Post Office Limited

POST OFFICE LIMITED
(Company Number 2154540)

Meeting of the AUDIT, RISK AND COMPLIANCE SUB-COMMITTEE to be held at 12.00 on 10th November in the Boardroom at GRO **GRO**

Members of the Audit, Risk & Compliance Committee (the "ARC") will be asked to declare any interest that could give rise to conflict in relation to any item on the agenda at the beginning of the item in question. All interests so disclosed will be recorded in the minutes of the ARC. If the chairman of the meeting deems it appropriate, the member shall absent himself or herself from all or part of the Committee's discussion of the matter.

12.00	1	Interim Report review and Ernst & Young half year review findings	Chris Day/Sarah Hall/Angus Grant
13.00	2	Minutes of the last meeting and matters arising • Minutes of the meeting held on 21 October 2014 • ARC status report	Alasdair Marnoch
13.10	3	Risk Appetite Statements – Markets	Chris Aujard/ David Mason
13.40	4	Internal Audit papers: • ARC Terms of Reference, IA Charter and Self-Assessment • IA status of agreed actions	Malcolm Zack
13.50	5	Proposed dates for 2015	Alwen Lyons

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

SECRETARY: Alwen Lyons (Company Secretary)

IN ATTENDANCE: Alice Perkins (Board Chairman)
Paula Vennells (CEO)
Chris Day (CFO)
Chris Aujard (General Counsel)
Sarah Hall (Financial Controller)
David Mason (Head of Risk Governance)
Malcolm Zack (Head of Internal Audit)
Garry Hooton (Internal Audit)
Angus Grant (Partner, Ernst & Young)
Steve Lyon (Senior Manager, Ernst & Young)

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POST OFFICE LIMITED AUDIT, RISK & COMPLIANCE SUB-COMMITTEE

Interim Report and Condensed Financial Statements for 2014-15

1. Purpose

The purpose of this paper is to:

1.1 Invite the Post Office Limited Board Audit Risk and Compliance Sub-Committee to review the Post Office Limited Interim Report and Condensed Financial Statements for the 2014-15 half year and recommend their approval to the Post Office Board.

2. Background

2.1 The Post Office prepared a full Annual Report and Financial Statements that met most of the requirements of a listed plc for the first time for the 2012-13 year. In 2013-14 the Interim Report also met this standard for the first time.

2.2 The following documents are attached to this paper:

- Annex A - Draft Interim Report and Condensed Financial Statements (incorporating Board and EY comments);
- Annex B - ARC briefing book to aid understanding.

3. Interim Report and Condensed Financial Statements approach and plan

3.1 As set out to the Board, the Interim Report is currently anticipated for publication in the first week of December. The context is continued progress against a backdrop of challenging market conditions, with significant transformation milestones delivered on the path to financial sustainability.

3.2 The Condensed Financial Statements have been prepared by Finance in accordance with IFRS, consistent with the interim reporting of listed PLCs. An ARC briefing book is attached. This provides a more detailed analysis of the first half results to aid understanding of the financial statements.

3.3 The current timeline is:

- 6 November – ARC papers issued incorporating board feedback on front half and including the Condensed Financial Statements
- 6 November – share draft with the Shareholder Executive and relevant sections with Royal Mail for comment
- 10 November – ARC review
- 19 November – Board papers issued including final draft Interim Report and Condensed Financial Statements
- *19 November - Royal Mail interim results announcement expected*
- 26 November – Board to approve Interim Report and Condensed Financial Statements
- Early December – Announce results

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4. Review process

4.1 The comments following the first review by Board members last week have been considered and addressed. This version of the draft will be shared with the Shareholder Executive and relevant sections with Royal Mail for comment.

5. Format

5.1 We will produce an electronic copy of the Interim Report in-house and make this available via the website. It will be similarly styled to the Annual Report.

6. Going Concern

6.1 The Going Concern work has been refreshed at the half year and a summary of the analysis is included in Section 12 of the ARC Briefing Book attached to this paper. Based on the analysis in this paper there is headroom remaining until March 2018 and it is believed that Post Office Limited will be able to meet its liabilities as they fall due in the foreseeable future. The funding beyond March 2015 is still subject to State Aid clearance so downsides have been applied to reflect a situation where the funding for NSP and transformation post March 2015 is not available in addition to downside scenarios reflecting that growth and savings may not be fully delivered. Subject to ceasing spend on transformation post March 2015, there could still be sufficient headroom to trade. It is therefore expected that the Post Office Limited directors will consider it appropriate to continue to prepare the financial statements on a Going Concern basis.

7. Audit

7.1 The audit work on the Interim Report and Condensed Financial Statements is largely complete. No significant issues have arisen to date.

8. Recommendation

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

- Review the Interim Report and Condensed Financial Statements and provide final individual comments to Chris Day and Mark R Davies by noon on Monday 17 November;
- Recommend to the Post Office Board
    - i. That the approach to Going Concern is approved and the Going Concern status for Post Office Limited at the half year is agreed;
    - ii. That the Interim Report and Condensed Financial Statements should be approved;
    - iii. That, if final amendments are required, authority is delegated for reviewing these amendments and completing the Interim Report and Condensed Financial Statements on behalf of Post Office Limited to a Sub-Committee, the quorum for which to be comprised of any three of Alice Perkins, Paula Vennells, Chris Day and Alasdair Marnoch.
- Note that the Chairman of the Audit Risk and Compliance Sub-Committee will be asked to provide a verbal update of this meeting to the Board.

Chris Day
November 2014

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Post Office Limited

Registered Number 2154540

Post Office Limited

Unaudited interim condensed consolidated financial statements

28 September 2014

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Post Office Limited

Our story in summary

Challenge, Commitment and Change

The first six months of the financial year showed the Post Office making further progress, in line with its strategic plan, towards the goal of commercial sustainability. It did so in market conditions which require it to move at even greater pace to improve customer experience across its network.

The business is making this progress while also further reducing its reliance on the Network Subsidy Payment from Government, easing pressure on the public purse. This manifested itself in the first six months of the year with the planned £20m reduction in the payment compared with the same period in the previous year.

At the same time, the business' programme to transform the branch network progressed faster than ever before. By the end of September 2014, 3,134 branches had been modernised. Of these, 1,076 were opened in the six month period from April to September 2014, compared to 588 in the same six month period in 2013 (an 80% increase in the pace of change).

Similar progress was seen within the Crown branch network, the larger branches directly operated by Post Office Limited. Through a combination of investment, automation, training, cost reduction and franchising, the Crown network, which as recently as 2012/-3 was losing £37m per year, continues on a path to break even in 2015. By the end of September, 248 large branches, the majority of the Crown network, had received significant investment to modernise their environment.

As a result of this progress, by the end of September there were more than 85,000 additional opening hours in post offices every week, with almost 2,000 branches now open on a Sunday. The Post Office has also developed the network to open 150 new access points - helping customers with their Home Shopping Returns. This addresses a key part of the market where ease and convenience is central, where competition is strong, and where the Post Office has an opportunity to benefit from overall market growth.

While the Post Office is therefore making progress in delivering its strategy, it is also operating in a tough trading environment. This requires it both to accelerate the pace of change and reduce its costs to become more streamlined and agile.

Overall revenue, excluding the Network Subsidy Payment, was £475m for the six months compared to £483m in the same period last year. This performance has been impacted by market pressures, particularly in a rapidly evolving mails market.

Mails and Retail revenue in the half year was broadly flat with prior year. The Post Office continues to work closely with its long term partners in Royal Mail, to drive revenue growth. This involves innovation as seen in the 'Drop and Go' service now used by over 60,000 small businesses, through continued 'Click and Collect' services, and through simplified products and pricing.

In Financial Services the Post Office performed strongly in the first half of the year - growing Personal Financial Services revenue by 11% year on year. The product suite is being further developed with a current account offer and growing presence in the mortgage market. Cash access and foreign currency businesses are also benefitting from greater convenience and enhanced opening hours - particularly notable at a time when traditional banks are closing branches.

Government Services and Telecoms had a difficult period, with year on year revenue decline of 9.3% and 9.2% respectively – the former impacted by increased use of digital channels as government departments seek to reduce spending and the latter by an adjustment period through the move to a new telecoms partner.

In both cases however, progress is being made. [The recent announcement of renewal of the Post Office Card Account contract by the Department of Work and Pensions and] the introduction of Identity Services point the way forward in Government Services. In Telecoms, the platform developed by the business' new partner, Fujitsu, will enable the Post Office to introduce more swiftly new products, and promotions that will facilitate more responsive trading strategies. This will enable the Post Office to compete effectively in the bundle Telecoms market.

To deliver the goal of commercial sustainability, there is an imperative to drive the highest levels of cost efficiency in all Post Office operations and in central support structures. The next six months will see further developments in re-structuring and cost control on a scale previously unseen in the business.

The Post Office is resolute in its determination to build a strong and stable future. The first half year has both demonstrated genuine progress and underlined the challenges to be faced in ensuring this positive future is not jeopardised.

Alice Perkins	**Paula Vennells**
Chairman	**Chief Executive**

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Business review

Key performance figures – six months ended 28 September 2014

Summary Group Profit and Loss Account

	2014	2013	Variance	Variance
	£m	£m	£m	%
Turnover	475	483	(8)	(1.7)
Network Subsidy payment	80	100	(20)	(20.0)
Revenue	555	583	(28)	(4.8)
People costs	(125)	(131)	6	(4.6)
Other operating costs	(431)	(422)	(9)	2.1
Total costs	(556)	(553)	(3)	0.5
Share of profit from joint ventures and associates	24	23	1	4.3
Operating profit before exceptional items	23	53	(30)	(56.6)
Operating exceptional items	(3)	132		
Profit on disposal of property, plant and equipment	-	2		
Profit before financing and taxation	20	187		

Revenue by Segment

	2014	2013	Variance	Variance
	£m	£m	£m	%
Mails and Retail	183	184	(1)	(0.5)
Financial Services	147	139	8	5.8
Government Services	68	75	(7)	(9.3)
Telecoms	59	65	(6)	(9.2)
Other income	18	20	(2)	(10.0)
Turnover	475	483	(8)	(1.7)
Network Subsidy payment	80	100	(20)	(20.0)
Revenue	555	583	(28)	(4.8)

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KEY FINANCIAL PERFORMANCE INDICATORS

Turnover £m 475 2013: 483	Operating profit before exceptional items £m 23 2013: 53
Operating loss before depreciation, amortisation, exceptional items and Network Subsidy Payment £m (57) 2013: (47)	Net cash flow £m 93 inflow 2013: 142 outflow

Revenue

The Post Office's revenue has declined by £28 million, including a £20 million reduction in the Network Subsidy Payment. Turnover decreased from £483 million in the first 6 months of the prior year, to £475 million this year with growth in the Financial Services business more than offset by decline in the Government Services and Telecoms businesses. The Mails and Retail business remained almost flat with £1m (0.5%) decline. The Network Subsidy Payment decreased by £20 million from the previous year to £80 million in line with the Government Funding Agreement. This will reduce further in 2015-16 as set out in the current funding agreement with the government.

