

Strictly Confidential

POLARC 17(4th)
POL ARC 17/43 – 17/62

POST OFFICE LIMITED
(Company no. 2154540)
(the 'Company')

Minutes of a meeting of the AUDIT, RISK AND COMPLIANCE COMMITTEE
held at 10.00 am on 18th May 2017 at 20 Finsbury Street, London EC2Y 9AQ

Present:

Carla Stent	Chair
Richard Callard	Non-Executive Director (RC)
Tim Franklin	Non-Executive Director (TF)
Ken McCall	Non-Executive Director (KMC)

In attendance:

Alisdair Cameron	Chief Finance and Operating Officer (CFOO)
Jane MacLeod	General Counsel (GC)
Nick Kennett	Chief Executive Financial Services and Telecommunications and CEO of POMS (NK)
Alwen Lyons	Company Secretary (CoSec)
Amanda Radford	Group Financial Controller (AR)
Johann Appel	Senior Manager Internal Audit (JA)
Richard Williams	Senior Manager Risk (RW)
Peter McIver	Audit Partner, Ernst & Young (PMI)
Claire Johnson	Senior Quality Leader, Ernst & Young (CJ)
Amanda Bowe	POMS ARC Chairman (AB) (Minute POLARC 17/45)
Deana Herley	Senior Assurance Manager (DH) (Minute POLARC 17/47-49)
Rob Houghton	Chief Information Officer (RH) (Minute POLARC 17/50)
Sharon Gilkes	Business Performance and IT Transformation Director (SG) (Minute POLARC 17/50)
Sally Smith	Head of Financial Crime (SS) (Minute POLARC 17/52)

Apologies for absence:

Paula Vennells	Chief Executive Officer (CEO)
----------------	-------------------------------

POLARC 17/43 WELCOME AND CONFLICTS OF INTEREST

- (a) A quorum being present, the Chair opened the meeting. The directors declared that they had no conflicts of interest in the matters to be considered at the meeting in accordance with the requirements of section 177 of the Companies Act 2006 and the Company's articles of association.

POLARC 17/44 MINUTES OF THE MEETING HELD ON 28TH MARCH 2017, MATTERS ARISING AND ACTIONS LIST

- (a) The minutes of the meeting held on 28th March 2017 were approved as presented and the Chair of the committee was authorised to sign them as a true record.

Strictly Confidential

- (b) The Committee noted the updated actions list.

POLARC 17/45

POMS ARC REPORT

POMS ARC Report

- (a) The Committee received a verbal report from Amanda Bowe, POMS ARC Chairman following the POMS ARC meeting held on 16 May 2017.
- (b) AB reported that good progress had been made to embed the POMS risk framework, but highlighted two areas of concern:
1. Potential risk of non-compliance in the branch network following mystery shopping undertaken by the POMS compliance team; and
 2. the lack of MI available to enable POMS to oversee POL as their Appointed Representative.

AB recognised that plans were in place to rectify both issues.

- (c) The ARC asked for more detail on the mystery shopping results and AB explained that issues had arisen with the sale of life insurance and despite recent training the mystery shopper had not been provided with all the necessary information. NK stressed that there had been no customer detriment and that the video mystery shopping had been a very small sample, but that the exercise had highlighted a need to revisit and test the training provided. **AB promised the POL ARC more detail once the internal audit had been completed.**

ACTION: NK

- (d) The second concern regarding MI was in development and initiatives such as EUM and SuccessFactors later in the year would assist.
- (e) AB explained that the POMS ARC had a good framework in place for assurance activity, with routine updates and a deep dive later in the year.

- (f) The POMS ARC had received an interim paper on vulnerable customers and had agreed the high level principles although acknowledged that more work was need to embed them. The ARC asked how vulnerable customers were being identified and how staff were being trained. It was noted that **Jonathan Hill would report to the RCC in July and the ARC in September on POL's proposed approach to vulnerable customers.**

ACTION: JH

- (g) AB reported that EY had attended the POMS ARC meeting to report on the POMS audit and to ratify the interim profit. No adverse issues had arisen and at the private meeting the auditors had provided a positive report on the POMS processes and management capability.
- (h) AB reported that Susie Hayward, POMS Head of Risk and Compliance had resigned and although AB was sorry to see her leave recruitment had commenced to replace her.

