A prior year credit of £3.0m has been recognised as a result of the closure of earlier periods (2000-01 and 2001-02) and developments in HMRC enquiries in other years. With regard to other open enquiries, it is anticipated that any increases in UK taxable profits arising as a result of these enquiries will be sheltered by a combination of rollover relief, capital losses and trading losses such that no additional provisions should be required.

Future changes

In the 2007 Budget, the Government announced their intention to phase out industrial buildings allowances (IBAs) through legislation to be implemented in Finance Act 2008. In the 2008 Budget, the Government published draft legislation confirming that there would be a phased abolition of IBAs with effect from 1 April 2008, with no further allowances being available after April 2011. These changes are still subject to Parliamentary approval, and so their effect is not reflected in the Group's balance sheet at March 2008. However, it is anticipated that these changes will reduce the Group's unrecognised deferred tax assets by approximately £100m.

As this is a non-adjusting post balance sheet event, in accordance with IAS 10, the nature and impact of such a change must be disclosed in the financial statements.

VAT

In relation to the VAT accounting issues outlined in papers to the ARC in March 2008, the Group has accrued £38.4m in relation to estimated over recoveries of VAT. The key elements to this liability are:

1. £31.6m in relation to over recovery of VAT as a result of the application of unsupported non EU revenue figures applied in the calculation. £26.7m relates to the difference in VAT claimed since 2004-05 up to March 2008. The balance of the accrual relates to management's estimate of interest and penalties.
2. £5.5m in relation to the potential underpayment of VAT as a result of general ledger mis-codings that have resulted in the incorrect treatment for VAT purposes.
3. Sundry items, including unreconciled VAT balance (£1.7m), and potential overrecoveries of VAT (£2.3m) and £0.1m for other minor items.

SIGNIFICANT AUDIT AND ACCOUNTING ISSUES

Non EU revenue related accrual

Level of subjectivity	EY assessment		
Low	L	M	H

In the absence of formal correspondence with HMRC on the likely assessment in relation to the over recovery of VAT as a result of the unreconciled non EU revenue figures, we obtained permission from management to speak directly with HMRC and confirmed the following:

- ▶ The proposed assessment for the overrecovery of residual VAT by RM will be for £26.8m, plus interest and penalties. The assessment is expected to be issued at the end of May
- ▶ The assessment is subject to review by the partial exemption specialist officer, but is not expected to change significantly
- ▶ The Client Relationship Manager for Royal Mail has indicated that penalties will be mitigated to the fullest extent possible
- ▶ There is no current intention to issue the assessment and then review the historic position in detail
- ▶ The partial exemption annual adjustment will be undertaken in September 2008 (for the year ended March 2008) which, as in any other year, could lead to an additional liability depending on the result of the adjustment calculations and/or the review thereof

On this basis, we are satisfied that this accrual is management's best estimate of the liability at March 2008.

Accrual for miscoding exposures

Level of subjectivity	EY assessment
High	Audit ongoing

The £5.5m accrual has been calculated from a high level analysis of likely error rate for each revenue material master code in the system. At the time of writing this report, our work in validating the appropriateness of this analysis and the adequacy, or otherwise, of the accrual is ongoing. Our current approach is to:

- ▶ Perform sample testing on both accounts payable and accounts receivable in the year to identify any miscoded items and to extrapolate our findings across the complete population of transactions
- ▶ Seek to 'cleanse' accounts payable data provided to us, so that we can run these details through our Discovery software which is designed to 'flag' potential miscoded items and would provide a more holistic indicator for the potential scale of miscoding within the accounts payable ledger

We will provide the ARC with a verbal update on the audit status of this item at its meeting on 7 May 2008.

SIGNIFICANT AUDIT AND ACCOUNTING ISSUES

Other issues

REIMS

Level of subjectivity EY assessment

Low	L	M	H
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At March 2008, Royal Mail has accrued £14.4m (March 2007: £11.3m) for potential settlements in respect of the difference between UPU and REIMS rates. This accrual is calculated based on the total balances known for periods up to March 2007 and includes an estimate of traffic for the year ending 30 March 2008. We have reviewed management's calculation and supporting assumptions and concur that the amount accrued is appropriate.

Vehicle leases

Level of subjectivity EY assessment

Low	L	M	H
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Royal Mail has used finance leases to fund their £90m 2007-08 fleet replacement programme. We have reviewed the details of the leases and concur that they are finance leases in substance and that the appropriate accounting treatment has been followed.