Mails and Retail

The Mails and Retail pillar includes all services provided for Royal Mail and Parcelforce as well as Lottery and retail services. Mails and Retail revenue of £183 million decreased by £1 million (2013: £184 million). This reduction in turnover was in relation to Royal Mail products and was driven primarily by continued lower parcel volumes through the Post Office. The overall express mails market has declined by 5% and this has had a detrimental impact on income from all of our priority services, Special Delivery and Parcelforce 24/48. Retail turnover and revenue derived from the sales of lottery tickets remained flat.

Financial Services

The Financial Services pillar includes Post Office branded personal financial services products, ATMs and travel services as well as traditional services such as bill payment and over-the-counter banking transactions. It offers products that are simple, fair, accessible and transparent, and value for money.

Financial Services revenue in the first half of the year increased by £8 million to £147 million (2013: £139 million). Personal Financial Services revenue rose by 11%, driven by growth in insurance, savings, international money transfer and mortgage products. Revenue from traditional financial services products, including bill payment services, National Savings and Investments (NS&I) premium bonds and Postal Orders, is generally continuing to decline but grew in the 6 month period by £1m largely due to increased premium bond sales following the increase in the maximum limit for holdings that took effect in June 2014.

Government Services

The Government Services pillar covers service provided under contract to Government departments. Government Services revenue of £68 million declined by £7 million (2013: £75 million) mainly due to a reduction in the number of active Post Office Card Account (POCA) accounts. Revenue from Motoring Services (car tax) continues to decline as more customers tax their vehicles via phone or online and it is a similar story for Passports where the launch of an improved online journey has led to a decline in Post Office revenue.

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Telecoms

The Telecoms pillar includes the Post Office HomePhone and Boradband services as well as e-top up services and phonecards. Telecoms revenue of £59 million decreased by £6 million (2013: £65 million). Revenue from HomePhone and Broadband decreased driven by a reduction in customer numbers and in the average revenue per user (ARPU). The reduction in the customer base is largely due to increased competition from bundle providers (phone/broadband/TV/mobile). The reduced ARPU is primarily due to changing customer behaviours as land lines are used less and remaining usage is migrating to 'anytime' packages which generate less revenue. Revenue from our Mobile top-up business was lower than the previous half year, as more customers continue to migrate away from pre-pay services onto contracts. The Post Office is still a significant provider in the top-up market, and its share of the declining retail market has been maintained at around 5%.

Operating costs

People costs of £125 million have decreased compared to the first 6 months of the prior year by £6 million. This was mainly due to savings in the Crown network as well as wider efficiencies and the outsourcing of some IT functions.

Other operating costs have increased by £9 million to £431 million mainly due to higher IT costs during the implementation of the transformation and for the newly outsourced elements of IT.

Joint venture

The share of profit from the joint venture, First Rate Exchange Services Holdings Limited, increased by £1 million to £24 million.

Exceptional items

Operating exceptional items include the costs of delivery of major change and the impairment of non-current assets. These are offset by Government grant funding, received towards the transformation programme and recognised to match the associated costs. In the half year Network Transformation resulted in costs of £74 million (2013: £56 million) and Crown Transformation costs were £10m (2013: less than £1 million). Costs of £6 million (2013: £5 million) relate to the IT transformation programme which will create the appropriate IT infrastructure for the future. There have also been severance costs of £10 million (2013: £2 million) and other restructuring costs of £7 million (2013: £1 million). Asset impairments of £66 million (2013: £35 million) are included within operational exceptional items. Exceptional items in the comparative half year included a gain of £102 million which arose on the change to the terms of the Royal Mail Pension Plan.

The Government grant funding for 2014-15 of £170 million (2013: £215 million) was received on 1 April 2014 and has been fully recognised in the half year to offset the costs as appropriate (2013: £129 million offset). Expenditure will continue on the delivery of major change in the second half of the year.

Profit

The Post Office tracks a Key Financial Performance Indicator of operating loss before depreciation, amortisation, exceptional items and Network Subsidy Payment which has increased by £10 million to a loss of £57 million (2013: £47 million). This increase in the loss is driven by a combination of the decline in turnover, primarily in Government Services and Telecoms, and a net increase in costs.

The operating profit before exceptional items has decreased by £30 million to £23 million (2013: £53 million) driven mainly by the reduction in the Network Subsidy Payment of £20 million and the increased loss above.

Profit before financing and taxation has decreased from £187 million to £20 million driven by the £30 million reduction in operating profit before exceptional items and the change year on year in exceptional items. This was mainly due to the gain of £102 million which arose on the change to the terms of the Royal Mail Pension Plan in the comparative half year.

Net cash flow

There has been a net cash inflow of £93 million during the period in contrast to the comparative half year which saw a net cash outflow of £142 million. The change in cash flow is driven by the repayment of the loan in the prior year. The cash position of the business remains strong, with cash and cash equivalents of £781 million (2013: £829 million).

Post Office Limited

Interim condensed consolidated income statement

	Notes	Half year to 28 September 2014 Unaudited £m	Half year to 29 September 2013 Unaudited £m
Continuing operations			
Turnover		**475**	483
Network Subsidy Payment		**80**	100
Revenue	3	**555**	583
People costs excluding restructuring costs		**(125)**	(131)
Other operating costs		**(431)**	(422)
Share of post tax profit from joint ventures and associates		**24**	23
Operating profit before exceptional items		**23**	53
Operating exceptional items	4	**(3)**	132
- government grant		**170**	129
- Royal Mail Pension Plan amendment		**-**	102
- restructuring costs		**(107)**	(64)
- other		**(66)**	(35)
Operating profit		**20**	185
Profit on disposal of property, plant and equipment		**-**	2
Profit before financing and taxation		**20**	187
Finance costs		**(1)**	(1)
Net pensions interest		**4**	2
Profit before taxation		**23**	188
Taxation credit	5	**5**	2
Profit for the period from continuing operations		**28**	190

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Interim condensed consolidated statement of comprehensive income

	Notes	**Half year to 28 September 2014** **Unaudited** **£m**	Half year to 29 September 2013 Unaudited £m
Profit for the period from continuing operations		**28**	190
Other comprehensive income:			
Remeasurements on defined benefit surplus	6	**13**	(54)
Income tax effect	5	**(4)**	(2)
Total comprehensive income for the period		**37**	134

There are no other comprehensive income items that will be reclassified to the profit and loss in subsequent periods.

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Interim condensed consolidated statement of cash flows

	Notes	Half year to 28 September 2014 Unaudited £m	Half year to 29 September 2013 Unaudited £m
Cash flows from operating activities			
Operating profit before exceptional items		**23**	53
Adjustment for:			
Depreciation and amortisation		**-**	-
Share of profit from joint ventures and associates		**(24)**	(23)
Pension operating costs		**15**	13
Working capital movements:		**55**	(6)
(Increase)/decrease in trade and other receivables		**(1)**	73
Increase/(decrease) in trade and other payables		**56**	(81)
Decrease/(increase) in inventories		**-**	1
Increase in non-exceptional provisions		**-**	1
Pension operating costs paid		**(11)**	(13)
Cash receipts in respect of operating exceptional items:		**70**	153
Government grant		**170**	215
Restructuring costs		**(105)**	(59)
Other		**5**	(3)
Net cash inflow from operating activities		**128**	177
Income tax recovered		**10**	10
Cash flows from investing activities			
Proceeds from sale of property, plant and equipment		**-**	2
Purchase of non-current assets		**(81)**	(38)
Net cash (outflow) from investing activities		**(81)**	(36)
Net cash inflow before financing activities		**57**	151
Cash flows from financing activities			
Payments to finance lease creditors		**(2)**	(2)
Proceeds from/(repayment of) bank borrowings		**38**	(291)
Net cash inflow/(outflow) from financing activities		**36**	(293)
Net increase/(decrease) in cash and cash equivalents		**93**	(142)
Cash and cash equivalents at the beginning of the period		**688**	971
Cash and cash equivalents at the end of the period	7	**781**	829

Post Office Limited

Interim condensed consolidated balance sheet as at:

	Notes	**28 September 2014 Unaudited £m**	30 March 2014 Audited £m
Non-current assets			
Intangible assets		**-**	-
Property, plant and equipment		**10**	10
Investments in joint ventures and associates		**85**	61
Retirement benefit surplus	6	**163**	148
Trade and other receivables		**12**	15
Total non-current assets		**270**	234
Current assets			
Inventories		**6**	6
Trade and other receivables		**296**	302
Cash and cash equivalents		**789**	738
Total current assets		**1,091**	1,046
Total assets		**1,361**	1,280
Current liabilities			
Trade and other payables		**(762)**	(767)
Financial liabilities - interest bearing loans and borrowings		**(38)**	-
- obligations under finance leases		**(1)**	(3)
Provisions		**(80)**	(70)
Total current liabilities		**(881)**	(840)
Non-current liabilities			
Other payables		**(33)**	(28)
Provisions		**(6)**	(8)
Total non- current liabilities		**(39)**	(36)
Net assets		**441**	404
Equity			
Share capital		**-**	-
Share premium		**465**	465
Retained earnings		**(26)**	(63)
Other Reserves		**2**	2
Total equity		**441**	404

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Post Office Limited

Interim condensed consolidated statement of changes in equity

For the half year ended 28 September 2014

	Notes	Share premium £m	Retained earnings £m	Other reserves £m	Total equity £m
At 31 March 2014 (unaudited)		**465**	**(63)**	**2**	**404**
Profit for the period		-	28	-	28
Remeasurements on defined benefit surplus	6	-	13	-	13
Income tax effect	5	-	(4)	-	(4)
At 28 September 2014 (unaudited)		**465**	**(26)**	**2**	**441**

For the half year ended 29 September 2013

	Notes	Share premium £m	Retained earnings £m	Other reserves £m	Total equity £m
At 1 April 2013 (unaudited)		465	(179)	2	288
Profit for the period		-	190	-	190
Remeasurements on defined benefit surplus		-	(54)	-	(54)
Income tax effect	5	-	(2)	-	(2)
At 23 September 2013 (unaudited)		465	(45)	2	422

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Notes to the interim condensed consolidated financial statements

1. Accounting policies

The interim condensed consolidated financial statements of Post Office Limited and its subsidiaries (collectively, the Group) for the half year ended 28 September 2014 were authorised for issue in accordance with a resolution of the directors on XX November 2014.

