Post Office Ltd – Strictly Confidential

To:	From:	Date:
General Managers (Retail Line)	Rod Ismay	5 Oct 2004
General Manager (Network Support Services)	Head of Risk & Control	
Head of Client Accounting & Cash Management		
Head of Security		
Project Leaders – "Sales & Service Project"		

cc:

Executive Committee
Group Head of Audit & Risk
Head of Compliance (Banking & FS)
Ernst & Young

Blackwood SPSO – Post Incident Review and Recommendations

1. Executive Summary

POL faces a potential loss of £451k at Blackwood. The chain of events, failures and learning points are outlined in sections 3-5, but in summary several parts of POL had visibility of this shortage but relied on the judgment of the Retail Line Manager to continue allowing the branch to trade. Communications and decisions were taken at lower management levels without escalation. Nor were there recognised channels for escalation in some areas.

The agent blamed the automated bureau system for the "accounting discrepancy" but we are not aware of any other offices reporting similar issues. Whether or not theft is proven, failures in supervision, reporting and escalation must be acknowledged. A challenge to systems integrity, valid or otherwise, should not have been allowed to fester in this way.

Immediate actions focus on MI and communication. Plans for other audit visits are attached. A full investigation and interviews is being led by POL Internal Crime.

2. Linkage to "Sales & Service Project"

The recommendations in this report include certain roles for the retail line. The retail line is well placed for these, given its "hire and fire" responsibility.

The "Sales and Service Project" may take a different view of prime responsibilities. The business must balance these different needs.

Question o/s
- *Tony Utting – prospects of recovery, other arrests*
- *Martin Norman – cash activity levels – whether should have seen rems going to pocket*
- *Martin F – findings of the s60 issue at Newport Street SPSO. Cash numbers £47k declared and £522k "generated". 3 rems of £20k but recorded as one pouch in Horizon. Horizon doesn't allow that? System blocking it from leaving suspense?*
- *Cash issues – ATM cash, LFS looks at current holdings and recent transactions rather than having long run targets, procedural compliance failures with s60 autorems*
- *Post sevenoaks actions – call people*
- *Jennifer / Paul Dann follow up – Tuesday*
- *Tim – top10 errors / branches*

1

Post Office Ltd – Strictly Confidential

3. Sequence of Events

April 04	The branch began declaring a shortage in its cash account Audit visit confirmed this as £16k – referred to retail line Branch had recently gone onto automated Bureau de Change It had also reinstated an employee who had previously been dismissed
July 04	Shortage £34k by mid July 2 visits by trainers – staff appeared to be operating as they should RLM aware from outset but felt it inappropriate to suspend the agent RLM informed Head of Area
Sept 04	Second audit visit confirmed the current shortage (£451k) RLM again recommended branch remain open Issue escalated to GM who decided on temporary closure 2 years overdue rent to POPH identified. Arrest made.

4. Observations

Business Area	Observations
1 Retail Line	The decision not to suspend earlier is questionable when the shortage was there so long, become so large and had not been explained after involvement of trainers and IT systems specialists.
Client Accounts & Cash Management	A fundamental principle of cash accounts is that "Balance due to Post Office" (the residue of receipts and payments at the counter) should equal the total of the "Cash and Stock Table". Differences should be investigated. This branch has had an ever increasing discrepancy, which the agent openly signed off against and attributed to problems with the new automated Bureau de Change system. From April to September, the "shortage" rose from £16k to £436k. There was no ownership or process to chase this type of discrepancy.
NBSC Support	NBSC National Problem Management Team had been in dialogue with Fujitsu for at least 3 months. Next steps planned by NBSC were for an "Environmental Check" at the branch (plug connection etc). We understand from the Fujitsu account managers in POL IT that they were not aware of this dialogue. Given the size and duration of the issue they would expect to have been alerted.
2 Trainers	The branch had 2 visits to check how the staff were accounting for transactions. Both times the trainers concluded that the staff were accounting for transactions as they should.
3 Audit	Audit visits confirmed the shortage in April and September. Blackwood appeared in the Audit Risk Model in the interim, but given the openness of the declared shortage and the line involvement no repeat visits were made until September.
Security	Internal Crime Team had not been made aware of this branch. Given the value and duration of incident they should have been notified.
Other Group Units (Property Holdings)	Some subpostmasters occupy property owned by Royal Mail. Many of these tenants are "MSPO" agents, individuals who took over former directly managed branches in the early 1990's. There are some significant overdue debts and these were not communicated to

