



POST OFFICE LIMITED

AUDIT, RISK & COMPLIANCE COMMITTEE REPORT

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| Title: | The Current Operation of Suspense Accounts | Meeting Date: | 27 July 2020 |
| Author: | Mark Underwood, Tom Lee & Tim Perkins | Sponsor: | Ben Foat & Alisdair Cameron |

Input Sought:

The ARC is asked to **note**:

- The findings from KPMG's review of Post Office's current operation suspense accounts.

The ARC is asked to **approve** the recommended approach:

- Whereby KPMG are instructed to explore whether it is possible to perform the same independent review, but for Post Office's historical operation of suspense accounts.

Previous Governance Oversight

- Post GLO Settlement Programme SteerCo of 1 July 2020
- RCC 13 July 2020

Executive Summary

1. Allegations continue to be made that Post Office may have recovered sums from Postmasters (including through civil and criminal proceedings) which were not 'real losses' to Post Office as they were housed in suspense accounts and taken to profit by Post Office.
2. KPMG were instructed to review Post Office's current operation of suspense accounts. Although their findings include a number of points to consider in terms of how Post Office could enhance best practice. In summary, given the robust and transparent investigations process that is undertaken, these suspense accounts should not result in Post Office pursuing Postmasters for sums it had or could eventually take to profit. This is because sums housed in suspense accounts are either:
 - not taken to a profit and loss account; or
 - relate to unmatched transactions due to customers (not postmasters); or
 - relate to surpluses rather than shortfalls.
3. BAU investigations and the Historical Shortfall Scheme provide mechanisms whereby shortfalls can be investigated and/or resolved. However, this is unlikely to satisfy Post Office's detractors.
4. Thus, and at a cost of c£47k, it is recommended that the ARC approve instructing KPMG to explore whether it is possible to perform the same type of independent review, but for Post Office's historical operation of suspense accounts.
5. The ARC should note that any documentation which is produced and findings made, may be disclosable as part of Post Office's ongoing disclosure obligations to those it has prosecuted historically and as part of any future claims made against Post Office as a result of historical



practices, in both a civil and criminal context and in the context of any relevant investigation or inquiry.

Questions addressed

1. What is a suspense account? What allegations have been made in respect of how Post office operates suspense accounts?
2. What assurance does KPMG's review give Post Office? What were the findings?
3. What options exist to Post Office for managing any historical and future suspense account related claims?
4. What further work could KPMG perform over the historical operation of suspense accounts? How much would this cost? What are the limitations and risks?

Report

History & Context

1. Post office uses suspense accounts:
 - To house branch discrepancies arising as part of the normal course of trading and which need to be cleared at the period end (either surplus or deficit).
 - To house surpluses arising from Postmasters where the Postmaster does not agree the surplus is due back to them.
 - To temporarily hold differences in payments moving between Post Office and its clients, where the client and Post Office's view of what is payable or receivable differ. Differences are investigated but in some cases neither Post Office, the client, nor the branch are able to determine the identity of the customer who performed the transaction in question or the specifics of the transaction. For example, Post Office may not be able to determine the details of the bank account to be credited. In such situations, and following enquiries with branches, unresolved differences are moved to Post Office customer creditor suspense account. Such discrepancies are held in its suspense account to give time for customers and other parties to put forward more information to explain what has happened.
2. A long standing assertion, made by applicants to the Complaint Review & Mediation Scheme, Claimants in the GLO, and by Lord Arbuthnot is that:
 - Post Office operates one or more suspense accounts in which it holds unattributed surpluses including those generated from branch accounts;
 - After a period of time, such unattributed surpluses are credited to Post Office's profits; and
 - Post Office therefore has recovered (through civil or even criminal proceedings) sums from Postmasters which were not real losses to Post Office, as they were housed in suspense accounts and ultimately taken to profit by Post Office.
3. These allegations were first made in the context of the Complaint Review & Mediation Scheme¹. Second Sight's² final report, published in 2015, claimed they had been informed that at each year end, substantial unreconciled balances existed on many individual suspense accounts and that these unreconciled balances for the 2014 financial year were approximately £96 million in respect of Bank of Ireland ATMs and approximately £66 million

¹ 'Project 'Sparrow' which, broadly speaking ran from 26 August 2013 – 01 February 2016.