POL Black Eagle costs

Level of subjectivity EY assessment

Low	L	M	H
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In previous years management had capitalised £8.2m of professional fees associated with obtaining further Government funding (Project Black Eagle) to enable them to restructure the Post Office network.

Following receipt of £533m of short-term and other funding, in addition to £150m rural network funding in the current year, management has written these previously capitalised costs off during the year. We concur with this accounting treatment.

POL broadband costs

Level of subjectivity EY assessment

Low	L	M	H
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Modems issued to POL broadband subscribers remain the property of POL throughout the subscription. Royal Mail has capitalised the costs of these modems with an appropriate useful life based on industry-expected subscription lives. We concur with this accounting treatment.

CONTROL THEMES AND OBSERVATIONS

Control themes and observations

Our review of the Group's system of internal control is carried out to assist us in expressing an opinion on the accounts of the Group as a whole. This work focuses on the key processes that impact the financial statements, namely payroll, revenue and IT. We selected key controls within these processes and performed testing to address the material financial statement risks in specific areas. We also revisited the recommendations that we made in 2007 and reviewed the status of management's agreed actions.

We set out below a high level summary of our observations and audit findings in these areas.

Group Finance

Control observations

Financial statement close process

The ability of the Group to accelerate, post year end, its results announcement by two weeks on the original timetable, is supported by the completion of P11 hard close audits and the quality of the Group finance team and its organisation in consolidating the Group results and preparing the Group accounts. The most challenging area of audit related to VAT, and we set out our specific comments below.

Taxation

The issues arising in relation to VAT in the current year, compounded by the changes of personnel within the Group tax department, meant that a high level of attention to this area was appropriate. The audit of the VAT balances was challenging and protracted. A key issue was continued lack of appropriate controls and processes to support the numbers in the VAT returns and the partial exemption calculations and as discussed at the ARC meeting on 6 March, the Group will need to contract in some specialist support and recruit appropriately to bolster their capabilities in this area. The following items will need to be addressed as a matter of urgency so that the Group can have certainty in its VAT accounting in future years and obtain a more favourable risk assessment from HMRC:

- ▶ Quarterly returns, calculations and submissions
- ▶ A detailed end to end review of the Group's VAT processes, controls and accounting including a review of transactions posted to facilitate possible disclosures of any additional liabilities
- ▶ Negotiations with HMRC to agree a new special method for Royal Mail Group for the partial exemption year ending March 2009 and beyond

Journal entry testing

As in prior year audits, one of the ways we have addressed the requirements of ISA 240, 'The auditor's responsibility to consider fraud in an audit of financial statements', is by performing testing of journal entries posted throughout the year.

All manual journals relating to the UK Group, GLS Germany, GLS France and GLS Italy operations, for the 12 month period, were input into a data analysis tool to highlight inconsistencies that may be due to fraud or errors. Any anomalies identified by the tool, such as debits to liability accounts, credits to asset accounts, significant round numbers, duplicate transaction references, significant journals posted close to the year-end, and journals with unusual descriptions were investigated, and support for the selected journals was obtained. We noted no exceptions in our procedures.

CONTROL THEMES AND OBSERVATIONS

2008 challenges

The Group is currently in the process of recruiting a new tax director whose role will need to encompass compliance, reporting, forecasting, processes, risk management, planning, transactions, litigation, lobbying and global responsibility and oversight in respect of GLS (in view of the increasing global reporting to HMRC). This individual should have responsibility for all taxes, mirroring the approach adopted by HMRC with their Customer Relationship Manager in their new risk-based approach. On this basis, addressing the VAT actions outlined above will be an immediate priority.

We also recommend that the tax department builds stronger links with:

- ▶ Internal Audit & Risk management, especially for assurance over processes and controls
- ▶ Business units to ensure proper understanding of the tax implications of transactions and quality controls over tax-relevant information processes

IT**Audit process and approach**

Following the challenges experienced in performing our IT audit in prior years, the audit process was greatly improved, in particular for Royal Mail Group, as the ownership within the Group IT function for managing third party suppliers and delivery of audit information requests becomes clearer and individuals are more accountable.

Where possible we sought to rely on SAS 70 certificates in respect of the control environments of the Group's IT suppliers. However, reliance was limited, as those available only related to part of the financial year and/or did not cover configuration of operating systems and databases as comprehensively as we required.

The opportunity for the Group to obtain greater assurance (and audit efficiency) from SAS 70 certificates is being considered as part of the ongoing review of arrangements with third party suppliers.

