

Post Office Limited

POST OFFICE LIMITED
(Company Number 2154540)

Meeting of the AUDIT, RISK AND COMPLIANCE SUB-COMMITTEE
to be held at 14.00 on Tuesday 13 November 2012
at 148 Old Street, London, EC1V 9HQ in the Board Room

14.00	1	Governance:	Alasdair Marnoch
		<ul style="list-style-type: none">• Review of updated Terms of Reference• General outline of meeting topics, annual meetings schedule and content of standing agenda.	
14.15	2	Annual Report and Accounts and half year Trading Statement	Chris Day
		<ul style="list-style-type: none">• Review and approve half year Trading Statement• Agree approach to Annual Report and Accounts• Communications strategy and key messages• Next steps	
15.00	3	Risks – high risk contracts	Lesley Sewell
15.15	4	External and Internal Audit	
		<ul style="list-style-type: none">• Post Office Internal Audit Charter• Internal Audit – recent results and status of 2012/13 Internal Audit plan (Royal Mail Internal Audit team)• External audit plan and approval of fees• Opportunity for auditor comments	Malcolm Zack/ Stephen Collins ¹
16.00	5	Specific matters referred by the Board to ARC	
		<ul style="list-style-type: none">• Governance of Eagle contract with Bank of Ireland• Uncommitted facilities	Nick Kennett Chris Day
16.30	6	Any other business	

PRESENT: Alasdair Marnoch (Chairman)
Tim Franklin (Non-executive director)
Susannah Storey (Non-executive director)
Neil McCausland (Non-executive director)

SECRETARY: Alwen Lyons (Company Secretary)

IN ATTENDANCE: Alice Perkins (Company Chairman)
Chris Day (CFO)
Sarah Hall (Head of Financial Control and Compliance)
Nick Kennett (Financial Services Director)
Lesley Sewell (Chief Information Officer)
Malcolm Staite (Interim Head of Risk Governance)
Malcolm Zack (Head of Internal Audit)
Stephen Collins (Audit Manager, Royal Mail Group Internal Audit)
Angus Grant (Ernst & Young)
Jeremy Midkiff (Ernst & Young)

APOLOGIES: Susan Crichton (HR & Corporate Services Director)

¹ Stephen Collins will join the meeting at this point.

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POST OFFICE LTD AUDIT, RISK AND COMPLIANCE COMMITTEE

Terms of Reference Review November 2012

1. Purpose

The purpose of this paper is to:

1.1 Present updated terms of reference for the Audit, Risk and Compliance Committee for approval by the Committee and recommendation to the Board.

2. Background

2.1 The terms of reference for the Committee were initially drafted before the Post Office Audit, Risk and Compliance Committee which met in May 2012.

2.2 The Board plans to review all terms of reference at its meeting in November 2012.

2.3 The initial draft has been reviewed, updated and amended to closer reflect accepted good practice insofar as it applies to Post Office. The changes have been discussed with Alasdair Marnoch, the Company Secretary's Office and the Head of Internal Audit.

3. Activities/Current Situation

The document outlines:

- Overall purpose of the committee
- Composition and terms of office
- Governance of the Committee and the internal and external auditing services
- Responsibilities towards accounting, financial control and disclosure
- Risk Management, Operational controls and policies including ethics, code of conduct and fraud.
- Administrative matters.
- Annual timetable

3.1 A proposed timetable is included in the appendix. At this point in time the items indicated and their suggested timings are illustrative only.

3.2 A timetable will assist the Committee in ensuring it covers its main requirements through the year, aid agenda planning and allow sufficient time for all items as appropriate. The Committee Chairman will agree the agenda for each meeting, taking into account matters arising from previous meetings, Board direction and items from management.

4. Recommendations

The Audit, Risk and Compliance Committee is asked to

- Review the terms of reference,
- Highlight amendments or items for clarification
- Recommend approval by the Board.

**Malcolm Zack
6th November 2012**

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TERMS OF REFERENCE FOR THE AUDIT, RISK AND COMPLIANCE COMMITTEE

1. Purpose

The purpose of the Audit, Risk and Compliance Committee (“ARC” or the “Committee”) is to assist the Board of Directors in fulfilling its fiduciary responsibilities by:

- Contributing an independent view on the accounting, financial control and financial reporting practices of the Company.
- Taking all reasonable steps to ensure accurate and informative corporate financial reporting and disclosures which meet appropriate accounting and corporate governance standards.
- Providing oversight of the company’s risk management systems, operational controls and key systems.
- The responsibilities undertaken by the ARC under delegated authority from the Board will be subject always to the powers and duties of the Board, as set out in the Articles of Association.

2. Composition, Terms of Office and Governance.

2.1 Composition and Terms of Office.

- The Committee shall serve as a standing committee of the Board. Its Chairman and members will be appointed by the Board. It shall consist of at least two independent non-executive directors.
- Only non-executive directors shall be eligible for membership of the Committee. Members of the Committee will normally serve for a period of three years. Their appointment may be renewed on an annual basis thereafter with the consent of the Chairman of the Committee but no director shall serve for more than six years.
- The quorum shall be two directors, of whom one will have recent and relevant financial experience.
- The Committee shall meet as often as required but at least three times per year.¹

¹ The Financial Reporting Council recommends a minimum of 3 meetings but suggests that more will be usually required.

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TERMS OF REFERENCE FOR THE AUDIT, RISK AND COMPLIANCE COMMITTEE

- The Company Chairman and executive directors may be invited to attend any meeting, or any part of any meeting, by the Committee Chairman.
- The CFO, HR & Corporate Services Director or General Counsel, Head of Risk Governance and Head of Internal Audit will be permanent invitees.
- The Company Secretary shall act as Secretary to the Committee and shall attend all meetings to keep minutes and record actions.
- The Committee Chairman will report regularly to the Board. Minutes of each Committee meeting will be circulated to all members of the Committee and, once agreed, to all members of the Board
- The External Auditors may attend all or part of any Committee meeting at the invitation of the Committee Chairman. As a minimum the External Auditors will attend to present their external audit plan for approval and to present their reports.
- The Company will provide current and new Committee members with any training, briefings or induction required. The Company Secretary, Head of Internal Audit and the External Audit Partner will keep members informed of relevant published guidance as necessary.

2.2 Governance of Auditing Services

The Committee will:

- Review and recommend to the Board the nomination or discharge of the independent external auditors, the proposed fees (in consultation with management) and the acceptance of the scope and general extent of the engagement.
- Formally review, challenge and approve the agreed annual external audit plans and approach.
- Periodically review the scope, resourcing and capabilities of the Internal Audit function.
- Review and re-approve the Internal Audit Charter on an annual basis.

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TERMS OF REFERENCE FOR THE AUDIT, RISK AND COMPLIANCE COMMITTEE

- Approve each year in advance the Internal Audit plans and review both resources and any proposed amendments that may occur through the following year. The review should include methods employed by the internal auditors to assess risk and to prioritise the various audit proposals identified in the annual plan.
- Assume a primary role in the appointment, assessment and if necessary the discharge of the Head of Internal Audit.
- Ensure the independence of the external and internal auditors including an annual review of any non-audit services provided by either.
- Ensure free and effective communication between the Committee, external auditors and internal auditors and hold separate sessions, or informal meetings and contact as required.
 - These meetings may discuss matters that any of these groups believes should be discussed privately with or without management.
- Ensure lines of communication are maintained with the Board.

2.3 Governance – Meetings

- Any member of the committee or the Company Secretary may convene a meeting. The External and Internal auditors may request a meeting with or without management present.
- Meetings may be held in person or by telephone or other electronic means, so long as all participants can contribute to the meeting simultaneously.
- Notice of each meeting shall be given to all those entitled to participate at least 2 working days before the meeting.
- Meetings shall be planned in accordance with key reporting and financial planning dates.

2.4 Governance – Other

The Committee will:

- Review and update its terms of reference annually.

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TERMS OF REFERENCE FOR THE AUDIT, RISK AND COMPLIANCE COMMITTEE

- Conduct an annual evaluation of the performance of its duties and responsibilities and of its effectiveness, and discuss the results with the Board of directors.
- Prepare an annual report on its activities for inclusion in the Annual Report and shall review and approve on behalf of the Board statements to be included in the Annual Report concerning financial controls, internal control and risk management.
- In the absence of express authority from the Board, the Committee will not, without the concurrence of both management and the auditors, have either the responsibility or authority for altering the financial statements or the accounting procedures of the Company.

3. Accounting, Financial Control and Financial Reporting and Disclosure

The Committee will:

- Review, discuss and consider with the external auditors their approach to risk assessment and the scope and plan of their audits
- Review the annual financial statements which are to be submitted to the Board, including Management's explanatory notes.

The review may include:

- Reports from the external auditors as to the results of their examination to date.
- Discussion of any problems regarding financial reporting which may need to be reported in the annual report to the shareholders including any disagreements that may have arisen between the auditors and management in any area.
- Meeting(s) with the senior financial executives who shall outline any problems as to financial policies, financial reporting or matters relating to internal control and any matters in contention with or under consideration by the external or internal auditors;

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TERMS OF REFERENCE FOR THE AUDIT, RISK AND COMPLIANCE COMMITTEE

- The appropriateness of existing accounting principles being employed and any change in accounting policies or practices which the corporate auditors may refer to in their report to the shareholders, and the impact on the Company's financial statements.
- Any proposed changes in the presentation of the financial statements or accompanying notes which the auditors may recommend.
- Other matters related to the conduct of the audit communicated to the Committee under generally accepted accounting standards.
- The Management Letter
- The Committee shall review with management any half yearly trading statements or financial reports and the contents of any press release concerning the Company's financial performance or situation, before release to the public or to shareholders.

4. Risk Management, Operational Controls and Policies

4.1 Risk Management Framework

The Committee will:

- Review the overall risk management framework in place for the Company including its appetite for risk.
- Oversee the Risk and Compliance Committee activities and receive summary reports as appropriate
- Review the Company's overall risk position and periodically invite management to outline risk management strategy and status within their specific business units.
- Review management's assessment of the degree of risk the Company prudently incurs in achieving a reasonable balance between the cost of managing risk and control systems and the benefits derived.
- Consider and review areas of specific risk as highlighted by the Risk and Compliance committee. This should include, but is not limited to, sufficient

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TERMS OF REFERENCE FOR THE AUDIT, RISK AND COMPLIANCE COMMITTEE

coverage of strategic risk, financial risk, operational risk, technology risk, reputation, regulatory, major change initiatives and people risks

- Review legal, regulatory and any other matters that may have a material impact on the financial statements, related Company compliance policies, and programmes and reports prepared to manage and monitor Company compliance policies.

4.2 Controls and Policies

The Committee will consider and review with the external auditors and the internal auditors:

- The adequacy of the Company's internal controls;
- Recommendations for the improvement of the Company's internal controls, processes and systems.
- Significant findings (the "management letter" from external auditors) and recommendations together with management's responses.
- Note any reportable restrictions experienced regarding scope or access to required information by either external or internal audit.

4.3 Fraud, Theft and ethics

The Committee will

- Review with management their fraud assessment, detection measures and their investigation of illegal acts, as appropriate.
- Review any summary of frauds, thefts and other irregularities of any size.
- Review with the internal auditors and the external auditors the results of any review of the compliance with the Company's codes of ethical conduct and similar policies including whistleblowing.

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4.4 Risk Management – Other

- The Committee shall have the power to conduct or authorise investigations into any company matters within the Committee's scope of responsibilities. The Committee shall be empowered to obtain independent legal advice, and engage counsel, accountants, or others to assist it in the conduct of any investigation.
- The Committee shall perform such other functions as may be assigned or delegated to it by the Board, and may review other items of an internal control or risk management nature which may from time to time be brought before the Committee.

5. Committee timetable.

A timetable shall be produced each year showing the current membership of the Committee and the major annual activities of the Committee, in a similar format to that set out in the appendix.

ARC Membership November 2012

Chairman	Alasdair Marnoch
Members	Tim Franklin
	Neil McCausland
	Susannah Storey
Company Secretary	Alwen Lyons
External Audit	Ernst & Young
Head of Internal Audit	Malcolm Zack

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TERMS OF REFERENCE FOR THE AUDIT, RISK AND COMPLIANCE COMMITTEE

Appendix²

Annual Timetable	April	June	Nov	Feb
<u>1. Governance items</u>				
Annual review of terms of reference and IA charter.			✓	
External Auditor review/appointment/reappointment		✓		
Minutes and actions of previous meeting	✓	✓	✓	✓
Evaluation (annual)			✓	
Private meetings with auditors/management	✓	✓	✓	✓
<u>2. Financial reporting and disclosure</u>				
Review and approve external audit plan			✓	
Financial statements full year	✓			
Financial statements – half year			✓	
External audit management letter	✓			
Approval of Committee report for inclusion in Annual Report		✓		
<u>3. Risk management and control</u>				
Internal Audit update report	✓	✓	✓	✓
Risk and Compliance activity and highlights	✓	✓	✓	✓
Strategic risk update		✓		✓
Financial risk update	✓		✓	
IT and systems risk update		✓		
Selected business risk review update	✓		✓	
Insurance review				✓
<u>Other (Less frequent)</u>				
Fraud and Theft report		✓		
Security update		✓		
Ethics and Code of Conduct and Whistle-Blowing policy				✓

² The timetable sets out standing agenda items. It may be modified by the audit committee in light of specific requests or actions arising from meetings. The months indicated are provisional and subject to change.

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POST OFFICE LIMITED BOARD AUDIT RISK AND COMPLIANCE SUB-COMMITTEE

Review of the Trading Statement for the 6 months ended 23 September 2012

1. Purpose

The purpose of this paper is to:

- 1.1 Share the final draft of the Post Office Trading Statement for the 6 months ended 23 September 2012 incorporating Board feedback for Audit Committee review and recommendation to the Board Sub-Committee.

2. Background

- 2.1 The Board reviewed the Trading Statement at its meeting on 23 October and comments have been incorporated into this latest draft for review by the Audit Committee. The intention is to publish the statement later in November after Royal Mail has made its announcement.
- 2.2 A copy of the draft Trading Statement for comment is attached at Appendix 1.
- 2.3 A briefing book providing more background to the half year results is attached for information at Appendix 2.

3. Recommendations

The Audit Committee is asked to:

- 3.1 Recommend that the Trading Statement is approved by the delegated Board Sub Committee.

**Chris Day
November 2012**

Post Office



Post Office results for the six months ended 23 September 2012

Chairman and Chief Executive's Statement

"An encouraging six months – and optimism for the rest of the year."

On 1 April 2012 the Post Office separated from the Royal Mail Group and became an independent business. This Trading Statement is the first that the Post Office has issued to update on progress made. The Government Funding Agreement reached in October 2010 provided investment for thousands of Post Office branches across the Post Office Network to be modernised to provide service improvements and longer opening hours to make them more accessible for customers. As well as developing the financial services, telephony and mails business, the Post Office is building on a long history of delivering essential Government services and becoming established as an effective Front Office for local and national Government.

The first six months have seen the Post Office take its first steps towards the longer term goal of becoming financially sustainable in a challenging environment. The financial results and achievements are encouraging though the scale of change ahead remains significant. The first tranche of Government funding was received on 2 April 2012 and expenditure has commenced to implement the transformational changes required towards the goals of Growth, Customer Excellence and Modernisation.

Financial Performance

Turnover increased from £485 million in the first 6 months of the prior year to £501 million this year with growth in the Mails, Retail, Financial Services and Telephony businesses. There has been continued strong performance in the mails area particularly in packets and premium mails products including Special Delivery. Government Services income has seen a small decline. In addition the Network Subsidy Payment from Government has increased by £13 million to £103 million consistent with the Government funding agreement. Other operating costs have increased by £19 million to £437 million driven by investment in activity to drive future revenue growth and build the brand as well as establishing the framework for longer term efficiencies and improving the supporting infrastructure across the network. Operating profit before exceptional items was £61 million, against a comparable performance of £56 million last year.

Key performance figures – six months ended 23 September 2012

Summary Group Profit and Loss Account		
	2012 £m	2011 £m
Turnover	501	485
Network Subsidy Payment	103	90
Revenue	604	575
People costs	(128)	(123)
Other operating costs	(437)	(418)
Share of post tax profit from joint venture	22	22
Operating profit before exceptional items	61	56

* All references to operating profit/(loss) are before exceptional items

Note that the Royal Mail Holdings plc Interim Report for the half year ended 25 September 2011 reported operating profit after modernisation costs but before other exceptional items of £55m. The prior year result has been presented to exclude modernisation costs consistent with 2012 where results are reported before all exceptional items.

Post Office Network

This year has seen the Post Office network at its most stable for over a quarter of a century with 11,818 branches currently open and trading. Our network is visited by nearly 20 million customers a week as well as by over half of all the nation's small businesses. 99.7% of the UK population is within 3 miles of their nearest Post Office outlet and the Post Office network remains a key part of the

Post Office

UK's infrastructure. Currently, 80% of UK bank personal customers can access their current accounts at Post Office branches and in the first six months an agreement was signed that will see this figure rise to 95% next spring.

Following the launch of the £1.34 billion branch investment and support programme in March this year to modernise and sustain the Post Office network, 269 new local and main-style branches were open or converted at the end of the half year. The transformation of the network represents part of a wider Post Office strategy to win new customers and revenue streams for our business to ensure its long-term viability. Extended opening hours, modern retail environments, and the unrivalled access and trust that our subpostmasters hold in communities mean we can better serve the needs of our existing and future customers. Independent research consistently shows that over 90% of customers are satisfied with the new style branch formats and the new formats are having a positive effect on the income subpostmasters generate from their retail businesses.

Post Office has extensively piloted the new style local and main branch formats and in doing so has benefitted from feedback from a variety of sources including Consumer Focus. This has helped to further develop, improve and finesse our new operating models and we will continue to roll out these new-style branches in the coming months, using the funding the Government has made available up to 2015 to support this important programme of investment. The Post Office modernisation programme remains a voluntary process and is conducted in close liaison with individual subpostmasters. It forms part of the Government's commitment to no further programme of branch closures and our continued focus on making our network accessible and convenient to ensure we maintain it at its current size and thereby increase both our customer base and our income.

Financial Services

The Post Office and Bank of Ireland have built a very successful partnership and business since 2004 providing accessible financial services across the Post Office network in the UK. At the beginning of August this year, we announced a three-year extension to this relationship with Bank of Ireland until 2023. Together, we are committed to investing in the capability and capacity of our financial services operation to deliver benefits to our customers and drive the next phase of business growth and long-term value.

The Post Office already has almost 3 million financial services customers as well as a savings book of over £17 billion. We provide a wide range of services and products including mortgages, savings accounts, foreign exchange, credit cards and insurance for both consumers and small businesses. Since March, the Post Office has introduced mortgage specialists into branches for the first time and the second stage of this programme will take place later this year. We continue to top best-buy tables and win accolades for the transparency, competitiveness and ease of use of our products and services. Post Office's overriding ambition continues to be to build on these strong foundations, and establish itself as a recognised and trusted financial services alternative to the major UK banks.

Front Office of Government

Post Office's goal is to build strong and lasting partnerships with key stakeholders to drive sales of existing and new Post Office services to build towards becoming a financially sustainable business. We see this as our public service responsibility and it builds on a long history of successfully delivering essential government services. In the first six months of this financial year, Post Office won a 4-year contract with Hammersmith and Fulham Council to provide government services to customers in the local area through the Post Office network of branches including payments for council tax, business rates, housing rents and service charges. The service will go live in early 2013 and can also be extended in the future to include more services and as this is a framework agreement, it can be readily taken up by other councils.

In the period under review, we also announced that the Post Office's Application Enrolment and Identification (AEI) programme had processed the biometric information of more than one and a half million applicants. The service captures applicant information such as fingerprints, photographs, and digital signatures within branch for efficient transmission to the relevant authority. The service is designed to serve multiple clients and is currently being used by the Driver Vehicle Licensing Authority (DVLA) and the UK Border Agency.

Building on this success, Post Office was delighted to be informed in (October 2012) that it had won the DVLA contract to provide a wide range of licence services as well as the majority of tax disc services. This x year contract is a key stepping stone to Post Office realising its vision to become a Front Office of Government and positions us as the key service provider for customer facing government departments.

Olympics

The Olympics and Paralympics captured the hearts and minds of millions of people across the UK this summer, particularly so with our colleagues here in the Post Office. Branches across our network were very much at the heart of these two great sporting occasions helping the public celebrate these historic events. We sold £8 million worth of Team GB Gold Medal stamps during both the Olympic and Paralympic Games. Over 500 branches opened on Sundays, many for the first time, to ensure customers could purchase the stamps the day after a Team GB Gold Medal win, with a further 4,700 branches selling the stamps within days of each win.

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The Post Office Board is complete

We are delighted to welcome Virginia Holmes, Susannah Storey, Alasdair Marnoch and Tim Franklin to the Board as Non-executive Directors in the first six months of the financial year. The Board looks forward with great anticipation to the opportunities ahead of us to grow and modernise the business.

Overview and the future

[For final review at Audit Committee]

The results for the first 6 months have been encouraging with strong mails revenue performance. The plans for growth, modernisation and excellence in customer service are underway but are challenging and there is a significant task ahead. However, the customer satisfaction results from the new style branch formats demonstrate that good progress is being made against these ambitions. The Post Office took a step forward in its aim to establish itself as a recognised and trusted financial services alternative to the major UK banks with the extension of its agreement with the Bank of Ireland [and the recent DVLA contract win underlines our strength in delivering Government Services]. The Post Office is changing, still at the heart of communities across the UK, but growing and modernising its products and services.

Alice Perkins
Chairman
Post Office
[xx] November 2012

Paula Vennells
Chief Executive
Post Office
[xx] November 2012

Basis of preparation

The information shown in this publication is unaudited and does not constitute statutory financial statements. It includes certain extracts of relevant financial information for the period ended 23 September 2012. The Post Office forms part of the Royal Mail Holdings plc Group which prepares its consolidated statutory financial statements on the basis of International Reporting Standards (IFRSs) as adopted by the European Union.