The information for the year ended 30 March 2014 does not constitute statutory accounts as defined in section 434 of the Companies Act 2006. A copy of the statutory accounts for that year has been delivered to the Registrar of Companies, including the auditors' report on those accounts. Their report was unqualified, did not draw attention to any matters by way of emphasis and did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

Basis of preparation

These interim condensed consolidated financial statements for the half year ended 28 September 2014 have been prepared in accordance with IAS 34, 'Interim Financial Reporting' as adopted by the European Union. This report should be read in conjunction with the Group's Annual Report and Accounts 2014, which have been prepared in accordance with IFRSs as adopted by the European Union.

Fundamental accounting concept – going concern

After careful consideration of the plans for the coming years, the Directors continue to believe that Post Office Limited will be able to meet its liabilities as they fall due for the foreseeable future. Accordingly, on that basis, the Directors consider that it is appropriate that these interim condensed consolidated financial statements have been prepared on a going concern basis.

The Group has net assets at 28 September 2014 and is reporting a profit before and after exceptional items. A funding agreement with Government was announced on 27 October 2010 which provided for:

- Funding of £410 million for 2012-13
- Funding of £415 million for 2013-14
- Funding of £330 million for 2014-15
- Extension of the existing working capital facility with the Department for Business, Innovation & Skills (BIS) of £1.15 billion 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. £410 million was received on 2 April 2012 and £415 million was received on 2 April 2013.

An additional funding agreement with Government was announced on 27 November 2013 which provided for:

- Funding of £280 million for 2015-16
- Funding of £220 million for 2016-17
- Funding of £140 million for 2017-18
- Extension of the existing working capital facility with the Department for Business, Innovation & Skills (BIS) amended with a limit of £950 million from 31 March 2015 up to 31 March 2018

State Aid approval for the funding for 2015-16 to 2017-18 has not yet been received.

This investment will take the form of a Government Grant and enable the Group to modernise the branch network and the continuation of the Network Subsidy Payment recognises the major social value that Post Offices provide to communities. New main and local branches are currently being rolled out across the United Kingdom. Customers are beginning to benefit from a much better retail experience including extended opening hours. This programme is designed to make the Post Office network more self-sustaining and, over time, less dependent on direct subsidy. This will not involve a branch closure programme.

The Directors are satisfied with the continued progress made towards modernisation during the half year ended 28 September 2014 and that the plans in place and the substantial investment secured will enable the Group to continue to modernise and to secure its future. However, they note that the scale of change required remains significant so not without risk.

New standards, interpretations and amendments adopted by the Group

The interim condensed consolidated financial statements have been prepared in accordance with the accounting policies set out in the Group's Annual Report and Accounts 2014. The Group has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

2. Risks and uncertainties

The principal and other significant risks and uncertainties affecting the Group were identified as part of the Strategic Report, set out on page 45 of the Group's Annual Report and Financial Statements 2013-14. These risks remain relevant for the remaining six months of the current financial year.

Post Office Limited

3. Segmental reporting

The Group's operating segments have been identified as Mails & Retail, Financial Services, Government Services, Telecoms and Other. The performance of these segments in the half year ended 28 September 2014 has been discussed further in the Business Review on page XX. Performance is assessed based on net revenue. This is calculated using segmental revenue less the directly attributable costs of delivering the service or product. Assets and liabilities as recognised on the Group balance sheet are not considered to be segmental assets or liabilities but rather are managed by the Group's central functions.

Half year to 28 September 2014	**Revenue £m**	**Directly Attributable Costs £m**	**Net Revenue £m**
Mails & Retail	**183**	**(2)**	**181**
Financial Services	**147**	**-**	**147**
Government Services	**68**	**(15)**	**53**
Telecoms	**59**	**(37)**	**22**
Other income	**18**	**-**	**18**
Sub total	**475**	**(54)**	**421**
Network Subsidy Payment	**80**	**-**	**80**
Total	**555**	**(54)**	**501**

Half year to 29 September 2013	Revenue £m	Directly Attributable Costs £m	Net Revenue £m
Mails & Retail	184	(2)	182
Financial Services	139	-	139
Government Services	75	(15)	60
Telecoms	65	(40)	25
Other income	20	-	20
Sub- total	483	(57)	426
Network Subsidy Payment	100	-	100
Total	583	(57)	526

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Post Office Limited

3. Segmental reporting continued
A reconciliation between segment net revenue and profit before taxation is provided below:

	Half year to 28 September 2014	Half year to 29 September 2013
	£m	£m
Underlying segment net revenue	**501**	526
Indirect costs	**(502)**	(496)
Share of post tax profit from joint ventures and associates	**24**	23
Operating profit before exceptional items	**23**	53
Operating exceptional items	**(3)**	132
Operating profit	**20**	185
Profit on disposal of property, plant and equipment	**-**	2
Profit before financing and taxation	**20**	187
Finance costs	**(1)**	(1)
Finance income	**-**	-
Net pensions interest	**4**	2
Profit before taxation	**23**	188

Seasonality of operations
Due to the seasonality of the Mails & Retail segment higher revenues are usually expected in the second half of the year. This is mainly attributed to the effect of the Christmas period. This information is provided to allow for a better understanding of the results, however management has concluded that this does not constitute 'highly seasonal' as considered by IAS 34.

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Post Office Limited

4. Operating exceptional items

These are items of income and expenditure arising from the operations of the business which, due to the nature of the events giving rise to them, require separate presentation on the face of the income statement to allow a better understanding of financial performance.

	Half year to 28 September 2014	Half year to 29 September 2013
	£m	£m
Government grant	**170**	129
Royal Mail Pension Plan amendment	**-**	102
Business transformation	**(1)**	-
Network transformation including subpostmasters compensation	**(74)**	(56)
Crown transformation	**(10)**	-
Restructuring – severance	**(10)**	(2)
- other	**(12)**	(6)
Impairment of intangible assets	**(25)**	(18)
Impairment of property, plant and equipment	**(41)**	(17)
Total operating exceptional items	**(3)**	132

Due to ongoing operational losses (excluding Network Subsidy Payment) the carrying value of intangible assets and all property plant and equipment other than freehold and long leasehold property has been impaired to nil.

5. Taxation

The overall taxation credit in the income statement is calculated by applying the tax rate that would be applicable to the expected total annual earnings to the reported interim profit.

The major components of income tax in the interim condensed income statement are:

	Half year to 28 September 2014	Half year to 29 September 2013
	£m	£m
Corporation tax credit for period	**-**	-
Tax over provided in previous periods	**1**	-
Current tax	**1**	-
Deferred tax credit relating to the origination and reversal of temporary differences	**4**	2
Income tax credit reported in the condensed consolidated income statement	**5**	2

Post Office Limited

6. Pensions

The Group participates in pension schemes as detailed below:

Name	Eligibility	
Royal Mail Pension Plan (RMPP)	UK employees	Defined benefit
Royal Mail Senior Executive Pension Plan (RMSEPP)	UK senior executives	Defined benefit
Royal Mail Defined Contribution Plan (RMDCP)	UK employees	Defined contribution

The charge in the interim condensed consolidated income statement for the defined contribution scheme and the Group contributions to this scheme was £1m in the half year to 28 September 2014. In relation to the defined benefit schemes payments of £10m were made in respect of future service contributions, nearly all relating to RMPP. The regular future service contributions for RMPP, expressed as a percentage of pensionable pay, has remained at 17.1%.

The following disclosures reflect the Post Office Limited sectionalised RMPP scheme which is independently operated by the Group. Disclosures in relation to Post Office Limited's approximately 7% share of RMSEPP (which is operated by Royal Mail Group Limited) have been excluded as they are not considered to be significant to the interim condensed consolidated financial statements.

a) Major long-term assumptions

	At 28 September 2014 % pa	At 30 March 2014 % pa
Rate of increase in salaries	**3.0**	3.2
Discount rate	**4.1**	4.5
Inflation assumption (RPI)	**3.1**	3.3
Inflation assumption (CPI)	**2.1**	2.3

Demographic assumptions, for example mortality, remain unchanged from those made in March 2014.

b) Plan's assets and liabilities

The plan assets and liabilities were:

	Market value	
Sectionalised RMPP	**At 28 September 2014 £m**	At 30 March 2014 £m
Fair value of assets	**297**	260
Present value of liabilities	**(116)**	(90)
Surplus in plan before IFRIC 14 adjustment	**181**	170
Less IFRIC 14 adjustment	**(20)**	(23)
Surplus in RMPP plan after IFRIC 14 adjustment	**161**	147
Surplus in plan for the Post Office Limited share (at approximately 7%) of RMSEPP after IFRIC 14 adjustment	**2**	1
Total retirement benefit surplus	**163**	148

Post Office Limited

6. Pensions continued

c) Movement in plan's assets and liabilities

Changes in the present value of the defined benefit pension surplus are analysed as follows:

Sectionalised RMPP	**Half year ended 28 September 2014 £m**	Year ended 30 March 2014 £m
Opening net retirement benefit surplus	**170**	99
Royal Mail Pension Plan amendment	**-**	102
Current service cost	**(14)**	(25)
Curtailment costs	**(1)**	(1)
Net financing credit	**4**	5
Employers contributions	**11**	22
Actuarial gains/(losses)	**11**	(32)
Closing net retirement benefit surplus before IFRIC 14 adjustment	**181**	170

7. Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise the following:

	At 28 September 2014 £m	At 29 September 2013 £m
Cash equivalents	**789**	855
Bank overdrafts	**(8)**	(26)
	781	829

Post Office Limited

8. Related party disclosures

There have been no material changes to the related parties listed in the Group's Annual Report and Accounts 2014. All related party transactions were in the ordinary course of business. The transactions entered into and the balances outstanding as at 28 September 2014 were as follows:

	Sales/recharges to related party		**Purchases/ recharges from related party**		**Amounts owed from related party including outstanding loans**		**Amounts owed to related party including outstanding loans**	
	2014	2013	**2014**	2013	**2014**	2013	**2014**	2013
Half year to September:	**£m**	£m	**£m**	£m	**£m**	£m	**£m**	£m
Royal Mail Plc	**165**	169	**21**	18	**26**	-	**31**	11
Romec Limited	**-**	-	**3**	6	**-**	-	**6**	4
First Rate Exchange Services Holdings Limited	**15**	16	**81**	80	**7**	8	**5**	5

The sales to, and purchases from, related parties are made at normal market prices. Balances outstanding at the year end are unsecured, interest free, and settlement is made by cash.