Control observations

The most significant finding related to the SAP system. Whilst we are satisfied that the mechanism for granting access rights to Royal Mail employees is appropriate, we identified 61 third party programmers at the year end (and a further 76 during the year) who had unlimited access to the Group's SAP systems as a result of having the all powerful 'SAP_ALL' profile for which there was no audit log or other such mechanism to monitor the use of this access. Whilst we acknowledge that some super users may require such extensive access, our experience indicates that it should only be granted on an exceptional basis and typically this is to a handful of users where the activities performed whilst using the SAP_ALL profile are monitored and reviewed.

In addition, for a sample of programme changes, evidence of authorisation, testing and approval to transport into production was not available.

As a result, we have not been able to rely on the IT general controls over the SAP environment and have extended our substantive work to address what we believe to be the principle risk of cash fraud, such as programmers creating and paying a 'ghost' employee, changing a supplier's bank details to their own, creating fictitious suppliers, or changing a customer's bank details and raising credit notes. As the majority of the users are third parties, we do not believe that there is an increased risk of the Group's results being manipulated. Notwithstanding this, our use of analytical tools on journal entries is designed to identify unusual items.

CONTROL THEMES AND OBSERVATIONS

In our experience, where IT systems and processes are outsourced, it is not unusual for third parties to have super user access to an organisations systems in order to discharge their contractual responsibilities. However, the number of individuals with these rights are usually relatively few and they are known to the company. Where it is necessary to provide this level of access rights to additional outsourced contractors, authorisation is required from the company prior to execution by the supplier. Access is then reported and monitored, which can be restricted to those security areas of greatest concern.

Our audit work also identified the following control items:

- ▶ E-Pro and Infinium payroll systems: Developers have access to move programme changes into production and there is no facility within the systems for such activity to be logged and monitored. Our extended audit procedures were designed to address the risks arising from this situation.
- ▶ POL-MI, MDR/FRS: A limited set of users have access to manipulate data as it is loaded into these databases. Our extended procedures were designed to address the risks arising from this and the ineffective change control issue for SAP-ADS. This extended testing also represented our alternate approach to Horizon.

We highlight that as a result of our findings, we did not complete our work programme in all areas and there may be other items that have gone undetected.

These findings are consistent with the broad themes and challenges in relation to the Group's IT environment presented to the ARC on 6 March 2008.

Royal Mail Group

Control observations

Financial statement close process

As in prior years, the finance teams across the UK were well prepared for our audit visits, with all information requests received on time and of a good quality.

Revenue process

Our work on the 'order to cash' revenue process focused on the ES Revenue, Meter Revenue and Counter Stamp income streams, representing circa 90% of total revenue. The controls we sought to rely on were tested as operating effectively, and we have a small number of minor control recommendations agreed with management to include within our management letter.

Payroll process

As a result of our IT audit findings on the Infinium payroll system (noted above), we concluded that we could not rely on the IT general controls in relation to access security and programme changes. Therefore, we have extended our sample testing in relation to application controls, have tested the source data for IT dependent manual controls and have recast any reports obtained from Infinium.

For those manual or management level controls we have sought to rely on for audit purposes, all were deemed to be operating effectively. Key management controls include the 40X Report and Area Performance Analysis (APA). The 40X Report produces a list of items that fall outside pre defined thresholds which are investigated (e.g. any payment > £2,750 per month). The APA analyses variances and trends such as staff hour's costs, sickness, by week and by area against budget and previous weeks.

CONTROL THEMES AND OBSERVATIONS

Payroll analytics

In addition to our sample testing of the payroll process controls, we obtained the full year's payroll data from Infinium and performed procedures using computer based analytical procedures. These tests interrogated the payroll details for 211,801 RMG employees (including casual labour) and included analyses that identified items for further investigation.

Item for investigation	Explanation
12,593 duplicate bank account numbers	▶ Couples employed paid into joint account ▶ Employees with same bank account number but different sort codes, i.e. no duplicates
1,363 duplicate national insurance numbers	▶ Reflects seasonal employment patterns, with individuals being re-employed resulting in new payroll record. Only one record is active
5 duplicate employee records	▶ As above, giving rise to several payroll records with duplicate national insurance numbers
9 individuals are aged 80 and over	▶ Relates to 8 temporary workers at Christmas and 1 permanent employee contracted for 3 hours per week.
282 individuals received more than 5 payments per month, on average	▶ Casual workers are paid for each individual day worked.
£38.8m in gross pay paid after leaving date	▶ The majority is redundancy pay. £3.5m relates to overpayment, of which £3.0m has been recovered.
£7.9m in gross pay paid before joining date	▶ Reflects the way employee data is managed e.g. switch from casual to contracted service. Joining date is recorded at date contract commences.
£439k who were receiving a 'round number' as salary (e.g. £17,000 exactly per month)	▶ All instances salary confirmed as accurate and legitimate.