Strictly Confidential

- (i) NK reported the regulatory developments of the Insurance Distribution Directive and the Senior Manager Regime for Insurance and noted that the POMS ARC received an hours training before each meeting to keep them updated.

ACTION: JM

The ARC requested future training on regulatory developments and specifically asked for a list of all the material regulators and regulations which affected POMS and POL.

- (j) The Committee noted the report from the POMS ARC Chairman.

POLARC 17/46

ANNUAL REPORT AND ACCOUNTS 2016/17 (ARA)

- (a) The Committee received a report from Alisdair Cameron, CFOO and Amanda Radford, Financial Controller.

ARA Covering Note

- (b) AR presented the draft financial statement section of the ARA, which had been prepared ready for signing at the end of July assuming that
1. confirmation of investment funding is received from BEIS by the end of June
 2. the EY audit procedures are complete, and
 3. the legal review of control accounts in POLSAP by Deloitte is finalised.

Financial Statements

- (c) The Committee reviewed the Financial Statements and Accounts in respect of Post Office Limited for the year ending 26th March 2017. The ARA had been prepared on a basis consistent with prior years with the following exceptions:
1. Impairment of fixed assets. The Financial Statements were presented with a change to the treatment of fixed assets moving to an impairment basis. This may have to be reversed if we cannot see our way to commercial sustainability post the Funding settlement.
 2. Accounting for FRES. The accounting treatment for FRES had been changed to move to use equity accounting in joint ventures. This meant that the Company and Group were now aligned. (supported by EY)
 3. Closure of the defined benefits pension scheme. With the closure of the DB scheme the net pension asset of £210m (which under accounting rules had been revaluated from £193m) had been removed from the balance sheet.
AR explained that there had been some debate with EY about the discount rate to be used to value the pension scheme asset. EY believed that the discount rate used was at the prudent end of the range, however in the round were content to support it.
The ARC supported this prudent approach.

Strictly Confidential

- (d) Work had been undertaken to verify the existence and value of the fixed assets included on the balance sheet. This was now being audited by EY. The controls over the revalued assets were being reviewed as part of the Financial Controls Framework.
- (e) The consolidated income statement, page 6 of the Financial Statements shows an EBITDAS of £13m compared with a restated loss of (£17m) in 2016, and includes amongst other things; the discontinued Cash in Transit business; the effect of the pension closure; and the strong underlying trading improvement.

ACTION: CFOO

The ARC thanked AR for the detailed presentation and stressed the need to explain the changes in the front end ARA narrative.

- (f) The ARC asked for comfort on the accuracy of the £42m Postmaster Compensation provision. The CFOO explained that the quantum of the provision had reduced significantly as the Network Transformation programme draws to a close. We were comfortable with the size of the provision which was intended to be a prudent but realistic amount based on the likely branch numbers and closure dates, with changes to the branches in the programme inevitably changing the compensation paid. EY had checked the accuracy of the calculations and had not discovered any issues, but would continue to reconcile the actual payments and the provisions made. However, they had not completed their work and could reach a different judgement on the provision at year-end.
- (g) AR explained the Quality of Earnings calculation and the year on year improvement in EBITDAS, excluding one-offs, of £35m.
- (h) Ernst and Young (EY) External Audit Risk Results
The Committee reviewed the preliminary audit results report which summarised the findings from EY audit of Post Office Limited's financial position and operations for the 52 week period ended 26th March 2017.
- (i) EY explained that the audit report was as advanced as it could be at this stage and subject to finalisation of the outstanding areas it was anticipated that EY would issue an unqualified audit opinion. Specifically:
 - 1. The revenue recognition work was completed satisfactorily
 - 2. The layout and classification of the P&L account were agreed
 - 3. Accounting treatment for Pension; FRES; discontinued Retail Cash in Transit Business; Sparrow litigation; Postmaster compensation; POMS; Goodwill and Fixed Asset impairment were all satisfactory subject to the areas already reported to the ARC

Strictly Confidential

- (j) EY would continue to monitor the contingent liability disclosures nearer to the date of signing the ARA.

ACTION: JM

The ARC discussed the Postmaster Litigation and JM was asked to circulate a note to update the ARC on the funding of the Postmasters' action.