The financial information presented herein has been prepared on a going concern basis and in accordance with the accounting policies used in the Royal Mail Holdings plc consolidated statutory financial statements for 2011-12 which have been filed with the Registrar of Companies. The preparation of this Trading Statement required management to make various judgements, estimates and assumptions. Actual results may differ from the estimates.

Cautionary statement

Where this trading update contains forward looking statements, these are made by the Directors in good faith based on the information available to them at the time of their approval of this report. These statements should be treated with appropriate caution due to the inherent uncertainties underlying any such forward looking information.

Registered Office & Corporate Website

Post Office Limited, 148 Old Street, London, EC1V 9HQ. Registered No: 2154540

www.postoffice.co.uk

Appendix 2



Post Office Limited
Audit, Risk and Compliance Board Sub-
Committee
Briefing Book
Half Year ended 23 September 2012

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1 Glossary review

Below is a listing of key abbreviations used throughout this document with the full meaning given:

Abbreviation	Meaning
ATM	Automated teller machine
BIS	Department for Business Innovation & Skills
CWU	Communications Workers Union
DVLA	Driver & Vehicle Licensing Authority
DWP	Department of Work & Pensions
Eagle	Deal in August 2012 to sell POFS to the Bank of Ireland, restructure commission rates for personal financial services and extend the contract to 2023
EC	European Council
FRES	First Rate Exchange Services
Gamma	A contract variation made in 2007 with POFS generating £100m cash and income over a number of years in return for a series of commitments through to 2020.
Horizon	Horizon Next Generation- Counter system
JV	Joint venture
LTIP	Long Term Incentive Programme
MDA	Master Distribution Agreement – agreement for distributing RM Mails products through POL outlets
MSA	Master Services Agreement – agreement for services provided between POL and RM post Separation
NBV	Net Book Value
NS&I	National Savings & Investments
NSP	Network Subsidy Payment
NTP	Network Transformation Programme
POCA	Post Office Card Account
POFS	Post Office Financial Services
POL	Post Office Limited
POOC	Project One Off Costs
RM	Royal Mail
RMPP	Royal Mail Pension Plan
SGEI	Services of General Economic Interest
UKBA	United Kingdom Borders Agency
WCF	Working Capital Facility

2. Introduction

This Briefing Book has been prepared to explain the Post Office Limited results for the half year ended 23 September 2012. It is a summary of the key data, trends and analyses to be read in conjunction with the Trading Statement, which readers may find useful to further their own understanding of the results for 2012-13. Post Office Limited has opted not to take advantage of the Companies Act exemption from the preparation of consolidated accounts as it is a wholly owned subsidiary within the Royal Mail Holdings plc group which prepares group accounts. The Trading Statement therefore reports consolidated results.

Most of the analyses are based on the comparison of the half year's actual results to prior year.

Comparison against budget is discussed in the Monthly Performance Report presented to the Post Office Limited Board on a monthly basis.

3. Accounting policies

There have been no changes to the accounting policies in the current year that have had a material impact on the financial information reported in the Annual Report and Financial Statements.

4. Primary Statements

4.1 Post Office Limited consolidated Profit & Loss account.

Post Office Limited consolidated Profit & Loss Account for the six months to 23 September 2012 and 25 September 2011

	Section	Sept 2012	Sept 2011	2011-12
		£m	£m	£m
Continuing operations				
Turnover		501	485	980
Network Subsidy Payment		103	90	180
Revenue	6.	604	575	1160
People costs	7.2	(128)	(123)	(254)
Other operating costs	7.3	(437)	(418)	(875)
Share of post tax profit from joint venture and associates		22	22	31
Operating profit before operating exceptional items	5.	61	56	61
Operating exceptional items	9.1	(21)	(9)	(39)
Operating profit		40	47	23
Profit/(loss) on disposal of fixed assets	9.1	(28)	-	1
Profit before financing and taxation		12	47	24
Net interest payable	11.1	(1)	(4)	(6)
Net pensions interest		1	1	2
Profit before taxation		12	44	19
Taxation credit		-	-	10
Profit for the financial period from continuing operations		12	44	30

4.2 Post Office Limited Cashflow Statement

Post Office Limited consolidated cashflow statement for the six months to 23 September 2012

	Sept 2012 £m	Sept 2011 £m
Cash flow from operating activities		
Operating profit before exceptional items	61	56
Add back		
Pension operating costs	13	12
Depreciation and amortisation	0	0
Share of post tax profit from joint ventures and associates	(22)	(22)
	52	46
Working capital and other non-cash movements:	128	78
(Increase)/decrease in inventories	(3)	(1)
(Increase)/decrease in receivables	(12)	(5)
Increase/(decrease) in payables	107	43
(Increase)/decrease in client receivables	3	0
Increase/(decrease) in client payables	33	45
Increase/(decrease) in non-exceptional provisions	0	(4)
Pension operating costs paid	(13)	(11)
Receipt of Government Grant	200	0
Cash payments in respect of operating exceptional items	(21)	(21)
Operating exceptions		
Business transformation	(17)	(10)
Redundancy	(2)	(7)
Redundancy related pension costs	0	(2)
Other	(2)	(2)
Cash inflow from operations	346	92
Income tax received	11	12
Net cash inflow from operating activities	357	104
Cash flows from investing activities		
Dividends received from associates and joint ventures	0	0
Proceeds from sale of property, plant and equipment	2	0
Proceeds from sale of associate company	3	0
Purchase of property, plant and equipment	(11)	(2)
Investment in Associate company	(11)	0
Purchase of intangible assets	(8)	(6)
Net cash outflow from investing activities	(25)	(8)
Net cash inflow before financing activities	332	96
Cash flows from financing activities		
Finance costs paid	(1)	(3)
Payment of capital element of obligations under finance lease contracts	(3)	(2)
Repayment of borrowings	(250)	(50)
Net cash outflow from financing activities	(254)	(55)
Net increase in cash & cash equivalents	78	41
Opening cash & cash equivalents	820	782
Cash & cash equivalents at the end of the period	898	823
Net cash inflow before financing activities	332	96
Finance costs paid	(1)	(3)
Movement in Network Cash	(19)	(44)
Free cash inflow	312	49

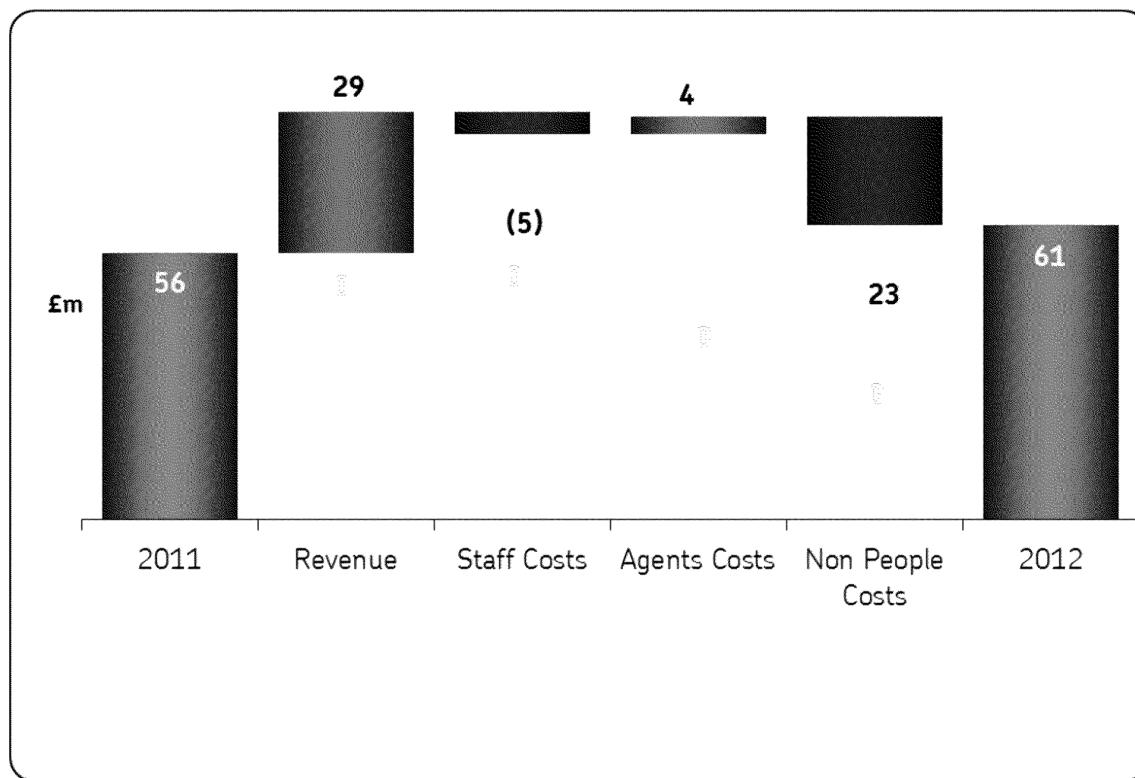
4.3 Post Office Limited consolidated Balance Sheet

Post Office Limited consolidated balance sheet at 23 September 2012 and 25 September 2011

	Sept 2012 £m	Sept 2011 £m	March 2012 £m
Fixed assets			
Intangible assets	-	-	-
Tangible assets	12	11	11
Investments in joint ventures and associates	90	118	90
Total fixed assets	102	129	101
Current assets			
Stocks	9	6	6
Debtors - receivable within one year	226	236	227
Financial assets - investments	119	82	62
Cash at bank and in hand	779	740	758
	1,133	1,064	1,053
Current liabilities			
Creditors - amounts falling due within one year	(893)	(655)	(588)
Financial liabilities - interest bearing loans and borrowings	(127)	(325)	(377)
Net current assets	113	84	88
Total assets less current liabilities	215	213	189
Creditors - amounts falling due after more than one year	(8)	(13)	(8)
Provisions for liabilities and charges	(18)	(19)	(15)
Retirement benefit obligation	53	(315)	(206)
Net assets/(liabilities)	242	(134)	(40)
Capital and reserves			
Called up share capital	-	-	-
Profit and loss account	238	(179)	(85)
Other reserves	4	45	45
Shareholder's surplus/(deficit)	242	(134)	(40)

5. Operating profit

5.1 Operating profit bridge analysis



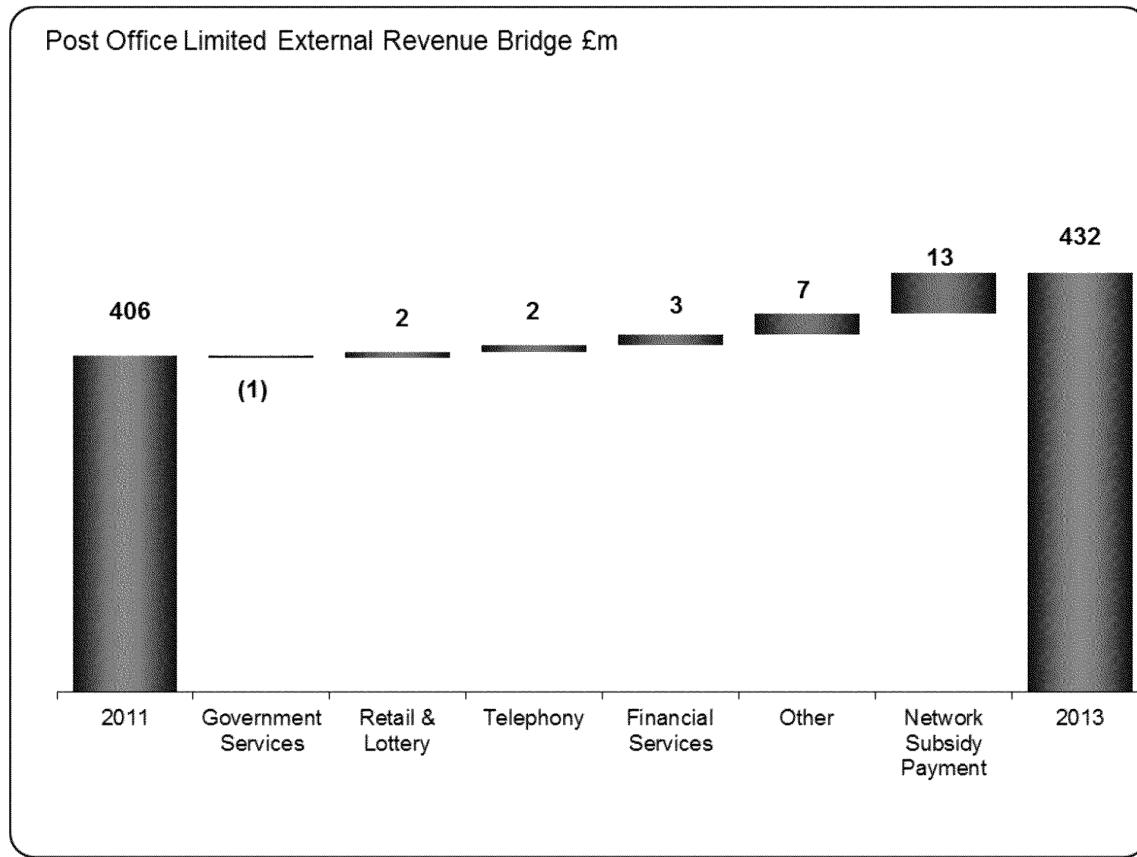
5.2 Explanations for some of the movements above are as follows:

- Revenue explanation is in section 6.1.
- The £4.6m increase in Staff costs was mainly due to:
 - Pay awards, and higher Productivity & Bonus costs
 - Higher temporary resource costs driven by recruitment to support various projects and higher agency labour in Network. Year on year the headcount figure has increased by 213.
- Agents' cost are £3.5m lower than last year due to a one off payment of £400 made in June 2011 to all agents to maintain stability in the network.
- Non people costs (including project one off costs) were higher by £22.6 mainly due to:
 - £16.6m higher project one off costs (POOC),
 - Last year's costs included a £2.4m release relating to WHS TUPE transfers,
 - £0.5m increase in compensation which includes a reassessment of the personal injury provision,
 - £1.8m increase in marketing expenditure,
 - £1.7m increase in property costs,
 - higher cost of sales by £1.8m mainly due higher UKBA volumes as a result of rolling out more ID Services terminals and also due to higher Retail costs due to the Olympic and Jubilee collectables, partially offset by;
 - £1.9m lower Interbusiness costs as a result of Separation.

6. Revenue

	Sept 2012 £m	Sept 2011 £m
Revenue		
External Revenue	432	406
Internal Revenue	172	169
Total Revenue	604	575

6.1 Post Office Limited – External revenue analysis



The increase in year on year external revenue of £26.8m (7%) to £432.3m (2011 £405.5m) is driven by the £13m increase in the Network Subsidy payment and an increase of £13.8m in like for like income.

The following commentary gives further detail on the external revenue variances by category:

6.1.1 Government Services

The £0.8m (1%) decrease in Government Services revenue is principally due to:

- £2.2m lower DVLA revenues as volumes are below the minimum guaranteed income levels and a one-off Service Level Agreement payment last year, and
- £1.0m adverse from falling numbers of POCA accounts through natural attrition and migration of customers to bank accounts.

This was offset by

- £1.9m higher revenues from the new UKBA contact.

6.1.2 Retail & Lottery

Retail and Lottery revenues have increased by £1.9m:

- Lottery is flat with last year, with both periods seeing high levels of rollovers,
- Retail up £1.9m benefiting from collectibles for the Olympic and Paralympic games as well as the Jubilee.

6.1.3 Telephony

Year on year increase in Telephony of £2.1m (3.5%) has resulted from:

- 22k more customers, following last year's Q4 marketing campaign, offset by;
- A decrease in E Top Up revenues of £0.8m is due to volume reduction.

6.1.4 Financial Services

Financial Services income has increased by £3.3m (2.5%) year on year. This continues the trend of increases in new products offsetting the decline of traditional products. The main variances are:

- a £7.7m increase in POFS products particularly savings related products (Growth Bonds, Instant Saver and Reward Saver - £2.6m, £1.8m and £1.4m favourable respectively). This includes the benefit of the renegotiated commission rates following the 'Eagle' deal, and
- a £0.2m increase in ATM revenue, driven by increased volumes as machines reach maturity.

This was offset by

- a £1.7m decline in NS&I revenues as NS&I look to provide some of their products, particularly savings, through their own direct channel,
- a £1.5m decrease in Banking revenue from:
 - a £1.6m fall from the Department of Work and Pensions (DWP) as volumes continue to fall as the Government is migrating customers to other payment methods, and
 - a £0.4m fall in Santander business revenues due to rate reduction from renegotiated contract, offset by
 - an increase of £0.5m in personal banking.
- flat revenues from Payment Services due to:
 - a £0.7m decline from bill payments, as utilities and other bill payment clients continue to migrate customers to other payment methods such as direct debit and online, and
 - a £0.7m increase in Postal Order income (including write back of uncashed Postal orders over 2 years old).

6.1.5 Other

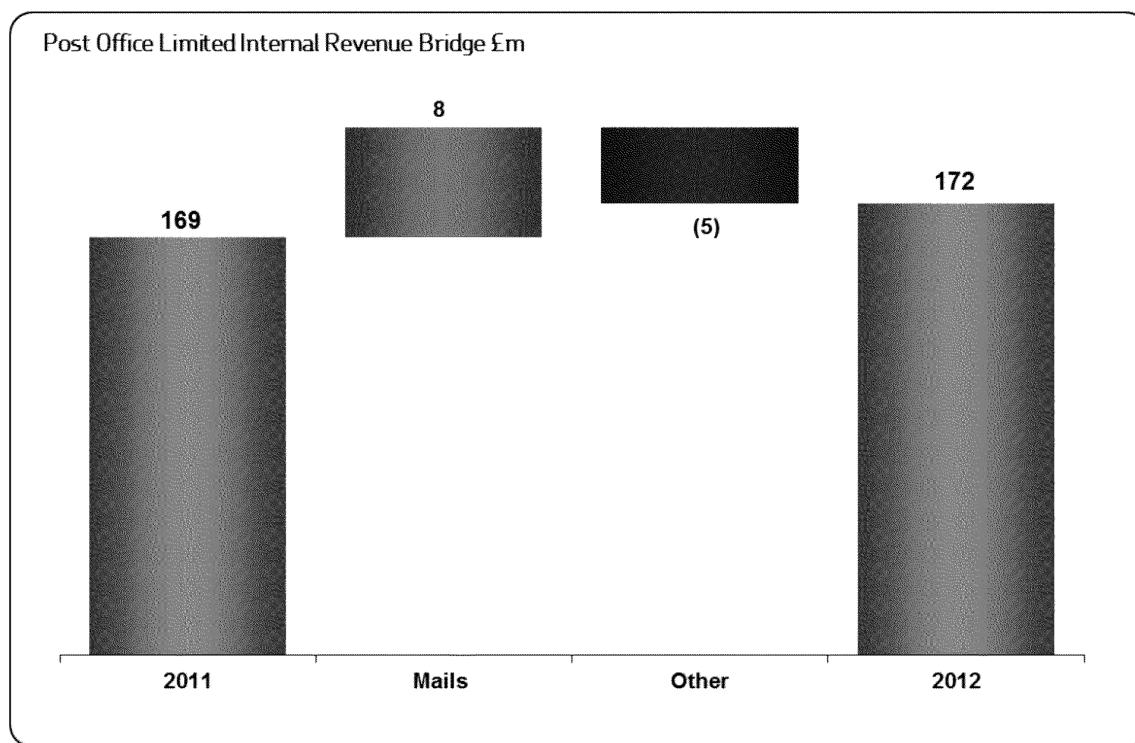
Year on Year increase of £7.3m was due to:

- a £6.5m movement due to the MDA (agreement post Separation) excluding Mailwork income from internal revenue (see 6.2.2). This will be corrected for year end, and
- an increase in Gamma income of £1.2m due to a change in the way the payments are structured.

This was offset by

- a £0.4m reduction from marketing services, primarily Photo Booth income where volumes and rates have reduced.

6.2 Post Office Limited – Internal revenue analysis



The following commentary gives further detail on the £2.4m internal revenue variances:

6.2.1 Mails

The £7.7m (4.7%) increase in Mails Revenue is driven by strong volumes accounting for £6.4m of the increase and £1.3m driven by price.

- Approximately £3.4m of the £6.4m volume variance was driven by stamp sales ahead of the price rise in April.
- The new Mails Distribution Agreement resulted in a reduction in fixed fee of £15.7m which is more than offset by increases in variable commissions of £17.0m resulting in a net price variance of £1.3m.

6.2.2 Other

The £5.3m decrease in other is due to:

- a £6.5m movement due to the MDA (agreement post Separation) excluding Mailwork income from internal revenue. This will be corrected for year-end (see 6.1.5) offset by £1.5m increase in Swindon Stores income as a result of Olympic stamp storage.

7. Costs and people

This section discusses expenditure, excluding exceptionals.

7.1 Total costs analysis (excluding exceptionals)

The following provides a breakdown of costs for the half year ending 23 Sept 2012 compared to the half year ending 25 Sept 2011:

Section	Sept 2012	Sept 2011	Variance	Variance
	£m	£m	£m	%
Expenditure - (pre- exceptional)				
Wages & Salaries	89	87	(2)	(2%)
Overtime	5	4	(1)	(16%)
Productivity/Bonus	7	8	1	13%
Employers NI	9	9	(1)	(8%)
Pensions	13	12	(1)	(10%)
Projects (temp people resource)	1	1	(0)	(30%)
Temporary Resource	4	2	(2)	(79%)
STAFF COSTS	7.2.1	128	(5)	(4%)
Agent costs	7.3.1	235	239	3
Collection, Delivery & Conveyance Charges	7.3.2	1	1	(0)
Compensation	7.3.3	1	(2)	(3)
Property Facilities	7.3.4	3	2	(1)
Property Maintenance	7.3.5	3	2	(1)
Vehicles	7.3.6	1	1	(0)
Computers & Telephones	7.3.7	36	36	(0)
Consultancy, Marketing & Legal Fees	7.3.8	12	4	(8)
Staff & Agent Related Costs & Consumables	7.3.9	0	5	6
Finance	7.3.10	9	7	(2)
Cost of Sales	7.3.11	58	56	(2)
Other Operating Costs	7.3.12	10	10	1
Depreciation	7.3.13	0	0	(0)
Interbusiness Expenditure	7.3.14	41	43	2
Group Overheads	7.3.15	7	10	3
Projects (excluding temp people resource)	7.3.16	21	4	(16)
TOTAL OTHER OPERATING COSTS	7.3	437	(19)	(5%)
TOTAL EXPENDITURE (Pre Exceptionals)		565	541	(24)
				(4%)

7.2 People costs (2012 £128m vs 2011 £123m)

7.2.1 Staff costs (2012 £128m vs 2011 £123m)

Staff costs have increased in total by £5m to £128m, representing 25% (2011 25%) of the cost base. The number of people employed increased by 213 to 7,912 at 23 Sept 2012 (2011 7,699) primarily due to the Network Transformation Programme. NTP staff costs are included within exceptional costs.

