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To: Baroness Neville-Rolfe
From: Justin Manson (x4513), Richard Callard (x3814)
Date: 22nd December 2015



Subject: Post Office Limited update – supplemental submission

Purpose: To provide supplemental information to Submission of 11th December, 2015

Timing: Routine.

Recommendation: That you note the issues.

A. Background

1. You asked that we review whether BIS has legal exposure to the restatement of POL's 2014/15 accounts and to set out the ownership structure and the role of the shareholder representative. Following a meeting with Mark Russell and Justin Manson on 17th December, you also asked about the impact on bonuses, the disclosure in the accounts, and the size of the error in relation to the network transformation programme as a whole.

B. The ownership structure and role of the shareholder representative

2. POL is a private company limited by shares set up under the Companies Act 2006 and wholly-owned by the Crown via its holding company (Postal Services Holding Company Limited (PoSH)). The sole shareholder of PoSH, which in turn wholly owns POL, is the Secretary of State.
3. POL's Board and Chair are appointed by the Secretary of State for the Business, Innovation and Skills or appointed subject to his approval. The directors have a duty to promote the success of POL for the benefit of its Government shareholder, although as a matter of company law their duties are owed to the company and not the shareholder per se.
4. The Shareholder Executive oversees the Government's shareholder function, and like many of Government companies, places a shareholder representative on the Board. It has no executive powers or responsibilities, although it has various rights e.g. information access, rights to appoint a director to the Board, approval rights on appointments and remuneration.
5. As an ex-officio member of the Board, the Shareholder Executive representative monitors and challenges performance of the company and the executive team via the Board, but also challenges the business from a shareholder team perspective (POL has not always had a shareholder representative on its Board).
6. It is the responsibility of the Board, and primarily the Executive, to run the business and ensure its smooth operation. Like many other Government businesses, it has

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been set up in this way with a view to ensuring a better running of the business than if it were a Government Department, and to put in place measures to distance ministers from the day to day decision-making responsibility of a commercial business.

C. Understatement of provision and possibility of legal exposure

7. If POL was a publicly-listed company in which investors had suffered losses as a result of trading shares based on incorrect information in the accounts, there might be a concern that it would be exposed to shareholder suits. There is no similar risk in this case because HMG has not made any investment decisions based on the accounts which contained the error. Even if POL were to have liability, it is a company limited by shares and liability would not pass up the ownership chain to BIS. This view relies on the need for restatement arising from error rather than fraud.

D. Impact on bonuses

8. The understatement of the provision has not led to anyone at Post Office being rewarded more than had the provision been correctly stated in the first place.
9. Remuneration at the Executive level, and below, is based on a mixture of financial metrics (e.g. revenue, operating profit) and operational metrics (e.g. customer satisfaction, number of branches transformed).
10. From a financial metrics perspective, the provision relating to exiting subpostmasters is an exceptional charge which falls below the operating profit line. It has not therefore informed or influenced any of the financial metrics upon which management are rewarded.
11. From an operational perspective, management were rewarded on the number of transformed branches opened. However, this error did not impact those figures and again there was no impact on bonuses.
12. Nevertheless, bonuses are at the Remuneration Committee's discretion, and there is a question as to whether such a serious accounting error should be reflected in one way or another in executive's pay. ShEx will raise this issue with the incoming Chair of the Remuneration Committee, Ken McCall, when he arrives in January. We will also question whether any clawback of the previous CFO's pay could be considered and whether such a move would be possible or practical.

E. Disclosure in the Accounts

13. The provisioning error will be disclosed in the accounts with a narrative to explain what happened. The current wording proposed below will be included in the

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Business Review section which summarises the business's performance and which follows the Chair and Chief Executive reports. Items in square brackets reflect information still to be confirmed:

- “An error was identified in the calculation for postmasters’ compensation within the Network Transformation programme on the balance sheet and exceptional items charged in the 2014-15 half year and full year. The March 2015 exceptional charge has been restated by [£86 million] of which [£50 million] was restated into the September 2014 exceptional charge. This was a timing error related to recognition of the liability. [It has not impacted payments to postmasters or the overall cost of the programme].
14. Similar statements are made again under the “exceptional items” narrative, and within the notes to the accounts. Post Office is seeking to strike the right balance between appropriate disclosure, and the accounting/non-cash nature of the error. The interim accounts where the first re-statement will be made is most likely to now occur in January.

F. Provision error as a proportion of Transformation costs

15. You asked how much an error of this size was in proportion to the network transformation programme. An £86m error is:
- 13.7% of the £630m cost of the network transformation programme to date
 - 9.8% of the £976m revenue (excluding subsidy) that POL earned in 2014/15.

Copied to: Perm Sec, Mark Russell, ShEx POL Team

Advice received from:

Finance	SpAds	Press	Legal	Analysts
N/A	N/A	N/A	Emma Bye (sections B & C)	N/A
Devolution Issues			Post Office is not a devolved matter.	
Equality Analysis			N/A	