- (k) EY recognised the progress made to improve the financial control environment. More work would be done to check the Joiners, Movers and Leavers data and manager access.
- (l) The Committee noted the progress and findings from the EY report.
- (m) The Chair explained that the papers covering; Top Risks; Executive Declaration; and Principle risks for the ARA would be taken next and considered as part of the ARA discussion.

POLARC 17/47

TOP RISKS

- (a) JM introduced the top risks and explained the changes made since the January report. The risks had been grouped into risk universe categories which were now aligned to the placemat work, and were cross referenced to any risks highlighted in the executive declarations.
- (b) A few risks had been downgraded including Royal Mail Alignment because of the closer working relationship with RMG including engagement with RMG through the CEOs. However a new RMG Industrial Action risk had now been added to the register.
- (c) The ARC discussed the IA risk and its effect on Post Office. JM advised the Committee that contingency planning was already underway for any RMG strike action.
- (d) The ARC challenged the consistency in reducing the IT delivery risk whilst IT delivery capability remained a disclosable risk in the ARA. **The ARC asked the Executive to consider the IT risk scoring again as despite the reduction in IR35 implications there were still challenges to the delivery of the IT transformation.**

ACTION: RH

- (e) The ARC discussed the reduction in the people capability risk. The CFOO explained the good track record on recent hires which had enhanced the people capability of the business. There had been debate at GE over the impact of cost reductions with an outcome that whilst individual situations might arise as a consequence, the overall risk was not extreme. There was now much better capability in the IT function, however if the ARC felt the reassessment was premature **the Executive would reconsider the people capability risk score to see if the change was justified.**

ACTION: MK

- (f) The Committee noted the report.

Strictly Confidential

POLARC 17/48 EXECUTIVE DECLARATION

- (a) DH introduced the Executive Declaration paper and explained the results and the 15 items which had been considered appropriate to disclose in the ARA. The ARC challenged whether more of the detail of the 58 disclosures which had been omitted from the report should have been presented to the ARC.
- (b) DH assured the ARC that 27 of the disclosures had been shared with the Financial Controller to understand if they required any accounting adjustment, and 31 of the disclosures were not considered to be material or were sufficiently addressed by other generic disclosures.
- (c) The Committee agreed the approach to disclosure as set out in the report, and noted the items to be disclosed.

POLARC 17/49 PRINCIPAL RISKS FOR THE ANNUAL REPORT AND ACCOUNTS

- (a) JM explained that the Top risks and Executive Declarations fed into the disclosures in the risk section in the ARA, but that the less material risks were still visible to the Executive.
- (b) The Chairman asked if the ARC was comfortable with the 15 risk which had been identified from the executive declarations and their cross reference to the 7 principle risks for the ARA.
- (c) The ARC asked if the HMRC fine should be disclosed in the ARA, JM reported that it would not be disclosed by HMRC. The CFOO explained that the Executive acknowledged that the inaccurate registration was an error which should not have happened but this was a historical problem, reflected over and under registration, the remedial action was now in place and this fine although significant was not considered a material amount for disclosure.
- (d) The Committee approved the draft principal risks, as set out in Appendix 1 to the report, for inclusion in the Annual Report and Accounts 2016/17.
- (e) DH left the meeting.

POLARC 17/50 IT CONTROLS UPDATE

- (a) Rob Houghton, CIO, and Sharon Gilkes, Business Performance and IT Transformation Director joined the meeting. The Chairman recognised the good progress being made and asked RH to give an update on the recent Ransomware Cyber Attack, and the internal audit report on access controls.
- (b) RH explained that the Post Office had not seen any evidence of the Ransomware attack compromising the IT systems. The investment to replace all the admin laptops a year ago had been