The staff cost movement comprises:

- A total increase of £2m (2%) in Wages and Salaries an increase reflecting impact of the agreed pay awards.
- Employers NI has increased marginally.
- Pension costs have increased by £1m (10%) as a result of a change in the FRS 17 rate for the RMPP service cost to 18.2% (2011 17.1%) driven by market conditions at 25 March 2012 and due to the increase in staff.
- Productivity costs have decreased by £1m (13%) driven by the reduced LTIP costs.
- Temporary resource costs have increased by £1m (67%) driven by recruitment to support various projects and higher agency labour in Network.

7.2.2 Staff numbers

The following analysis shows the movements in the number of people employed during the year.

The staff numbers were as follows:

	Period end employees		Average employees	
	23 Sept 2012	25 Sept 2011	2012	2011
Total employees	7,912	7,699	7,867	7,722

7.2.3 Average cost per employee

The 2012 average number of employees of 7,867 includes 192 NTP employees who have been excluded for the purposes of this calculation. The average annual cost per employee based on the average number of people employed at 23 September 2012 of 7,675 excluding NTP (2011 7,722) has increased by 5% to £33,355 (2010-11 £31,856) due to the pay awards.

7.3 Other Operating costs (2012 £437m vs 2011 £418m)

7.3.1 Agents costs (2012 £235m vs 2011 £239m)

	23 Sept 2012	25 Sept 2011
Total Agents number	8,061	8,207

There were 8,061 Agents at the half year-end 23 September 2012 (2011 8,207). The 146 (2%) reduction in Agents is mainly due to natural attrition in the Post Office network.

The average annual cost per Agency branch (excluding VAT and NI) is £42,283 (2011 £43,394), a 3% decrease which is mainly due to a move away from fixed pay.

Total agents costs have decreased by £4m (1%) due to the one off payment made in 2011 of £400.

7.3.2 Collection, Delivery & Conveyance charges have generally remained flat year on year.

7.3.3 Compensation costs have increased by £3m mainly due to a one off provision release relating to the CWU TUPE claim for the WHS transfers in 2011-12 of £2m.

7.3.4 Property Facilities costs have increased by £1m due to external venue costs relating to Post Office Vision events and cross company electricity charges.

7.3.5 Property Maintenance costs have increased by less than £1m due to the increased number of Post & Go machines requiring annual maintenance.

7.3.6 Vehicles costs have remained flat.

7.3.7 Computers and Telephones costs have generally remained flat year on year.

7.3.8 Consultancy, Marketing & Legal Fees have increased by £8m mainly due to the higher number of IT Programmes in 2011/12 requiring contractor/ consultancy individuals and spend for 'point of sale' and rebranding. Note that the increase is charged to projects through the Staff and Agent Related line below.

7.3.9 Staff and Agent related Costs & Consumables have decreased by £5m due to increased number of programmes which has resulted to higher recharges to projects.

7.3.10 Finance costs have increased by £2m due to a one off purchase order benefit last year of £0.5m and increased Bureau and ATM losses.

7.3.11 Cost of Sales has increased by £2m driven by higher Retail costs due to the Olympic and Jubilee collectables combined with higher UKBA volumes as a result of rolling out more ID Services terminals and telephony sales campaign. The main reasons are detailed below:

Cost of Sales

	Sept 2012	Sept 2011	Variance	Variance	Comments
	£m	£m	£m	%	
Home Phone	40	39	(1)	(2%)	Increase of £1m due to more customers, following marketing campaign
Retail	3	2	(1)	(54%)	Increased Sales
Financial Services	1	2	1	63%	Decrease in Travel Insurance
Government Services	15	14	(1)	(8%)	Increase due to higher UKBA volumes as a result of rolling out more ID Services terminals and higher ATM usage
Total	58	56	(2)	(3%)	

7.3.12 Other operating costs have remained flat.

7.3.13 Depreciation costs have remained flat.

7.3.14 Interbusiness expenditure has decreased by £2m due to reduced property and facilities management charges.

7.3.15 Group overhead expenditure has decreased by £3m due to general reduction in Group charges as a result of Separation.

7.3.16 Non people related project expenditure has increased by £17m due to the acceleration of work towards full implementation of major transformation programmes such as Brand Marketing, IT Delivery, Finance Roadmap and Front Office of Government as well as the costs of separation from Royal Mail.

8 Quality of Earnings

	2012-13 £m	2011-12 £m	Growth £m	%
Post Office Limited (consolidated)				
Operating profit before exceptional items	61	56	5	9%
Network Subsidy Payment	(103)	(90)	(13)	(14%)
Project one off costs	22	5	17	(340%)
Operating (loss) before project one off costs, exceptional items and NSP	(20)	(29)	9	31%
Litigation re 2007-08			(2)	
Total adjustments	0	(2)		
Total adjusted operating (loss) before project one off costs, exceptional items and NSP	(20)	(31)	11	35%

Each item in the table is explained further below:

8.1 Network Subsidy Payment

The Network Subsidy Payment increased from £180m in 2011-12 to £210m in 2012-13. The Network Subsidy Payment has been accounted for as a government grant in both years.

8.2 Project one off costs

Project one off costs are non exceptional costs of project activity in the year. They increased in 2012-13 as the pace of implementation towards the new plan has continued. These costs do not form part of the underlying business as usual performance of the company.

8.3 Litigation relating to 2007-08

This cost relates to a provision for litigation relating to the CWU challenge regarding the transfer of staff to WH Smith during 2007-08. £6m was raised in 2008-09 and £4m of it released in 2009-10 when the CWU lost their challenge. All routes of challenge were exhausted during 2011-12 and the remaining £2m was released.

9. Exceptional items and provisions

9.1 Exceptional items and provisions summary

The following exceptional items were recognised in the consolidated income statement for the six months ended 23 September 2012 and 25 September 2011

Exceptional items	Section	2012-13		2011-12	
		£m	£m	£m	£m
Operating Exceptionals					
Capital grants utilised	9.2	35		-	
Restructuring costs: Network Transformation		(14)		-	
Provision for restructuring: Severance	9.3	(6)		(1)	
IT & Change transformation costs	9.4	(3)		-	
Project Eagle exceptional costs of disposal	9.4	(1)		-	
Sub-total					
			11		(1)
Other operating exceptional costs:					
Impairments	9.5		(32)		(8)
Total operating exceptionals					
			(21)		(9)
Non-operating exceptionals:					
Loss on disposal of fixed asset investment	9.6		(30)		-
Profit on disposal of property	9.7		2		-
Net Exceptional costs					
			(49)		(9)

9.2 Grants received at the start of 2012/13 arising from the 2010 Government Funding Agreement have been designated by BIS towards POL's capital expenditure and agents' compensation. The remainder of the grant offsets NTP operating costs. At half year grants utilised of £35m – accounted for as exceptional income – matches £21m of capex and £14m NTP opex.

9.3 Restructuring: severance (2012/13 £6m vs 2011/12 £1m)

Included in the £6m charge is £5m in respect of Crown Transformation, a programme to return the Crown network to profit by 2014/15, and this phase of redundancy will release c. 135 Crown staff.

9.4 Other charges (2012/13 £4m vs 2011/12 £nil)

Costs attributable to IT & Change Transformation programme, a commitment to modernisation arising from the 2010 Government strategic plan, and Project Eagle, the disposal of POL's interest in the POFS associate investment, have been accounted for as operating exceptionals.

9.5 Impairments (2012/13 £32m vs 2011/12 £8m)

Impairments charged in exceptional items comprise:

Impairment	Sep-12	Sep-11
Property, plant and equipment	11	2
Intangible fixed assets	10	6
Investment in associate company: Midasgrange Ltd	11	0
<hr/>		
Total fixed asset impairments	32	8

Section 12.1 identifies the impaired capital expenditure as summarised above. The increased investment in Midasgrange was for a C share and relates to the Gamma arrangements. It was impaired to reflect the carrying value of nil. Subsequently the investment has been disposed of.

9.6 Loss on disposal of fixed assets (2012/13 £39m vs. 2011/12 £nil)

The associate investment with the Bank of Ireland – in Midasgrange Ltd (POFS) – was disposed of in August 2012. The balance sheet carrying value at the time was £32.4m. Sale proceeds were £2.7m and a loss on disposal of £29.7m has been included in the half year results.

9.7 Profit on property disposals (2012/13 £2m vs 2011/12 £nil)

In September 2012 the freehold property of the former Crown office at Woking was sold for £1.75m (NBV £24.0k). There were no equivalent disposals in the first half of 2011/12.

10. Interest, cash, debt, funding, hedging and going concern

10.1 Going concern

Post Office Ltd has net cash and cash equivalents of some £771m (March 2012 £443m) and a borrowing facility of some £1,150m of which £127m (March 2012 £377m) was drawn down. The improvement is driven by the receipt of £200m Government grant in addition to the upfront receipt of the full year NSP of £210m.

The going concern position has been reviewed and the year-end assessment (below) is still applicable.

10.2 Background

On 24 March 2010 a further funding agreement was agreed that provided up to £180m for compensation for losses sustained in parts of the network in 2011-12 as well as providing access to the working capital facility to 31 March 2016. These arrangements received State Aid approval on 23 March 2011 though the working capital facility was limited until 31 March 2012.

A further funding agreement with Government was announced on 27 October 2010 which provided for:

- Funding of £410m for 2012-13 (recieved 2 April 2012)
- Funding of £415m for 2013-14
- Funding of £330m for 2014-15
- Extension of the existing working capital facility of £1.15bn up to 31 March 2016.

State Aid approval for the funding for 2012-13 to 2014-15 was received on 28 March 2012 and it was also recognised that the working capital facility was no longer deemed State Aid.

The going concern analysis is based on the latest strategic plan refresh prepared and noted by the Post Office Limited Board and Royal Mail Holdings plc Board in October 2010. This was updated to reflect the 2012-13 budget process and an updated view of the later years as at March 2012. The Post Office Board approved the 2012-13 budget on 15 March 2012 and has undertaken an initial review of the later years.

10.3 Assessment for POL

POL has finished implementing its 2005-11 strategic plan and has completed its closure programme. It posted an operating profit before exceptional items for the first time for a number of years in 2008-09 and has continued to do so but still operates with a cash outflow. The 2011-15 plan is intended to reverse the trend of an increasing Network Subsidy Payment (NSP).

The 2011-15 strategic plan, updated for latest views, has been shown in section 11 and shows that POL has sufficient cash headroom to continue to trade. The available facility has been defined to include network cash, ATM cash, ATM debtor, POCA debtor and SGEI cheques. Headroom was increased as the result of a more widely defined criterion for use of the Working Capital Facility (WCF). In the EC's decision of 23 March 2011 they noted that

“...the WCF is provided on condition that it is used for financing the cash and near-cash requirements involved in delivering the SGEIs...” and not limited it to cash for cash-withdrawal Services of General Economic Interest (SGEI) as previously. Therefore the WCF can now be used to finance all SGEI working capital requirements in particular those associated with HMRC cheques in January and July. This will mean the peak funding requirement from non-WCF sources will no longer be required for those months. This change has had a positive effect on all months of c£40m.

Other changes introduced in the one year funding deal for 2011-12 included the ability to borrow up to £50m from other sources as well as the up to £50m in finance leases previously allowed which would improve the headroom capacity if required.

10.4 Summary conclusion

Based on the analysis there is available borrowing headroom remaining until March 2015. Royal Mail Group Limited is a key trading partner with POL and, in arriving at the conclusion that POL is a going concern, the assumption is made that Royal Mail Group Limited is a going concern or that an alternative mails provider would work similarly with POL providing a similar level of income.

It is believed that POL will be able to meet its liabilities as they fall due in the foreseeable future. It is therefore expected that the POL directors will consider it appropriate to continue to prepare the accounts on a going concern basis.

11 POL Funding Analysis

Table 1 MARCH 2012 DRAFT

£m (cumulative apart from free cash flow)	2011-12	2012-13	2013-14	2014-15
Opening Funds	(321)	(336)	(421)	(451)
Borrowing Facilities	1,150	1,150	1,150	1,150
Restriction due to level of network cash	(326)	(400)	(400)	(400)
Borrowing from other sources - finance leases, bank overdraft etc	21	16	11	6
October 2010 plan free cashflow before assumed equity injection	(15)	(285)	(245)	(207)
Assumed equity injection per October plan		200	215	170
Closing Funds Headroom	509	345	310	268
Adjusted Headroom pre risk	509	345	310	268

Table 2 Risks, with management actions

£m (cumulative)	2011-12	2012-13	2013-14	2014-15
Headroom pre risk (as above)	509	345	310	268
Risk				
New Govt income does not materialise		(6)	(18)	(42)
Innovation income does not materialise		(2)	(7)	(14)
Pension contribution rates increase		(9)	(18)	(27)
Headroom post risks pre management actions	509	328	267	185
Management actions				
Headroom post risks pre management actions (A)	509	328	267	185

Headroom pre further management actions	509	328	267	185
Further management actions				
Headroom post further management actions (B)	509	328	267	185

Notes:

2011-12 shows the year end outturn and last years are the latest view of the strategic plan.

Available facilities are defined as network cash, ATM cash, ATM debtor, POCA debtor and SGEI cheques.

Table 1

This table shows the October 2010 strategic plan cashflow updated for the 2012-13 budget and latest reviews of subsequent years. It demonstrates positive headroom throughout the plan period.

Table 2

This table sets out the impact of theoretical downside scenarios if the plan does not generate the income streams anticipated and if the pension scheme costs increase.

Clearly mitigating management actions could be initiated but there remains sufficient headroom even if they are not taken. There are a range of management actions including implementing non-staff cost saving initiatives and closing non NSP offices without compensation, and the overriding principle is that management will take whatever action is required to mitigate any risk that materialises.

There are further actions that could be taken but are not required. These include:

- Closure of the defined benefit fund replacing it with the existing defined contribution scheme
- Sell shareholding in First Rate
- Defer settlement of bureau to First Rate
- Sell BT book
- Sell property
- Sell bill payment business
- Sell tax losses
- Compulsory redundancy on statutory minimum terms

11.1 Net finance costs (interest) (2012/13 £1m vs 2011/12 £4m)

	2012-13 £m	2011-12 £m
Finance costs & investment income		
Interest received on investments – UK	0.5	0.3
Total finance income	0.5	0.3
Interest charged on Government borrowings	(0.4)	(1.5)
Interest payable on finance leases	(0.7)	(1.0)
Unwinding of discounts	(0.5)	(0.7)
Other finance costs	(0.7)	(0.5)
Total finance costs	(2.3)	(3.7)
Net finance cost	(1.8)	(3.4)

Interest payable on the BIS Loan has reduced due as the amounts borrowed have been lower due to £200m capital grants received at the commencement of the financial year.

12. Property, plant and equipment and intangible fixed assets

12.1 Net Book Values

The net book value (NBV) of land and buildings, plant and fixtures and intangible fixed assets was £12m (Sept 2011 £11m). The movements in the half year were as follows:

Movement in NBV	Land and buildings £m	Vehicles, plant and fixtures £m	Intangible fixed assets £m	Total £m
NBV at 25 March 2012	11	-	-	11
Add capital expenditure	9	3	10	22
Less disposals (mainly property)	-	-	-	-
Less depreciation	-	-	-	-
Less impairment	(8)	(3)	(10)	(21)
NBV at 25 March 2012	12	-	-	12

12.2 Assets held under finance leases

The value of equipment held under three finance leases is £nil (Sept 2011: £nil) having been impaired in the years in which it was acquired. One finance lease - Supply Chain cash boxes - capitalised and impaired in 2007-8 with an asset value of £2m, expires in the second half of 2012-13.

12.3 Capital expenditure

The following table summarises the capital expenditure to 23 September 2012:

Capital expenditure analysis	Land and buildings £m	Vehicles, plant and fixtures £m	Intangibles £m	Total £m
Network Transformation: property-related	5	-	-	5
Supply Chain property-related	1	-	-	1
Property transfers ex RM	1	-	-	1
Other property	2	-	-	2
Technology roadmap	-	-	8	8
Pinpads	-	2	-	2
Secure vehicles	-	1	-	1
Other (items <£1m)	-	-	2	2
Total	9	3	10	22

All capex was impaired except the Property transferred from Royal Mail giving an impairment charge of £21m.

13. Investments

13.1 Investments in joint ventures and associates

	Sept 2012 £m	Sept 11 £m
Investment in joint ventures and associates	90	118

Joint ventures

During 2012-13 and 2011-12 Post Office Limited's joint venture investment was a 50% interest in First Rate Exchange Services Holdings Limited with a carrying value of £90m (2011 £96m), whose principal activity is the provision of Bureau de Change.

Associates

During 2012-13 and 2011-12, Post Office Limited's associate investment was a 49.99% interest in Midasgrange Limited with a carrying value of £nil (2011 £22m), whose principal activity is the provision of personal financial products. Midasgrange Limited trades as Post Office Financial Services and is a company registered in the United Kingdom. During the period POL waived £11m due under Gamma in return for a C share. The share was deemed of nil value and was immediately impaired. This investment was disposed of in August 2012 by the sale of POL's interest to the Bank of Ireland.

13.2 Movements in investments in JV and associate (consolidated for information)

	Associate:		
	Midasgrange		
	(POFS)	Joint venture: FRES	Total
	£m	£m	£m
At 25 March 2012	22	68	90
Increased investment in Midasgrange	11	0	11
Share of profit/ (loss) after tax	0	22	22
Sub Total	33	90	123
Sale proceeds	(3)	0	(3)
Loss on disposal of investment	(30)	0	(30)
At 23 September 2012	0	90	90

13.3 The loss on disposal of investments of £28m includes the £30m loss above, offset by a £2m profit made on the sale of property as covered in section 9.7.

14. Litigation and Claims- Potential Claims regarding Horizon.

- 14.1 Post Office Ltd has received notification of five potential claims from former subpostmasters. Each of these subpostmasters had their appointments terminated following the discovery at audit of significant cash losses at their respective branches. Two of the subpostmasters were subsequently prosecuted and pleaded guilty to false accounting.
- 14.2 Each has claimed wrongful termination of contract on the basis that the losses are alleged to have arisen due to the unfairness of the system devised by Post Office Ltd and/or have been generated by a computer error in the Horizon system. More specifically, it is alleged that (a) the accounting procedures in place are unfair in that they do not permit subpostmasters to properly verify losses which are alleged to have been incurred, (b) the Horizon system itself contains inherent defects and/or (c) the training and support for subpostmasters using the system is inadequate.
- 14.3 Each subpostmaster is claiming circa £150,000 by way of damages.
- 14.4 Four of the claims remain at the pre-action stage (i.e. there are no live court proceedings). Post Office Ltd has strongly denied liability and rebutted the allegations made. The fifth claim was struck out by the Court and cannot be pursued further.
- 14.5 The last correspondence received on these matters was in December 2011. Post Office Ltd is not aware of any further substantive steps having been taken to advance these claims through the Courts since that date.
- 14.6 Post Office Ltd continues to receive challenges to the integrity of the Horizon system and it is possible that further claims may be received. Reports in the press have previously suggested that solicitors Shoosmiths may have consulted on between 85 and 150 potential cases in total.
- 14.7 Several subpostmasters have also made complaints about Horizon to Members of Parliament. Post Office Ltd has commissioned an independent third party, Second Sight Support Services Ltd, to investigate an initial sample of sixteen cases where allegations have been made that the Horizon system is the source of unresolved accounting shortages. That investigation is ongoing.
- 14.8 Post Office Ltd is also actively considering proposals from Justice for Subpostmasters Alliance, an organisation “established to raise awareness of the issues within the Post Office Horizon system”, to develop a system by which individual subpostmasters can raise concerns with Horizon within a “no blame” framework.
- 14.9 On the basis of the evidence to date, no provision has been made and it is not considered appropriate to make any disclosure on this matter. This position is being actively monitored.

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POST OFFICE LIMITED BOARD AUDIT RISK AND COMPLIANCE SUB-COMMITTEE

**Format and Content of Annual Report and
Financial Statements for 2012-13**

Purpose

1. The purpose of this paper is to:

- Invite the Post Office Limited Board Audit Risk and Compliance Sub-Committee to consider the format and content for the 2012-13 Post Office Limited Annual Report and Financial Statements and agree the approach to be taken; and
- Update the Committee on the planned timetable for year end.

Background

2. In previous years the main focus of the audit and financial statements production and approval has been on the Royal Mail Holdings plc Group consolidated financial statements with the other legal entities within the Group structure simply meeting the statutory obligation to produce audited financial statements.
3. Following the structure changes for separation with effect from 1 April 2012 the emphasis will change and it is anticipated that the focus of attention will be on the two main subsidiaries of Royal Mail Holdings plc (RMH) – Royal Mail Group Ltd (RMG) and Post Office Limited (POL). It should be noted that, despite the structure changes, technically POL is not required to provide anything additional to the standalone company financial statements and disclosures made in the past therefore the recommendations made in this paper are merely options for consideration.
4. RMH plc will still be required to prepare a full consolidated set of financial statements but it is understood from Royal Mail that these will not be the main document for external communication purposes. However, it should be noted that Post Office Limited will need to liaise with Royal Mail to ensure a smooth and consistent approach to content and timing.
5. In preparation of the recommendations below, consideration has been given to the approach taken by RMH plc, which is likely to be mirrored by RMG where possible for 2012-13. Other approaches have been reviewed for comparison including:
 - John Lewis Partnership plc (JLP) - JLP has similarities to POL in that it is high profile but not listed. It is also perceived to be owned by its employees, but in fact has preference share capital with the employees' interests determined by constitution.
 - British Airways plc (BA) - BA was listed until its merger with Iberia in January 2011 at which point a new parent was created above BA. It has therefore moved from producing full listed plc financial statements to a reduced disclosure while maintaining many of the elements of listed financial statements.
 - BP plc – meets full listing requirements for the group in IFRS and includes UK GAAP parent company financial statements at the back of the group financial statements.