² The firm of independent forensic accountants instructed to investigate each of the applicants cases accepted into the Scheme



in respect of Santander. They said that *"these unmatched balances represent transactions from individual branches that occurred in the preceding 6 months"* and they *"...remain concerned that these balances may include transactions that ultimately should be credited back to individual branch accounts"*.

4. In its 'Reply' to the Second Sight Report, Post Office stated that Second Sight had misunderstood the information provided by Post Office. The balances of £96m and £66m were taken from routine trading balances yet to be settled with other organisations at a particular month end. In other words, they represented amounts due to other parties, not amounts that were unreconciled and which may be due to Postmasters.
5. Second Sight were also provided with details of the credits released from Post Office's suspense accounts to profit for the period 2008 to 2013. As there was a 3 year retention period – no amounts at that time had been released for the years 12/13 and 13/14. The total gross credits released from suspense to profit from 2007/8 onwards was as follows:

| Years released to profit | Value |
|-------------------------------------|----------|
| 2010/11 | £612,000 |
| 2011/12 | £207,000 |
| 2012/13 | £234,000 |
| 2013/14 | £104,000 |
| 2014/15 (YTD at the point provided) | £8,000 |

6. In its reply to Second Sight, Post Office stated that amounts should be considered within the overall context of Post Office performing around 2.5 billion transactions per annum, with a combined value in the order of £60bn. The amount of unresolved credits that end up in Post Office's P&L (at the time) was therefore less than 0.001% of all transactions (by value) undertaken by branches.
7. Allegations continue to be made in respect of Post Office's suspense accounts. In February 2020 Lord Arbuthnot wrote to Nick Read. In Nick's response, he committed to better understanding how Post Office operates its suspense accounts. Nevertheless, in the House of Lords on 18 June 2020, Lord Arbuthnot complained that the Terms of Reference for the recently announced 'Independent Review into the Post Office Horizon IT System and Trials' do not *"say anything about the likelihood of the Post Office improperly making a profit from the sub-postmasters, or about the suspense accounts"*.

KPMG's Suspense Account Review

8. KPMG were instructed to review how Post Office currently operates its suspense accounts. The scope of this review was as follows:
 - Confirm the number of relevant suspense accounts operated by Post Office into which sums are placed which could, theoretically, relate to discrepancies at a branch level and from which any unmatched sums may be taken into a Profit and Loss (P&L) account.
 - For these accounts, assess whether how they are operated reflects the associated documentation and best practice.



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- Identify whether there are any gaps / challenges within existing processes which could result in risk to Post Office and or Postmasters.
 - Assess whether the current resolution criteria adopted by Post Office for dealing with discrepancies appears 'fair and reasonable' to both Post Office and Postmasters, based upon KPMG's understanding of best practice.
 - Comment on any further work that Post Office might want to consider.

KPMG's Findings

9. KPMG identified 4 relevant suspense accounts which are currently operated by Post Office; details of which are provided within the table on the following page. In summary, given the robust and transparent investigations process that is undertaken, these suspense accounts should not result in Post Office pursuing Postmasters for sums it had or could eventually take to profit.
10. This is because sums housed in suspense accounts:
 - are either not taken to a profit and loss account; or
 - relate to unmatched transactions due to customers (not Postmasters); or
 - relate to surpluses rather than shortfalls.
11. For completeness and although purely hypothetical, included at **Annex 1** is a worked example for how a postmaster could repay a shortfall which Post Office has or eventually could take to profit via a suspense account. Post Office is not aware of any examples of this having taken place and it requires, for example:
 - a Postmaster not following process;
 - refunding a customer, prior to an investigation taking place and without contacting Post Office;
 - not recording the refund on Horizon; and
 - not recalling the refund during the subsequent investigation.

