

Royal Mail Group plc

IMPACT POL FS

Post Office Limited

Internal Audit & Risk Management

Internal Audit Report: 06/041

Date: March 2007



Royal Mail - CONFIDENTIAL

Contents & Distribution

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Executive Summary & Appendices

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Executive Summary

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Derek K Foster	Internal Audit & Risk Management Director
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Internal Audit Team

Steve Webb, Benjamin Boyce, David Britain and Gina Thurman

Executive Summary: Overview

Background

The Post Office Limited network of some 14,000 branches processes client and business transactions in excess of £100 billion annually. The majority of transactions are conducted on behalf of other parties, for example, receiving payment for domestic utility bills and paying out National Savings.

Customer transactions are captured through the Horizon Electronic Point of Sale equipment in branches, and daily summaries are transmitted overnight to the central accounting system, POL FS (a standard SAP system). The translation process between the two systems is enabled by the Reference Data System (RDS) and this system provides a mechanism to manage the portfolio of clients, branches and products.

The POL FS system was implemented in 2005/06 and contains functionality to calculate branch balances (cash, stocks, suspense, debtors and creditors) and to settle client balances. Additionally, the data from branches populates a Management Information System (MIS).

Objective and Scope

To ensure that the revised central accounting procedures implemented in the POL FS system are adequate to maintain the integrity of accounting data:

MASTER DATA: Amendments to product, branch, client, customer and General Ledger (GL) data are processed in an accurate and timely manner.

BRANCH TRANSACTIONS: Transactional data is received from branches in an accurate and timely manner and branch balances can be substantiated.

CENTRAL ACCOUNTING: Significant Branch Discrepancies (BDs) are investigated and processed consistently; settlements with clients are processed in accordance with client agreements; suspense items are promptly resolved; and summary transactions are posted into the POL financial accounts.

Audit Rating

AREA CONTROL ENVIRONMENT: Some Improvement Required. Processes to retrieve data from branches and post transactions into POL financial accounts operate satisfactorily. Further work is required to resolve suspense account aged balances and branch discrepancies.

GROUP IMPACT: Low. At the Group level the impact of issues identified in this report is low.

Summary

Overall, the extraction of financial records from branches by Fujitsu and the processing of these by the Product and Branch Accounting department was operating as prescribed. The POL FS system enables transactional data to be interrogated and there is an opportunity to enhance the efficiency and effectiveness of this functionality.

Issues identified in the review are:

Branch Discrepancies: Branch Discrepancies and Transaction Corrections (TCs) totalled £2.3m at P9, of which 38% related to the prior financial year. If these are not resolved, the risk of bad debts increases.

Suspense accounts: There were 17 suspense accounts, with balances ranging from £1k to £2.8m and the net total being £2.2m debit, containing a high level of aged balances. Any delays in clearing these accounts makes reconciliation more difficult and may require additional resource to resolve.

Moneygram transactions: There were discrepancies between the Moneygram transactional data (upon which POL make settlements) and the data recorded in POL FS. At P11, £472k of transactions required investigation. Moneygram did not appear to be cooperating fully with ongoing investigations. These discrepancies need to be resolved to minimise the risk of bad debts and respond to the possibility of fraud as a reason.

Customer master data: Internally, data from the SAP HR system is uploaded into RDS. Missing and incorrect customer master data resulted in a high level of upload failures (failure rate in January 2007: 23%). This causes additional costs in rework, and also risks impacting customer goodwill (e.g. when transactions are not recorded on a timely basis, causing unnecessary TCs to be issued).

Importance	Number of actions	Completed	Implementation timetable by quarter			
			By Jun 07	By Sep 07	By Dec 07	By Mar 08
High	-	-	-	-	-	-
Medium	9	-	9	-	-	-

Executive Summary: Control Assessment and Key Findings by Scope Area

Objective: The overall objective of the review is to ensure that the revised central accounting procedures implemented with the POL FS system are adequate to maintain the integrity of accounting data.