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- General Medical Clinics plc (GMC) – meets plc requirements and produces consolidated and parent company financial statements in UK GAAP.

Decisions

6. POL has three initial decisions to make which are explained further below and summarised in a decision tree diagram in Appendix 1.
7. Once these decisions are confirmed POL has a further option to consider what, if any, additional disclosures it wishes to make towards meeting the requirements of being a listed plc.
8. **Decision 1** – POL has historically taken advantage of the exemptions from being a wholly owned subsidiary of a UK plc that produces Group financial statements but could take the decision not to take these exemptions. The main exemptions are:
 - Not to prepare a cash flow
 - Reduced financial instruments notes
 - Reduced related parties disclosure

The decision to produce consolidated financial statements is linked to these exemptions. POL was not required to produce consolidated financial statements as it was not a parent company but, having taken the decision to incorporate a subsidiary undertaking, it will be a parent undertaking by the year end. As such, a further exemption exists not to produce consolidated financial statements.

The decision has already been taken to produce consolidated financial statements in addition to the required standalone company financial statements. The additional disclosure required for the other exemptions is not considered onerous and these disclosures are standard content for plc financial statements. In addition, the decision not to take advantage of the exemptions would be a clear signal of steps towards full independence.

The potential disadvantages are that this will be the first time that a Post Office cash flow will have been in the public domain, which may be a sensitive issue, and there may be some sensitivity with Royal Mail regarding the related party disclosures.

It is recommended that the exemptions are not taken and POL acts as fully independent in production of its Report & Financial Statements but that the potential sensitivities are noted and re-visited at the year end prior to publication.

9. **Decision 2** – The consolidated and company financial statements could be prepared under UK accounting standards (UK GAAP) or International accounting standards (IFRS). There is also an option to prepare the company financial statements under UK GAAP and the consolidated financial statements under IFRS.

There are not material differences between IFRS and UK GAAP with the main difference being the terminology. Generally large UK plc's report using IFRS for their consolidated financial statements and RMG is expected to use IFRS as it already uses this for RMH. JLP, BA and BP all report under IFRS. It is therefore recommended to report the consolidated financial statements under IFRS.

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POL company financial statements are currently prepared under UK GAAP which is consistent with the rest of the RMH group company financial statements. It is also not uncommon for the parent company financial statements to be prepared in UK GAAP even in large plcs. This practice was more common when IFRS was first implemented due to concerns relating to distributable reserves if IFRS was used for company financial statements. Many companies have continued with this approach, for example, BP prepares UK GAAP parent financial statements, although JLP and BA both prepare IFRS parent financial statements. At this stage RMG has not indicated any plans to change its company financial statements from UK GAAP. With effect from 2015 (POL's March 2016 year end), it will become mandatory to prepare company financial statements under IFRS.

It is recommended that POL continues to prepare its parent company financial statements in UK GAAP at this stage but prepares the consolidated financial statements under IFRS.

10. **Decision 3** – The Report and Financial Statements could be prepared as one formal document incorporating the consolidated results with the business review and other optional disclosures at the front and the statutory parent company financial statements attached at the back. The whole document would form POL's formal submission to Companies House and be retained on the record. Alternatively, as POL is not required to submit consolidated financial statements to Companies House, the statutory parent company financial statements could be prepared as a standalone document for submission to Companies House and the consolidated Report and Financial Statements could be prepared separately for external communications purposes. The consolidated Report and Financial Statements would have no status and would not form part of the formal record at Companies House.

BP is required to prepare consolidated financial statements as well as parent company financial statements and prepares these as one formal document. RMH has also historically followed this approach but RMG has not yet confirmed if it will follow this approach. However, this approach will result in more information than POL is required to prepare being part of the formal Companies House record.

The alternative approach of two sets of financial statements results in considerable duplication and potential confusion between the public document and the formal Report and Financial Statements lodged at Companies House.

It is recommended that one formal document is produced forming both the formal record at Companies House and being the document that is communicated externally.

11. There is then a further option to report as if POL was a listed plc or to adopt some of the requirements where they are considered appropriate. RMH has sought to do this for the last few years and, with a few minor exceptions, has met this standard. The main features that would be added for POL if it reported as if listed are an expanded Business Review, a Corporate Governance section and a Directors' Remuneration Report. At half year a full set of interim financial statements under IAS 34 would be required to meet this level in full.

- The additional requirements for the Business Review include trends and factors likely to affect the future development of the business as well as more information on environmental matters, employees and social and community matters. It is recommended that POL includes these additional requirements where appropriate.

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- The Corporate Governance section is determined by the requirements of the UK Corporate Governance Code (the Code) and the Disclosure and Transparency Rules (DTR). RMH aims to comply with these requirements and RMG is expected to do likewise for 2012-13. It is a requirement to report exceptions and RMH reports that it complies as far as is appropriate for a public company with a single shareholder. JLP also reports against the Code but notes that it has some exceptions and BA has reported against certain elements of the requirements that it deems appropriate. It is recommended that POL investigates the requirements and aims to meet the Code and the DTR to the extent that it is appropriate. A draft of this content will be brought to the Audit Committee for review in February.
- The Directors' Remuneration Report (DRR) Regulations set out the requirements for listed plc's. RMH states that it complies as far as it can for a non-listed company and it is expected that RMG will act similarly. This would involve full disclosure for each named director of their pay broken into component parts, as well as the incentive scheme details (long term and short term) and pension arrangements. JLP does not comply with these regulations but includes the directors' pay disclosure required for the notes to the financial statements. This includes the highest paid, some description of the bonuses and pension arrangements and the pay in £50,000 bandings without names. However, the directors' pay arrangements do not appear complex and their incentives amount to the same percentage bonus as all the other employees. BA also does not comply with these regulations and includes the pay disclosure within the notes to the financial statements. It is recommended that POL does not comply with the regulations at this stage but will disclose a summary of the directors' pay within the notes to the financial statements.
- Half year reporting under IAS 34 would involve producing an abridged version of the full year financial statements and notes. RMH did not comply with this standard until its 2011-12 half year and may opt not to comply for 2012-13. It is understood that RMG is likely to use IAS34 in future but has prepared pro-forma interim statements for 2012-13 in the IAS34 style but not fully complying as it has chosen to exclude the POL results from the whole period although POL was a subsidiary for 1 week to 1 April 2012. JLP prepares interims under IAS 34. It has already been decided that POL will not comply with this standard for 2012-13, but instead will produce a short half year trading statement. This decision could then be re-visited for the 2013-14 interims.

12. As in 2011-12 a full Audit Committee briefing book will be produced in 2012-13 to support the financial statements. This provides a more detailed analysis of the results to aid understanding.

Timetable

13. The additional reporting set out above will have a significant workload impact on the Finance team as well as Communications, HR and Company Secretariat. An initial draft timetable is attached at Appendix 2 with the assumption that all recommendations within this paper are taken.

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Recommendation

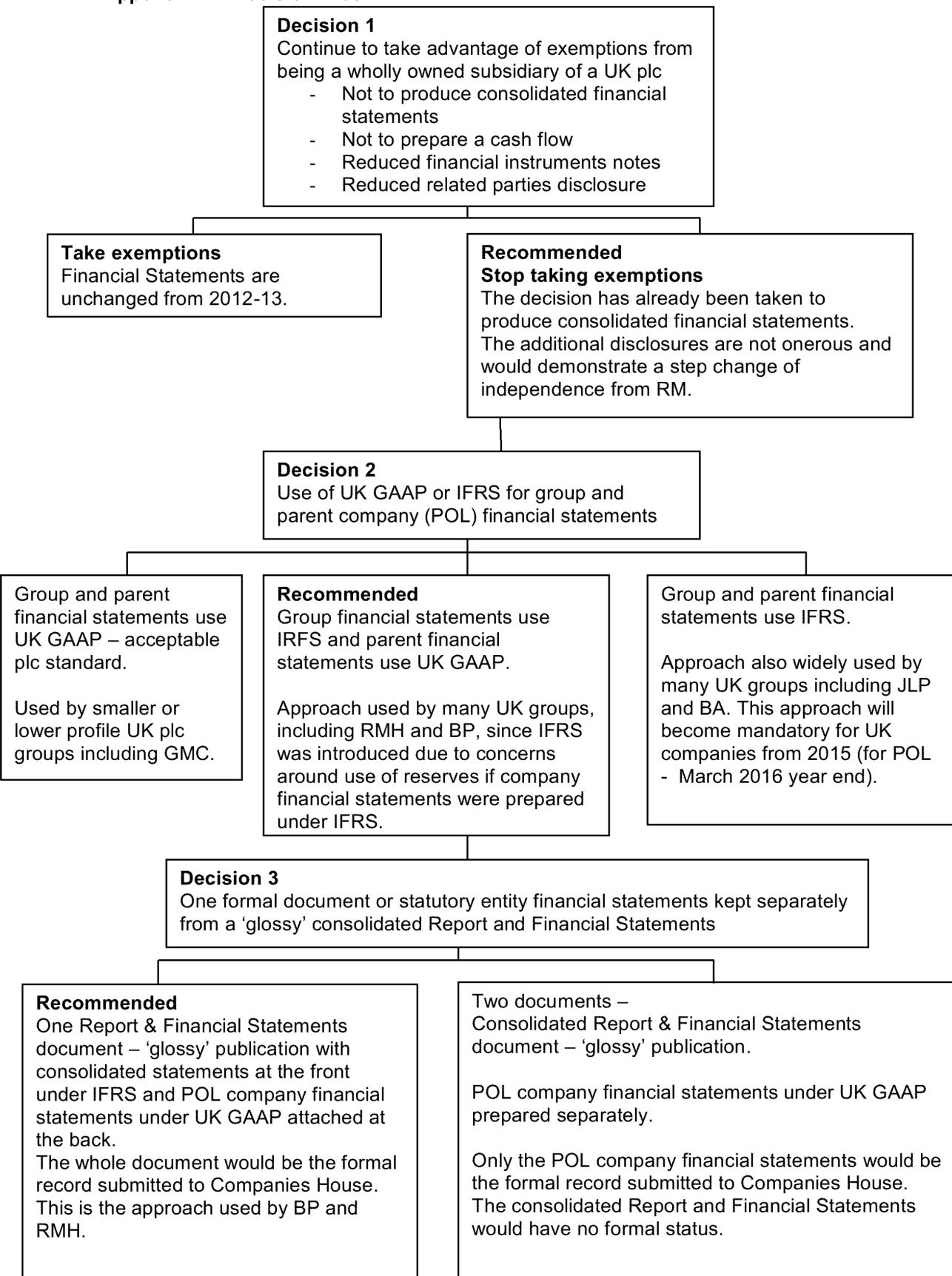
14. The Post Office Limited Board Audit Risk and Compliance Sub-Committee is asked to:

- Agree
 - i. That POL will not take advantage of the exemptions from being a wholly owned subsidiary of a UK parent producing group financial statements;
 - ii. That POL will continue to report under UK GAAP but that the consolidated financial statements will be under IFRS;
 - iii. That the POL Report and Financial Statements will be prepared as one formal document for lodging at Companies House;
 - iv. That POL will include the additional Business Review disclosures applicable to quoted companies where appropriate;
 - v. That POL will aim to meet the Code and DTR Corporate Governance disclosure requirements that are appropriate; and
 - vi. That POL will not meet the DRR regulations;
- Note that a draft of the Corporate Governance disclosures will be brought to the February Audit Committee meeting;
- Note that a draft template for the Report and Financial Statements will be brought to the March Audit Committee meeting; and
- Note the draft timetable for year end.

Chris Day
November 2012

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Appendix 1 – Decision Tree



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Date	Activity
13 February	Audit Committee meeting – review of Corporate Governance disclosures
Mid February	Provide template for year end financial statements to EY for technical review prior to issuing to the Audit Committee
13 March	Audit Committee meeting – review of template for year end financial statements
24 February	Period 11 month end hard close
4 March	Pension Committee meeting – initial review of potential year end accounting assumptions for pension
March	EY perform audit procedures on Period 11 results
Late March	EY period 11 closing meeting
31 March	Year end
2/3 April	Pension Committee – phone call or by correspondence to agree pension assumptions for recommendation to the Board (not yet booked)
April	EY field work
Late April	EY year end closing meeting
20 May	<i>For information - RMG Board meeting to approve financial statements</i>
21 May	Board Meeting – to approve the financial statements and delegate to the Audit Committee for detailed review and to a sub-committee for final review and signing Could be re-scheduled to be: Audit Committee – to review the Report & Financial Statements and recommend to the Board for approval
5 June	Audit Committee – to review the Report & Financial Statements and recommend to the Board sub-committee for signing Could be re-scheduled to be: Board meeting – to approve the financial statements and delegate to a sub-committee for final review and signing
From early June	Announce results (subject to alignment and discussion with Royal Mail)

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POST OFFICE LTD AUDIT, RISK and COMPLIANCE COMMITTEE

Implementation of the Internal Audit Charter

1. Purpose

The purpose of this paper is to:

1.1 Approve the Internal Audit Charter for the newly formed Post Office Internal Audit department. (IA)

2. Background

2.1 As part of the separation of Post Office from Royal Mail Group, Post Office Limited will continue to be subject to internal audit activities by the Royal Mail Internal Audit team up to 31st March 2013 only.

2.2 Post Office appointed its own Head of Internal Audit on October 1st 2012 with the remit to create, lead and develop the Post Office Internal Audit team. An initial budget of the Head of Internal Audit plus 3 high calibre Audit Managers supported by co-sourcing where necessary has been agreed.

2.3 The IA department will operate under the International Standards set by the Global Institute of Internal Auditors. These are widely recognised ways of working and form part of the International Professional Practices Framework.

2.4 One of the required elements of governance for an internal audit team operating within the framework is the establishment of an Internal Audit Charter.

2.5 The Charter sets out how Internal Audit operates within an organisation and requires approval and annual review from the Audit, Risk and Compliance Committee.

2.6 It has been discussed with the CFO, General Counsel and the Committee chairman. Once approved, it will be distributed to Executive Committee members for noting.

3. Current Situation

The charter outlines the following areas

- The long term goals of the IA department
- Independence of line management.
- The role and scope of the function.
- Access and Authority
- Reporting and Audit Planning
- Liaison with the Audit, Risk and Compliance Committee
- Staffing and Resource
- Advice and support
- Standards of Audit Practice

4. Recommendation

The Committee is requested to approve the Internal Audit Charter.

**Malcolm Zack
13th November 2012**



Internal Audit Charter

Internal Audit is an independent review function set up within the Post Office organisation as a service to the Board and all levels of management. The Head of Internal Audit is responsible for evidencing the effectiveness of the design and operation of all aspects of risk management and internal control frameworks throughout the organisation's activities.

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.¹

1. Goals of Internal Audit

- To provide the Board with independent and objective assurance over Post Office organisation controls.
- Provide assurance that the Post Office processes for identifying, assessing and managing risks are effectively deployed.
- To help management improve their decision making processes, controls and operations through risk and control advice and support.

2. Independence

2.1 Reporting Line

- The Head of Internal Audit will report to the Chairman of the Audit, Risk and Compliance Committee, who is a Non-Executive Director of the Board, and on a day to day basis to the Chief Financial Officer. The Head of Internal Audit has access to the Board Chairman, Non-Executive Directors and the Chief Executive. The Internal Audit staff report to the Head of Internal Audit.

¹ Definition of Internal Auditing – Global Institute of Internal Auditing Inc.

3. Role and Scope

The role of Internal Audit is to understand the key risks of the organisation and to examine and evaluate the adequacy and effectiveness of the frameworks of risk management and internal control as operated by the organisation.

Internal Audit, will therefore review, appraise, evidence and report on:

- 3.1 The adequacy and effectiveness of the frameworks of
 - Operational control across the organisation including outsourced services.
 - Financial control
 - Management control
- 3.2 The integrity of processes and systems, including those under development, to ensure that controls offer adequate protection against error, fraud and loss.
- 3.3 Company policies, (risk and non risk) standards and procedures including their use and appropriateness.
- 3.4 National and International legislation where applicable are effectively recognised and acted upon by the company.
- 3.5 The operation of the organisation's corporate governance and risk governance arrangements.
- 3.6 Significant aspects of the organisation's activity including major projects and change programmes and as directed by the Audit, Risk and Compliance Committee (the "Committee").

3.7 Fraud

Management remain responsible for establishing and maintaining systems for the prevention of fraud and theft.

- The internal audit department may be requested to assist in the investigation of significant suspected fraudulent activities and notify the Committee of the results.
- Where regular audit work may reveal fraud risk or actual fraud and irregularities, this will be reported to management and to the risk and audit committees.

3.8 Other key stakeholders

The Internal Audit team will liaise with other providers of assurance including second line defence functions, external audit and Risk Governance Compliance.

4 Access and Authority

- The Post Office Internal Audit team have unrestricted access to all functions, records, property and personnel at all management levels including the external auditors and contractors insofar as it applies to authorised audits, reviews and investigations.
- All members of the Internal Audit team will abide by company and professional standards with regards to confidentiality. Audit files and evidence will be appropriately secured.
- Where information is of particular sensitivity, management may request that access to the information be restricted to the Head of Internal Audit only.
- If required access has not been forthcoming and following due process remains as such and this has a significant restriction on the effective completion of an audit, the limitation should be reported. Effort to resolve the situation should be undertaken and only after these steps should such limitations be reported to the Committee.

4.1 Reporting on activity

- The findings on engagements shall be cleared upwards through line management and to the appropriate Executive Committee member. Reports will be summarised for the Committee, who may request access to the full reports. Reports will also be provided to the CEO, CFO and Head of Risk Governance Compliance as appropriate.
- Formal reports will be classified as confidential. Access to final reports by individuals not directly associated with the audit, shall be approved by the Head of Internal Audit and the owning Executive Committee member.

5 Audit Plan

- The Head of Internal Audit will submit an rolling risk based plan for approval by the Committee, review progress with the audit committee quarterly and where necessary amend the plan to reflect changing risk priorities.

- The plan will project a maximum of 6-12 months into the future although some areas will require annual review.
- This plan will also be made available to the Board and the Executive Committee and be flexible to requests from the business that arise during the year.
- Audits will generally be planned alongside management and announced but at times visits, checks and investigations may be unannounced to the business area concerned. This includes all aspects of the group including head office functions
- A follow up process will be implemented. The results of follow ups including the implementation rate of recommendations will be reported to the Committee on a periodic basis.

5.1 Management Requests

Management may make requests for audits or reviews through the year.

- Requests will be evaluated in terms of risks and effort will be made to address these requests wherever possible.
- Other than short assignments, the Committee should be informed of proposed changes to the plan especially where this will impact delivery or delay start of currently planned work.
- The Chair of the Committee and the Head of Internal Audit will discuss significant changes to the plan and agree steps with the business.

6. Audit, Risk and Compliance Committee Liaison

- The Head of Internal Audit should meet with the Chairman of the Committee outside of regular audit meetings, without the presence of management at least twice a year.
- The Head of Internal Audit may meet with any of the other members of the Committee and with the external audit partner outside Committee meetings.
- All members of the Committee may request a meeting with the Head of Internal Audit to discuss risk, control and audit matters.
- The Head of Internal Audit will ensure that all Committee members are confident in fulfilling their responsibilities and provide support and guidance where requested.

7. Staffing and Resource

- The Head of Audit shall ensure that the department is sufficiently resourced to carry out its duties in terms of professional competency, business knowledge and awareness and technical proficiency. Additional technical training needed to ensure an audit can be effectively conducted should be arranged.
- Specific audit tools to improve efficiency and effectiveness of audits (such as for extraction and analysis of large quantities of data) should be identified and obtained.
- In accordance with international standards, the department should not undertake audit work where it does not feel it is sufficiently skilled to do so. In which case, specialised services or staff from either within the organisation or external to it should be considered and sought.

8. Advice and support

Internal Audit should not be required to:

- Perform operational duties
- Operate controls, other than those within the department
- Approve accounting transactions outside of the department.
- Implement controls that are the responsibility of management.

It is within normal accepted practice and International Internal Auditing Standards for Internal Audit to be requested to assist in a facilitative or consulting nature. Where this falls within the general remit of advising on risk and control this will be considered part of the service offering, with regard to resources available and time required.

Where it is agreed as appropriate for a member of the IA team to provide significant input to an activity or project that is beyond the normal remit which means they should be temporarily seconded to another department or team, then the following will take place.

- The request will be approved jointly by the Head of Internal Audit and the Chairman of the Committee.
- The resource impact on the approved audit plan should be approved by the Committee who will either approve the reduction in scope to the

audit plan or request the Board to approve temporary resource to address the shortfall.

- The work conducted by the seconded member will be the responsibility of the receiving manager, not the Head of Internal Audit. The work will not be defined as internal audit.

9. Standards of Audit Practice

The Head of Internal Audit will implement recognised international internal auditing standards and techniques such as those developed by the Institute of Internal Auditors, COBIT and COSO as appropriate to the Post Office.

Chief Executive Dated:

Chair of Audit, Risk and Compliance Committee Dated:

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POST OFFICE LTD AUDIT, RISK AND COMPLIANCE COMMITTEE

Internal Audit Report

1. Purpose

The purpose of this paper is to:

- 1.1 Summarise the initial activities of the newly established Post Office Internal Audit department.
- 1.2 Explain the recruitment plan.
- 1.3 Summarise the status of the Internal audit plan currently run and managed by the Royal Mail Internal Audit Team.
- 1.4 Highlight findings from recently completed reviews
- 1.5 Outline the proposed activity over the next quarter.

The Audit, Risk and Compliance Committee is asked to note the above, the attached RMIA internal audit plan and summary of the Supplier Contract Management audit.