2

Post Office Ltd – Strictly Confidential

| the CA&CM agent debt teams. Blackwood was £22k in arrears. |

5.   Recommendations

Ref	Action	Owner	Timescale	Status
1.	**Suspensions / Non Suspensions – Decisions** Decisions to be mandatory for all cases of branch irregularity > £10,000 and > 1 month old, and not dependent on audit visit. Authority delegated to Retail Line Managers, but must obtain GM authority for non-suspension where irregularity > £25,000 and > 1 month old.	Richard Barker Sue Huggins Alwen Lyons	Oct 04	
2.	**Suspensions / Non Suspensions – Reporting** All decisions to be forwarded to CA&CM Debt Recovery Team Manager, in standard 9 column Excel format as follows: FAD Branch Agent RLM Date £ Value Ageing Decision Reason Summary monthly reporting of all cases to GMs and Heads of CA&CM, Risk and Security.	Case reporting: Richard Barker Sue Huggins Alwen Lyons Summarisation: Jennifer Robson	Oct 04	Early knowledge of suspensions helps support our leavers process and recovery where possible from final remuneration. JR
3.	**Branch Cash Accounts – Monitoring & "Debt Collection"** CA&CM Debt Recovery Team to include the cash account lines for shortages and surplus within their remit.	Jennifer Robson	Oct 04	We will certainly highlight the top values to RL for discreps. We then need to understand the business process for action. JR
4.	**Debt Collection – Priority and Retail Line** RLMs to agree and enforce commercially viable debt recovery plans with agents within a month of identification of the issue.	Richard Barker Sue Huggins Alwen Lyons	Nov 04	
5.	**CA&CM Management Information Pack**	Vicky Noble	Nov 04	Similar to 3 above. Our

3

Post Office Ltd – Strictly Confidential

		Jennifer Robson	6 Oct 04	
	Risk & Control Team to work with CA&CM in defining an MI pack for branch monitoring. Pack to include high value shortages, surpluses, errors and suspense. Also to reflect "frequent offenders", national distributions and key variances. Short term actions to identify areas for "Top 10" reporting and investigation (eg. high value errors, shortages, unauthorised suspense etc)	Jennifer Robson	6 Oct 04	Top 10 would probably include Authorised /unauthorised shortages Top 10 aged errors by value to fed into the risk model JR.
6.	**CA&CM Exceptions & Escalation** High value and aged exceptions from the CA&CM MI Pack to be reported to GMs for further action and to Audit Team and Security Team for input and possible branch investigation.	Vicky Noble	Nov 04	
7.	**Agent Credit Ratings – Initially and updates** Update and deploy policies for credit vetting at recruitment and for periodic updates.	Jennifer Robson	Dec 04	We do a credit check on prospective agents (CS200). I'm awaiting more info from HR SC
8.	**Other Overdue Debt Information** CA&CM Debt Recovery Team to be copied monthly on all other business units aged debt with subpostmasters and franchisees – may only relate to the Property Holdings records.	Jennifer Robson	Oct 04	We are now advised on POPH bad debts. Awaiting info from LS on any reasons why we could not take from remuneration on POPH's behalf. Need strategic decision but will work with Damion Taylor (and others) once agreed. JR
9.	**NBSC Problem Management – Escalation** Cases of significance by value and age (irregularities > £25,000 and > 1 month old) or by significance of	Ruth Holleran	Oct 04	