Owing to its nature therefore, it would be extremely difficult if not impossible for Post Office to prevent.

| Account | Description | Houses Deficits and or Surpluses? | Postmaster Affecting? | Are unmatched sums taken to P&L? | KPMG Findings Summary |
|--|---|---|-----------------------|--|---|
| Branch Snapshot. Current Balance: £355,204 | This is a holding account within branch accounts which allows Postmasters to investigate discrepancies that have arisen within their branch without the need to recognise and potentially settle the amount at their trading period end. | Deficits and Surpluses potentially due to Postmasters | Yes | No. These accounts relate to discrepancies identified by Postmasters and which result in a Postmaster either repaying (deficit) or being repaid (surplus) amounts. | Branch Deficits KPMG's assessment is that Post Office are moving towards best practice. There is an established, robust and timely investigation and resolution process which is undertaken in conjunction with Postmasters and the development of a tailored training course encompasses the key aspects of best practice. In addition, the level of monitoring and oversight is robust ensuring there are no unauthorised transactions and aged balances do not build up. |
| Local Suspense. Current Balance: £0 | Branch discrepancies arising at the period end are posted to this account. The balance on this account must be cleared before the branch can complete their period end roll over. Depending on the value of the discrepancy, the balance is either made good through the Postmaster putting cash into the office (if less than £150) or can be 'settled centrally' (if over £150) meaning the balance is moved in to the Postmaster's personal account in the Group Ledger. Discrepancies can be investigated after they are made good or posted to the Postmaster's personal account in the GL | | | Resolution of these discrepancies is either in cash or via Postmaster's personal accounts in the Group Ledger. | Whilst operational documentation provides Post Office with a clear audit trail, there is a lack of formal detailed process documents and inconsistencies between documented and actual practices. Branch Surpluses Policy and procedures are unclear and Postmasters are not routinely informed when surpluses arise on their personal accounts in the Group Ledger. The timeliness of repayment is dependent upon the value of the surplus and is in direct contrast to the branch deficit policy. There is a currently a backlog into investigations of surpluses and monitoring of branch surpluses is inconsistent. |
| Agent Creditor. Current Balance: £17k | This account holds surplus discrepancies which Post Office believes are due to Postmasters, but that Postmasters dispute being due to them. | Surpluses potentially due to Postmasters | Yes | Yes. This accounts house surpluses from which unmatched items can be released to the Post Office P&L account after 5 years. However, as this account relates to <u>surpluses</u> which are disputed by the Postmaster (as opposed to | Formal policies in place regarding when amounts can be released to the P&L account. Though operational policies are clearly understood, they are informal and not yet fully documented. |



| Account | Description | Houses Deficits and or Surpluses? | Postmaster Affecting? | Are unmatched sums taken to P&L? | KPMG Findings Summary |
|---|---|--|--|--|---|
| | | | | Post Office) any improper operation should not result in Post Office potentially pursuing Postmasters for monies it had already or could eventually take to profit | |
| Customer Creditor: Current Balance: £3.5m | <p>This account holds amounts repaid to Post Office from third parties due to issues identifying who the money is owed to.</p> <p>Third parties include Santander, MoneyGram and Camelot customers.</p> <p>Amounts are held in this account, pending inquiry from the customer.</p> | Surpluses potentially due to customers | <u>No</u> . These monies relate to <u>customers</u> who cannot be traced due to inaccurate data. | <p>Yes. This account houses surpluses from which unmatched items can be released to the Post Office P&L account after 6 years or earlier where specific policy is to do so.</p> <p>However, as this account relates to unmatched sums potentially due to customers (as opposed to Postmasters) any improper operation should not result in Post Office potentially pursuing Postmasters for monies it had already or could eventually take to profit.</p> | <p>An established level of best practice in respect of documentation, monitoring and resolution.</p> <p>A good level of operational documentation provides a clear audit trail and monitoring ensures there are no unauthorised transactions to or from the account.</p> <p>All amounts posted in this account are investigated with the relevant branch prior to being posted in this account.</p> <p>No evidence that amounts posted to this account would relate to branch discrepancies which were previously repaid by a Postmaster.</p> |