2. Background

- 2.1 The Royal Mail Internal Audit team comprises over 30 managers and staff. As part of the separation, an agreed audit programme for 2012/13 for 500 man days work commenced in April 2012. A summary of the audit plan to date and current status is shown in appendix 1. RMIA Resource is supplemented by co-sourcing arrangements with Deloittes.
- 2.2 The programme is managed by Stephen Collins, Manager RMIA, with oversight from the Royal Mail Director of Audit and Risk. The audit process from setting terms of reference, through fieldwork, reporting and clearance follows the RMIA protocols and processes.
- 2.3 Malcolm Zack, joined Post Office as Head of Internal Audit (HIA) on October 1st to commence the transition of internal audit activity to Post Office. The current RMIA programme as agreed with Post Office management will continue to run, with some involvement and management from the HIA.
- 2.4 In the intervening time the HIA will determine the actions necessary for the transition.

3. Initial Activities/Current Situation

Activities completed or underway

- Governance of Internal audit (Internal audit charter and Committee terms of reference review).
- Assessment of recruitment needs (underway)
- Establishment of Post Office internal auditing methods, terms of engagement and ways of working. (Commencing Q4)
- Visits to sites and business functions across the organisation for general induction

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- Beginning to understand the key risks of the organisation to support Audit Planning.
- RM Internal Audit activity on
- Supplier Contract Management
- Post Office SAP environment (POLSAP) (at Executive Committee member clearance)
- Transformation Programme – Financial controls. (underway)

4. IA Structure and Recruitment

- 4.1 The initial budget for the Internal Audit team is HIA, plus 3 Audit Managers supported by co-sourced arrangements. The team will be based at Old Street.
- 4.2 The calibre of the audit managers needs to be sufficient to enable effective engagement at all levels of management including Executive Management. They are therefore likely to be qualifieds (CIIA, ACA, CISA) with at least 5 or more years PQE, with previous internal audit experience.
- 4.3 The focus will be on the higher more strategic risks facing the organisation rather than lower operational risks, although these will not be excluded. Based upon exposure to the business to date and the wide variety of risks facing the organisation, the team will need to take a risk based/prioritised approach.
- 4.4 Following discussions with management the team is likely to be:
 - IT Audit Manager - high level of IT infrastructure and systems change over the next 3 years, complex head office and branch IT environment, extensive 3rd party support.
 - Audit Manager - With particular focus on Projects and Programme Assurance. Focus on key aspects of the change programme, transformation and key initiatives
 - Audit Manager - With particular focus on the retail branch network, supply chain and liaison with the inhouse teams that work in these areas.
- 4.5 Recruitment processes are underway for the IT Audit Manager as this need was determined early on in the process.
- 4.6 Whilst there may well be some activity in the Financial Services arena needed, there is work conducted by the Internal Audit team of the Bank of Ireland.
- 4.7 In order to maintain flexibility, remain up to date with new skills and requirements, most modern internal audit departments set up co-source arrangements with external firms. (For example, Royal Mail use Deloittes). An initial budget of 150 days external support is under consideration and a tender process will commence once agreed.

5. Internal Audit Plan and recent results.

- 5.1 Please refer to the Royal Mail IA summary plan status in Appendix 1 and the Post Office summary of the Supplier Contract Management Audit in Appendix 2.
- 5.2 At time of writing the Audit of the POLSAP system environment was at Executive clearance with the CIO. A verbal summary will be provided at the Audit Committee meeting.

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6. Internal Audit Activity Nov 2012 – End January 2013

- Continue recruitment of IT Audit Manager
- Commence recruitment of rest of team.
- Commence tendering for co-sourcing support
- Risk Management Framework input
- Create proposed plan for 2013/2014 internal audit work.
- Agree budgets for 2013/2014 including relevant audit tools.
- Audits on: Transformation – Financial controls, Horizon, LINK, and Payroll.

7. Recommendations

The Audit, Risk and Compliance Committee is asked to:

- Note the activity.
- Raise any questions on recent audit results if needed.
- Highlight any areas of remaining focus for the Royal Mail IA team
- Comment on the Post Office structure and resource proposals.

Malcolm Zack
6th November 2012

Post Office Limited (POL) - Internal Audit & Risk Management Plan (IA&RM) 12/13

Proposed Business Area for Review in 2012/13	Proposed Scope	Status	Planned Issue	Days Allocated	Actual Days To Date	Projected Total Days	Comments
POL Transformation Programme	Network Transformation	Fieldwork	Ongoing 12/13	100	32	100	Independent assurance plan proposal issued to Programme Executive. Financial Controls assignment started. At least two more assignments to be executed in 12/13.
	Front Office of Government	In audit plan not yet started	Ongoing 12/13	30	-	TBC - See Comments	Assurance activity will be undertaken if the timing and scope will benefit the Programme, otherwise this resource will be used for the NT Programme.
	IT Transformation	In audit plan not yet started	Ongoing 12/13	40	-	TBC - See Comments	Assurance activity will be undertaken if the timing and scope will benefit the Programme, otherwise this resource will be used for the NT Programme.
Payroll Data Analytics	To provide substantive assurance on aspects of payroll processing using data analytics.	Cancelled	Cancelled	-	N/A	N/A	No longer required as per discussion with S Hall/ S Crichton. Replace with LINK.
Agents' Remuneration	Assurance of controls around non-volume related elements of remuneration to sub-postmasters including a high level review of core tier payments.	Cancelled	Cancelled	-	N/A	N/A	No longer required as per discussion with S Hall/ S Crichton. Superseded by NT Programme. Replace with Critical Controls and E&Y support.
Key Business Risk Assurance	An assessment of where and how POL is getting assurance on its key business risks and the adequacy and effectiveness of this activity.	Issued	July	40	39	39	Not Satisfactory - fragmented assurance approach.
Contract Management	A review of existing supplier contract management in POL.	Reporting	October	50	52	52	Report to be issued October
POL SAP	A review of POL SAP with regards to the integrity of processing, security and systems continuity.	Reporting	November	50	52	54	Report to be issued November
Information Security	Review of IS for: Identity and Access Management; Information Asset Management; Threat and Vulnerability Management; Information Security Risk Event Identification; and, Information Security Awareness Training.	Issued	August	40	45	45	Not Satisfactory - poor visibility of IS processes from 3rd party providers.
Business Risk Attestation	Ongoing assurance on the management and status of the Executive Team key risks.	Scoping	December	40	2	45	Scope to be confirmed.
Risk and Assurance Support	Transition of services and data to POL for March 2013 handover	Ongoing	Ongoing 12/13	20	12	20	We are active in providing support to the new POL Risk and Audit teams - sharing processes, methods etc.
Speak Up	Provision and management of Speak Up arrangements for POL	Ongoing	Ongoing 12/13	10	2	10	One POL related disclosures received to date. Case not upheld.

Sub Total

420 days 236 Days 365 Days

500 days as agreed per RMG / POL MSA. So far two assignments (Payroll Data Analytics and Agents Remuneration) cancelled totalling 80 days, replaced by additions below.

LINK	Annual attestation of compliance requirement	Scope agreed start date TBC	February	20	3	20	February start planned. Awaiting confirmation of start date from Security.
Critical Business Controls	Assurance support for Critical Business Controls	Scope agreed start date TBC	December	20	2	20	December start planned.
E&Y Support	Assurance support for the external auditors for POL Payroll controls	In audit plan not yet started	February	15	-	15	February start planned.
E&Y Horizon Actions	Follow up of progress made by POL in addressing Horizon control points raised in the 11/12 Ernst & Young Management Letter	Scoping	December	25	1	30	November start planned.

Sub Total

80 Days 6 Days 85 Days

Grand Total

500 Days 242 Days 450 Days

Supplier Contract Management – summary of Royal Mail IA report

Further improvement
needed



Audit Highlights and Opinion

Overview.

- POL has a Contract Management Function that manages suppliers. The review was agreed between POL and Royal Mail Internal Audit as part of the 2012/2013 internal audit plan.
- The review assessed controls to assess supplier contract risk including:
- Changes to existing contracts including authorisation controls,
- Case management, legal review, management of supplier charges and supplier performance.
- General governance of the function and supplier risk management.

Overall Conclusions (from Royal Mail report)

- "The controls in place over existing supplier management are largely derived from the **Service Delivery Framework**,
- Contract Management provide varying levels of support.
- In a stable environment with a low level of change, this would suffice with some improvements.
- With the anticipated high level of change being undertaken by the business, a more proactive commercial approach to managing suppliers is recommended. Management are aware of this and are developing a **Contract Management Framework**.
- There is some concern over access to Horizon software after exit because Fujitsu own the IPR rights.

Strengths

- 1) Service Delivery Framework in place
- 2) Individual working practices for each supplier contract
- 3) Formal process for review and agreement of changes between POL and supplier.
- 4) Legal consulted on contract changes
- 5) Governance meetings to monitor contracts and some issue escalation
- 6) Service Delivery managed through a mix of service levels, KPIs and improvement plans

Weaknesses (Ambers)

- 1) Need more proactive management of supplier relationship, contract costs and supplier risk
- 2) No formal standard policies for whole of Contract Management function
- 3) Inconsistencies between contract management across different contracts.
- 4) Risk Management varies from contract to contract
- 5) No formal assessment of the risks of the supplier base as a whole
- 6) Contract governance weak. Documentation stored on local drives or based in emails. (*underway*)
- 7) Legal review process not formalised for sign off, amendment, or audit. (*underway*)

Top Priority Agreed Actions

- 1) Develop formal risk management process for all supplier contracts
- 2) Formalise policies and procedures across Contract management function.
- 3) Formalise the Legal Review process
- 4) Strengthen senior management review and documentation.
- 5) Clarify exit and IPR issues

Top Concerns (Reds)

- 1) No items of serious risk noted

Executive Responsible

Distribution (date)

Prepared By

Names

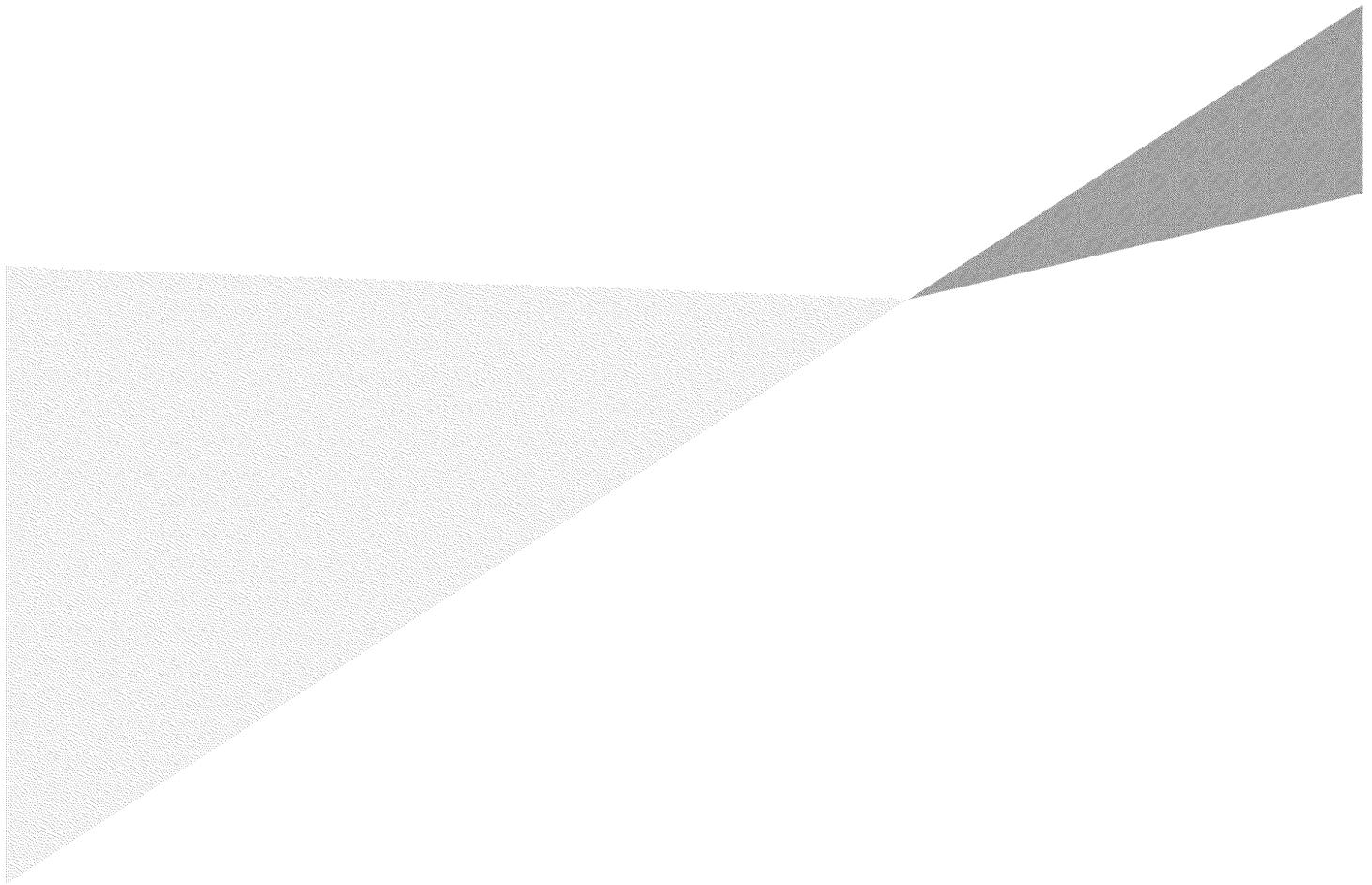
Reviewed By

Names

Post Office Limited

Report to the Audit and Risk Committee 2012-13 Audit Planning Report

6 November 2012





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Private and confidential

6 November 2012

Audit and Risk Committee
Post Office Limited
148 Old Street
London
EC1V 9HQ

Dear Members of the Audit and Risk Committee

Planning Board Report

We are pleased to attach our audit planning board report for the forthcoming meeting of the Audit and Risk Committee. The purpose of this report is not only to provide the Audit and Risk Committee with a basis to review our proposed audit approach and scope for the 2012/13 audit, in accordance with the requirements of the auditing standards and other professional requirements, but to also ensure that our audit is aligned with your service expectations.

This report summarises our assessment of the key issues which drive the development of an effective audit for Post Office Limited, considering the relevant emerging market forces coupled with the operational, finance, and business risks which drive POL's financial statement risks. We have aligned our audit approach and scope with these.

This report is intended solely for the information and use of the Audit and Risk Committee, Board of Directors and management, and is not intended to be and should not be used by anyone other than these specified parties.

We welcome the opportunity to discuss this report with you on 13 November 2012, as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

GRO

Angus Grant
Engagement Partner
For and on behalf of Ernst & Young LLP

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Appendices

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Appendix B	Audit fees
Appendix C	Insights on IT risk
Appendix D	Independence report
Appendix E	Required communications with the Audit and Risk Committee

Section 1

Executive Summary

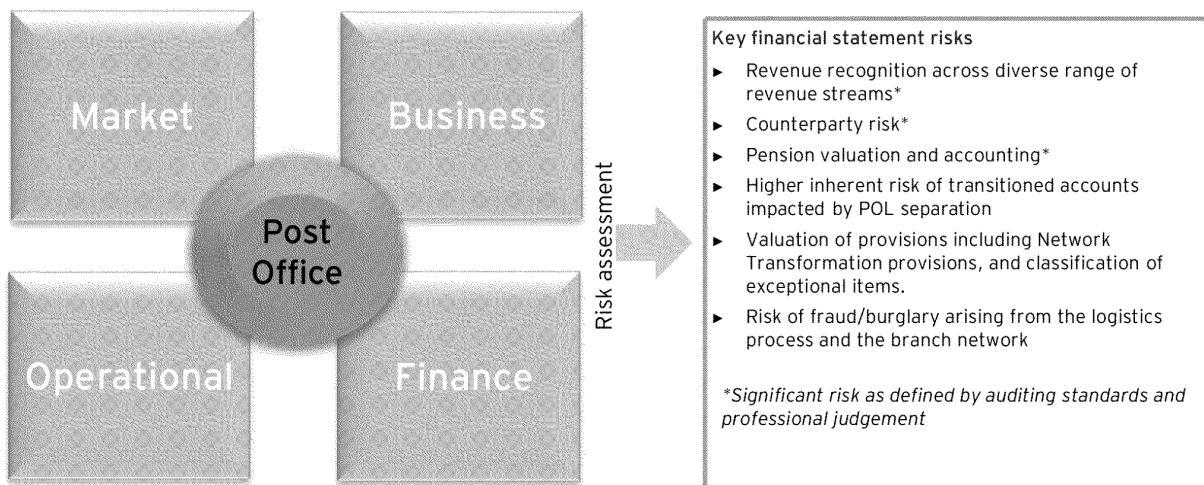
Executive Summary

1. Introduction

Less than a year from the official separation of Post Office Limited ('POL') from Royal Mail Group ('RMG'), we continue to witness the time and efforts expended to make changes vital for success in this new chapter of POL's history. We have also continued to challenge our audit strategy for the coming 2012-13 financial year, working with management so that our approach focuses on the risks faced by POL in response to changes within the industry, economic environment and internally.

In order to identify the key drivers of audit risk, we analyse the risks inherent in the sector, the markets in which POL operates, the key strategic, operational and finance risks for POL you have identified through your risk assessments and our knowledge of other factors that may impact POL's financial statements.

By considering these inputs, we focus our audit on the areas that matter to POL, so that our feedback is more relevant to your business.

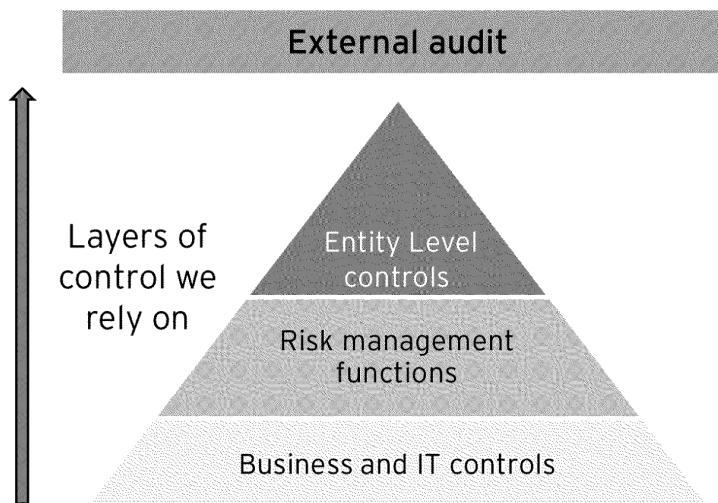


Our audit approach is designed to appropriately respond to these risks. We will continue to focus on the key areas where we believe there is higher inherent risk to the financial statements due to the nature and level of judgement involved. We will also consider changes in financial reporting standards and regulations and their impact on the presentation and disclosure in the financial statements.

Executive Summary (cont'd)

2.

Controls based audit



Controls based approach

- We will adopt a controls-based approach, being the most efficient approach to a business with a high volume of low value transactions.
- We will seek to place reliance on business and IT general controls as well as placing reliance on POL's own risk management policies and other entity level controls.

3.

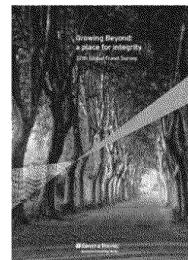
Service delivery

Your audit team

- Your audit team is led by Angus Grant, who is in his fourth year on the engagement, supported by Jeremy Midkiff, who has three years involvement with POL.
- In response to POL's establishment as a standalone company, our audit team will include more specialists to assist us with our procedures, covering pensions, tax and corporate restructuring.

Insights and value

- We will use our knowledge of your business and our experience of working with you to bring you insights and ideas in areas that matter most.
- At the end of the audit, we will issue a 'Controls Themes & Observations' report (a 'Management Letter') to share insights identified from the audit.
- We will share insights from our Governance, Retail and Public Sector thought leadership, as well as both global and local perspectives.



Section 2

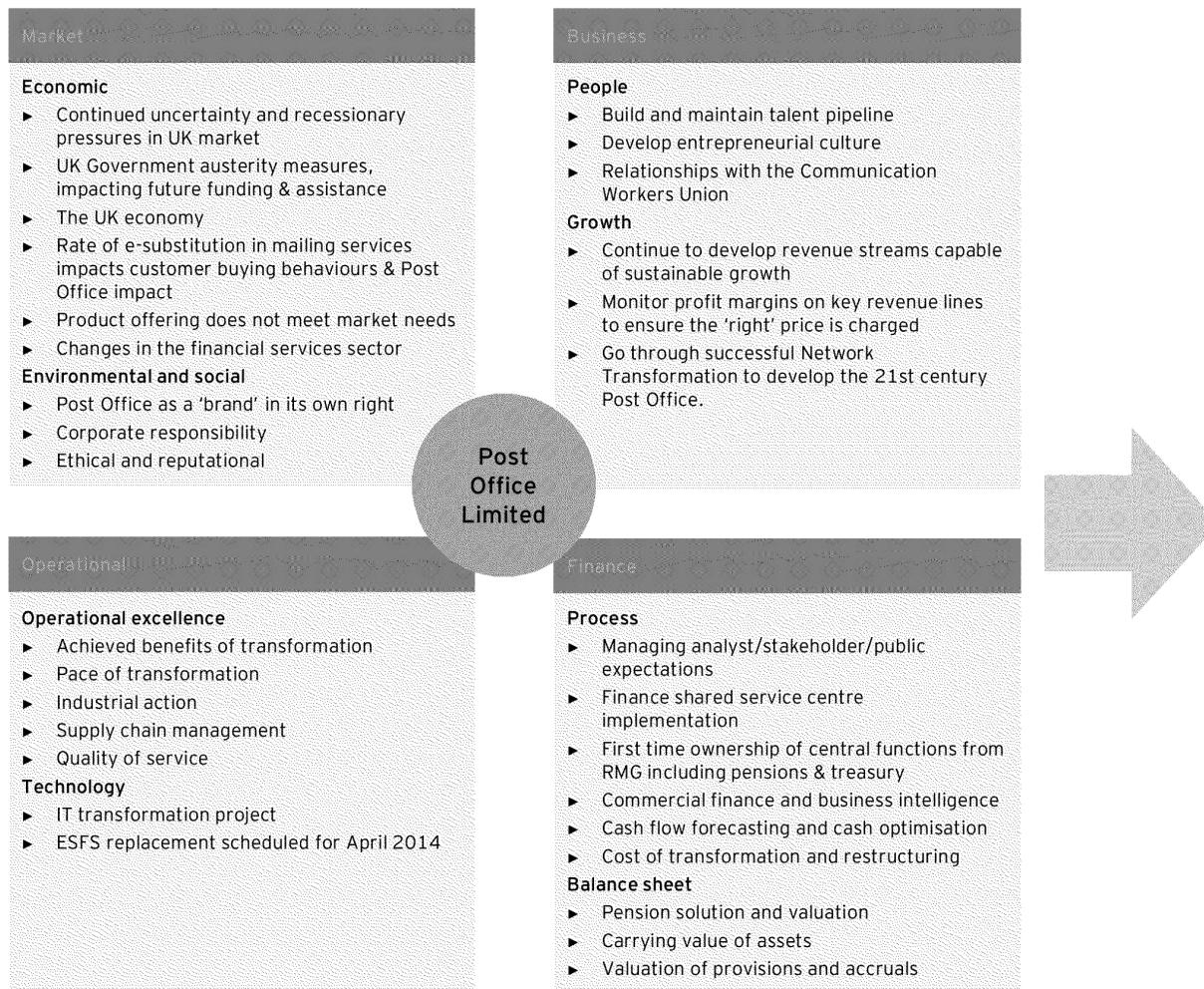
Risk based approach

Risk based approach



Through our risk assessment approach, we analyse the risks inherent in a government funded entity, the markets in which you operate, the key strategic, operational and tactical risks for the Company you have identified through your risk assessments, and our knowledge of other factors that may impact the Company's financial statements. We then map these risks to financial statement risks. This risk assessment process informs where we will focus our audit work for 2012-13.