For each category of 'anomaly', we have selected a test sample for which appropriate explanations were sought and obtained.

Status on 2006-07 management letter points

- ▶ As reported to the ARC in November 2007, the Letters' finance team have focused on simplifying the SITHOP/MITHOP accrual. This has included a review of the numerous surveys and assumptions inherent in the calculation. This work has resulted in greater transparency of the components of SITHOP/MITHOP with the application of updated and more relevant inputs. The net impact on the recorded liability of these updates is not material.
- ▶ The key 'Human Asset Check' payroll control was updated and initially trialled in January 2007 in the North region. During 2007-08 the Human Asset Check was rolled out and completed twice across the UK business, and consequently we were able to place reliance over its operation for the first time in a number of years.
- ▶ There were a number of control observations and recommendations agreed with management in relation to the Revenue and Payroll processes, to the extent we sought to rely on these controls in the current year, all deficiencies had been addressed.

CONTROL THEMES AND OBSERVATIONS

2008 challenges***Wholesale revenue process***

As part of the ongoing drive to ensure compliance with Licence Condition 10, much of the revenue process for the wholesale business will be extracted from the existing Letters revenue activities at Peterborough and Bolton, with credit control and cash collection activities being set up within the central Wholesale team in London. This move will result in the creation of a new revenue team and the design and implementation of a controls framework for this income stream.

New human resources/payroll system development

The next 12 months will be critical in the first phase of development of the SAP solution to replace the existing human resources Infinium system. A key workstream of this project will be the controls to be embedded within the system and their role within the overall human resources/payroll controls framework. We will share with management insights from our work with other organisations on similar projects, to ensure that the opportunities to systemise controls are maximised and ultimately that the controls provide the necessary assurance over the human resources operations.

Post Office Limited**Control observations*****Financial statement close process***

The Product and Branch accounting ('P&BA') team in Chesterfield has been streamlined over the last few years. Despite this reduction in headcount, we observed a step change in the preparation and timely review of reconciliations. We recommend that P&BA team receive ongoing support as they continue to develop and improve the control environment over this fundamental area of POL accounting.

Given the ongoing change in key personnel, and the complexity and demands arising from the funding and transformation programme, we did not observe the same overall improvement in the close process at POL centre. However, we wish to highlight that the quality of the documentation and support for the severance provisions were of a high standard.

Payroll process

The POL payroll process is independent of the process and systems that support RMG. It covers approximately 20,000 employees which primarily include front line workers and agents working at Post Offices around the country. The system supporting this process is SAP-HR module.

Many of the controls that we have relied on in prior years, have been assessed as ineffective in the current year. These controls included not only those at a transactional level but also management controls such as the Employee Performance Pack review (i.e. detailed variance analysis). In the main, the control weaknesses that we observed related to review procedures not being undertaken, exacerbated by the move of the POL payroll function from Salford to Bolton during the year. Our management letter will include a number of detailed recommendations. As a result of our controls findings, we have adopted a fully substantive audit approach for POL payroll.

Management is in the process of transferring the Payroll operation from a Group shared service back into POL in order to ensure the necessary control improvements are implemented.

CONTROL THEMES AND OBSERVATIONS

Status on 2006-07 management letter points

Many of the prior year controls observations have been addressed and were reflected in the improvement in the control environment and financial statement close process at Chesterfield. The key themes that we will include in our 2007-08 management letter are:

- ▶ policy and review procedures in relation to aged credits on the balance sheet (e.g. GNRI and client balances)
- ▶ recommendations in relation to the control deficiencies observed in the payroll process

2008 challenges

Senior management will be focussed on executing a challenging transformation plan whilst growing the business in new products and services and securing ongoing funding post 2011. It is essential that they are adequately supported by their teams, and in particular that the integrity of the internal financial control environment is maintained and strengthened during this period of change. We will continue to provide management with our views on the quality and adequacy of their teams during this period.

GLS**Control observations****Financial statement close process**

In order to meet the Group reporting requirements at year end, GLS entities report eleven months of actual results together with one month of forecast results. GLS have a number of years of experience in this methodology and in 2008 the difference between the P12 forecast and P12 actual EBITA was only €0.2m. This accurate forecasting allows GLS to meet the Group's fast timetable for consolidating results with a true-up performed once the actual results are finalised, and allows us to complete our audit procedures in line with the Group reporting deadlines.