Post Office Ltd – Strictly Confidential

	challenge to the integrity of POL IT systems should be escalated to [Director Commercial Contracts – Ian O'Driscoll]			
10.	**NBSC Problem Management – Monitoring** NBSC internal processes for recording and resolving incidents to be reviewed.	Ruth Holleran	Nov 04	
11.	**Audit Frequency** Introduce checkstep around risk based plan of branches identified for audit. Do not automatically discount branches which have been visited recently	Martin Ferlinc	Oct 04	
12.	**Audit Risk Model and Reporting** Conclude prioritisation and reporting project with GMs (end October). Consider reporting on "risk model" branches which we choose not to visit as well as those we do.	Martin Ferlinc	Oct 04	
13.	**Provisions and Write Offs** New CA&CM MI pack to be used in determining provisions in month end processes.	Vicky Noble	Oct 04	
14.	**Future Post-Incident Reporting** Audit and Security to agree on mechanism for single, prompt reporting of sequence of events and recommendations.	Rod Ismay Tony Utting	Nov 04	
15.	**Losses Data** Provide first half year losses data in CA&CM, reconcile to ESFS data and draw out root causes	Rod Ismay Alison Bolsover data	Oct 04	
16.	**Sales & Service Project** Communicate headline question about future ownership of branch financial control to the project	Vicky Noble	Done	
17.	**Rolling Losses** Investigation of "case study" branches from the top 10 worst branches in section 7 of this report	Jennifer Robson Rod Ismay	5 Oct 04	Team are looking at this however we can only suggest possible causes
18.	1 **Staff Reward Schemes** Incentivise identification of suspicious activity in branch cash accounts – provide £25 rewards for successful identification of offending branches	Vicky Noble	Oct 04	

5

Post Office Ltd – Strictly Confidential

6. **"Stop Gap" Response to Issues in Branch Cash Accounts**
   1. Identify offices of concern based on best available data – with particular focus on high cash and high "shortage"/suspense offices (focussing on the risk indicators under Sevenoaks and Blackwood). Also consider high error rate offices
   1. Decide whether branch warrants an audit visit, an order to remit cash back or a challenge of the CACM / debt recovery plans.
   1. Whether making physical visits or desktop reviews, we may need to ask for or challenge decisions about (non) suspension and debt recovery

,

Post Office Ltd – Strictly Confidential

1.1. Can we see any other such danger branches from data today?

Blackwood appears by far the worst branch. At the end of August, nationally, there were:
- 6,667 offices with a shortage ranging from 1p to Blackwood's £0.4m. Total shortages nationally were £1.6m
- There were also 6,127 offices reporting surpluses (ie. more cash and stock than expected based on transactions). These ranged from 1p to £78k and totalled £1.4m nationally

The top ten "shortage branches" and action plans are as follows. In general they have had little in their suspense accounts but have reported intermittent or long standing shortages. Some have also had high value and high frequency of error notes.

Shortage £'000	Office	FAD	Findings / plans
451	Blackwood SPSO	364632	Audited 23/9 and suspended. Write off likely
82	Hertford Street BO	007205	Audited 15/9 and no discrepancy. Appeared to be an accounting error which reversed the following week, but we are now to re-audit. It had not been possible to verify ATM contents at the 1st audit.
70	Shortheath Rd SPSO	123900	Audited 15/9 and a further £70k (total £140k) agreed as loss. Legal action under way
32	Kings Cross IFPO	177005	Audited in June which led to this shortage being identified. RLM not agreed debt recovery plan yet. To be escalated to GM.
25	Honor Oak Park SPSO	125007	Understood to be a 4 week old query about a cash remittance. Escalated for resolution in CACM.
16	Albany Road FPO	482611	Audited 30/9 and a further £16k (total £32k) agreed as loss. Branch had high frequency of errors.
16	Ringmer SPSO	169907	Amount reversed the following week. CACM investigating before we commit audit visit
13	Woodbridge FPO	201130	Audit in w/c 4/10. Shortage has been rolled in the books for at least 2 months. Was OK at last audit in April 04, but has had high error rates since then.
12	Northwood MSPO	255020	Audit in w/c 4/10. Long standing shortage and many errors
10	Longborough SPSO	273247	Audit in w/c 4/10. Low error rate, but a £3k surplus moved to £10k shortage a month ago.