Strictly Confidential

- (c) key as the new machines had high protection against viruses, which would have caught the attack if it had reached Post Office.
- (d) Over the weekend the IT security team had upped the spam filter for incoming mail and made sure that any vulnerable parts of the operation were not connected to the network.
- (e) Contact had also been made to IT suppliers to ensure that they were safe. The in-branch SSK and AEI machines which run on older software had been checked and were OK.
- (f) HR reported that the business does use some XP software but that this was ring-fenced behind a fire wall, these machines would be patched over time but they were not a threat to the wider business.
- (g) A report had been sent to BEIS to update them on the position and provide details and contact numbers for IT and Business Continuity.
- (h) The ARC thanked RH and his team for the work to date. RH was pleased with the position but would be more comfortable when the ITSOC (IT security centre) was completely operational.
- (i) INTERNAL AUDIT – JOINERS, LEAVERS AND MOVERS
JA introduced the report of the internal audit carried out on the 26th April to test access management and Joiners, Movers and Leavers (JML) processes. The audit had found that there was; no overall process or ownership for JML; no system and data owner; and no access management process. The ARC were very concerned about the findings of the audit report.
- (j) JM explained that she had taken over responsibility for setting up the oversight for JML with involvement from HR, HR Operations and IT. The ARC thanked JM for taking on the coordination role but queried whether delivery should be owned by one individual who had complete dependencies on other functions; no matter how well understood and managed.

ACTION: JM

It was agreed that this would be monitored and if issues arose and remained unresolved JM would advise the ARC Chair.

- (k) JM recognised that the actions highlighted in the internal audit report needed to be addressed urgently to ensure the HR data is correct.

ACTION: JA

It was stressed that a similar issue had been raised at the ARC three years ago and the Committee asked JA to investigate who had taken ownership of the issue at that time, and why it had not been put right.

- (l) The ARC were very concerned with Leavers still having access to the system. RH reported that removing Leavers from the

Strictly Confidential

system was straightforward if the information processes were in place.

- (m) The ARC asked if the Executive were comfortable that the payroll was accurate and that Leavers were not receiving inappropriate pay. **EY assured the ARC that their payroll audit tests had not shown any problems but that they would go back and check again to give assurance.**

ACTION: EY

The ARC asked the CFOO to brief the CEO on the discussion and the urgency of the situation and asked the CFOO and the CEO to be ready to discuss at the Board on the 25th May.

ACTION: CFOO

- (n) The Committee noted the report.
- (o) RH and SG left the meeting.

POLARC 17/51

FINANCIAL REPORTING CONTROLS

- (a) The Committee thanked AR and EY for their work on the financial controls.
- (b) EY explained that they were investigating one area of the Journal Controls in POLSAP which they did not at this point think was a material risk to the results. An update would be provided when the situation was clear.
- (d) The Committee noted the report.

POLARC 17/52

FINANCIAL CRIME RISK UPDATE

- (a) The Committee received a report from Sally Smith, Head of Financial Crime.
- (b) SS explained the work undertaken with HMRC to deliver the action plan which was in place. AML training was underway with branch training starting 10 days ago.
- (c) There was no further news on the HMRC AML penalty or the 4th AML directive, but the meetings with HMRC were positive. The ARC asked if SS was getting the support that she needed from the business and SS assured the ARC that she was.
- (d) Product Risk assessments were broadly on plan, with work on Drop & Go nearing completion and good progress on MoneyGram and Giftcards. Work was underway on Bureau de Change to articulate the risks and understand the actions required.
- (e) HMRC had flagged that it proposed to review bill payments later in the year. SS advised that work was underway with the legal team to review the legal and regulatory framework around bill payments to determine the extent of POL's responsibilities.

Strictly Confidential

- (f) The ARC asked about the AML training completion rates. SS explained the flaws in the original HR data which had now been cleansed but still included people on long term sick or maternity leave. However the completion rates had significantly improved.
- (g) JM acknowledged that the accuracy of HR data had been an issue and migration to SuccessFactors involved a cleanse, and would therefore resolve many of these issues.

ACTION: MK

The ARC asked for the plan to cleanse the HR data to be presented by the HR Director at the next ARC, and to return to update the ARC at every following alternate meeting.

- (h) SS assured the ARC that all the risk assessments were due by the end of May.
- (i) The Committee noted the report.
- (j) SS left the meeting.

POLARC 17/53 FINANCIAL SERVICES CONDUCT RISK UPDATE

- (a) The Committee noted the report.

POLARC 17/54 SAFETY

- (a) The Committee noted the report.

POLARC 17/55 TRANSFORMATION – CHANGE RISK UPDATE

- (a) The Committee noted the report.