Status on 2006-07 management letter points

A controls-based audit approach is taken at the significant GLS locations. Management is conscious of the recommendations that we raise and appropriate attention has been given to the points that we have made in previous years, including foreign exchange rates used for consolidation and amendments to the intercompany confirmation process.

2008 challenges

The key focuses for senior management in 2008-09 will be executing the new business model in France, supporting the new Italian management and considering the potential Spanish acquisitions. It is essential that the current plan to provide an additional level of support continues in order to maintain a strong control environment.

SCOPE UPDATE AND STATUS OF THE AUDIT

Scope update and status of the audit

We conducted our audit, for the year ended 30 March 2008, in accordance with International Standards on Auditing (UK and Ireland) in order to provide reasonable assurance that your financial statements are free of material misstatement.

Our Audit Planning Report was presented to the Audit and Risk Committee in September 2007. As discussed in our March 2008 Audit Update Report, the scope of our work has been extended to include full scope reporting from PricewaterhouseCoopers on First Rate Exchange Services Ltd, the joint venture between Post Office Limited and Bank of Ireland. We have also performed additional procedures following the deficiencies noted in the IT general control environment and the POL payroll controls as discussed in the Control themes and observation section of this report.

Status of audit

Our responsibilities in regard to the Group's preliminary announcement are set out in the APB Bulletin 2008-02. As the preliminary announcement will be issued before the audit is complete, we have conducted our work so that we are satisfied that the outstanding audit procedures are unlikely to result in changes to the information contained in the preliminary announcement. Accordingly, our work has focused on the primary statements and related notes to the accounts and we anticipate that the audit thereof will be substantially complete by the time we meet the Audit and Risk Committee on 7 May 2008, prior to finalisation of the preliminary announcement and release the following day.

The following tasks will need to be completed following the results announcement and prior to accounts finalisation and sign off in the week commencing 19 May.

Item	Actions to resolve
Outstanding items	
Review of 'front end' statements including audit of the Directors' Remuneration Report, Chairman's and CEO's statements and completion of EY technical review thereon.	Review of 'front end' statements and review of the final draft pending finalisation by management.
Input from the Audit and Risk Committee (including representations on fraud).	To be discussed at the Audit and Risk Committee on 7 May 2008.
Post balance sheet events.	Completion of our post balance sheet events review up to the date of signing our opinions.
Receipt of letters of representation, for the Group, and Royal Mail Holdings plc company accounts.	To be tabled at the Audit and Risk Committee on 7 May 2008 and signed by management in the week commencing 19 May 2008.
Audit of Royal Mail Holdings plc company balance sheet and notes, prepared under UK GAAP.	Royal Mail to provide draft financial information. EY to audit once received.

SCOPE UPDATE AND STATUS OF THE AUDIT

Audit conclusion

On the basis of our work performed to date, we have not identified anything which would lead us to believe we will not issue an unqualified audit report in respect of the Group financial statements and related notes. On this basis, we are satisfied to provide our auditor's consent letter for the unaudited preliminary announcement (see appendix B). However, as described above, there are a number of outstanding matters and until we have completed these procedures, it is possible that further matters requiring amendment may arise.

Summary of audit differences

Our technical review of the Annual Report is ongoing and feedback to date has been reflected in subsequent drafts of the accounts. As required by International Auditing Standards (UK and Ireland), we will draw to the attention of the Chairman of the Audit and Risk Committee any material technical comments that are not reflected in subsequent drafts as this process is finalised.

There are no unadjusted audit differences greater than our reporting threshold of £1.0m. No audit differences identified in previous years have a turnaround impact of greater than £1.0m in 2007-08.

There are no amounts that we have identified that are individually or in aggregate material to the presentation and disclosures of the consolidated financial statements for the year ended 30 March 2008.

APPENDIX A - AUDITOR INDEPENDENCE AND FEES

Appendix A Auditor independence and fees**Independence confirmation - update**

We confirm that there are no changes in our assessment of independence since our confirmation in our report to the Audit and Risk Committee, dated 6 March 2008. We have complied with the APB Ethical Standards and in our professional judgment the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning of regulatory and professional requirements.

We consider that our independence in this context is a matter that should be reviewed by both you and ourselves. It is therefore important that you consider the facts of which you are aware and come to a view.

2007-08 non audit fees

Set out below is a summary of the non-audit services provided by Ernst & Young in the last financial year.

