

Royal Mail – Strictly Confidential

ARC (08)4TH
36 - 43

ROYAL MAIL HOLDINGS plc

(Company no. 4074919)

AUDIT AND RISK COMMITTEE

Minutes of the meeting held at 148 Old Street on 10th November 2008

Members of the Committee Present:

Helen Weir	Non Executive Director, Chair of the Committee
Margaret Prosser	Non Executive Director
Andrew Carr-Locke	Non Executive Director

Apologies:

Richard Handover	Non Executive Director
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In attendance:

Adam Crozier	Chief Executive
Ian Duncan	Group Finance Director
Jonathan Evans	Company Secretary
Doug Evans	General Counsel
Derek Foster	Internal Audit & Risk Management Director
Mike Moores	Financial Management & Control Director
Will Rainey	Ernst & Young
Alison Duncan	Ernst & Young
Anup Sodhi	Deputy Company Secretary
Andrew Poole	POL Finance Director for ARC08/41
Peter Corbett	POL Finance Director for ARC08/41
Keith Woollard	Head of Compliance POL for ARC08/41

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MINUTES

- (a) The minutes of the meeting of the 3rd September 2008 were considered and approved as an accurate record of the meeting.
- (b) The Committee noted the minutes of the GLS Group Audit & Risk Committee dated 24 October 2008, the minutes of the Corporate Risk Management Committee dated 6 August 2008 and 4th November 2008.

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STATUS REPORT

ARC(08)25

The Committee noted the status of actions from the previous meetings. In particular the Committee noted the following matters;

- (a) ARC08/27(c) Succession Planning: Helen Weir confirmed that she had raised the issue of Succession planning at the

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Holdings Board. Adam Crozier noted that the Group Executive Team would be reviewing succession later on in the month and would report back to the Nomination Committee in December.

- (b) ARC08/28(c) Review of Committee effectiveness: All of the Non-executive directors would shortly receive an invitation to participate in the E&Y 2009 programme for NEDs, which would include amongst other topics IFRS latest developments, managing risks in major IT projects and Strategic and Operational risks. A focussed briefing session on accounting developments would also be provided at the next A&RC meeting.
- (c) ARC08/31(e) IT Control Environment: an update on the IT control environment would be given at the March 2009 meeting.

ARC08/38 INTERNAL AUDIT & RISK MANAGEMENT QUARTERLY REPORT

- (a) Derek Foster introduced a report summarising the activity of IA&RM for the period August to October 2008. The Committee noted:-
- (b) fifteen IA&RM reports had been issued in the period and the three reports of most significance were noted as being Response Services Product (RM Letters), Revenue Leakage (RM Letters) and Telephony products (POL). The Committee noted the actions being taken to address the issues raised in the reports;
- (c) the level of not satisfactory assessments for the year to September 2008 was 29% of total rated reviews compared to 19% in 2007. The proportion of assignments where results were assessed as High impact from a Group perspective was 9% compared to 10% in the previous year. The increase reflected increased exposure in specific areas of the Group, a move into the execution phase of the Transformation programme and more focussed targeting of problem areas;
- (d) the Committee requested that a senior representative of the Letters Business attend a future Committee meeting to provide an update on what action had been taken to mitigate the risks identified in relation to the Response Services product and on Revenue leakage. The update would include an explanation of the targets that had been set to improve the position together with an update on progress towards achieving the targets;
- (e) the Committee noted the quarterly IA&RM report dated November 2008.

**ACTION
Adam Crozier****ARC08/39****E&Y RESULTS ARC(08)27-30**

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<p>ACTION Ian Duncan</p> <p>ARC08/40</p>	<p>(a) The Committee <u>noted</u> a paper setting out the results of the half year accelerated audit procedures. Following the decision not to issue IFRS interim accounts for the half year ended 28 September 2008 E&Y had not performed a review on the half year trading statement in accordance with International Standards on Review Engagements but had agreed to accelerate certain elements of the 2008-09 year end audit procedures in areas determined by the Company and shared the observations arising from that work;</p> <p>(b) The Committee <u>noted</u> a summary of the results of the work and which had been discussed with Management on the 15th October and also at a meeting of the Sub-committee of the Board on the 16th October 2008;</p> <p>(c) Doug Evans had raised a new employment tribunal matter in relation to the WH Smith franchising and how the changes in employee terms and conditions (TUPE) were handled when their employment contract was transferred to WH Smith. The employment tribunal had found that POL had not properly consulted with relevant employees. Royal Mail had appealed against the decision and based on advice from two leading employment experts believed that the ruling would not stand. The maximum exposure had been estimated at £22.8 million based on compensation being paid to all employees in the Crown Office network. If compensation was only paid to the employees that had transferred to WH Smith then the figure would be £3.9 million. No amount had been accrued at the half year and a formal legal decision was expected in near future.</p> <p>(d) E&Y had performed an analysis of debtors at GLS. The overall level of debt had increased from Euros 233m in March 2008 to Euros 242 million at September 2008. This was in part due to the additional two working days in the September accounting month but also due to an increase in the ageing profile of debtors following the recent economic downturn. Ian Duncan agreed to keep the debtors position under review.</p> <p>(e) The Committee <u>noted</u> the report and thanked E&Y for their help in finalising the half year trading statement.</p>
	<p>INVESTMENT APPRAISAL LESSONS LEARNED FROM TRACKED +</p> <p>ARC (08)31</p>
	<p>(a) The June 2008 Holdings Board had re-authorised £67m investment in Tracked +, an increase of £22m from the initial approval in 2007. The Committee <u>noted</u> a paper setting out the lessons learnt from the Investment Appraisal process and the actions identified to address the issues identified;</p> <p>(b) a number of actions had been, or were being, put in place that would address the lessons learnt from Tracked + and these included taking a firm stand on not allowing projects to progress for approval if investment appraisal had not been</p>