Post Office Ltd – Strictly Confidential

There are also a large number of branches declaring high value surpluses. Again some of these are long standing. It is not clear what these relate to, nor how they are being dealt with. On the face of it shortages are the immediate risk to the business, but surpluses may be equally indicative of branch problems. We will therefore explore the following top ten "surplus branches" too in the short term.

		Surplus
008405	BLACKPOOL BO	78,151
488641	MARKET DRAYTON MSPO	55,465
374207	HILL STREET SPSO	44,000
004900	CAMBERLEY BO	34,496
223618	PUTSON SPSO	34,364
308549	NORTH PETHERTON SPSO	30,720
328329	BLACKFELL SPSO	30,604
210424	CROWHILL SPSO	29,382
082007	ARDGOWAN ROAD SPSO	25,035
158642	BLACKPILL SPSO	24,986

7.2   Could the shortages be understating the exposure?
Yes, if the branch "suppressed" (or stole) moneys paid in by customers, or if it created fictitious outpayments. The audit visits can only confirm cash and stock on hand. Verification of transactional data is reliant on front end and CACM back end controls.

With regard to Blackwood, Security have taken the Horizon terminals to Fujitsu. Transaction data will be re-run and will help answer this question.

In the interim, a summary graph of key client streams by week is shown below. The peaks and troughs broadly reflect "double pension payments" and other bank holiday period activity. The decline in pensions activity might be expected based on migration to card account. However, the decline in Giro deposits may warrant explanation. The nil banking deposits in week 25 data also require explanation.

8
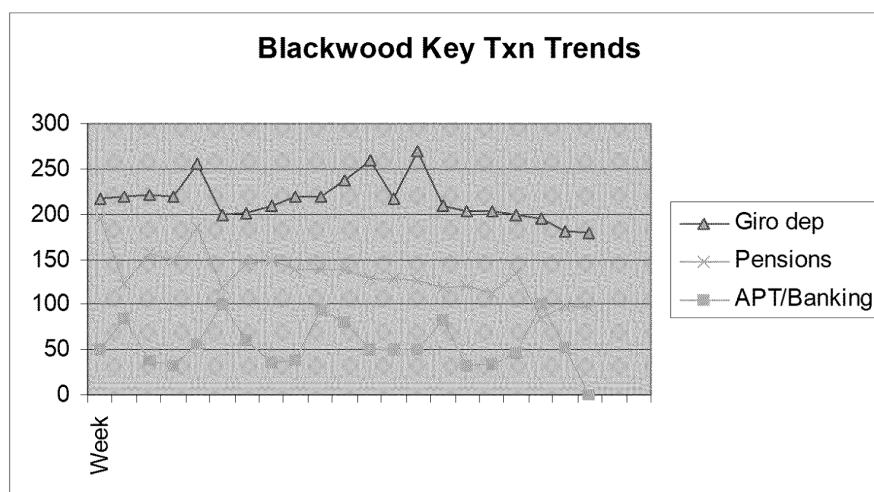
Post Office Ltd – Strictly Confidential