	Notes	Apr 07- Jan 08 £'000	Feb 08- Mar 08 £'000	Total YTD 2007-08 £'000	Total 2006-07 £'000
United Kingdom					
Other services supplied pursuant to legislation		-	-	-	20
Taxation services		1	-	1	74
Litigation services	1	40	205	245	128
Corporate finance services		-	-	-	-
Other		51	-	51	133
Total United Kingdom		92	205	297	355
Overseas					
Taxation services (GLS)		274	8	282	215
Corporate finance services (GLS)	2	-	109	109	91
Total		366	322	688	66

Note 1: Litigation services relate to Tele2

Note 2: Corporate finance services relate to potential GLS acquisitions

APPENDIX A - AUDITOR INDEPENDENCE AND FEES

2007-08 non audit fees

	Audit related				Tax Services		Other Services	Approval		
	GLS		Other		GLS	Other		EY	RM	ARC
	Accounting advice	Third party reporting	Accounting advice	Third party reporting						
Pre-approval limit (k)	€170	€30	£250	£250	€400	£200	£250			
Previous total pre-approval by Royal Mail			£15	£55	€334	£14	£209			
Pre approvals during 1 Feb - 30 Mar										
China Tax						13		✓	✓	Note 1
GLS Denmark - Tax					2			✓	✓	Note 1
GLS Netherlands					55			✓	✓	Note 1
Tele2							145	✓	✓	Note 2
UK-Tax						50		✓	✓	Note 1
Total pre-approvals 1 Feb - 30 Mar 08					€57	£63	£145			
Total pre-approvals to 30 Mar 08			£15	£55	€391	£77	£354			
Billings (k)										
Billings previously reported:			£15	£36	€378	£1	£40			
Total billings during 1 Feb - 30 Mar 08					€23		£314			
Total billings to 30 Mar 08			£15	£36	€401	£1	£354			Note 3

Note 1: As noted in the 'Approval of Auditors' Remuneration' paper submitted to the Audit and Risk Committee in May 2007, these amounts are below the pre-approval limits and have therefore, in accordance with the process, been approved by the Group Finance Director. They are presented here for final approval by the Audit and Risk Committee.

Note 2: As discussed at the March Audit and Risk Committee, an additional £145k was pre-approved taking the total pre-approval for this project during 2007-08 to £245k.

Note 3: Included in the total billings to GLS is €57k relating to services pre-approved prior to the current pre-approval policy.

APPENDIX B - PRELIMINARY ANNOUNCEMENT - AUDITOR CONSENT LETTER

Appendix B Preliminary announcement - auditor consent letter

The Directors
Royal Mail Holdings plc
148 Old Street
London
EC1V 9HQ

8 May 2008

Dear Sirs

Royal Mail Holdings plc: preliminary announcement of results for year ended 30 March 2008

In accordance with the terms of our engagement letter dated [date once signed], we have reviewed the attached proposed preliminary announcement of Royal Mail Holdings plc for the year ended 30 March 2008. Our work was conducted having regard to Bulletin 2008-2 "The auditor's association with preliminary announcements made in accordance with the requirements of the UK and Irish listing rules" issued by the Auditing Practices Board. As directors you have accepted responsibility for preparing and issuing the preliminary announcement.

Our responsibility is solely to give our agreement to the preliminary announcement having carried out the procedures specified in the Bulletin as providing a basis for such agreement. In this regard we agree to the preliminary announcement being published.

As you are aware we are not in a position to sign our auditor's report on the annual financial statements as they have not yet been approved by the directors and we have not yet completed the subsequent events review or obtained final signed written representations from directors. Consequently there can be no absolute certainty that we will be in a position to issue an unmodified audit report on financial statements consistent with the results and financial position reported in the preliminary announcement. However, at the present time, we are not aware of any matters that may give rise to a modification to our report. In the event that such matters do come to our attention we will inform you immediately.

Yours faithfully

Alison Duncan
Partner
For and on behalf of Ernst & Young LLP

APPENDIX C - DRAFT LETTERS OF REPRESENTATION

Appendix C Draft letters of representation

Ernst & Young LLP
1 More London Place
London, SE1 2AF
United Kingdom

X May 2008

Dear Sirs

Royal Mail Holdings plc and subsidiaries ('the Group')

This representation letter is provided in connection with your audit of the financial statements of the above Group for the year ended 30 March 2008 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view of the financial position of the Group as of 30 March 2008 and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

The financial statements have been considered and approved at a duly convened meeting of the Board of Directors at which the attention of the Board was drawn to their responsibilities in connection therewith. The undersigned were authorised to sign the balance sheet on behalf of the Board and to give you the assurances below. We acknowledge our responsibility for the fair presentation of the financial statements in accordance with International Financial Reporting Standards.