Risk assessment





Risk based approach (cont'd)

Significant risks

Of the financial statement risks identified, we consider some of them to be significant to our audit. Auditing standards define significant risks as those with a high likelihood of occurrence and, if they were to occur, could result in a material misstatement of the consolidated financial statements.

Once identified we are required by Auditing Standards to perform specific procedures over significant risks, including the identification and testing of the effectiveness of key controls designed to address the risks.

The identified financial statement risks for POL are as follows:

Financial statement risk	Area of audit emphasis
Revenue recognition across diverse range of revenue streams	<ul style="list-style-type: none"> ▶ The incentive to deliver expected revenue targets ▶ The accounting for deferred revenue and specific commissions within complex or new legal agreements across a variety of revenue lines.
Counterparty Risk	Perceived heightened risk since 2008 credit crisis over the credit risk exposure to counterparties, particularly given the concentration of risk associated with the Bank of Ireland.
Pension valuation and accounting [NEW]	The accounting for the pension solution and subsequent valuation of the reported balance sheet surplus/(deficit) is very sensitive for POL management and key stakeholders
Higher inherent risk of transitioned accounts impacted by POL separation [NEW]	Accounts which were previously handled by Royal Mail's finance team will be fully transitioned to the POL finance team, such as treasury and pensions.
Valuation of provisions including Network Transformation provisions and classification of exceptional costs [NEW]	Assessing the financial statement impact of any provisions, including those arising from the Network Transformation programme, and the classification of related exceptional costs.
Risk of fraud/burglary arising from the logistics network and the branch network	There is a large quantity of cash in the cash centres, branches and in transit which is potentially subject to misappropriation or the focus of burglary attempts.

Fraud risks and risk of management override

The risk of fraud exists in any business. However, frauds involving the manipulation of results to achieve performance targets are particularly harmful to stakeholder value and the current economic environment has increased their likelihood of occurrence.

Our responsibility is to plan and perform audits to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements whether caused by error or fraud. To address the increased potential risk arising from manipulation of results to achieve performance targets, we consider the incentives and opportunities for individuals to override internal controls in our audit procedures.

Section 3

Areas of audit emphasis

Areas of audit emphasis

Summary

In determining our approach to the 2012-13 audit, we consider how the risks faced by the Company might impact the financial statements. From our experience of working with a number of companies in the government and financial services sector, our understanding of the key risk areas focused upon by management and from our prior knowledge of the Company, we identified a number of key financial statement risks, outlined below. These do not represent all risks but do include those items that in our opinion are the most significant for POL in 2012/13.

The risks are largely consistent with the prior year with additional emphasis surrounding the changes that the separation of Post Office from Royal Mail and the Network Transformation programme will bring to the business.

Risks	Considered a significant risk by auditing standards	Considered a fraud risk by auditing standards	Changes from prior year
► Revenue recognition across diverse range of revenue streams	✓	✓	No change from prior year
► Counterparty risk	✓		No change from prior year
► Pension valuation and accounting	✓		Focus on the final valuation post pension solution and 'go-forward' valuations
► Higher inherent risk of transitioned accounts impacted by POL separation			Additional risk following POL separation
► Valuation of provisions including Network Transformation provision & classification of exceptional costs			Additional risk following high level of network transformation exceptional costs budgeted in current year
► Risk of fraud/burglary arising from the logistics process and the branch network			No change from prior year
► Project Eagle/Gamma accounting			Following sale of investment in POFS associate

Areas of audit emphasis (cont'd)

Accounts with significant risks

Significant risks are risks with both a higher likelihood of occurrence and a higher magnitude of effect that require special audit considerations. The risks we have identified as significant risks are detailed below, along with how we propose to address those risks.

Area of emphasis	Summary of planned audit procedures
<p>Revenue recognition across diverse range of revenue streams</p> <p>POL sells a large variety of products/services across a number of revenue streams, from providing ATM services through the Bank of Ireland arrangements, to providing telephony broadband services under POL's Homephone brand. Most of these revenue streams will have their own specific rates, commissions and calculations for allocating the amount of revenue owing to Post Office, which are dependant on their underlying contracts.</p> <p>Whilst we note that most of the revenue lines are not overly complex in their revenue calculations, the main risk associated with the diverse range of revenue streams is in the correct contractual terms being applied to the revenue lines.</p> <p>We also note that reward and incentive schemes based on achieving profit targets may also place undue pressure on management to achieve revenue forecasts, which makes us identify revenue recognition as a fraud risk.</p>	<ul style="list-style-type: none"> ▶ We will perform detailed controls work on revenue during interim, which will include testing whether the revenue lines selected are using the correct contractual rates and volumes in their calculations. ▶ We will perform a detailed analytical review to analyze and evaluate the movements in the key revenue lines across the business. ▶ For significant new products or revenue streams, we will review the accounting treatment in line with the revenue recognition accounting standard and relevant contractual terms.
<p>Counterparty risk</p> <p>In light of the current economic environment, POL undertakes a review of all counterparties to assess their level of exposure and relative risks. In particular, given the concentration of risk associated with the Bank of Ireland (BoI), POL has performed a more detailed assessment to determine if steps should be taken to mitigate any risk exposure perceived excessive.</p> <p>As part of their assessment, the appropriate detailed contingency plans have been put in place, in particular focusing on Instant Saver and general banking areas.</p> <p>It is noted that the counterparty risks associated with the BoI mainly relate to the daily trading balance which is owed from BoI to POL with the most significant exposure in respect to the ATM debtor. On any given weekday the exposure is approximately £20-30m; however on a Sunday, the exposure could be approximately £80m, as it would include the full weekend's transactions.</p> <p>Management will need to continue to regularly monitor and assess the level of relative risk and exposure of their trading partners, in order to determine at any point if steps should be taken to mitigate any perceived risk through collateral or other arrangements.</p>	<ul style="list-style-type: none"> ▶ We will discuss the counterparty risk at year end with the Head of Corporate Finance, and understand management's assessment of the counterparty risk the business is exposed to and if this would have any related financial statement impact. ▶ We will keep abreast of the volatility in the financial markets and any changes to POL's key partners such as the Bank of Ireland's credit rating. ▶ We will consider the recoverability and financial statement presentation of any material counterparty receivables due to POL, performing subsequent cash testing where necessary. ▶ We will perform detailed substantive tests on all material vendor reconciliations at year end.

Areas of audit emphasis (cont'd)

Accounts with significant risks

Area of emphasis	Summary of planned audit procedures
<p>Pension valuation and accounting</p> <p>On 1 April 2012 – after the granting of State Aid by the European Commission to the Government on 21 March 2012 – almost all of the pension liabilities and pension assets of the Royal Mail Group pension scheme, RMPP, built up until 31 March 2012, were transferred to HM Government ('HMG'). On this date the RMPP was also sectionalised, with Royal Mail Group Ltd and Post Office Limited each responsible for their own sections in future. This arrangement left the RMPP fully funded on an actuarial basis in respect of historic liabilities at that date.</p> <p>The accounting of the transfer of the RMPP and related disclosures is sensitive due to the number of stakeholders involved, including HMG and the Communications Workers Union.</p> <p>At 23 September 2012, the Group recognised a net pension asset of £53m on their balance sheet.</p> <p>Management will satisfy themselves that the assumptions used in calculating the pension obligation at the year end are reasonable and the appropriate disclosures are made by consultation with actuaries.</p>	<ul style="list-style-type: none"> ▶ We will audit the accounting treatment in line with IAS 19 and IAS 1. ▶ For the final Post Office RMPP year end valuation we will review the key financial assumptions supporting the valuation, with input from Ernst & Young pension specialists and ensure that the methodology and application is consistent with IAS 19 and IAS 1. ▶ Benchmark POL assumptions against peers. We will assess and provide insight into the relevant position of the treatment adopted. ▶ Obtain evidence and support for the valuation of pension assets. ▶ Review the pension disclosures provided in the financial statements.

Other areas of audit emphasis

The other areas of audit emphasis are set out below:

Area of emphasis	Summary of planned audit procedures
<p>Higher inherent risk of transitioned accounts impacted by POL separation</p> <p>On 1 April 2012 Post Office Limited ceased to be a subsidiary of Royal Mail Group Limited, and became a directly owned subsidiary of Royal Mail Holdings plc.</p> <p>As a consequence of POL's separation from Royal Mail Group during the current year, the POL finance team will be directly responsible for all its finance functions, some of which were previously accounted for at Royal Mail Group. Such accounts/finance functions will include but are not limited to pension valuation accounting and treasury management.</p>	<ul style="list-style-type: none"> ▶ We will be performing detailed testing on the new processes, acting in close concert with management and build on the knowledge that the Royal Mail Group team had when these accounts were prepared and audited at RMG level. ▶ We will use the same specialist teams that were used by Royal Mail Group wherever possible such as the Pensions team to ensure a smooth transition from the audit side.
<p>Valuation of provisions including Network Transformation provision & classification of exceptional costs</p> <p>Following its separation, POL has been going through a Network Transformation all of its existing branches in order to modernise them as part of their overall strategy to make the Post Office competitive for the future.</p> <p>The financial implications of Network Transformation for FY2012-13 are anticipated to be approximately in the region of £127m.</p> <p>£24m of exceptional costs relating to Network Transformation had been incurred as at September 2012.</p> <p>Risks include:</p> <ul style="list-style-type: none"> ▶ Costs are provided for before or after they have been committed and are recognised in the incorrect period; and ▶ Other costs, not associated with the Network Transformation are inappropriately included within this category and reported outside of the trading profit. 	<ul style="list-style-type: none"> ▶ We will review management's monitoring process for being able to differentiate between Network Transformation costs and normal operating costs, and assess whether it captures the appropriate information and detail to track these costs. ▶ We will review the detail of the costs provided and establish when the committed obligation arose to assess whether the cost has been recorded in the appropriate period. ▶ The costs included will be reviewed to understand whether they are directly linked to the Network Transformation and appropriately included within this category and reported outside of the trading profit.

Areas of audit emphasis (cont'd)

Other areas of audit emphasis

Area of emphasis	Summary of planned audit procedures
<p>Risk of fraud/burglary arising from the logistics process and the branch network</p> <p>POL holds large quantities of cash within its retail centres, cash centres and in transit (£642m as at 23 September 2012), which is potentially subject to misappropriation or under the threat of burglary attempts by organised crime. Management has in the past created strong controls to prevent and detect any risk of fraud and attempted burglary, and keep re-assessing whether they need to increase their security measures.</p>	<ul style="list-style-type: none">▶ We will visit both cash centre and branches to attend cash counts by internal audit, and observe controls around cash management.▶ We will also hold a meeting with head of security at cash centres to gain insight into their assessment of risks and events of fraud in logistics process and branch network.▶ We will perform detailed substantive tests on cash and bank reconciliations at year end.▶ We will perform detailed cash and bank cut off testing at year end.
<p>Project Eagle/Gamma accounting</p> <p>BOI sells a number of financial services products through the POL branch network in the UK. Historically, the services were operated through Midasgrange Limited, which traded as Post Office Financial Services ('POFS'), a JV between POL and BOI.</p> <p>In April 2007 a deed of variation was signed between POL, BOI and POFS. This deed of variation was intended to compensate POL for continuing to maintain a network of 370 Crown offices rather than their plan of converting 50 of these offices to franchise offices by 2015 ('Gamma').</p> <p>We understand that subsequent to year-end, Gamma was terminated as POL sold its investments in POFS to the BOI for proceeds of approximately £2.7m (Project Eagle).</p> <p>Going forward, we understand that the arrangement between POL and BOI will be 'commissioned based' whereby POL will directly receive a contractual commission for each BOI product that it sells to customers through its branches.</p>	<ul style="list-style-type: none">▶ We will review the new contract between POL and BOI to determine the accounting effects on POL.▶ We will review management's accounting for the sale of their investment in POFS and treatment of cash proceeds and resulting gain/(loss) on disposal.▶ We will review existing revenue deferral under 'old agreement' for appropriateness and any impact on current year financial results.▶ We will review resulting disclosures in the year-end consolidated financial statements.

Section 4

Controls based audit

Controls based audit

Gaining assurance through the control environment



POL's Control Processes

A key consideration in our audit planning process is the extent to which POL assesses risk and implements controls in order to minimise risk.

We intend to continue to utilise a controls-based approach in respect of IT, which is discussed in detail on pages 16 and 17.

We also intend to continue to utilise a controls based approach in respect of the identified significant processes of revenue, purchasing, cash settlements and payroll. Our controls testing approach focuses on the controls implemented across the entire POL business, including the London head office, Bolton (payroll) and Chesterfield (shared services), branches and cash centres.

We are also aware that the POL finance systems and control environment will continue to change in a post-separation environment, as POL begins to undertake new accounting processes and activities that it had hitherto not carried out, such as the consolidation of results at a POL level for statutory purposes and the development of governance structure and accounting for treasury and pension facilities. We will consider if any of these new separation related activities will have an impact on the control environment, modifying our approach and conducting walkthroughs to understand the new environment where applicable.

Although our audit is not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you any significant deficiencies in internal control. We will also provide you a detailed letter at the end of the audit incorporating certain recommendations for process improvements noted by us in the performance of this year's audit.

A controls based approach	Reliance on controls
<p>Underpinning our entire approach is a controls-based audit. It is the most efficient approach for a business that has a very high volume of low value transactions.</p> <p>In adopting an efficient controls based approach we consider the various layers of assurance and leverage where there is potential to do so. This informs our basis of working with management.</p>	<p>We will test controls for POL's payroll, purchasing, cash settlement and revenue processes.</p> <ul style="list-style-type: none"> ▶ IT systems and applications: we will review the IT general controls built in to POL's core IT applications, together with IT application controls over your critical business processes ▶ Entity level controls: we will maximise efficiency by seeking to rely on entity level controls and processes, such as your budgeting process.

Controls based audit (cont'd)

Gaining assurance through the control environment



IT Control Planning - Background

IT underpins a significant proportion of the Post Office's transactions. Our audit plan is designed around reliance on certain IT applications and the use of electronic audit evidence. The following IT applications are in scope for our POL audit: HNGX, POLSAP, SAPHR and SAP ESFS.

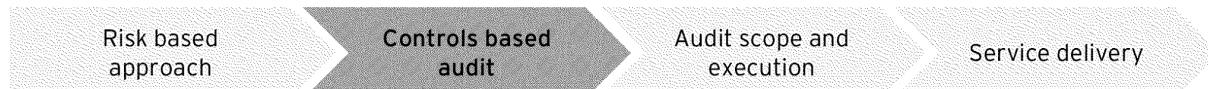
The IT audit process has historically, and continues to be, complex as a result of factors such as control weaknesses in POL's IT environment, including the lack of oversight of service provider Fujitsu's control environment. During the 2011-12 audit, the audit process improved as a result of remediating certain high risk control weaknesses, the involvement of all parties (POL, Fujitsu and Ernst & Young) in planning activities at an early stage of the financial year and the continued sponsorship of POL management and commitment from Fujitsu.

2012-13 IT Audit Strategy - key considerations

- ▶ During this financial year, Fujitsu took steps to commission an ISAE 3402 report for 2012-13 on the controls operated by Fujitsu over POL's business critical systems.
 - ▶ In order to reduce our testing, we intend to place reliance on the report, with the extent of our reliance being dependent on the opinion expressed in it.
 - ▶ In the event that control exceptions are identified in the report, we will need to perform additional procedures to address the risks.
 - ▶ To support this approach, the POL, Fujitsu, Ernst & Young IT audit and Ernst & Young ISAE 3402 teams have taken part in workshops to consider the control framework for POL based on the previous audit, and the respective roles of the parties in providing an assessment on these controls for the 2012-13 financial year. During these workshops, key milestones and protocols have been agreed so that the parties are kept up to date with the progress of the ISAE 3402 testing.
- ▶ The remediation of prior year IT audit observations is also a key consideration in our planning for the IT audit this year, as it impacts on the extent of our testing.
 - ▶ From our discussions with POL, we understand that a process of formal risk acceptance has not yet been undertaken for some of the risks relating to the findings identified by the previous audit.
 - ▶ As we have previously highlighted, these areas will remain in scope for the upcoming IT audit and therefore we will carry out additional procedures (substantive tests of the controls or tests of mitigating controls) to gain comfort over the remaining risk relating to the financial statement audit.
 - ▶ The remediation of open findings from last year's audit has been considered in the approach to the ISAE 3402 report as part of the workshops attended by POL, Fujitsu, Ernst & Young IT audit and Ernst & Young ISAE 3402 teams.

Controls based audit (cont'd)

Gaining assurance in the IT environment sphere



2012-13 Audit Strategy – key considerations (cont'd)

- ▶ Other key considerations for the IT audit this year are POL's separation from Royal Mail Group and the related IT transformation initiatives. We plan to work closely with POL to understand both the changes to the organisation's risk landscape that these activities create, and the further development of POL's governance and control frameworks. Of direct relevance to the 2012-13 audit are:
 - ▶ The status of the transition plan and transitional services agreements with Royal Mail Group to maintain and monitor the third party contractual obligations during the period of separation including ensuring service levels are met
 - ▶ How access to sensitive data, such as payroll information, is restricted during the transition period.
- ▶ Finally, a key consideration is the audit approach for two key systems that are operated by Royal Mail Group and support POL's financially significant processes; to date these have been reviewed as part of the Royal Mail Group IT audit. These systems are SAP ESFS, which supports the processing of branch returns, fixed assets, purchasing and general ledger transactions, and SAP HR - HRP, which supports the payroll for POL employees. The existing audit approach adopted for these two systems is based on the audit efficiencies gained from assessing the controls managed by third party provider CSC, which are common across Royal Mail Group's key financial systems. Whilst Royal Mail Group continues to provide these services, we would anticipate requesting comfort over these systems from the Royal Mail Group audit team. To the extent that POL migrates relevant data and applications to itself or implements new systems to cover these requirements over time, they will fall within the scope of the POL IT audit.

We will continue to work together with POL to agree planning milestones and protocols at the early stage of the financial year to continue to improve the audit process for the upcoming IT audit.

Controls based audit (cont'd)

Gaining assurance in the IT environment sphere



2012-13 Audit Strategy – looking forward

- ▶ We intend to continue to place reliance on the ISAE 3402 report for future audits for the duration of POL's current contract with Fujitsu. We anticipate that the extent of involvement of POL, Fujitsu, Ernst & Young IT Audit and Ernst & Young ISAE3402 teams in planning for the audit will reduce over time as this process matures.
- ▶ Our current understanding of the timescales for POL's IT separation and transformation is that whilst it will have limited direct impact on our audit approach during 2012-13, it will potentially have a more significant effect in 2013-14 and beyond as POL potentially implements new systems.

The following aspects of the transformation plan will become relevant to the audit at that stage, and we plan to gain an insight into them during the 2012-13 audit so that we can highlight at an early stage any potential concerns they raise for the organisation or risks to the audit approach:

- ▶ Plans and approaches to migrate or procure systems and software licences
- ▶ Plans for the segregation/separation of networks and email systems
- ▶ The planned supplier framework.
- ▶ We also understand from management that as part of the separation plan between Royal Mail Group and POL, there is a plan to migrate to a new core finance system for FY2014-15. With this in mind, we have highlighted what we have learnt from our experience with IT programme risk management at Appendix C.

Section 5

Audit scope and execution

Audit scope and execution

Risk based approach

Controls based audit

Audit scope and execution

Service delivery

2012-13 Ernst & Young services

Services and deliverables	
Financial reporting	<ul style="list-style-type: none">▶ Express opinions on, and report to the Audit and Risk Committee the results of our audits of:<ul style="list-style-type: none">▶ The consolidated financial statements of Post Office Limited (IFRS) and parent company financial statements (UK GAAP) for the year ending 31 March 2013.▶ We are required by the primary audit team of Royal Mail Holdings ('RMH') to perform a full scope audit of POL for the period ended 31 March 2013 in accordance with International Financial Reporting Standards (IFRS) and Clarified ISAs (UK and Ireland) as required in the engagement instructions received by us from them.▶ The following procedures are required by UK company law:<ul style="list-style-type: none">▶ Opining on whether the information contained in the Directors' Report is consistent with the financial statements▶ Auditing the disclosures that unquoted companies are required to make with respect to directors' remuneration▶ Express opinions on, and report to appropriate members of management (or the Audit and Risk Committee, when required) on the results of our audits of:<ul style="list-style-type: none">▶ The separate statutory financial statements for any POL subsidiaries in accordance with local requirements
Internal control communications	<ul style="list-style-type: none">▶ Express our views on control themes and observations, including recommendations for improvements in controls and procedures. We will issue a written communication at year end to:<ul style="list-style-type: none">▶ Management and the Audit and Risk Committee describing significant deficiencies and material weaknesses identified during our audit, if any▶ Management describing all deficiencies (not previously communicated to management in writing) in internal control over financial reporting identified during our audit that are of a lesser magnitude than significant deficiencies
Regulatory audit and other assurance related services	<ul style="list-style-type: none">▶ In addition to the statutory audit requirements, we are required, as auditors of POL, to perform certain procedures on a number of reports required by postal regulation and related matters, including:<ul style="list-style-type: none">▶ Procedures in connection with the Post Office Limited credit facilities from BIS and DVLA motor vehicle license transactions▶ Procedures in connection with the Bank of England Note Circularisation Scheme, which includes an AAF 01/06 Report delivered to POL management and the Bank of England.