The Group trades with numerous government bodies at an arm's length basis. Transactions with these entities are not disclosed owing to the significant volume of transactions that are conducted. Separately, the Group has certain loan facilities with government, and receives a government grant and the Network Subsidy Payment from government. There were no material transactions or balances between the Group and its key management personnel during the half year ended 28 September 2014.

Statement of Directors' responsibilities

The directors confirm that these condensed set of interim financial statements have been prepared in accordance with IAS 34 'Interim Financial Reporting', as adopted by the European Union.

By order of the Board

P A Vennells
Chief Executive

C M Day
Chief Financial Officer

XX November 2014

POL00026973

Post Office Limited

Report on review of interim condensed financial statements

The Board of Directors to Post Office Limited

Introduction

We have been engaged by the company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 28 September 2014, which comprises the interim condensed consolidated balance sheet of Post Office Limited and its subsidiaries (the Group) and the related interim condensed consolidated statements of income, comprehensive income, changes in equity and cashflow statement for the six month period then ended and the explanatory notes. We have read the other information contained in the half yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the company in accordance with guidance contained in International Standard on Review Engagements 2410 (UK and Ireland) "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company, for our work, for this report, or for the conclusions we have formed.

Directors' Responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the accounting policies set out in note 1.

As disclosed in note 1, the annual financial statements of the Group are prepared in accordance with IFRS as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting" as adopted by the European Union.

Our Responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 28 September 2014 is not prepared, in all material respects, in accordance with the accounting policies set out in note 1, which comply with International Accounting Standard 34 as adopted by the European Union.

Ernst & Young LLP
London
[Date]

POL00026973

Annex B

Post Office Limited

Audit, Risk and Compliance Board Sub-Committee

Briefing Book

Half Year ended 28 September 2014

POL00026973

1. Glossary

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

Abbreviation	Meaning
ATM	Automated teller machine
BACS	Bankers' Automated Clearing Services
BIS	Department for Business Innovation & Skills
BOI	Bank of Ireland
CPI	Consumer Price Index
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
FOoG	Front Office of Government
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
GRNI	Good Received Not Invoiced
Horizon	Horizon Next Generation- Counter system
NBV	Net Book Value
NS&I	National Savings & Investments
NSP	Network Subsidy Payment
POCA	Post Office Card Account
PFS	Personal Finance Services
POFS	Post Office Financial Services
RMPP	Royal Mail Pension Plan
RMSEPP	Royal Mail Senior Executive Pension Plan
RMDCP	Royal Mail Defined Contribution Plan
RBS	Royal Bank of Scotland
RPI	Retail Price Index
SGEI	Services of General Economic Interest

POL00026973

2. Introduction

This Briefing Book has been prepared to explain the Post Office Limited results for the half year ended 28 September 2014. It is a summary of the key data, trends and analyses to be read in conjunction with the Interim Report which readers may find useful to further their own understanding of the results for half year 2014-15.

Most of the analysis is based on the comparison of this 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

Post Office Limited has reported its results under International Financial Reporting Standards (IFRS).

POL00026973

4. Primary Statements

4.1 Interim Condensed Consolidated Income Statement

	Half year to 28 September 2014	Half year to 29 September 2013
	Unaudited	Unaudited
	£m	£m
Continuing operations		
Turnover	**475**	483
Network Subsidy Payment	**80**	100
Revenue	**555**	583
People costs excluding restructuring costs	**(125)**	(131)
Other operating costs	**(431)**	(422)
Share of post tax profit from joint ventures and associates	**24**	23
Operating profit before exceptional items	**23**	53
Operating exceptional items	**(3)**	132
- government grant	**170**	129
- Royal Mail Pension Plan amendment	**-**	102
- restructuring costs	**(107)**	(64)
- other	**(66)**	(35)
Operating profit	**20**	185
Profit on disposal of property, plant and equipment	**-**	2
Profit before financing and taxation	**20**	187
Finance costs	**(1)**	(1)
Net pensions interest	**4**	2
Profit before taxation	**23**	188
Taxation credit	**5**	2
Profit for the period from continuing operations	**28**	190

4.2 Interim Condensed consolidated statement of cash flows

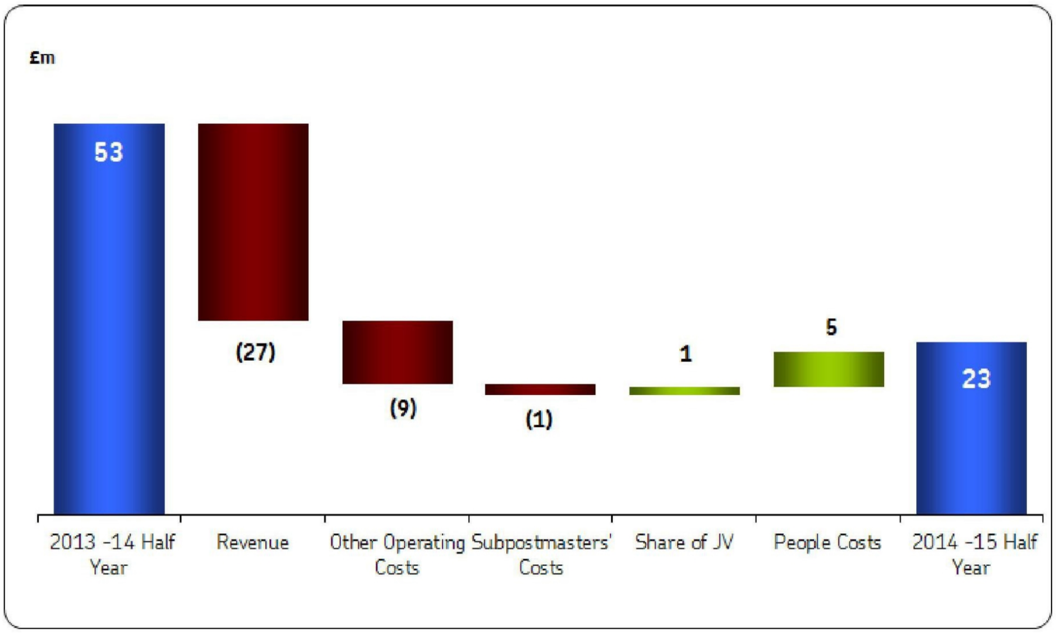
	Half year to 28 September 2014	Half year to 29 September 2013
	Unaudited	Unaudited
	£m	£m
Cash flows from operating activities		
Operating profit before exceptional items	**23**	53
Adjustment for:		
Depreciation and amortisation	**-**	-
Share of profit from joint ventures and associates	**(24)**	(23)
Pension operating costs	**15**	13
Working capital movements:	**55**	(6)
(Increase)/decrease in trade and other receivables	**(1)**	73
Increase/(decrease) in trade and other payables	**56**	(81)
Decrease/(increase) in inventories	**-**	1
Increase in non-exceptional provisions	**-**	1
Pension operating costs paid	**(11)**	(13)
Cash receipts in respect of operating exceptional items:	**70**	153
Government grant	**170**	215
Restructuring costs	**(105)**	(59)
Other	**5**	(3)
Net cash inflow from operating activities	**128**	177
Income tax recovered	**10**	10
Cash flows from investing activities		
Proceeds from sale of property, plant and equipment	**-**	2
Purchase of non-current assets	**(81)**	(38)
Net cash (outflow) from investing activities	**(81)**	(36)
Net cash inflow before financing activities	**57**	151
Cash flows from financing activities		
Payments to finance lease creditors	**(2)**	(2)
Proceeds from/(repayment of) bank borrowings	**38**	(291)
Net cash inflow/(outflow) from financing activities	**36**	(293)
Net increase/(decrease) in cash and cash equivalents	**93**	(142)
Cash and cash equivalents at the beginning of the period	**688**	971
Cash and cash equivalents at the end of the period	**781**	829

4.3 Interim condensed consolidated balance sheet

	28 September 2014 Unaudited £m	30 March 2014 Audited £m
Non-current assets		
Intangible assets	**-**	-
Property, plant and equipment	**10**	10
Investments in joint ventures and associates	**85**	61
Retirement benefit surplus	**163**	148
Trade and other receivables	**12**	15
Total non-current assets	**270**	234
Current assets		
Inventories	**6**	6
Trade and other receivables	**296**	302
Cash and cash equivalents	**789**	738
Total current assets	**1,091**	1,046
Total assets	**1,361**	1,280
Current liabilities		
Trade and other payables	**(762)**	(767)
Financial liabilities - interest bearing loans and borrowings	**(38)**	-
- obligations under finance leases	**(1)**	(3)
Provisions	**(80)**	(70)
Total current liabilities	**(881)**	(840)
Non-current liabilities		
Other payables	**(33)**	(28)
Provisions	**(6)**	(8)
Total non- current liabilities	**(39)**	(36)
Net assets	**441**	404
Equity		
Share capital	**-**	-
Share premium	**465**	465
Retained earnings	**(26)**	(63)
Other Reserves	**2**	2
Total equity	**441**	404