We confirm to the best of our knowledge and belief, the following representations:

a. Availability of information

As far as we are aware, all the accounting records have been made available to you for the purpose of your audit and all the transactions undertaken by the Group have been properly reflected and recorded in the accounting records. All other records and related information have been made available to you, including the minutes of all directors' and shareholders' meetings which are a complete and authentic record of the proceedings at those meetings.

b. Transactions with directors (or persons connected with them)

At no time during the year has an entity within the Group had any arrangement, transaction or agreement to provide credit facilities (including loans, quasi-loans or credit transactions) for directors (or persons connected with them) or to guarantee or provide security for such matters.

c. Related parties and related party transactions

We have identified and disclosed to you all related parties. During the year the Board has identified and approved, in a manner deemed appropriate by the Board, related party transactions and provided the information for disclosure of all transactions relevant to the Group in note 29 of the financial statements. They are not aware of any other matters which require to be disclosed under IAS 24 ('Related Party Disclosures') or other requirements.

APPENDIX C - DRAFT LETTERS OF REPRESENTATION

d. Events after the balance sheet date

Other than those mentioned in Note 30 in the financial statements, there have been no events since the balance sheet date which necessitate revision of the figures included in the financial statements or the inclusion of a note thereto. Should any such material events occur before the date of the AGM, we will advise you accordingly.

We have also reviewed events occurring in subsidiary undertakings, associates and joint ventures since the dates of their respective balance sheets and this enables us to conclude that nothing has occurred in those periods which necessitates a revision of the figures included in the Group financial statements or inclusion of a note thereto.

Royal Mail Holdings plc has no plans or intentions that would materially affect the operations of its subsidiary undertakings, associates and joint ventures or the carrying value or classification of their assets and liabilities at 30 March 2008. We are not aware of any information that has not been appropriately considered in preparing the financial statements of the subsidiary undertakings, associates and joint ventures.

e. Going concern

The financial statements have been prepared on the going concern basis. In assessing the appropriateness of the going concern basis, we have taken account of all relevant information covering a period of at least twelve months from the date of approval of the financial statements.

In respect of preparing the Group accounts on a going concern basis, we have fully considered the agreed financing arrangements with BERR relating to the funding of the Group at year end and the associated EU challenge in relation to funding.

We are satisfied that relevant disclosure has been made in the financial statements which enables them to give a true and fair view.

f. Fair Value measurements and disclosures

The measurement methods, including the significant assumptions used, in determining fair values under International Financial Reporting Standards are reasonable in the circumstances, and appropriately reflect our intention and ability to carry out specific courses of action on behalf of the Group where relevant to the fair value measurements or disclosures made in the financial statements.

g. Compliance with law or regulations

We have disclosed to you all known actual or possible non-compliance with law or regulations, including the actual or contingent consequences which may arise from the non-compliance, of which the directors are aware, whose effects should be considered when preparing the financial statements.

h. Fraud and error

We acknowledge our responsibility for the design and implementation of internal control systems to prevent and detect fraud and error. We have disclosed to you all significant facts relating to any frauds or suspected frauds known to management that may have affected the Group. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

APPENDIX C - DRAFT LETTERS OF REPRESENTATION

i. Audit differences

There are no unadjusted audit differences identified pertaining to the latest period presented.

j. Contingent liabilities

Provision has been made where a material loss is expected to result from any litigation or claims against the Group. Other contingent liabilities at the balance sheet date, none of which are expected to result in a material loss to the Group or commitments which it cannot meet, have been disclosed in the financial statements, unless the possibility of losses occurring is considered remote.

All significant matters which have been referred to solicitors have been disclosed to you.

k. Retirement benefits

On the basis of the process established by us and having made appropriate enquiries, we are satisfied that the actuarial assumptions underlying the scheme liabilities are consistent with our knowledge of the business. All significant retirement benefits and all settlements and curtailments have been identified and properly accounted for.

l. Intra-Group profits

Necessary adjustments have been made to eliminate all material intra-Group unrealised profits on transactions amongst parent, subsidiary undertakings and associated undertakings.

m. Specific accruals

We consider that the £35m accrued in relation to the bulk compensation scheme represents management's best estimate of the liability at 30 March 2008.