Audit scope and execution (cont'd)

Materiality

For the purposes of determining whether the accounts are free from material error, we define materiality as the magnitude of misstatement, which makes it probable that the judgement of a reasonable person, relying on the accounts, would have been changed or influenced. Such misstatements can result from errors or omissions and need to be considered in the light of the surrounding circumstances, both individually and in aggregate. Our evaluation of it requires professional judgement and necessarily takes into account qualitative as well as quantitative considerations implicit in the definition.

We would be happy to discuss with you your expectations regarding our detection of misstatements in the financial statements.

Consolidation considerations – Scope of audit procedures

This year will also see POL financial statements prepared for the first time at a consolidated level. When performing audit procedures on consolidated financial statements, we are required to set audit scopes for each reporting unit, based on size and risk factors, which when taken together, enable us to form an opinion on the POL group accounts as a whole.

POL's consolidation is expected to be made up of two reporting units; the Post Office Limited parent entity (which contains the majority of transactions) and the POL joint venture First Rate Exchange Services ('FRES') which will also form part of the consolidated POL financial statements.

The vast majority of the audit work is carried out by the Ernst & Young team from London, except for the POL joint venture First Rate Exchange Services ('FRES') which is audited by PricewaterhouseCoopers, which will also form part of the consolidated POL consolidated financial statements.

Given the relative contribution of FRES to POL consolidated operating profit (£31.4m in 2011-12), we will instruct PricewaterhouseCoopers to report the results of their audit to us, in line with our reporting timetable. This was done by the Royal Mail Group team in previous years when results were directly consolidated at Royal Mail Group level, and will be taken over by us during the current year.



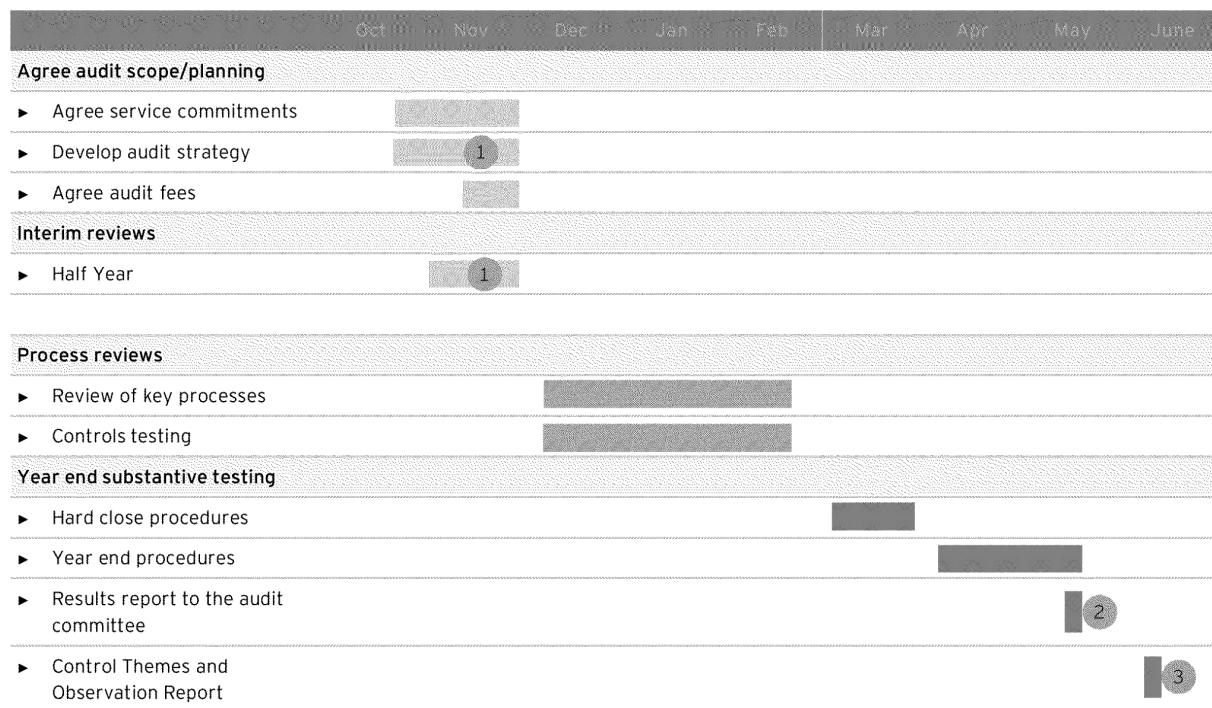
Audit scope and execution (cont'd)

Timetable of communication, insight and deliverables

We set out below a timetable showing the key stages of the audit and the deliverables we have agreed to provide to you through the 2012-13 audit cycle.

We will provide formal reports to the Audit and Risk Committee at the planning stage and at year end for the consolidated POL accounts. These reports will incorporate the outputs from our planning review and our year end audit procedures respectively. From time to time matters may arise that require immediate communication with the Audit and Risk Committee and we will discuss them with the Audit and Risk Committee Chairman as appropriate.

Following the conclusion of our audit we will prepare a Control Themes and Observations report for Post Office Limited, outlining our comments on areas where we believe the Company exposes itself to risk, where control matters exist or where we believe improvements can be made. This will be circulated to senior management and to the Audit and Risk Committee in 2013, following the end of the audit. We will also provide you with real-time control themes and observations as identified throughout the year as appropriate, as well as practical business insights, updates on corporate governance and regulatory matters through our reporting to the Audit and Risk Committee.



Deliverables

- 1 2012-13 Audit Planning & Half Year Report
- 2 2012-13 Year-end Results report
- 3 2012-13 Control Themes & Observation Report

Section 6

Service delivery

Service Delivery

Risk based approach

Controls based audit

Audit scope and execution

Service delivery

Your POL audit team

The POL engagement team is led by Angus Grant from our London office, who as the Lead Engagement Partner is ultimately responsible for all services provided to POL by Ernst & Young, the Post Office Limited audit opinion and oversight of all other statutory and related work for POL.

Angus is supported by Jeremy Midkiff as Senior Manager and Darrell Martin as Manager. We have established our engagement team with the principle of providing the right blend of industry, multinational and technical experience to execute the audit and deliver on our commitments to you. This engagement team has been set up to mirror your organisational structure. In addition, we recognise how important continuity of key Ernst & Young team members is to your organisation.

Whilst our core team remains the same, the structure of our team has been carefully tailored to best mirror your organisation in a post separation environment. Whilst until last year our audit team previously directly reported to the Royal Mail Group team, during the current year, we will be directly accountable and the first point of contact to the POL Audit & Risk Committee.

Specialists

As you are aware from experience in prior years, our audit strategy relies significantly on the leverage of IT systems and controls. Denise Fabb (Executive IT Director) will continue to oversee delivery of the IT element of the audit. In addition, we will also be looking to involve our Pension specialists at year end, as best suits the auditing requirements at POL, this will be headed by Christopher Bown (Pensions Partner). Gillian Wild, who is the tax audit partner for RMG, will also take responsibility for the audit of POL tax utilising her prior experience in addressing the complexity of the POL tax structure, along with Julie Hadfield.



Appendices

Appendix A - Half Year review

Appendix B - Audit fees

Appendix C - Insights on IT risk

Appendix D - Independence report

Appendix E - Required communications with the Audit and Risk Committee

Appendix A

Half Year Review

A new chapter begins for the Post Office...

Introduction

Post Office Limited ('POL') will issue a half year trading statement in place of interim accounts for the half year 2012/13. There is no formal requirement for Royal Mail Holdings to issue financial information for the first half of the year, however, POL wish in their first year of separation from the Royal Mail Group to publish a trading statement with selected disclosure information, as their pre-separation parent Royal Mail Group did in prior years.

POL does not issue full IAS34 Interim financial statements and the trading statement is not in compliance with IAS 34. We are therefore not required to, nor have we been engaged to perform a review under ISRE 2410, the standard that covers interim reporting procedures.

Instead, at the request of management, we have accelerated certain elements of our 2012-13 year-end audit work. This is intended to provide some level of comfort to Post Office Limited management and the Audit and Risk Committee on the trading statement and the scope of work is broadly similar to those procedures we would have performed on specific balances for a half year review. Management understands that these procedures represent neither a half year review nor a full audit.

We also note that since management's trading statement will only disclose up to the point of the earnings before interest, tax and exceptional costs, that our review will exclude these items.

We set out the full details of the Half Year procedures performed in the following pages.

Appendix A

Half Year Review (cont'd)

Half Year Review results

Procedure	Findings
Review of primary statements numbers and support	<ul style="list-style-type: none"> ▶ Perform analytical review for the current year financial numbers included in the P&L (on profit before interest, tax & exceptional items) and Balance Sheet, which have been included in the trading statement. ▶ Review financial numbers included in the trading statement to ensure consistency with the financial statements and our understanding of the business. <ul style="list-style-type: none"> ▶ We performed an overall analytical review on both the Balance Sheet and Profit & Loss account (on profit before interest, tax and exceptional items). ▶ We noted that operating profit before exceptional was £61.0m, up by 10% or £5.5m on the same time last year. One of the main reasons for the increase was better than expected performance of mails services, which benefited from both a price increase and a volume increase in the month that preceded the price rise. ▶ We report one factual difference in relation to LTIPs, which was also reported at year-end. <ul style="list-style-type: none"> ▶ This error is an overstatement of the LTIP Bonus accrual for the current half year. The LTIP Bonus creditor was overstated by £1.9m as management accrued for the full LTIP expense of the 2010/11 award and 2011/12 award by the end of the prior period. This is assessed by Ernst & Young to be not in compliance with IAS19 which requires that the award for such benefits be spread evenly over the lifetime of the bonus award until vested/paid. ▶ The impact of unadjusted audit differences at 23 September 2012 would be to increase profit before exceptional by £1.4m. ▶ The unadjusted amounts are not material to the presentation and disclosures in the trading statement for the period ended 23 September 2012. ▶ Based on our discussions with management including financial controller, the fluctuations and variances experienced during the period are consistent with our understanding of the entity and of its financial position as of 23 September 2012. As a result of our procedures, we have not identified any previously unidentified risks of material misstatement due to fraud.
Review of current material litigation & regulatory fines, compensation and accruals.	<ul style="list-style-type: none"> ▶ Review papers containing an update on (i) the current material litigation and (ii) regulatory fines, compensation and accruals. ▶ Hold a meeting with Susan Crichton to enquire of: <ul style="list-style-type: none"> ▶ Any changes in POL's legal position since our last legal update, and to understand the status of any legal/regulatory claims if applicable; ▶ Any issues with a potential material exposure that have not been included in the above papers. ▶ Review minutes to ensure completeness of legal and regulatory accruals made by POL. <ul style="list-style-type: none"> ▶ The POL finance team provided us an update on all material provisions and exceptional costs in the business incurred during the half-year. We noted that no material provisions or exceptional costs were incurred or booked in relation to litigation and regulatory fines. ▶ We also made enquiries of Susan Crichton to gain an update of POL's litigation and compliance with laws and regulations since year-end, with no issues noted. ▶ We also discussed the Horizon subpostmaster claim with Susan Crichton and Sarah Hall, and noted that POL had contracted a firm of forensic accountants to investigate the system in order to gain assurance over the integrity of the system. ▶ It was also noted that management had not made any reserve related to the Horizon subpostmaster claim to date and have assessed they did not require to make one. Based on our discussion with management, we agree that their view appears to be reasonable. We will continue to revisit and gain updates from management on the situation through the audit. ▶ We also reviewed the minutes of Post Office Limited and noted there were no other material litigation claims or regulatory claims that management should consider providing for.
Review of GRNI Accrual	<p>Review the GRNI accruals analysis and provide an update on issues reported at the year end.</p> <ul style="list-style-type: none"> ▶ The GRNI accrual has increased by £6m (or 14%) to £49m at the end of the half-year. This increase is mainly due to an increase in capital expenditure as a result of the Network Transformation project increasing pace this period. We also noted that 97% of GRNI balance is below six months old, compared to 99% of GRNI balance at the prior year end. We note that GRNI appears to be fairly stated at the half year end.

Appendix A

Half Year Review (cont'd)

Half Year review results

Procedure	Findings
Review of non-exceptional provisions in business	<ul style="list-style-type: none"> ▶ Review the breakdown of non-exceptional provisions as at the current half year end, including movements since the prior year. For movements greater than £5m obtain explanations from management. ▶ Hold a meeting with management and ensure that the assumptions used are appropriate and consistent with the prior year end. Where assumptions differ from those at the prior year end, understand management's reasons for changing.
Review accounting treatment of Project Eagle/Gamma	<ul style="list-style-type: none"> ▶ Review the accounting treatment of Project Gamma and the proposed accounting for the disposal of the associate Post Office Financial Services.
Obtain update on significant accounting and audit issues from year-end	<ul style="list-style-type: none"> ▶ Obtain update on significant accounting and audit issues from year-end.
Review all board meeting minutes in the half-year	<ul style="list-style-type: none"> ▶ Obtain meeting minutes for all board meetings up to our review date from management.
	<ul style="list-style-type: none"> ▶ We have met with management and have reviewed the breakdown of non-exceptional provisions at September 2012. No movements greater than £5m were noted. ▶ The assumptions used at the half year are consistent with those used at the year end and we agree that they remain appropriate.
	<ul style="list-style-type: none"> ▶ We have reviewed the accounting treatment for Project Eagle and agree with management's accounting for the transaction. We also concur with management's treatment of the future revenue profile for Gamma and the Project Eagle disposal accounting.
	<ul style="list-style-type: none"> ▶ We obtained from management an overall review on the significant accounting and audit issues from year-end, with no further issues to note aside from those mentioned in this half-year review summary.
	<ul style="list-style-type: none"> ▶ We have reviewed all the meeting minutes for all board meetings up to the latest date of the Remuneration Committee on 4th October 2012. No further issues to note.

Appendix B

Audit fees

A fair fee reflecting a changing business

A summary of Ernst & Young's proposed fees for the 53-week period ending 31 March 2013 are set out below.

The fees below have been discussed with management to understand our cost base and to continue to work proactively with management to identify additional efficiencies.

Most notably, given the change to the business and the impact of separation, we have differentiated between those costs which are considered to be 'one-off' and those which will form a part of our cost base going forward. We have also considered the impact of the first-year SOCR/ISAE 3402 reporting.

It is important to note that the fee provided represents a 'best case' scenario, especially as it relates to the result of the ISAE 3402 report. Given that this work is ongoing it is not possible to predict the level of, if any, remediation work which will be required. In this respect, the following are the key assumptions underpinning the IT cost element of the audit:

- ▶ The cost assumes no significant exceptions require mitigation work. Any additional time required to mitigate exceptions will be flagged and agreed in advance prior to carrying out the mitigating procedures.
- ▶ Whilst there are indications that last year's IT issues are not fully remediated, we have not budgeted for any remediation work until we are able to quantify the level of effort required.
- ▶ The budget has been prepared based on minimal project management time required to obtain required information from Fujitsu. However, if we encounter difficulties similar to previous years, the project management time currently anticipated will not be sufficient. Similarly, if additional mitigation work is required, this will result in an increase in project management time.

The fee has been calculated on the assumption that the level of client assistance relative to the prior year is consistent.

Appendix B

Audit fees (cont'd)

A fair fee reflecting a changing business

	Cost (£)	Fee (£)
Total FY11/12 audit costs agreed with RMG	674,000	269,600
Overruns incurred in respect of IT element of FY12 audit	128,000	*
(*overrun still in discussion with management)	802,000	
Non-recurrence of IT overruns	(128,000)	
<i>Additional scope changes resulting from separation</i>		
<i>Recurring costs</i>		
Audit of treasury function	7,200	
Audit of pensions	12,700	
Technical review of stats	19,800	
Consolidation considerations of FRES	14,000	
Taxation (POL specific)	26,800	
Half Year Review Costs	22,500	
Corporate governance and reporting	27,700	
	130,700	52,280
<i>One-off costs</i>		
Stats disclosures/determination of 'first year' accounts	11,400	
Additional contracts (property, treasury, MSA)	10,700	
Dissolution of POFS, Eagle transaction	7,000	
Assessment of IT Transformation project	9,000	
First year SOCR reliance set-up time	37,000	
	75,100	30,040
<i>Market factors</i>		
Inflation	33,700	13,480
<i>Change in scope/efficiencies</i>		
Anticipated impact of reliance on SOCR	(76,000)	
Efficiencies	(11,000)	
	(87,000)	(34,800)
Total 2012 audit costs	826,500	330,600

Appendix C

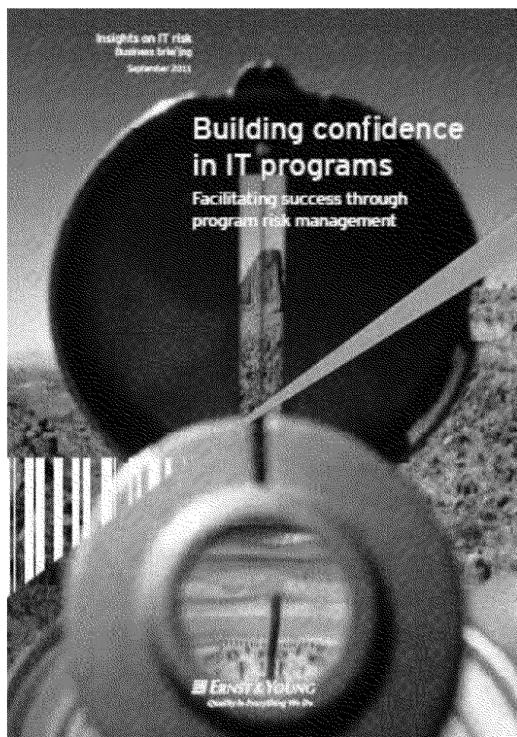
Insights on IT risk

Facilitating success in IT through program risk management

As discussed on page 18 of this report, we understand that POL may migrate to a new core finance system for FY2014-15.

If and when POL plan to go through this process, consideration should be given in managing the risk associated with such a major programme. We have seen that despite an increase in investment, some organisations continue to fail to deliver on large IT programmes. They frequently go over budget, are completed too late and/or do not deliver the expected benefits.

The following publication 'Building Confidence in IT programs' document outlines the principles of Program Risk Management from our experience, including common IT programme pitfalls and the options of strategic IT initiatives that teams can take. This is available at your request.



We also note that we have recently carried out an IT Risk Benchmarking survey with POL, which covers a broader IT risk agenda. Once these results are available, we plan to discuss this with POL's IT management. The result of the survey can help in forming a basis to track improvements of POL's IT risk management initiatives.

Appendix D

Independence report

Introduction

In order to carry out our duties and responsibilities as auditor, we are required to consider our independence and objectivity within the context of the regulatory and professional framework in which we operate.

UK APB Ethical Standards, International Standard on Auditing (UK and Ireland) 260, Communication of audit matters to those charged with governance, and Rule 3526 Communication with Audit and Risk Committees Concerning Independence of the Public Company Accounting Oversight Board (PCAOB) require us to communicate on a timely basis and at least annually on all significant facts and matters that bear upon our independence and objectivity since our last letter. The aim of these communications is to ensure full and fair disclosure is made by us to you on matters in which you have an interest.

Relationships, services and related safeguards

We are not aware of any relationships between Ernst & Young and the Company that may reasonably be thought to bear on our independence as of the date of this letter. As part of our considerations for any non-audit engagement, we review potential threats in respect of self-interest, self-review, acting as management and advocacy. We establish appropriate safeguards, which we communicate to the Audit and Risk Committee in respect of any potential threat. Our next page details all the related services aside from the core audit for POL.

Other required communications related to independence matters

The APB Ethical Standards require total fees you have paid us in the year ending 31 March 2013 to be communicated to you. Details of all fees are provided to the Audit and Risk Committee with measurement against pre-approved limits.

Listed on the following page are Ernst & Young's key firm-wide policies and processes to maintain independence and objectivity which are required to be communicated to you by APB Ethical Standards.

Confirmations

We are not aware of any inconsistencies between the company's policy for the supply of non-audit services and APB Ethical Standards. We are not aware of any apparent breach of that policy.

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. We look forward to discussing these matters with you at our upcoming meeting on 13 November 2012.

This report is intended solely for the information and use of the Audit and Risk Committee of the Board of Directors, management, and others within the Company and should not be used for any other purpose.

Appendix D

Independence report (cont'd)

Relationships, services and related safeguards

We highlight the following significant facts and matters that may be reasonably considered to bear upon our objectivity and independence, including the principal threats, if any. We have adopted the safeguards noted below to mitigate these threats along with the reasons why they are considered to be effective.