POLARC 17/56 TAX UPDATE

- (a) The Committee received the interim tax update from the CFOO who explained the main areas of taxation which effect the Company:
 - Value Added Tax
 - Corporation Tax, and
 - Employment taxes/PAYE
- (b) The CFOO reported the partial VAT exemption from HMRC and the advisory relationship with KPMG for VAT advice. KPMG believe that the partial exemption was secure but the CFOO recognised the need to keep close to HMRC on VAT.
- (c) AR explained that as the Company moved to a position of profitability more focus would need to be given to Corporation Tax and the treatment of Research & Development spend. AR reported the activity to recruit a tax generalist to be responsible for all areas with the ongoing external support for specialist advice.

Strictly Confidential

ACTION: CFOO

The CFOO reminded the ARC that a Tax strategy paper was due at the November ARC meeting, which would include any outstanding HMRC issues, the response to the tax internal audit, and tax planning as the Company moves into profit.

- (d) The ARC discussed the possible change of emphasis away from EBITDAS, when the Government investment funding is in place, and the Company moves into profit. The CFOO proposed that at this point the Board should consider moving to profit after tax as the primary scorecard measure.
- (e) The Committee noted the report and understood that a further update would be provided at the November meeting.

POLARC 17/57**INTERNAL AUDIT REPORT**

- (a) The Committee received a report from Johann Appel, Senior Manager Internal Audit.
- (b) The Chairman noted that at the previous meeting JA had flagged there would be approximately 9 IA reports to table at this meeting and queried why this was not the case. JA explained that he had started with a back log in the plan but that all the internal audits for 2016/17 had now been completed with reports in final draft. Final reports would be available in the next 2 weeks.
- (c) The ARC asked for assurance that management were not prevaricating or negotiating away the action points. JA assured the ARC that this was not the case.

The ARC asked JA to introduce SLAs for AI reports:

- 10 working days following fieldwork to complete and issue the draft report to management; and
- 10 working days for management to respond.

ACTION:JA

The IA process should set out how reports would be provided, and the timings for response. The GE member responsible should see the initial draft report, and be involved in ensuring that managers respond with the agreed timescale.

ACTION: JA

- (d) The Committee noted the Internal Audit Report.

RISK UPDATE**POLARC 17/58****SUPPLY CHAIN PILOT OF THE PLACEMAT**

- (a) The Committee noted the report which would presented at the next ARC.

Strictly Confidential

POLARC 17/59 BUSINESS CONTINUITY PLANNING

- (a) The Committee noted the business continuity and crisis management update.

DECISION PAPERS**POLARC 17/60 MODERN SLAVERY ACT STATEMENT**

- (a) The Committee received a report in the name of Martin Kirke, Group HR Director, presented by JM.
- (b) The ARC asked where the modern slavery risk existed in the Business. JM explained that there was potential for risk in the postmaster network, but that the statement provided a proportionate response to the legislation.
- (c) The ARC challenged the passive nature of the statement and asked whether the business should be doing more, especially with regards to postmasters' assistants.

ACTION: JM/MK**The ARC asked for a note on the number of Postmaster contracts which had been amended to take into account the modern slavery act.****ACTION:JM/MK****The ARC supported the statement but asked for feedback on how the requirements of the Modern Slavery Act were being deployed in the business**

- (d) The Committee recommended the 2017/18 Modern Slavery Act Statement to the Board for approval and endorsed the actions set out in the report with the addition of those actions raised by the ARC.

NOTING PAPERS**POLARC 17/61 WHISTLEBLOWING REPORT**

- (a) JM presented the Whistleblowing (WB) report and explained that 4 specific WB reports had been received since March 2016. She acknowledged that this was a very low number of WB incidents and explained that individuals used other processes to register issues, and this data was not captured as WB. A communication had also been sent out to advertise the help line.
- (b) The ARC asked if postmasters' assistants had access to the WB helpline, and although they do not have access to WB they can use the Grapevine help line to report. JM reported that 2 recent incidents were registered by postmaster assistants on Grapevine, which gave some comfort that the process was recognised by postmasters' assistants.
- (c) The ARC recognised that 4 incidents was very low but accepted that the Executive were doing all the right things to promote the support.

Strictly Confidential

- (d) The Committee noted the report.

POLARC 17/62 ANY OTHER BUSINESS

- (a) There being no further business the Chair closed the meeting at 13.05pm.

Carla Stent

25/9/2017
Date