Where certain targets have not yet been agreed with the Shareholder Executive for the UK LTIP scheme and management bonuses, we consider that the use of Board-approved targets is the most appropriate way to estimate the liability at 30 March 2008.

We consider that the £38.4m accrued in relation to VAT represents management's best estimate of the liability at 30 March 2008.

We confirm that we intend to pay the full stakeholder dividend of £800 per employee and the 30 March 2008 accrual has been calculated appropriately on this basis.

We confirm that the above representations are made on the basis of enquires of management and staff with relevant knowledge and experience (and, where appropriate, inspection of evidence) sufficient to satisfy ourselves that we can properly make each of the above representations to you.

Yours faithfully

For and on behalf of ROYAL MAIL HOLDINGS plc

APPENDIX C - DRAFT LETTERS OF REPRESENTATION

Ernst & Young LLP
1 More London Place
London
SE1 2AF

X May 2008

Dear Sirs

Royal Mail Holdings plc

This representation letter is provided in connection with your audit of the financial statements of the above company for the year ended 30 March 2008 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view of the financial position of the company as of 30 March 2008 and of the results of its operations and its cash flows for the year then ended in accordance with United Kingdom accounting standards.

The financial statements have been considered and approved at a duly convened meeting of the Board of Directors at which the attention of the Board was drawn to their responsibilities in connection therewith. The undersigned were authorised to sign the balance sheet on behalf of the Board and to give you the assurances below. We acknowledge our responsibility for the fair presentation of the financial statements in accordance with United Kingdom accounting standards.

We confirm to the best of our knowledge and belief, the following representations:

a. Availability of information

As far as we are aware, all the accounting records have been made available to you for the purpose of your audit and all the transactions undertaken by the company have been properly reflected and recorded in the accounting records. All other records and related information have been made available to you, including the minutes of all directors' and shareholders' meetings which are a complete and authentic record of the proceedings at those meetings.

b. Transactions with directors (or persons connected with them)

At no time during the year has the company had any arrangement, transaction or agreement to provide credit facilities (including loans, quasi-loans or credit transactions) for directors of the company (or persons connected with them) or to guarantee or provide security for such matters.

c. Related parties and related party transactions

We have identified and disclosed to you all related parties. During the year the Board has identified and approved, in a manner deemed appropriate by the Board, related party transactions and provided the information for disclosure of all transactions relevant to the company in the financial statements. They are not aware of any other matters which require to be disclosed under FRS 8 ('Related Party Disclosures') or other requirements.

d. Events after the balance sheet date

There have been no events since the balance sheet date which necessitate revision of the figures included in the financial statements or the inclusion of a note thereto. Should any such material events occur before the date of the AGM, we will advise you accordingly.

APPENDIX C – DRAFT LETTERS OF REPRESENTATION

e. Going concern

The financial statements have been prepared on the going concern basis. In assessing the appropriateness of the going concern basis, we have taken account of all relevant information covering a period of at least twelve months from the date of approval of the financial statements.

We are satisfied that relevant disclosure has been made in the financial statements which enables them to give a true and fair view.

f. Carrying value of investment

We believe that the carrying value of the investment in Royal Mail Group plc is supportable and does not require an impairment.

g. Fair Value measurements and disclosures

The measurement methods, including the significant assumptions used, in determining fair values under United Kingdom accounting standards are reasonable in the circumstances, and appropriately reflect our intention and ability to carry out specific courses of action on behalf of the company where relevant to the fair value measurements or disclosures made in the financial statements.

h. Compliance with law or regulations

We have disclosed to you all known actual or possible non-compliance with law or regulations, including the actual or contingent consequences which may arise from the non-compliance, whose effects should be considered when preparing the financial statements.

i. Fraud and error

We acknowledge our responsibility for the design and implementation of internal control systems to prevent and detect fraud and error. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud. We have disclosed to you all significant facts relating to any frauds or suspected frauds known to management that may have affected the entity.

j. Uncorrected misstatements

There are no unadjusted audit differences identified pertaining to the latest period presented.

k. Contingent liabilities

No material loss is expected to result from any litigation or claims against the company. There are no other contingent liabilities at the balance sheet date which are expected to result in a material loss to the company or in commitments which it cannot meet.

We confirm that the above representations are made on the basis of enquiries of management and staff with relevant knowledge and experience (and, where appropriate, inspection of evidence) sufficient to satisfy ourselves that we can properly make each of the above representations to you.

Yours faithfully

For and on behalf of ROYAL MAIL HOLDINGS plc