Description of relationship or service and related independence threat	Period provided/duration	Safeguards adopted and reasons considered to be effective
Fujitsu ISAE 3402 report - ISAE3402 report for the Fujitsu services supporting the POL account. This report will provide an assessment of the Fujitsu controls supporting POL business critical systems. The intention is to place reliance on the ISAE3402 as part of the 2012-13 financial statement audit.	April to December 2012	<ul style="list-style-type: none">▶ Not a prohibited service▶ A separate team from the POL IT team has been engaged for the review of the ISAE3402 report, and standard ring fencing applied between two teams.▶ Went through review exercise to ensure in line with Ernst & Young independence rules

Appendix D

Independence report (cont'd)

Firmwide policies

Ernst & Young LLP (EY) has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained. Listed below are some of the key policies and processes in place within Ernst & Young for maintaining objectivity and independence:

Service	Timing
Financial interests	<p>Our Partners and client facing (technical) staff are prohibited from investing in any audit client around the World.</p> <p>All partners and staff are required to confirm their compliance each year with the firm's independence policies. Monitoring of compliance in respect of all partners and professional managers takes place through a worldwide investment tracking system.</p> <p>New starters are required to confirm their compliance with the firm's independence policies on commencement of their employment.</p>
Training	All partners and professional staff are required to undergo regular mandatory training on our Independence and Ethical policies and processes.
Partner rotation	The firm has detailed policies on the rotation of the audit partner, and in the case of listed clients key audit partners, the independent partner and 'other partners and staff in senior positions'.
Consultation	The firm requires consultation outside the audit team on complex accounting, auditing and ethical matters. Major issues of principle arising on all audits are referred to a panel of independent experienced audit partners.
Independent partner reviews	Before listed company audit opinions are issued, an audit partner independent of the audit team reviews the nature of the relationship with the client, aspects of the accounts that are subject to significant estimates and judgements, and the adequacy of the presentation of information in the accounts.
Quality reviews	<p>The firm operates a worldwide programme under the direction of senior partners that annually assesses the quality of our work. Over a three year period, a proportion of the work of all audit partners is reviewed. The results of the programme help us to evaluate the firm's quality controls and personnel performance and identify areas for improvement.</p> <p>As with other firms, Ernst & Young's audit practice is subject to annual review by the Audit Inspection Unit (AIU) and the Quality Assurance Directorate (QAD) of the Institute of Chartered Accountants in England and Wales (ICAEW) for compliance with Audit Regulations. As part of its visits, the AIU/QAD evaluate the system of quality control operated by the firm for its audit practice.</p>
Business relationships	<p>Ernst & Young has implemented a centralised process for the review and pre-approval, by our quality and risk management team, of all new business relationships. A submission must be made and approved for each new business relationship before committing the firm.</p> <p>In addition, all new business relationships must be notified and approved by the lead audit or client service partner before committing the firm.</p>
Ethics	Our Global Code of Conduct provides an ethical framework on which we base our decisions and our actions—as individuals and as members of our global organisation. Ernst & Young has also established the Ernst & Young/Ethics hotline which will allow any person, inside or outside of Ernst & Young, to confidentially and anonymously report an activity that they believe may involve conduct that is unethical, illegal, in breach of professional standards, or is otherwise inconsistent with Ernst & Young's established policies and Code of Conduct.
Non-audit services	<p>Our audit engagement partners must approve any non-audit services offered to their clients. This allows them to:</p> <ul style="list-style-type: none"> ▶ Ensure the objectives of the proposed engagement are not inconsistent with the objectives of the audit of the financial statement; ▶ Identify and assess any related threats to our objectivity; and ▶ Assess the effectiveness of available safeguards to eliminate such threats or reduce them to an acceptable level. <p>Where no satisfactory safeguards exist we do not carry out the non-audit service.</p>

Appendix E

Required communications with the Audit and Risk Committee

There are certain communications that we must provide to the Audit and Risk Committees. We have detailed these here together with a reference of where and when they were covered:

Communications required on all audits	Communicate on a timely basis, at least annually	Planned/actual timing of communication to the Audit and Risk Committee
Overview of planned scope and timing of the audit	✓	Discussed within this report.
Major issues discussed with management in connection with initial or recurring retention	✓	This will be included, as necessary, within our 2012-13 year end audit reports.
Other information in documents containing audited financial statements	✓	We will review the other information included in annual financial statements and report to you in the Audit and Risk Committee report.
Significant audit adjustments	✓	This will be included, as necessary, within our 2012-13 year end audit report.
Unrecorded misstatements considered by management to be immaterial	✓	This will be included, as necessary, within our 2012-13 year end audit reports.
Expected modifications to the audit report	✓	If applicable, this will be included, as necessary, within our 2012-13 year end audit report.
Our judgements/views about qualitative aspects of the Company's accounting practices and financial reporting	✓	This will be included within our year end 2012-13 Audit and Risk Committee report.
Disagreements with management	✓	This will be included, as necessary, within our 2012-13 year end audit reports.
Consultations with other accountants	✓	This will be included, as necessary, within our 2012-13 year end audit reports.
Serious difficulties encountered in dealing with management when performing the audit	✓	This will be included, as necessary, within our 2012-13 year end audit reports.
The adoption of, or a change in, an accounting policy	✓	This will be included, as necessary, within our 2012-13 year end audit reports.

Appendix E

Required communications with the Audit and Risk Committee (cont'd)

	Communicate when event occurs	Communicate on a timely basis at least annually	Planned/actual timing of communication to the Audit and Risk Committee
Communications required on all audits (cont'd)			
Methods of accounting for significant unusual transactions and for controversial or emerging areas	✓	✓	This will be included, as necessary, within our 2012-13 year end audit reports.
Events or conditions that cause us to conclude that there is substantial doubt about the entity's ability to continue as a going concern	✓	✓	This will be included, as necessary, within our 2012-13 year end audit reports.
Sensitive accounting estimates		✓	This will be included, as necessary, within our 2012-13 year end audit reports.
Consideration of laws and regulations		✓	This will be included, as necessary, within our 2012-13 year end audit reports.
Fraud and illegal acts involving senior management and fraud and illegal acts that cause a material misstatement of the financial statements	✓		This will be included, as necessary, within our 2012-13 year end audit reports.
Significant matters arising during the audit in connection with the entity's related parties		✓	This will be included, as necessary, within our 2012-13 year end audit report.
Management's refusal for us to request external confirmations or our inability to obtain relevant and reliable audit evidence from other procedures		✓	This will be included, as necessary, within our 2012-13 year end audit report.
Representations that the auditor is requesting from management		✓	We will provide the management letters of representation as part of our year end report.
Significant deficiencies and material weaknesses in internal control over financial reporting		✓	This will be included, as necessary, within our Controls, Themes and Observations Report which will be shared with you after the conclusion of our audit.
Group audits			
► An overview of the type of work to be performed on the financial information of the components		✓	An overview of the planned approach for the audit is included within this report.
► An overview of the nature of the Group audit team's planned involvement in the work to be performed by the component auditors on the financial information of significant components			We will report on any further items with our year end audit report.
► Instances where the Group audit team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work			
Any limitations on the Group audit, for example, where the Group engagement team's access to information may have been restricted			
Fraud or suspected fraud involving Group management, component management, employees who have significant roles in Group-wide controls or others where the fraud resulted in a material misstatement of the Group financial statements.	✓	✓	This will be included, as necessary, within our 2012-13 year end audit reports.

Appendix E

Required communications with the Audit and Risk Committee (cont'd)

	Communicate on a timely basis at least annually	Planned/actual timing of communication to the Audit and Risk Committee
Audit and Risk Committee pre-approval of services, including specific pre-approval of internal control-related services and non-prohibited tax services	✓	This will be included, as necessary, within our 2012-13 year end audit reports.
Critical accounting policies and practices. ISA 260 (UK and Ireland) requires the auditor to communicate the auditor's views on the qualitative aspects of the Company's accounting practices and financial reporting	✓	This will be included in our 2012-13 year end audit reports.
All material alternative accounting treatments discussed with management	✓	This will be included in our 2012-13 year end audit reports
Fees	✓	Discussed within this report and within our 2012-13 year end audit reports
Other material written communications with management	✓	We will provide our 2012-13 year end audit reports
Communication of independence matters	✓	This will be included in our 2012-13 year end audit reports
Other findings or issues regarding the oversight of the financial reporting process	✓	This will be included, as necessary, within our 2012-13 year end audit reports

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POST OFFICE LTD AUDIT, RISK AND COMPLIANCE COMMITTEE

Governance for the Post Office - Bank of Ireland joint venture

1. Purpose

- 1.1 This paper provides an overview of the governance structures Post Office has in place with the Bank of Ireland UK (plc) (Bol) following the conclusion of the Eagle negotiations. It is tabled for noting.

2. Background

- 2.1 Prior to Eagle, the governance of the joint venture was managed through Midasgrange, the jointly owned company established to build Post Office's financial services business.
- 2.2 The business model created too much complexity and did not deliver sufficient income to Post Office; further, the Post Office became very concerned at the financial position of Bol and the lack of termination rights.
- 2.3 The new joint venture agreement, which came into effect on 3rd September 2012, created a bilateral relationship, supported by clear governance structures, rights and obligations on both Parties and new termination rights to Post Office. This paper sets out this governance framework.

3. Operational Governance

- 3.1 The governance of the relationship is formally managed through various committees.
- 3.2 The overall relationship is managed through the Senior Executive Committee (SEC), comprising the leading executives of each organisation¹. The SEC determines the strategic direction of the relationship and sets the wider governance and operational requirements. It defines the strategy for the relationship, approves the annual business and sales plans and is responsible for overall performance delivery. The SEC is quorate with two representatives from each Party and voting (if required) is based on equal votes aligned to the lower number of representatives. The Chair, which rotates annually, does not have a deciding vote – the initial Chair is Bol. Disputed matters within the wider relationship are escalated to the SEC; if resolution is not achieved, the matter is escalated to the Chief Executive Officers of both organisations.
- 3.3 There are five additional committees that manage day-to-day matters, viz:
 - a) Product & Pricing Forum (PPF);
 - b) Sales & Marketing Forum (SMF);
 - c) Service, Performance Management & IT Forum (SPMITF);
 - d) Joint Insurance Committee (JIC);
 - e) Regulatory Risk Committee (RRC).

¹ Bol's current representatives are the Chief Executive Officer, Chief Finance Officer and Directors of Distribution and Product. Post Office's representatives are the Chief Finance Officer and the Directors of Strategy, Financial Services and Sales & Distribution.

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- 3.4 The PPF defines and reviews the overall product propositions, including confirming features, channel mix and competitive pricing (versus the benchmark). It assesses recommendations from either Party and if appropriate approves changes. As with the SEC, both Parties have equal voting rights; Bol is the permanent Chair of the PPF:
 - Bol has the ultimate control over pricing but has to meet agreed benchmarks and pricing to achieve the agreed plans.
- 3.5 The SMF agrees the sales and marketing plans (including the allocation of the £15 million annual marketing budget funded by Bol) and monitors their effectiveness. It reviews sales literature, internal and external PR and communications, sales training and sales compliance, in conjunction with the PPF. Both parties have equal voting rights and the Post Office is the permanent Chair:
 - Post Office has the final say on the allocation of the marketing fund, with the Parties having agreed the general allocation by category sector.
- 3.6 The SPMITF oversees the systems and contact centre service levels and change management processes and performance. It has equal representation from each party with a rotating Chair.
- 3.7 The JIC provides the governance and oversight for the Insurance business, approving the strategy, plans and budget. It also gives direction to Bol's Insurance Product Team, giving Post Office greater comfort that the business is meeting its requirements. The Chair rotates annually, with Post Office initially holding the position².
- 3.8 The RRC oversees and monitors the compliance to the standards for the production and distribution of products, minimising the reputational and regulatory risks for Post Office and Bol. It is permanently chaired by Bol with Bol's Chief Risk Officer and Post Office's Legal & Compliance Director attending quarterly. The minutes of this meeting are tabled at the Bol Board and are made available to the Financial Services Authority (FSA)³.
- 3.9 The new governance structures set out above are operational with all committees formally constituted.

4. Operational Processes and Responsibilities

- 4.1 While the governance structure establishes the decision making processes, the contract also sets out the roles and responsibilities of each Party, viz:
 - The Parties will jointly agree the business strategy and set the direction of the business.
 - Bol will manufacture the products to specifications agreed with the Post Office and supply the RGM, provide on-going product servicing (e.g., sending statements, paying interest) and establish the regulatory requirements for product marketing and sales.
 - The Post Office will deploy an effective sales network, create and deliver the marketing and sales strategies as agreed by the SMF and ensure that

² As previously discussed at the Board from September 2014 Post Office has a two year one-way option to buy out Bol's share of the insurance business.

³ This is a continuation of the pre-existing arrangements.

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all products and services (including all customer interactions) meet the Post Office's brand and the Regulatory Guidance Manual (RGM)⁴.

- 4.2 To ensure that the customer proposition remains competitive the contract requires that:
 - All products will be reviewed on a two-year rolling basis to ensure that they remain competitive;
 - Product pricing meets agreed benchmarks.
- 4.3 While either party can propose new/changes to products and services Bol must deliver products (itself or through a third party) that Post Office reasonably requests and that align to the business plan.
- 4.4 Bol can only refuse to deliver a product requested by Post Office if:
 - It is prohibited by regulation;
 - It is uneconomical for it to do so;
 - It is technically incapable of providing the product.
- 4.5 If both parties agree to develop a product but cannot agree on the aspects of the product (e.g., features and commissions) a formal dispute process occurs. If it remains unresolved an Independent Expert (IE) is appointed. The IE's recommendations are non-binding, but if Bol does not agree with them and Post Office does, Bol is obliged to use reasonable endeavours to deliver the product to the IE's proposed recommendation. If it cannot, the Post Office can identify a 3rd party for Bol to enter into an agreement to manufacture the product. If this is not possible exclusivity falls away.

5. Bol Financial Stability

- 5.1 The final component of Eagle governance relates to Post Office's termination rights and the information that Bol must provide to support these rights.
- 5.2 As previously presented to the Board, Post Office has a termination right if:
 - Bol's minimum core tier one capital ratio falls below the threshold^{5 6};
 - Bol fails to maintain liquid assets required by the regulator;
 - Bol breaches the Net Stable Funding Ratio (NSFR) (to the extent that these rules apply to Bol when they become operational from 2018); or
 - Bol, or its parent, becomes insolvent.
- 5.3 To support these rights, Bol must inform Post Office immediately of any threshold breach; failure to do so is in itself a breach of the contract.
- 5.4 To provide the Post Office with some notice of the potential that Bol may breach a termination benchmark, Bol must provide Post Office with regular updates of its financial position, including:

⁴ The RGM sets out the actions and duties that Post Office must perform for each product to meet its regulatory obligations as a financial services intermediary.

⁵ Bol has certain grace period to remediate the situation as previously tabled to the Board.

⁶ The definition of core tier one ratio is article 87(1)(a) of the draft European Regulation plus 3.5 percent until 2016. A new formula will be agreed in 2016.

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- Formal update on its capital and liquidity status and immediate notice if it becomes aware of any capital or liquidity issues that might give rise to a termination event.
- 15 days after each public announcement of annual and half yearly results and any interim management statement Bol must provide a certificate stating⁷:
 - a) Its Minimum Core Tier One Ratio, the actual Core Tier One Ratio and any Common Equity Tier 1 (CET1) Capital buffers or other requirements applicable to Bol;
 - b) Bol's regulatory liquidity requirement and its position against the benchmark;
 - c) Any NSFR requirement and Bol's position;
 - d) That Bol is not in breach of the termination obligations, or of any remediation plan agreed with the regulator.
- After each half year financial announcement a senior Bol executives must provide a trading performance update.
- Bol must provide a presentation of its annual results, including a summary of any Recovery and Resolution Plan (RRP)⁸ submitted to the regulator and summaries of any ARROW⁹ Letters received from the FSA as far as they relate to the Post Office or Bol's obligations to the Post Office.

6. Bol Compliance on Post Office

6.1 Post Office acts as the intermediary for Bol and is its “appointed representative”. As such, Bol is accountable to its regulator¹⁰ to ensure that Post Office is acting compliantly:

- The Compliance teams in both Parties monitor Post Office’s performance to the RGM and the financial promotions rules set by the FSA. Bol assess Post Office’s compliance through mystery shopping and other monitoring (e.g., complaints reporting). It supports the product, marketing and sales teams ensuring that both Bol and Post Office are meeting the applicable Treating Customer Fairly standards. This is a continuation of the established procedures.

6.2 Compliance performance and regulatory issues are reviewed by the joint Regulatory Risk Committee.

7. Initial Issues

7.1 The governance processes with Bol are now operational and have already thrown up issues that previously would have not been shared:

7.2 Savings pricing

⁷ The first presentation of these matters is due to Post Office in February 2013, following the presentation of Bol's 2012 full year results.

⁸ RRP are FSA-required plans setting an institution’s plan for a stressed situation including orderly wind-down.

⁹ Advanced Risk Response Operating Framework reviews are the existing FSA process to assess and manage risk. With the establishment of the Financial Conduct Authority and the Prudential Regulation Authority the approach is changing with increased focus on prevention rather than post-event resolution.

¹⁰ Currently the FSA.

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- Following recent significant drops in both wholesale and retail liability (deposit) pricing, Post Office's deposits have grown substantially ahead of plan, reaching almost £18 billion against a 2012/13 plan of £16.6 billion. This is not only a material cost to Bol but also risks regulatory intervention if Bol is perceived to be securing a disproportionately large market share. As a result, over three "emergency" Product & Pricing Committee meetings Bol and Post Office are working together to agree a sustainable pricing position, consistent with Post Office's brand and competitive position, the benchmarks and Bol's balance sheet requirements.

7.3 *Securitisation*

- Securitising assets is a standard process for banks. The Agreement requires that Bol seeks Post Office's consent to securitise any Post Office's customers' assets. This is to protect customers and ensure that Post Office is able to enforce the termination rights.
- Bol has requested Post Office consent to a series of "test" repo transactions, which includes some Post Office assets. This would not have occurred under the previous arrangements. Post Office has given consent for one year, provided that the counterparty is rated by Standard & Poors as a minimum of A- and that each tranche does not exceed £250 million.

8. Conclusion

8.1 The new arrangements are in place and operational, giving Post Office greater insight, certainty and control over the operations and direction of the joint venture.

8.2 The Audit, Risk and Compliance Committee is asked to note the paper.

Nicholas Kennett
Director, Financial Services
November 2012

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POST OFFICE LTD AUDIT, RISK AND COMPLIANCE COMMITTEE

Approval of uncommitted loan facilities

1 Purpose

This paper seeks Committee endorsement to proceed to the Board with the following recommendations:

- To approve entry into two uncommitted credit facilities of up to £50m each.
- To delegate authority to the CFO and Head of Corporate Finance to negotiate and sign all related loan facility documentation.
- To approve a Board resolution in the form required by counterparties with whom a loan facility may be agreed.

2 Introduction

At the October board meeting questions were raised regarding the counterparties that provide operational financial and treasury banking services to Post Office Limited many of which were inherited from Royal Mail. As a result, a review will be undertaken to determine a strategic approach to the selection of financial counterparties. The outcome of this review will be presented at the next Committee meeting in February for onward ratification by the Board.

In the short term, to reduce external interest costs and improve operational efficiency approval is requested to enter into two uncommitted credit facilities. The anticipated interest saving resulting from this is approx. £200,000 pa as it reduces the funds that need to be held on deposit as a contingency for unexpected working capital movements.

The banks were selected on their strength of their relationship with Post Office – though currently no other banks have offered to provide any facility.

3 Funding Background

Under the funding agreement signed with BIS (Department of Business, Innovation and Skills) Post Office Limited can borrow externally up to £50m, in addition to the £1.15bn working capital loan facility from BIS. The drawdown of funds from the BIS facility requires two days' notice which could potentially generate a short term funding requirement.

4 Rationale

Corporate Finance seeks approval to enter into two external facilities. These facilities would enable the daily drawdown of funds from BIS to be managed more effectively. It is anticipated that drawdown on these facilities will be infrequent but will provide the flexibility to drawdown overnight to manage any shortfalls in daily cash flows. This arrangement would replicate those previously in place with Royal Mail.

5 Operation of Facilities

Two facilities are recommended to ensure cost efficiency, flexibility, ease of access and mitigate the financial risk of one facility being unavailable. Controls will be implemented within Finance to ensure that the total drawdown on the two accounts does not exceed £50m and that Post Office continues to operate within the terms of the BIS agreement. Borrowing is limited to a term of 7 days.

6 Counterparties and negotiation

The Head of Corporate Finance is currently negotiating with two financial institutions; RBS (Royal Bank of Scotland), a current Post Office banking partner, and Citibank, to secure external facilities of up to £50m each. These counterparties were selected as current Royal Mail service providers. If negotiations are not successful with these counterparties, other counterparties will be considered. Approval is requested for the CFO and Head of Corporate Finance to enter into negotiations with these or other counterparties and to sign all relevant loan documentation.

7 Facility & Interest Costs

There are no arrangement or commitment fees associated with these facilities. The only cost is the interest charge on drawn funds. The interest cost is likely to be in the region of LIBOR + 50 to 200 basis points. It is anticipated that these facilities will be drawn infrequently when there is a large unexpected working capital movement e.g. bad weather reducing the amount of physical receipts over the counter.

8 Recommendation

The Committee is asked to endorse the following recommendation to the Board:

The Board is asked to:

- 8.1 Confirm its approval for Post Office to enter into external borrowing facilities up to a maximum value of £100m, such that external borrowing of up to £50m may be drawn down at any one time.
- 8.2 Confirm its approval for the CFO (Chris Day) and Head of Corporate Finance (Charles Colquhoun) to conduct negotiations with counterparties and sign and deliver the loan and related documentation.
- 8.3 Confirm its approval of the attached form of Board resolution required by the Royal Bank of Scotland or any similar resolution required by Citibank or another counterparty with whom a borrowing facility may be agreed by the CFO and Head of Corporate Finance.

Chris Day
November 2012

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Appendix

Board Resolution re Loan Facility (as requested by the Banks)

"After due and careful consideration of all the circumstances, the Board expressed the opinion that it was satisfied that it would be most likely to promote the success of the Company for the benefit of its members as a whole to enter into the letter in the form now produced from The Royal Bank of Scotland plc (the "**Bank**") in respect of the uncommitted revolving credit facility of £50,000,000 made or to be made available to the Company by the Bank.

IT WAS RESOLVED that in addition to and without amending, prejudicing or revoking any Bank Mandate / Company Excerpt Minute or any other instruction/s provided or to be provided by the Company to the Bank the CFO (Chris Day) and the Head of Corporate Finance (Charles Colquhoun) be and are hereby authorised to sign and deliver the letter on behalf of the Company."