Process Area	Result	Key Findings	Action Ref
Master data - Amendments to product, branch, client, customer and GL master data are processed in an accurate and timely manner.		A robust process exists for amendments to product, branch, client and GL data. There is a high failure rate during the upload of customer master data from SAP HR data to Reference Data System (RDS) (22.9% for January 2007) due to missing or incorrect data.	4
Data harvesting - Transactional data is received from branches in an accurate and timely manner.		Transactions harvested from Horizon systems in branches are validated for accuracy and completeness prior to central processing. The nightly conversion of financial transactions through the SAP Xi middleware into POL FS is suitably monitored.	-
Branch accounting - Branch balances can be substantiated.		Monthly trading statements and monitoring undertaken by Branch Control and Conformance offer assurance that erroneous entries are investigated on a timely basis. The interrogation of management information and transactional data could be enhanced.	5
Branch discrepancies - Significant Branch Discrepancies (BDs) are investigated and processed consistently.		Only disputed BDs are investigated on a subjective basis. At P9, blocked BDs and Transaction Corrections (TCs) totalled some £2.3m of which 38% related to 2005/06.	3
Client settlements - Settlements with clients are processed in accordance with client agreements.		Discrepancies exist between Moneygram transactional data (upon which POL make settlements) and the data recorded in POL FS.	2
Suspense accounts - Suspense items are promptly resolved.		A number of suspense accounts include high levels of aged balances, for which root cause analysis or appropriate resolution plans are yet to be completed.	1
Summary reporting - Summary transactions are posted into the POL financial accounts.		The transfer of data from POL FS to ESFS appears to be appropriately controlled and managed.	-
Ratings:	Satisfactory	Some Improvement Required	Not Satisfactory
			Critical

Appendices

Detailed Findings

Appendix A

The following identifies issues and the related actions within POLFS. These issues were identified in the review and the action plans were agreed by the business. All of the actions shown are deemed important, however, a further ranking (1-2) has been provided to assist in prioritisation. Priority 1 relates to the higher risk issue.

Issue	Agreed Action Plan	Action Owner	Timing
<p>1. Suspense account management</p> <p>Suspense accounts are reconciled and reported via Probity Statements on a monthly basis. Various suspense accounts include excessive aged items, requiring additional resource to resolve.</p> <p>Owing to restructuring within Product and Branch Accounting (P&BA), root cause analysis of some suspense accounts has been delayed. Furthermore, detailed knowledge and understanding of some accounts has been diminished after internal restructuring or individuals leaving the business.</p> <p>Before the commencement of this review the issue of suspense account management had been identified by the POL team and a series of workshops arranged to identify root causes. Progress in the majority of cases is satisfactory.</p> <p>Our assessment of the individual suspense accounts overleaf reflects the position of the accounts at P9 and the level of work required to bring the account to a satisfactory status, on the following basis:</p> <ul style="list-style-type: none">• Account cleared on a timely basis;• Corrective action underway; and• Further root cause analysis required. <p>Business Impact: <i>Delays in completing reconciliations may mean that any errors in suspense accounts remain undetected for longer. Also, the delays mean that the business may incur additional costs to reconcile the accounts.</i></p>	<ul style="list-style-type: none">• Use the workshops to develop action plans and subsequent resolution for the problem suspense accounts. (Priority 2)• Document current understanding of accounting processes to provide continuity of control of these accounts. (Priority 2)	<p>Rod Ismay</p> <p>Rod Ismay</p>	<p>Jun 07</p> <p>Jun 07</p>

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Issue

Agreed Action Plan

Action Owner

Timing

1. Suspense account management (continued)

Set out below is our assessment of these suspense accounts at P9:

GL Code	Description	Owner	Balance @ P9 £'000	IA&RM Assessment @ P9	P&BA Assessment @ P11
PRODUCT					
531200	Client pay upfront	KW	1,066		
533210	Corporate bureau holding	MW	636		
627210	GTS/POL FS differences	MW	(803)		
627211	A & L Giro payment clearing	CC	473		
629400	Horizon idoc control	KW	(662)		
629406	Horizon idoc control	KW	(1)		
629407	Horizon idoc control	KW	(26)		
CLIENT					
500800	Stock in Transit	PL	85		
629350	Camelot Net Adjustments	PS	(103)		
BRANCH					
539107	Robbery & Burglary	CM	179		
250800	Robbery & Burglary write off	CM	1,356		
620220	Emergency	CM	(152)		
250564	Emergency write off	CM	6		
539106	Remittance - Shortages	CM	2,832		
629452	Remittance - Surpluses	CM	(1,936)		
250563	Remittance write off	CM	20		
539591	Local	CM	(537)		
	Account cleared on a timely basis.				
	Corrective action underway.				
	Further root cause analysis required.				