5. Operating Profit

5.1 Operating profit bridge analysis



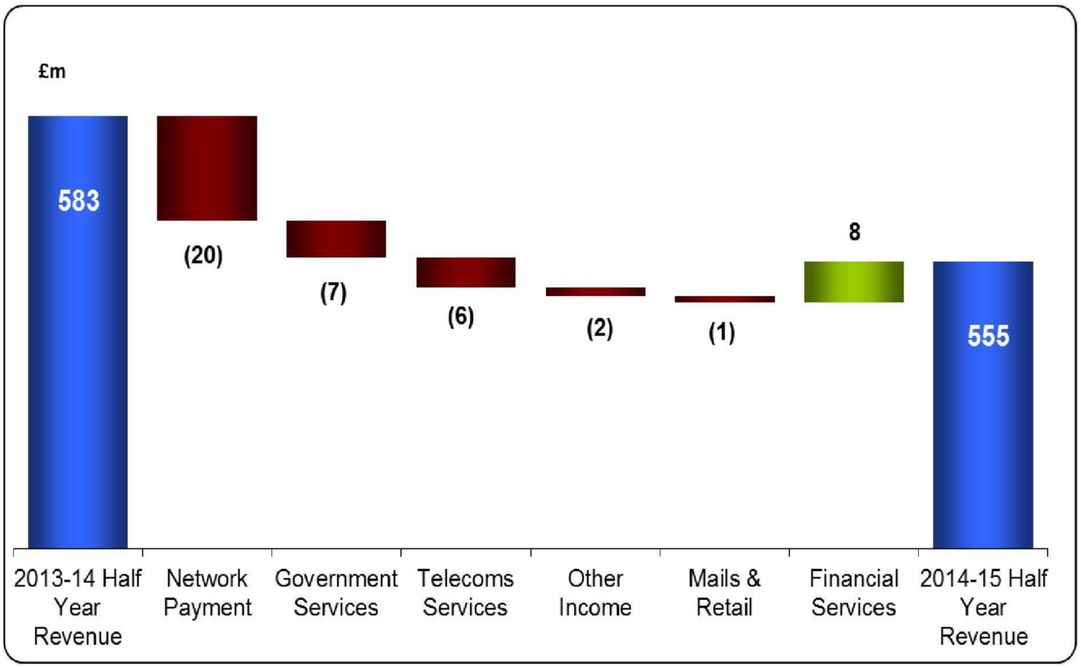
5.2 Explanations for key movements are as follows:

- Revenue - section 6
- People costs – section 7.2
- Subpostmasters – section 7.3.1
- Non People Costs / Other – section 7.3.2 to section 7.3.8

6. Revenue

	28 Sept ember 2014 £m	29 September 2013 £m	Variance £m
Turnover	**475**	483	(8)
Network Subsidy Payment	**80**	100	(20)
Revenue	**555**	**583**	(28)

6.1 Revenue bridge analysis.



The decrease in year on year total revenue of £28m (4.8%) to £555m (2013 £583m) is driven by the £20m decrease in the Network Subsidy Payment and a decrease of £8m in turnover.

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

6.1.1 Mails

The £1.7m (1.1%) decrease in Mails revenue is driven by volume reductions in priority products specifically Parcelforce (£0.6m), Special Delivery (£1.0m), International (£1.2m), lower label income (£2.5m) and a further (£1.0m) net from the remaining Mails products. This is partially offset by increases from Dangerous Goods income by £1.6m, increased 'signed' for income by £1.7m and increased Home Shopping Returns by £0.6m.

- Approximately £3.4m was driven by volume decreases, (mainly PFW, Special Delivery, International, labels and stamps), partially offset by Dangerous Goods, Signed For and Home Shopping Returns volumes.

Offset by

- Approximately £1.8m increase in price related income mainly from Signed For and fixed fee.

6.1.2 Retail & Lottery

Retail and Lottery revenues have increased by £0.5m:

- Lottery is £0.5m higher than last year, all driven by the Health lottery. Camelot income is flat even after the UK Lottery price increase in Oct 2013.
- Retail is flat with prior year.

Mails & Retail Income is analysed in the table below:

	2014 £m	2013 £m	Variance £m	Volume £m	Price £m
PF 24 & 48	4.7	5.3	(0.6)	(0.7)	0.1
PF International	2.0	2.4	(0.3)	(0.4)	-
Royal Mail Special Delivery	24.2	25.2	(1.0)	(1.3)	0.3
RM International	14.6	15.5	(0.9)	(0.6)	(0.3)
Stamps	10.3	11.1	(0.7)	(0.7)	(0.1)
Labels	42.1	44.6	(2.5)	(2.5)	-
Signed For	10.8	9.1	1.7	0.8	0.9
Dangerous Goods	2.7	1.1	1.6	1.7	-
Home Shopping Returns	4.4	3.8	0.6	0.6	0.1
Other PF	3.3	3.2	0.2	0.1	-
Other RM	11.7	12.0	(0.3)	(0.4)	0.1
Total Variable Income	131.0	133.3	(2.3)	(3.4)	1.2
Fixed Fee	28.5	28.0	0.6	-	0.6
Total Mails	**159.6**	**161.3**	**(1.7)**	**(3.4)**	**1.8**
Lottery	19.6	19.1	0.5	0.1	0.4
Retail	4.0	4.0	-	-	-
Total Mails & Retail	**183.1**	**184.3**	**(1.2)**	**(3.4)**	**2.2**

6.1.3 Government Services

The £7.0m (9.3%) decrease in Government Services revenue is principally due to fewer POCA customers and a move towards online services for products traditionally bought at the Post Office. The main variances are:

- £4.9m adverse from falling numbers of live POCA accounts due to natural attrition and migration of customers to bank accounts. Approximately £2m of this decrease is due to the identification of 'death notified accounts' that were billed as active accounts in prior years and are now recognised as dormant.
- £0.9m lower DVLA revenues from lower volumes.
- £0.8m decrease in Check & Send revenues driven by lower volumes.
- £0.4m decrease in Rod & Game Licences.

POL00026973

6.1.4 Telecoms

The Telecoms Services pillar includes the Post Office Homephone and Broadband services, as well as sales of mobile top-ups and phonecards.

Telecoms Services revenue of £59.3m (2013: £64.7m) has decreased by £5.4m. Income from the Post Office Homephone and Broadband product decreased by £4.3m, primarily due to lower customer numbers and reduced average revenues per customer.

Income from mobile top-ups and phone cards was £0.4m below prior year, as transaction volumes declined due to the mobile networks actively migrating customers away from pre-pay, and also reducing their transaction fees. Despite this reduction in income, Post Office is still a significant player in the top-up market. Our share of the retail market has been maintained at circa 5%.

6.1.5 Financial Services

Financial Services income has increased by £7.8m year on year. Overall PFS (defined as Post Office savings, insurance, travel, mortgages and transaction services) is up by £6.6m (11.0%) year on year. Revenue from traditional products has declined with the exception of NS&I as explained below. By product the main Financial Services variances are:

- £2.8m increase from Moneygram due to an improved contract, increasing volumes due to increasing market and as Moneygram has increased its market share,
- £2.3m increase in Insurance revenues driven by the new BOI/ Junction contract and better rates,
- £2.1m increase in NS&I revenues driven by an improved contract and increased volumes following the increase in the maximum holding with effect from June 2014,
- £1.5m increase from mortgages due to sales increases online and as the product awareness increases,
- £1.0m increase in ATM revenue, driven by the rollout of new machines and increased volumes as machines reach maturity,
- £0.8m increase in credit cards due to increased marketing and resultant increased volumes,
- £0.3m increase from Payment Services due to:
  - a £1.4m increase in Postal Order income for the write back to revenue of uncashed postal orders over 12 months old (a change from 24 months previously). (See 15.3.3),
  - a net increase of £0.5m from Gift Cards and Post Office Payout, offset by
  - a £1.7m 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
- £0.3m increase in savings products.

The above increase was marginally offset by:

- £1.0m decrease in travel insurance due to volumes. This is also evident in other travel related areas such as Bureau and passports,
- £1.3m decrease in other FS related income, and
- £0.9m net decrease in Banking revenue from:

POL00026973

- a £1.8m decrease in business banking revenues due to rate reduction from renegotiated contract, offset by
- an increase of £0.9m in personal banking due to increased volumes and new clients.

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 28 September 2014 compared to the half year ending 29 September 2013

		2014	2013	Variance	Variance
		£m	£m	£m	%
Expenditure - (pre- exceptional)	Notes				
Wages & Salaries		**88**	88	1	1%
Pensions		**15**	14	(1)	(4%)
Overtime		**5.5**	5	(0)	(9%)
Bonus & Productivity		**4**	11	7	63%
Employers NI		**10**	10	(0)	(1%)
Temporary Resource		**3**	3	(1)	(22%)
Staff Costs Efficiency Target		**0**	0	0	
PEOPLE COSTS	7.2.1	125	131	5	4%
Subpostmasters' costs	7.3.1	**221**	220	(1)	(1%)
Legal Costs		**0**	1	1	95%
Staff & Agent Related Costs		**5**	5	0	3%
Consultancy & Advisory Services	7.3.2	**0**	(1)	(1)	163%
Brand & Marketing	7.3.3	**16**	7	(9)	(132%)
Property & Facilities Management		**32**	33	1	3%
IT Infrastructure & IT Services	7.3.4	**45**	39	(6)	(16%)
Finance & Losses	7.3.5	**(1)**	12	12	105%
Cost Of Sales	7.3.6	**54**	57	3	5%
Other Operating Costs	7.3.7	**55**	44	(10)	(23%)
Vehicles		**3**	4	1	25%
Non-Staff Costs Efficiency Target		**0**	0	0	
Depreciation		**0**	0	(0)	(14%)
Total Other Operating Costs	7.3	**431**	422	(9)	(2%)
TOTAL EXPENDITURE (Pre Exceptionals)		**556**	553	(3)	(1%)

7.2 People Costs (2014 £125m vs 2013 £131m)

7.2.1 People costs (2014 £125m vs 2013 £131m)

People costs have decreased by £5.6m (4.3%) to £125.3m, representing 22.5% (2013 23.7%) of the cost base.
The number of people employed also decreased, by 645 to 7,354 at 29 September 2014 (2013 7,999), primarily due to redundancies arising from the Crown Transformation Programme.

The people cost movement comprises:

- Wages and Salaries have decreased by £0.7m (0.8%).
- Pension costs have increased by £0.6m (4.2%), reflecting an increase in the RMPP IAS19 service cost rate to 23.0% (2013:20.6%)
- Productivity costs have decreased by £6.7m (62.9%), due to a reduction in the management bonus accrual to 50% in current year reflecting current performance levels compared to 100% bonus booked in prior year and a catch up of an under accrual at the end of 2012-13 in the prior year.
- Overtime has increased by £0.5m (9.0%).
- Temporary resource costs have increased by £0.6m (22.1%),

7.2.2 People Numbers

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

The People numbers were as follows:

	Period end employees		**Average employees**	
	28 September 2014	29 September 2013	**2014**	2013
Total employees	**7,354**	7,999	**7,465**	7,946

7.2.3 Average Cost per Employee

The average number of employees for year ending 29 September 2014 was 7,465 (2013 7,946). The average annual cost per employee (excluding exceptional costs and exceptional heads) based on these averages has decreased by £1,108 (3.2%) to £33,977 (2013 £35,085). This is largely due to the reduced productivity cost.

