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To: Secretary of State
Baroness Neville-Rolfe
From: Richard Callard, ShEx, (x3814)
Date: 3 December 2015
Subject: **Post Office Update on Restatement of Prior Year Accounts and IT transformation**

Purpose: To make you aware of two issues that are currently being considered and investigated by Post Office Limited (POL), ~~following the last Board meeting.~~

Recommendation: That you:

- A. Note that due to a material accounting error, the 2014/15 exceptional charges of POL were understated by an amount currently estimated to be €85m (precise amount to be confirmed). Whilst this is a non-cash movement and should not affect POL's funding position, this will require a restatement of ~~their POL's prior year~~2014/15 accounts.
- B. Note, separately, that POL has re-assessed ~~their~~ plans to implement ~~their~~ new IT systems. ~~Initial views are that there could be a~~An €11 month delay ~~and at~~ an additional cost ~~to the programme~~ of £60m ~~are likely.~~ ~~WAs noted below, work is under way to assess the mitigating actions available, which are not without risk, and the~~any impact on POL's future funding position ~~is in~~ progress.
- C. Note that both issues are being further investigated by POL management and Board, ~~and we will provide further advice as the position becomes clearer.~~ We will provide a further update late next week.

Timing: Routine (although the ~~need to~~ restatement of accounts will become public late next week at the earliest, as POL issue their interim accounts for mid-2015/16).

Background

Accounting Error

1. During the preparation of the 2015/16 interim accounts, POL ~~has~~ discovered an accounting error relating to the previous year which impacts the balance sheet ~~and income statement through and~~ the exceptional items charged to last year's accounts. The error is material and the ~~2014/15 prior year~~ accounts will need to be restated.
2. The error relates to the provision made in the accounts in relation to compensation to subpostmasters as they sign to leave POL as part of Network Transformation. Data from an excel spreadsheet that was used to prepare the accounts was not being pulled in to the accounts in full, and was itself

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incomplete and didn't reflect the underlying data held elsewhere in the organisation. This meant that the provision in last year's accounts¹ was understated by c£85m for the year (c£50m for the 6 months ended 30 September 2014), although POL has yet to confirm the final amount.

3. Work is continuing at POL to understand the full extent of the error, ~~which is non-cash-related~~. Work to date has shown that payments to exiting subpostmasters have not been effected and POL's current view is that this does *not* affect the cost of the Network Transformation programme, or POL's funding position, although investigations are ongoing.
4. The CFO, who arrived in January, had already reported to the Board that the financial reporting environment was not strong enough and had started a detailed programme of remediation. He fully acknowledges the unacceptability of the position, has replaced the financial controller of POL and has commissioned a systematic programme to review and document controls, supported by KPMG, to ensure there are clear lines of responsibility and control. He will be meeting with Mark Russell of ShEx on Friday next week to explain how this error occurred and how it will be prevented in future. We will also request a formal written report. A new chair of the Audit & Risk Committee joins the Board in January, and will bring further scrutiny and review.
5. The disclosure in the interim accounts due to be published in the next couple of weeks could require sensitive handling, and ShEx will be liaising with BIS and POL comms. HMG, through the Secretary of State for BIS, owns 100% of POL's parent, the shares in the Postal Services Holding Company Limited (POoSH), the company which owns POL. PoSH's accounts have not been finalised for 2014/15, meaning this change will be This means the POL error will correctly reflected in POoSH's 2014-15 annual accounts without restatement (although this could cause a delay in filing), which has not yet been finalised. POoSH falls within the BIS Departmental boundary, but we have been advised Tthis error does will not impact the BIS's Group 2015-16 accounts, and is not as it -thought-is deemed not material enough to require a restatement of ~~the-those~~ national accounts.

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IT Update

6. As part of POL's transformation, the company is updating all aspects of its IT system, including front office hardware and software. The total estimated cost of this programme is c£280m over the next three years.

¹ For reference, original accounts stated - Full year operating profit before exceptionals: £100m. Post exceptionals: £(85)m. Balance Sheet net assets £395m.

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7. This is a complex programme using a number of different suppliers. Over the last six months POL has commissioned a very detailed and integrated work programme from their new Director of Transformation. His analysis shows that initial timetables were too ambitious and did not allow for sufficient testing and rollout of front office IT. He considers that the programme will require 11 additional months, and (if not mitigated) an additional cost of around £60m.
8. POL are examining mitigating actions in preparation for a specially convened Board call on 17th December. The key mitigating action is to request that the current front office supplier, Fujitsu, extend their current contract with POL given that they have already recently updated and refreshed the front office software in preparation for the transition to a new supplier. Fujitsu had previously declined to participate in the original procurement process, generating increased cost and complexity for the IT programme by forcing POL to move to a new provider.
9. Continuing with Fujitsu would significantly reduce costs and technical complexity, and recent changes in management at Fujitsu have made them more amenable to continuing the relationship with POL. POL are therefore examining this option confidentially, which would require some form of financial settlement with the winning supplier IBM, and taking legal advice on the procurement law risks. This work also considers the impact this issue may have on POL's funding position. We will provide further advice following the call on 17th December.

Copied to:

Perm Sec, SpAds; Mark Russell (ShEx), Howard Orme (Finance), Justin Manson (ShEx), ShEx POL Team, Charu Gorasia (Finance), Nick Gordon (Finance), Tobi Adetimilehin (Finance), Claire French (Comms), Matt Barker (Comms), Emma Bye (Legal)

Advice received from:

Finance	SpAds	Press	Legal	Analysts
Tobi Adetimilehin	Nick King / Salma Shah	Claire French	Emma Bye	N/A

Have devolution issues / impacts been considered?

Devolution Issues	
No	N/A

Have equality impacts been assessed?

Equality Analysis	'Impact on Families'
N/A	N/A

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