Recommendations Included within the KPMG Review

12. The KPMG report includes a number of points to consider in terms of how Post Office could improve its operation of suspense accounts to enhance best practice. These include:
- Implementing and documenting policies and procedures including details of ownership, format, content and version control for all relevant suspense accounts.
 - Ensuring all processes are adequately documented and that policies are consistently applied within the documentation.
 - Implementing an overarching branch discrepancy process document linking all relevant policies and processes.
 - Formalising the reporting and review by senior management of suspense accounts and investigation outcome metrics.
 - Undertaking a review of the branch deficits written off centrally to identify whether any Postmasters are regularly benefitting from the policy.
 - Reviewing the policy and process for branch surpluses with specific focus on:
 - i. Communicating surpluses to postmasters.
 - ii. Repayment timescales not being determined by value.
 - iii. Timeliness of investigation process.
 - iv. Aligning the branch deficit and branch surplus policies and expectations.
 - Implementing a process to address the current backlog that has arisen in the investigation of branch surpluses and the resolution of old branch surpluses that are in dispute to ensure:
 - i. Repayments are made in a timely manner; and
 - ii. Where appropriate, amounts are moved into the Agent Creditor Account.
13. All recommendations are being taken forward, and will be implemented through BAU over the course of the 20/21 financial year.

Next Steps

14. Although the KPMG report gives Post Office assurance that its current operation of suspense accounts should not result in sums being pursued from Postmasters which Post Office has already or could also take to profit via a suspense account, the scope of the review did not include Post Office's historical practices.
15. If a historical error, in relation to the operation of suspense accounts, was to adversely affect a branch, this would almost certainly manifest itself as a shortfall. The Historical Shortfall Scheme provides a mechanism for shortfall claims to be investigated. The only caveat to this is if their claim relates to a period of time for which the branch in question was operating on HNGA. This is because HNGA related claims are ineligible for the Scheme.
16. However, any such 'suspense account related claim' which relates to a period during which HNGA was in operation at the branch in question would still manifest itself as a shortfall and can therefore be investigated through current BAU processes (which KPMG have found to be transparent and robust).



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17. Nevertheless, this is unlikely to satisfy Post Office's detractors and the allegations will continue. As such it is recommended that the ARC approve instructing KPMG to explore whether it is possible to perform the same independent review, but for Post Office's historical operation of suspense accounts. It may not be possible, owing to the timeframes involved (2000 – 2019), key personnel no longer being in the business and documentation being destroyed in line with retention schedules (prior to legal holds being in place). KPMG has provided a cost estimate of £47k to complete this work.
18. If it is possible, the ARC should note that any documentation which is produced and findings made, may be disclosable as part of Post Office's ongoing disclosure obligations to those it has prosecuted historically and as part of any future claims made against Post Office as a result of historical practices, in both a civil and criminal context and in the context of any future investigation or inquiry.



Annex 1 – Theoretical example for how a Postmaster could repay a shortfall which Post Office has or eventually could take to profit via a suspense account³:

| Step | Customer balance | Branch balance | Postmaster balance | POL balance | Bank balance |
|---|------------------|----------------|--------------------|-------------|--------------|
| A customer makes a £10 deposit in branch. | £0 | £0 | £0 | £0 | +£10 |
| The customer complains the deposit has not been received in the associated banking account. By way of an example, this could be as a result of the Postmaster incorrectly recording the account details on Horizon. | -£10 | £0 | £0 | £0 | +£10 |
| The Postmaster chooses to refund the customer £10, without recording it on Horizon | £0 | -£10 | £0 | £0 | +£10 |
| The bank refunds £10 to Post Office. | £0 | -£10 | £0 | +£10 | £0 |
| Prior to Post Office moving £10 to its Customer Creditor Account, Post Office investigates with the branch in question any sums originating from transactions performed within that branch. If the Postmaster does not recall refunding the customer - the £10 would be moved to the Customer Creditor Account. | £0 | -£10 | £0 | +£10 | £0 |
| At the end of the trading Period (having still not recalled refunding the customer) the Postmaster chooses to make good the £10 shortfall. | £0 | £0 | -£10 | +£10 | £0 |
| If after 6 years the amount remains unmatched, it is released to Post Office's Profit & Loss Account | £0 | £0 | -£10 | +£10 | £0 |
| Thus, Post Office has received £10 from the Postmaster but still houses the original £10 within its Customer Creditor Account | £0 | £0 | -£10 | +£10 | £0 |

³ For simplicity, this table ignores any applicable transaction fees.