7.3 Other Operating Costs (2014 £431m vs 2013 £422m)

7.3.1 Subpostmaster costs (2014 £221m vs 2013 £220m). Total subpostmasters costs increased by £1.4m (0.6%) and this increase includes £0.7m for additional payments in relation to the increased dangerous goods enquiries work and mails segregation payments of £0.8m (all paid in the second half of the year in the prior year).

The average annual cost per subpostmaster branch (excluding VAT and NI) is £41,836 (2013 £40,549). This is a 3.0% increase on the prior year. The increase is as a result of the points above and the small impact of franchised Crowns, which generally have higher income and so bring the average up

	2014	2013
Agency Branches (incl. Mains and Locals)	**10,195**	10,269
Outreach	**1,095**	1,076
Crown	**341**	372
Total Branches	**11,631**	11,717

7.3.2 Consultancy & Advisory Services have increased by £1.3m. The table below shows the movement between a £0.8m credit last year and the £0.5m cost this year. The level of consultancy/ contractors has reduced this year and the skills group off-charge has reduced accordingly.

	2014-15	2013-14	Variance
	£m	£m	£m
Skills Group off- Charge	**(4.4)**	(8.6)	(4.2)
Consultancy	**4.9**	7.8	2.9
	0.5	(0.8)	(1.3)

7.3.3 Brand & Marketing have increased by £9.0m (131.7%) year on year. £4.6m relates to increased market research costs, £1.7m increase in POL website and TV. In addition £6.5m relates creative agency fees and a net increase of £1.8m in database management and print advertising and archiving. In the prior year brand costs were within project one- off costs,

7.3.4 IT Infrastructure & IT Services costs have increased by £6.3m (16.2%) mainly due to £3.1m ATOS outsource costs and £1.4m relating to Horizon Fujitsu costs RPI increase. In addition there was a net increase of £1.0m for software licences and BT costs.

7.3.5 Finance costs have decreased by £12.1m, mainly driven by £15.6m VAT rebates, offset by Telephony provisions of £2.6m.

POL00026973

7.3.6 Cost of Sales has decreased by £2.6m (5.5%), driven by new supplier contract. The main reasons are detailed below:

Cost of Sales

	28 September 2014 £m	29 September 2013 £m	Variance £m		Comments
Telecoms	**37**	**40**	3	7%	Reduction of £2.6m due to new supplier contract (Fujitsu) and volume reduction.
Government Services	**15**	**15**	0	3%	
Mails & Retail	**2**	**2**	0	1%	
Financial Services	**0**	**0**	0	5%	
Total	**54**	**57**	3	6%	

7.3.7 Other Operating costs have increased by £10.1m is due to a provision client compensation relating to the historical overcharges relating to 'death notified accounts' (DWP).

7.3.8 Project expenditure is now reported within the appropriate cost categories and has decreased by £1.2m to £11.8m and is detailed below:

2014-15 Project Expenditure	**£m**
Financial Services (Portfolio)	4.3
Telephony (Home Phone & Mobile)	2.6
HR & Compliance	2.1
Customer Engagement (Brand Campaign)	0.6
Government Services	0.9
Mails (Initiatives)	0.7
Digital & Multi Channel	0.3
IT (Supplier Procurement)	0.2
Supply Chain	0.1
Grand Total	**11.8**

POL00026973

8. Quality of Earnings

Post Office Limited (consolidated)	2014-15 £m	2013-14 £m	Growth £m	Growth %
Reported profit before other exceptional items	**23**	**53**	**(30)**	**(57%)**
Network Subsidy Payment	(80)	(100)	**20**	**20%**
Reported profit before exceptional items and NSP	**(57)**	**(47)**	**(10)**	**(21%)**
Provision for client compensation for past overcharges	10	(2)		
VAT recovery in 2013-14 re 2011-12 (received in second half year)	0	0		
VAT recovery in 2014-15 re 2013-14	(11)	5		
Total adjustments	**(1)**	**3**		
Total	**(58)**	**(44)**	**(14)**	**(32%)**

Each item in the table is explained further below:

8.1 Network Subsidy Payment

The Network Subsidy Payment decreased from £200m for 2013-14 to £160m for 2014-15. The Network Subsidy Payment has been accounted for as a government grant in both years.

8.2 Provision for client compensation

An error has been identified that has led to a client being overcharged for approximately 5 years and a provision has been booked for compensation for the overcharges. £2m of the overcharge related to the 6 month period to September 2013.

8.3 VAT recovery re earlier years

There were additional VAT recoveries relating to earlier years when the final recovery rates were confirmed with HMRC.

9. Pensions

9.1 Background

The Post Office participates in pensions schemes and detailed below:

Scheme	Eligibility	Type
Royal Mail Pension Plan (RMPP)	UK employees	Defined benefit
Royal Mail Senior Executive Pension Plan (RMSEPP)	UK senior executives (closed)	Defined benefit
Royal Mail Defined Contribution Plan (RMDCP)	UK employees	Defined contribution

Royal Mail Pensions Trustees Limited manages the main defined benefit scheme Royal Mail Pension Plan (RMPP) which has circa 5,000 Post Office active members.

9.2 Assumptions

IAS 19 revised requires a number of assumptions. The choice of assumptions used for the calculations is the responsibility of the Directors, based upon advice given by an independent actuary. The key assumptions for the half year to 28 September 2014 are set out in the table below.

Towers Watson has confirmed that the assumptions have been determined in a manner consistent with those used for the disclosures at 30 March 2014.

% pa RMPP Post Office Section	September 2014	March 2014
Inflation (RPI)	**3.1**	3.3
Inflation (CPI)	**2.1**	2.3
Discount rate (i.e. bond rate)	**4.1**	4.5
Rate of increase in Pensionable salaries	**3.0**	3.2
Rate of pension increases – RMPP A/B	**2.1**	2.3
Rate of pension increases – RMPP C	**3.0**	2.3
Rate of increases in deferred pensions	**2.1**	2.3

Demographic assumptions, for example mortality, remain aligned with the assumptions used for the actuarial valuation and unchanged from those made in March 2014.

9.3 Movements in the defined benefit surplus

The movement in the RMPP defined benefit surplus during the half year to 28 September 2014 is detailed below. Scheme assets are assessed at fair value at the balance sheet date. For example, quoted equities are valued at the latest 'bid' price. Scheme liabilities are discounted using a high quality corporate bond rate. The IAS 19R surplus/deficit is usually therefore different to the cash funding surplus/deficit (the "actuarial" valuation) assessed by the Trustees, for which the scheme liabilities are discounted using the expected returns available on scheme assets.

	Half year ended 28 September 2014 £m	Year ended 30 March 2014 £m
Opening sectionalised RMPP net retirement benefit surplus	**170**	**99**
Royal Mail Pension Plan amendment	**-**	**102**
Current service cost	**(14)**	**(25)**
Curtailment costs	**(1)**	**(1)**
Net financing credit	**4**	**5**
Employers contributions	**11**	**22**
Actuarial gains/(losses)	**11**	**(32)**
Closing RMPP net retirement benefit surplus	**181**	**170**
RMSEPP surplus	**3**	**2**
Total net retirement benefit surplus	**184**	**172**
Effect of asset ceiling	**(21)**	**(24)**
Closing net retirement benefit surplus	**163**	**148**

The current service cost is intended to represent the amount by which the liabilities will increase due to employing active members for one more year. The current service cost, expressed as a percentage of pensionable pay is 23.0% for RMPP (2013 – 20.6%). Payments of £10m were made in respect of RMPP future service contributions at a rate of 17.1% (2013 - 17.1%) and £1m was paid in respect of redundancies.

The net financing credit of £4m, a non-cash item, is reported under finance income and reassessed annually.

Actuarial gains and losses are recorded directly in the statement of changes in equity (and not the income statement). The actuarial gain of £11m during the year arose primarily due to an increase in the value of assets as a result of changes in market conditions.

A £1m deficit contribution was paid in relation to RMSEPP and the RMSEPP surplus has increased from £2m to £3m at 28 September 2014.
The charge in the income statement and cash contributions for the defined contribution scheme were £1m in the half year to 28 September 2014.

9.4 Assessment of recoverability of surplus under IFRIC 14

In order to recognise a surplus it is necessary to prove that the Post Office could recover the surplus either through lower future contributions or through a refund. [redacted] Towers Watson has calculated that Post Office Limited would be able to recover £125m of the £181m surplus in RMPP through lower contributions and the

POL00026973

remaining £56m could therefore be recovered through a refund. The element of surplus that is recoverable through a refund would be subject to a 35% withholding tax and therefore the overall surplus on the balance sheet, (made up of a £181m surplus for RMPP and £3m surplus for RMSEPP), has been reduced by £21m to £163m. The element that is recoverable through lower contributions has resulted in a deferred tax liability of £25m, which represents an increase of £4m from the deferred tax credit recognised up to the year to 30 March 2014.

10. Exceptional Items and Provisions

This section discusses the exceptional items on the income statement together with movements in the related balance sheet provisions/payables.

10.1 Exceptional items summary

The following exceptional items were recognised in the consolidated income statement for the half years ended 28 September 2014 and 29 September 2013.

10.2

Exceptional items	**2014-15 £m**	2013-14 £m
Operating Exceptionals:		
Royal Mail Pension Plan amendment	**-**	102
Government Grants	**170**	129
Restructuring costs including Subpostmasters compensation	**(107)**	(64)
Impairments	**(66)**	(35)
Total operating exceptionals	**(3)**	132
Non operating exceptionals:		
Profit on disposal of property	**-**	2
Net Exceptional gain/ (loss)	**(3)**	134

Government Grants – In April 2014 the Post Office received grants totalling £170m from the Government, (April 2013 £215m) to fund capital projects and transformation. The larger amounts utilised in the half year to September 2014 are: £43m against Subpostmasters' compensation, £59m against capital spend, £44m Network Transformational exceptionals and £11m IT transformational costs.

10.3 Restructuring costs - include the costs (£107m) of delivery of a major change in the network. Network and Crown Transformation introduces new style agency offices and seeks to improve fundamentally the profitability of the Crown network. The overall figure includes £39m (below) Network Transformation and Crown Transformation programme costs, £45m Subpostmasters' compensation and £8m Crown redundancy costs.
The IT Transformation programme (£6m) will create the IT infrastructure appropriate for an independent group with ambitious growth plans. Other costs included are business separation of £3m, redundancy of £2m, business transformation payments chiefly for Crown staff of £2m and other items of £2m.