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Issue	Agreed Action Plan	Action Owner	Timing
<p>2. Discrepancies exist between Moneygram transactional data (upon which POL make settlements) and the data recorded in POL FS</p> <p>Issues have been identified within the process that reconciles the differences between Client Transaction Summaries (CTS) & POL FS. CTS data is supplied by Fujitsu and is based on transactions recorded on Horizon in the branch network. POL FS data is based on a file sent by Moneygram and loaded into POL FS. Transactions claimed by Moneygram do not match with CTS data.</p> <p>Moneygram services are available at some 3,350 branches, allowing customers to undertake electronic fund transfers to foreign bank accounts and generating commission income of some £6.5 million per annum. Historically, these transactions have taken place via a Moneygram terminal or by the POL clerk making a phone call to instruct the transfer. All transactions should be recorded on Horizon.</p> <p>Queries have been sent to Moneygram yet no response has been received.</p> <p>POL Investigations Team (POL IT) are considering potential internal fraud for some of the transactions. However, it is not clear what action is being taken with regard to potential fraud within the Moneygram organisation.</p> <p>POL and Moneygram are currently testing an automated process to eliminate transactions via phone calls and to replace the Moneygram terminals. Transactions will be entered directly onto the Horizon terminal and sent to Moneygram via a webserver.</p> <p>Business Impact: <i>The business may incur bad debts if it does not resolve these issues. Also, investigations require significant resource, which may detract focus from other business priorities.</i></p>	<ul style="list-style-type: none">• Agree resolution with Moneygram for current issues including establishing bad debt provisions as appropriate, and establish a process for identifying fraudulent transactions and communication to POL IT on a timely basis. (Priority 2)• Initiate a process to monitor contract performance and compliance in conjunction with the Marketing department. (Priority 2)	<p>Dawn Brooks</p> <p>Dawn Brooks</p>	<p>Jun 07</p> <p>Jun 07</p>

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Issue	Agreed Action Plan	Action Owner	Timing
<p>3. At P9, blocked Branch Discrepancies and Transaction Corrections totalled some £2.3m, 38% of which related to the prior financial year</p> <p>Generally, only disputed BDs are investigated with payment expected for all other items. Each Product team maintains a list of those items under investigation or in dispute. There are limited local guidelines on how to investigate, subsequently the majority of the process is subjective.</p> <p>The Current Agents Debt team maintain a listing of the frequency of disputed BDs. This is informally used to highlight potential ongoing issues (none noted). All blocked transactions (i.e. disputed BDs and TCs) are logged in POL FS and available to view. At P9, there were some 1,440 items outstanding (some £2.3 million), with 331 items (some £884k) from the previous financial year.</p> <p>System functionality does not provide sufficient analysis of outstanding items.</p> <p>Business Impact: <i>The business incurs further bad debts as a result of failure to resolve issues regarding historic and future transactions.</i></p>	<ul style="list-style-type: none">Establish and implement a strategy to resolve and clear the outstanding items from 2005/06. <p>(Priority 2)</p>	Marie Cockett	Jun 07

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<p>4. Customer Master Data upload failures</p> <p>The failure rate of the SAP HR customer master data upload to RDS was 22.9% for January 2007. The high failure rate is due to missing or incorrect data contained in the SAP HR file. RDS rejects the file during the validation process unless manual intervention takes place.</p> <p>The errors or omissions appear to be as a result of customer master data not being updated accurately in SAP HR. Missing data is flagged when TCs are raised against these customers.</p> <p>Business Impact: <i>When data files are incomplete or inaccurate, this results in file rejections, which means that unnecessary TCs are issued and transactions are not recorded promptly. As well as incurring unnecessary costs, this may damage customer goodwill.</i></p>	<ul style="list-style-type: none">• Liaise with P&ODS to review controls that ensure the SAP HR file containing updates to customer master data is accurate and complete. (Priority 2)• Review process to establish reason for customer data not being transferred accurately. Resolve issues prior to the implementation of an automated fix. (Priority 2)	<p>Martin Knights and Eddie Harris</p> <p>Martin Knights and Eddie Harris</p>	<p>Jun 07</p> <p>Jun 07</p>

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Issue	Agreed Action Plan	Action Owner	Timing
<p>5. Management Information</p> <p>Branch Control and Conformance currently undertake a range of Management Information (MI) and transactional reviews including:</p> <ul style="list-style-type: none">• Range checks;• Local suspense reviews; and• Rota checks. <p>These reviews are considered appropriate, take place on a timely basis and are supported by the Audit & Security and Outlet Support teams.</p> <p>The following issues were identified during the course of our review:</p> <ul style="list-style-type: none">• Concerns were raised by members of the POL team regarding the coverage offered by these procedures and that there may be some duplication of effort within POL;• Current sampling procedures and reviews rely heavily upon staff knowledge and experience; and• Smaller and less suspicious branches may not be subject to review for a considerable length of time. <p>Business Impact: <i>The business fails to optimise utilisation of both MI and staff resources. Discrepancies are not highlighted on a timely manner and subsequently require increased resources to resolve.</i></p>	<ul style="list-style-type: none">• Review latest range of MI, transaction and rota checks and associated actions arising. Address any obvious gaps or duplication. (Priority 2)• Compare results of action above with latest Audit Risk Model and other sources of data for the risk model. Update the risk model as appropriate. (Priority 2)	<p>Marie Cockett</p> <p>Rod Ismay and Keith Woollard</p>	<p>Jun 07</p> <p>Jun 07</p>