8.   How do we decide where to go on audits?

Our assets audit risk model draws on many tried and tested data streams:
- Reinstated agents – past suspensions being the concern
- Cash specials – may indicate unexpectedly high cash usage
- Nil discrepancies – ie. too good to be true?
- Repayment schemes – branches where debts are already in existence
- Management concerns – ad hoc concerns
- Cheques held at period end – none should remain on site at end of day
- Previous asset findings – past experience of this branch
- Error notice activity at this branch – number and value
- Losses at this branch
- ONCH (cash holdings) variances against "target" - £ and %
- "Discounted cash" – declaring high values in unexpected denominations
- Cash rises in the week and month on month

A review of the model began last month and is exploring new data streams. These may include:
- Branch / demographic profiling
- ONCH variances against predictions
- Hardship applications
- Frequent queries on cash/stock remittances
- High levels of reversal transactions
- Abnormal transaction trends

Our audit visits to date this year (periods 1 to 5) can be summarised as:

606	Transfers
668	Closures
78	Robbery / burglary
47	Other
1,200	Risk based visits
2,599	Total number of audits

The risk based audits include the following:

60	From Internal Crime team leads
50	Audit managers directly alerted to issues
350	Compliance only audits
740	Full asset based audits driven by the risk model
1,200	

Up to period 4 we have been able to perform all the audits which our risk model identified as "high" or "immediate high" risk. We have had resource constraints in Scotland.

Prior to "Sevenoaks" we had suspended DMB asset audits due to low incidence of problems and higher degree of segregation of duties. We have reintroduced DMB audits and will cover 5% of them by Christmas.

Our basic risk model for week 25 identified 364 branches of most concern. 220 of these were then discounted on grounds of having been audited not long ago or that they were the lowest priority of the population. 50 of the offices discounted had risk indicators arising purely from the last audit report rather than new issues. The remainder had error notices or losses

9

Post Office Ltd – Strictly Confidential

exceeding £1k each week. On further review, 2 of these offices are now to be prioritised for urgent audit despite having been visited recently. This is because they are now reporting high shortages.

19. Update re Actions post Sevenoaks (o/s email updates)

Retail Line
 	
Alwen
	1. **Branch supervisory controls:**
	   1.1. RLMs to formally monitor holiday and absence - managers and assistants
	   1.2. Reinforce personal responsibility of managers for whole branch operation and requirement for at least sample checks of stocks
	   1.3. Revisit policy - individual or team balancing?
	2. **Conclude on branch "sanctions"**

Cash Management
 	
Martin N
	3. **Monitoring cash statistics** (inc ATM)
	4. **Monitoring cash remittance discrepancies**:
	   4.1. Time lag exceptions (& review principles of matching including our "risk appetite")
	   4.2. Frequent offender reports in "late rems"
	5. **Exceptions reporting to include Cash Account figure as well as ONCH declaration and target**

IT / CA&CM
 	
Vicky
	6. **Fujitsu / Horizon change**:
	   6.1. Front end range checks (inc £ and fx)
	   6.2. High value and trend exception reports
	   6.3. Renegotiate POL rights of data access + Horizon interrogation terminal [Internal Crime submitted High Level Blueprint on this]
	   6.4. Set CACM authority for rem reversals
	   6.5. Reporting of frequent reversals
	   6.6. High value reporting of 'stock units'
	   6.7. User ID exception reports re logon times and evidence of segregation of duties
	   6.8. Dual sign off for high cash offices
	   6.9. Cash declaration (blind) + exceptions

Audit
 	
Rod
	7. **Audit & Inspections branch visits**:
	   7.1. Short term – reinstate DMB audits and make "top 10" visits based on cash data streams
	   7.2. Update audit risk models and review quality of data in risk model feeds
	   7.3. Confirm time lag checks in audit of rems

Business wide communication	8. **Escalation of issues**:
HR Jennifer / Jeff Fail – "Leavers processes" **for DMB**	9. **Exit** – update process to ensure effective absence records, challenge about balancing / errors history and a pre-exit cash count.
Network Support Ruth	10. **Cash centres** – clear inward rem processing backlog – this is clouding the errors issue

10