Network and Crown Transformation costs to September 2014:

Network Transformation	**£m**
Programme Costs	13
Investments (e.g. enabling works)	7
Property project resource	5
Management Consultancy	0
Other (Legal, Comms, consultation, IT projects)	4
Total Network Transformation	**29**
Crown Transformation	**10**
Total	**39**

11. Interest, Cash, Debt, Funding and Hedging

11.1 Net finance costs September 2014 £m vs September 2013 £1m

Finance costs & investment income	28 September 2014 £m	29 September 2013 £m
Interest received on investments – UK	–	–
Total finance income	**-**	-
Interest charged on Government borrowings	-	-
Interest payable on finance leases	-	-
Other finance costs	(1)	(1)
Total finance costs	**(1)**	(1)
Net finance cost	**(1)**	(1)

Interest payable on the BIS Loan remains low due to low draw down throughout the year, which was also the case in the equivalent six months of 2013/14.

Other finance costs include commitment fees to BIS for the Post Office credit facility, and charges to RBS for their note sorting facility.

11.2 Cash, cash equivalents and debt within the balance sheet

Net cash/debt analysis	Section	28 September 2014 £m	30 March 2014 £m
Cash in the Post Office Limited network	11.3	**743**	708
Other cash at bank (overdraft)		**(8)**	(50)
Cash equivalent investments		**46**	30
Total cash and cash equivalents		**781**	688
Loans, repayable on demand or less than 1 year	11.4	**(38)**	-
Obligations under finance leases (current)	11.5	**(1)**	(3)
Total current financial liabilities		**(39)**	(3)
Obligations under finance leases (non-current)	11.5	**-**	-
Total		**742**	685

11.3 Cash within the Post Office Limited network (September 2014 £743m vs March 2014 £708m)

The increase in Post Office network cash from March 2014 levels is due to Bureau seasonality and growth in debit card usage.

11.4 Loans and borrowings (September 2014 £38m vs March 2014 nil)

Daily borrowings from BIS are increasing as the transformational spending increases in line with the programmes' spend. This will continue over the next 6 months.

POL00026973

11.5 Obligations under finance leases (current & non-current) (September 2014 £1m vs March 2014 £3m)

The obligations under finance leases have decreased by £2m in the half year attributable to lease repayments in 2014-15. Both remaining finance leases end this financial year.

11.6 Loan facilities

At the half year the Post Office had external borrowings of £38m and an £8m overdraft facility.

POL00026973

12. Going concern

Post Office Limited has net cash and cash equivalents of £789m, a bank overdraft of £8m and a borrowing facility of £1,150m of which £38m was drawn down at 28 September 2014.

12.1 Background

On 24 March 2010 a 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 (received 2 April 2012)
- Funding of £415m for 2013-14 (received 2 April 2013)
- Funding of £330m for 2014-15 (received 1 April 2014)
- Extension of the existing working capital facility with BIS 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. It was also recognised that the working capital facility was no longer deemed State Aid. However, no drawing under the Facility may extend past the Final Maturity Date (31 March 2016).

On 27 November 2013, a funding agreement was announced providing:

- Funding of £280m for 2015-16
- Funding of £220m for 2016-17
- Funding of £140m for 2017-18
- Extension of the existing working capital facility with BIS up to 31 March 2018 but at a reduced level of up to £950m.

State Aid approval for the funding for 2015-16 to 2017-18 is currently being sought and is anticipated to be given during the 2014-15 financial year.

The going concern analysis is based on the 2020 strategic plan that was the basis for the Government funding agreed.

POL00026973

12.2 Assessment for the Post Office

The Post Office 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, with the exception of 2012-13 and 2013-14, still operated with a cash outflow and expects further cash outflows in the coming years. The 2011-15 plan reversed the trend of an increasing Network Subsidy Payment (NSP) and the 2020 Strategy continues on the path to a sustainable Post Office supported by a much lower subsidy.

The 2014-15 budget and the 2020 Strategy plan financials have been shown in Table 1, and show that Post Office 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. The funding beyond March 2015 is still subject to State Aid clearance so downsides have been applied to reflect a situation where the funding for NSP and transformation post March 2015 is not available. In addition, downside scenarios have been overlaid reflecting the possibility that the growth and savings plans are not fully delivered. Subject to ceasing spend on transformation post March 2015, there could still be sufficient headroom to trade. The working capital facility was deemed not to be State Aid in 2012 so does not require further clearance and is now available (at the reduced level of £950m) through to March 2018.

The one year funding deal for 2011-12 added 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 shown if required.

12.3 Summary conclusion

Based on the analysis, there is available borrowing headroom until March 2018. Royal Mail Plc is a key trading partner with Post Office Limited and, in arriving at the conclusion that Post Office Limited is a going concern, the assumption is made that Royal Mail Plc is a going concern or that an alternative mails provider would work similarly with Post Office Limited providing a similar level of income. Post Office Ltd and Royal Mail entered into a ten year agreement (Mails Distribution Agreement) in 2012 for the provision of mails products through post offices.

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

Post Office Limited Funding Analysis

Table 1 September 2014 £m (cumulative apart from free cash flow)	2014-15	2015-16	2016-17	2017-18
Opening Funds	(24)	(191)	(505)	(442)
Borrowing facilities	1150	950	950	950
Restriction due to level of network cash	(300)	(100)	(100)	(100)
Latest plan free cashflow before assumed non NSP grant injection	(328)	(455)	(68)	24
Non NSP grant injection per October 2010 plan/ April 2013 plan	170	150	140	70
Closing Funds Headroom	**668**	**354**	**417**	**502**
Downside impact of no NSP beyond March 2015		(130)	(210)	(280)
Downside impact of no further grant injection beyond March 2015		(150)	(290)	(360)
Adjusted Headroom pre risk	**668**	**74**	**(83)**	**(138)**

Table 2: Risks,with management actions £m (cumulative)	2014-15	2015-16	2016-17	2017-18
Headroom pre risk (as above)	668	74	(83)	(138)
Risks				
Financial Services growth slower than plan		(10)	(50)	(80)
Mails revenue decline halted but not reserved (net of agents' cost saving)	(10)	(20)	(30)	(40)
Home Services growth does not materialise	(10)	(30)	(60)	(90)
Government Services growth does not materialise	(5)	(15)	(30)	(45)
Network Transformation benefits are not fully delivered	(6)	(9)	(12)	(12)
Crown Transformation benefits are not fully delivered	(5)	(10)	(15)	(20)
Pension contribution rates increase		(4)	(8)	(12)
Increase in cost as a consequence of stopping transformation post March 2015		(42)	(126)	(180)
Headroom post risks pre management actions	**632**	**(66)**	**(414)**	**(617)**
Management actions	**10**	**410**	**627**	**751**
Stop transformation post March 2015		188	319	373
Reduce capex to replacement only (£30m pa) post March 2015		202	278	338
Sell Corporation tax losses to FRES	10	20	30	40
Headroom post risk and management actions	**642**	**344**	**213**	**134**

Notes:
2014-15 shows the Quarter 2 forecast and later years are the strategic plan.
Available facility is defined as network cash, ATM cash ATM debtor, POCA debtor and SGEI cheques.

Notes:

Table 1

This table shows the 2020 strategic plan projections for 2014-15 and beyond. It demonstrates positive headroom throughout the plan period assuming funding post 2015 is agreed. If it is not there would be a need to take management action as set out in Table 2.

Table 2

This table sets out the impact of theoretical downside scenarios if the plan does not generate the income streams anticipated, the network programmes fail to deliver the benefits and if the pension scheme costs increase.

The action identified to manage the lack of future funding and downside risk within the headroom would be to cease the transformational spend and reduce capex to replacement only at £30m pa. This adds further downside but results in positive headroom to March 2018 even without the funding post March 2015. There are further actions that could be taken but are not required. These include the sale of property.

13. Property, plant and equipment and non-current assets held for sale

13.1 Net Book Values

The net book value (NBV) of land and buildings, plant and fixtures and intangible fixed assets at September 2014 was £10m (March 2014 £10m). Movements during the six months were as follows:

Movement in NBV	Land and buildings £m	Vehicles, plant and fixtures £m	Intangible fixed assets £m	Total £m
NBV at 30 March 2014	10	-	-	10
Reclassification	(17)	17	-	-
Add capital expenditure	5	36	25	66
Less disposals	-	-	-	-
Less depreciation	-	-	-	-
Less impairment	12	(53)	(25)	(66)
NBV at 28 September 2014	**10**	**-**	**-**	**10**

Reclassifications mainly consisted of network and crown transformation project capitalisation which had initially been brought to account as property spend and subsequently classified as fixtures.

13.2 Assets held under finance leases

The value of equipment held under finance leases is £nil (March 2014: £nil) having been impaired in the years in which it was acquired. Two finance leases are held and expire during 2014/15:

- Counter printers, capitalised and impaired in 2006-07 with an asset value of £10m, and
- Identity equipment in branches, capitalised and impaired in 2010-11, with an asset value of £8m.

13.3 Capital expenditure

The following table summarises capital expenditure to 28 September 2014:

Capital expenditure analysis	Land & buildings £m	Vehicles, plant & fixtures £m	Intangibles £m	Total £m
Technology Roadmap	-	-	8	8
Crown, Network Transformation	5	33	-	38
Separation (from RMG) project	-	-	9	9
IT Delivery	-	-	4	4
Finance Roadmap	-	-	2	2
FOoG Front Office of Govt	-	-	1	1
Vehicles	-	2	-	2
Other (items <£1m)	-	1	1	2
Total	**5**	**36**	**25**	**66**

POL00026973

14. Goodwill, investments and intangibles

14.1 Investments in joint ventures and associates

	28 September 2014 £m	30 March 2014 £m
Investment in joint ventures	**85**	61

Joint ventures

Post Office Limited's joint venture investment is a 50% interest in First Rate Exchange Services Holdings Limited, whose principal activity is the provision of Bureau de Change.

The movement during the half year is Post Office Limited's share of 2014-15 post tax profit of £24m.

15. Working capital

15.1 Inventories (September 2014 £6m vs March 2014 £6m)

	28 September 2014 £m	30 March 2014 £m
Scratchcards	**4**	**4**
Retail	**2**	**2**
Total	**6**	6

15.1.1 Inventory written off

The provision for stock write downs and discrepancies remains at £0.5m (March 2014 £0.5m. Shrinkage and obsolete stock written off at half year was £0.2m (March 2014 £0.3m).