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independently engaged in line with the process, undertaking a refresh the investment policy, alignment of the Letters investment process to allow sufficient time for challenge, inclusion of project governance in the investment template and obtaining robust and unconditional concurrences for all business cases;

(c) The Committee noted the lessons learnt from the Tracked + Investment Appraisal process and the actions that had been, or were being, put in place.

ARC08/41

POL RISK & COMPLIANCE REPORT ARC (08)40

(a) At its last meeting, the Committee had reviewed a summary of the report to POL's Risk & Compliance Committee and requested that POL senior management attend this meeting to report on the key issues. The Committee noted a paper providing an update on the issues of most concern including FSA compliance, Telephony and Cash losses;

(b) FSA Compliance: In August POL had commissioned Deloitte and Touche to undertake a review of POL's financial services compliance arrangements, including its approach to the FSA's Treating Customers Fairly (TCF) theme. They had now presented their findings to the POL ET and an implementation plan for their recommendations would be approved at the POL ET on 10th November 2008;

(c) the implementation plan would address all the issues raised and target the earliest possible implementation dates. At a minimum POL would implement measures to meet its TCF requirements and reduce its reliance on the Bank of Ireland. There were some judgemental areas where POL would seek to exceed the minimum requirements for an authorised representative without necessarily aspiring in the immediate term to the level required for a fully authorised company;

(d) Telephony: BT Wholesale (BTW) had failed to meet our expectations in delivering a fully managed telecoms service. As well as damaging our brand and our sub postmasters' confidence in promoting our telecoms products, failure by BTW had meant that POL were in breach of Ofcom requirements in relation to publication of Quality of Service measures and accuracy of call metering and billing. POL had reorganised the team to ensure that BTW were managed more effectively and were agreeing with BTW action plans to address the remaining problems. POL would be pursuing redress from BTW for failure to meet SLAs and for any lost income from billing failures;

(e) Losses: POL's forecast for losses from controls and compliance failures for 08/09 was £17.25m. This was broadly in line with previous years and in our plan for this year, but within that losses through physical crime (robberies etc) were down whilst the discovery of sub postmaster fraud had

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increased;

ACTION
Peter Corbett

(f) The POL Network Efficiency Programme had been established in response to the recognised need to achieve a step change across all aspects of branch conformance and compliance. Key elements of the 08/09 activity - undertaken with a view to a significant improvement in performance during 09/10 included the introduction of

- a clear standard index of conformance and compliance throughout the business; and
- a revised tough but fair consequences policy;

(g) The Committee noted that the POL directors had been individually approved by the FSA under the compliance regime. POL were asked to provide a report on the level of FSA Regulatory expertise within the business;

ACTION
Peter Corbett

(h) The Committee noted the report and requested Senior Management to attend future meetings of the Committee to present an update on the issues identified by the Deloitte report, including a mapping of the Regulatory requirements, and an explanation of the plans/targets that had been put in place to address the issues. The Committee would also be looking for assurance that the business was making significant progress in dealing with the issues identified in the report.

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ANY OTHER BUSINESS

(a) Ian Duncan tabled a paper outlining improvements to the risk performance process. The Committee noted that the Group Executive Team were now much more involved in reviewing the top 20 major risks facing the business, in addition the GET reviewed one corporate risk at each of its monthly meetings;

(b) In order to enhance the Boards confidence in the risk process the following steps would be implemented:

- as well as the inclusion of the Group Risk profile in the ARC papers, summaries would be provided on the risk reviews carried out at the GET and at the Risk Committee;
- the Chair of the Audit & Risk Committee and the Group Finance Director would review the Corporate Risk Profile annually with the Board;
- the Board would continue to review major finance risks as part of the process to approve the strategic Plan and annual budget;

(c) The Committee endorsed the steps being taken to enhance the Boards confidence in the risk management process.

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DATE OF NEXT MEETING

The date of the next meeting of the Committee was Thursday
5th March 2009.