15.2 Trade receivables

Receivables are tabulated below, followed by a detailed explanation of the various balances.

Receivables

	Section	**28 September 2014 £m**	30 March 2014 £m
Trade receivables	15.2.1	**52**	54
Client receivables	15.2.2	**161**	158
Prepayments and accrued income	15.2.3	**83**	82
Other receivables			8
Total		**296**	302

15.2.1 Trade receivables: Current (due within one year)

Trade receivables

	28 September 2014 £m	30 March 2014 £m
Sales ledger	**23**	30
Doubtful debt provision	**(4)**	(2)
Homephone debtors	**13**	12
Homephone provision	**(7)**	(6)
Subpostmasters debt	**14**	13
Subpostmasters debtors provision	**(9)**	(8)
Property debtors	**5**	3
Bank of Ireland, FRES cost recovery	**17**	12
Total	**52**	**54**

POL00026973

The decrease in sales ledger is largely explained by the Bank of Ireland opening at £14m and is £3m at P6.

Telecoms debtors are similar to opening. Despite some difficulties in establishing a reliable billing pattern – following POL switching provider from BT to Fujitsu – the debtor position is now stable.

Receivable balances in relation to former subpostmasters of £9m have been provided for in full in line with previous years. The remaining £6m of subpostmaster debt which is unprovided against relates to current subpostmasters debt which are usually settled through a deduction from remuneration.

The Bank of Ireland cost recovery debtor relates to marketing and promotional spend incurred on their behalf and which should be pre-funded. Agreement of both parties to the costs incurred will enable POL to raise invoices and reduce this debtor.

A profile of the trade receivables is as follows:

Trade receivables

	28 September 2014	30 March 2014
	£m	£m
Royal Mail	**1**	3
Bank of Ireland	**3**	11
NS&I	**3**	
FRES		1
Partner banks	**2**	2
DWP	**4**	
Bank of Ireland (ATM commission)		3
Bill payment partners	**2**	3
Subpostmasters	**-**	-
Telecoms under-billing (Fujitsu)	**3**	3
Others	**5**	4
Total	**23**	**30**

Ageing of trade receivables:

Debtors over 60 days overdue: September 2014 £0.7m (March 2014: £0.5m).

The Post Office does not have a general risk in relation to bad debts due to the agency and business partner nature of our client base. This is fully provided for.

POL00026973

15.2.2 Client receivables

Analysis of the significant client balances at year end is as follows:

Client receivables

	28 September 2014 £m	30 March 2014 £m
ATM (Bank of Ireland)	**101**	96
Card Account (JP Morgan)	**29**	30
Partner banks	**26**	22
Others	**5**	10
Total	**161**	**158**

The reason for the increase in Client levels year on year is due to ATM withdrawals due from Bank of Ireland which opened at £96m, but at P6 was £101m, reflecting greater customer use.

15.2.3 Prepayments and accrued income September 2014 £83m (March 2014 £82m)

Accrued income represents the majority of this amount (September 2014: £74m, March 2014: £65m), The main reason for the difference is the Bank of Ireland balance has increased by 8m this is due to commission accrued for that is due to be billed at the end of P7. Otherwise year on year the product components and values are similar.

The "one-year" prepayment of telephony take-on costs with Fujitsu is £6m at September 2014 (March 2014: £6m). The total Fujitsu telephony prepayment at September 2014 was £17.5m (March 2014: £21m), with £11.5m representing the element that will be amortised beyond one year until the contract end date in September 2016.

15.3 Payables: **amounts due within one year**

A summary of payables categories is:

	Section	28 September 2014 £m	30 March 2014 £m
Trade payables	15.3.1	**26**	55
Accruals and deferred income	15.3.1	**182**	133
Client payables	15.3.2	**411**	438
Advance customer payments		**27**	37
Capital payables		**16**	31
Social security		**10**	14
Business transformation		**2**	10
Government grant deferred income (NSP)		**80**	-
Bank Overdraft		**8**	50
Total		**762**	767

15.3.1 Trade payables and accruals

Trade payables and accruals

	28 September 2014	30 March 2014
	£m	£m
Trade payables	**26**	55
Accruals, GRNI	**106**	98
Subpostmaster, employee pay balances	**64**	14
Productivity, bonus schemes	**9**	14
Others	**3**	7
Total	**208**	**188**

Manual accruals and GRNIs represent the material trade liabilities at any point. High levels of project activity commensurate with the Transformational programmes currently underway are driving this liability, being Crown, Network, Separation and Finance Roadmap programmes.

Trade payables chiefly comprises supplier invoices awaiting payment (Accounts payable, AP). At March this totalled £44m and was £19m at September. The balance at March was high and included some one-off Royal Mail invoices, RM was then £12m and was £2m at September. Separately, the take-on of AP functionality into POL during September encountered some initial teething problems with some invoices not processed in time and had to be manually accrued.

Subpostmaster and employee balances include £51m pay due for September. The equivalent pay creditor at March, also £51m, was disclosed as bank overdraft for reason of proximity to year end and calendar month end.

15.3.2 Client payables

	28 September 2014	30 March 2014
	£m	£m
Santander	**132**	135
NS&I	**20**	19
DVLA	**34**	56
Utility companies	**8**	18
Bank of Ireland	**12**	5
BACS	**59**	45
Royal Mail	**24**	36
Others	**122**	124
Total	**411**	**438**

The DVLA balance is sensitive to proximity of accounting month end to calendar month end. March 2014 was one day before month end which drove the balance higher. Royal Mail was subject to a tariff increase from end-March and this increased stamp sales beforehand. NS&I has benefitted from an increase in the premium bond allowance per head in 2014. Otherwise, no material fluctuations during 2014/15.

15.3.3 Client advances

This category also includes specific, non-client, creditors as follows:

Client advances

	28 September 2014 £m	30 March 2014 £m
Client advances, deferred income	**5**	11
Postal order liability	**12**	15
Homephone line rental advance payments	**10**	11
Total	**27**	**37**

Movement in deferred income attributable to six-month's amortisation of DVLA and DWP pre-paid contractual income settlements.
The Postal order liability reflects a creditor for uncashed Postal orders. Postal orders are valid for 6 months but the liability was retained for 24 months reflecting that they would normally be honoured up to this date. At September 2014 the liability was reduced to 12 months. Postal orders presented for encashment after 12 months will normally be declined in future. The liability reduced as a result of this change.

15.4 Payables: **amounts due after one year**

Payables due after one year

	28 September 2014 £m	30 March 2014 £m
Bank of Ireland deferred income (Gamma)	**33**	28
Total	**33**	**28**

Bank of Ireland deferred income concludes in financial year 2022-23 and is recognised in line with an agreed amortisation schedule. The final two receipts are £5m in 2014/15 (received) and £2m in 2015-16.

POL00026973

16. Provisions

Provisions (September 2014 £86m vs March 2014 £78m)

	Crown Conversions Project £m	Network Transformation £m	Other £m	Total £m
At 30 March 2014	2	51	25	**78**
Charged/ (released) in operating exceptional items	(1)	45	12	**56**
Charged in operating costs		–	14	**14**
Utilisation	–	(39)	(23)	**(62)**
At 28 September 2014	1	57	28	**86**
Disclosed as: Current				**80**
Disclosed as: Non current				**6**

The Network Transformation provision relates to compensation payments due to subpostmasters who have signed up to the new contract terms or for a termination payment at September 2014. The programme is further advanced than a year ago hence the liability is increased.

Crown conversions relates to the contract with WH Smith for the original tranche of Crown outlets franchised (2008-9). This provision concludes in 2014-15.

Included within Other provisions is the current tranche of onerous lease provisions in relation to Crown office franchises of £5m, and a severance provision of £4m, Bank of Ireland sales capability investment (Eagle provision) £2m and the ATM business rate provision £2m. Also included is a provision of £11m that has been made in relation to the overcharge that has been made to the DWP under the POCA contract, dating back to 2009. This provision represents the potential repayment that will need to be made at some point in the future.

POL00026973

17. Litigation and Claims- Potential Claims regarding Horizon

17.1 Post Office Limited has received various claims from subpostmasters (SPMs) alleging defects in the Horizon system and Post Office Limited's internal processes.

These allegations were initially made in 5 claims brought through solicitors Shoosmiths. Similar allegations have been made through:

- SPMs' MPs;
- the "Justice for Subpostmasters Alliance" (JFSA);
- defences to court proceedings brought by Post Office Limited to recover debts from SPMs; and
- direct contact with Post Office Limited.

17.2 Following discussions with James Arbuthnot MP and JFSA, in July 2012 independent investigator Second Sight Support Services Ltd (Second Sight) was appointed to carry out a review into these allegations.

17.3 On 8 July 2013, Second Sight published a Report finding shortcomings in Post Office Limited's internal training and support to SPMs on the Horizon system, but no systemic problems with Horizon itself.

17.4 Following Second Sight's July 2013 Report, on 27 August 2013 Post Office Limited launched an Investigation and Mediation Scheme aimed at resolving individual complaints made about Horizon.

17.5 The Scheme has received 150 applications. These are being progressed through the Scheme under the direction of a Working Group chaired by retired Court of Appeal Judge Sir Anthony Hooper, and comprising representatives from POL, Second Sight, and JFSA.

17.6 Currently, 131 cases are still being progressed through the Scheme or are being scheduled for mediation. Mediations have been held for the first 3 applications, with a further 9 mediations currently being scheduled. The POL project team continue to handle the applications in line with the direction received from POL's Board.

17.7 POL has also reviewed its approach to the criminal prosecutions it brings against SPMs which use Horizon data and generally, and is developing a new policy for prosecutions with assistance from former First Senior Treasury Counsel Brian Altman QC.

17.8 To date, no claim has been made against POL in the civil courts, and no appeal has been made to the Court of Appeal against any conviction obtained in the criminal courts, arising out of the matters raised in Second Sight's July 2013 Report or through the Scheme.

POL00026973

18. Taxation

18.1 Income statement

A breakdown of the tax credit for the half years to September is shown in the table below:

	Half year to 28 September 2014 £m	Half year to 29 September 2013 £m
Corporation tax credit for the period	**-**	-
Tax under provided in previous periods	**1**	-
Current tax	**1**	-
Deferred tax credit relating to the origin and reversal of temporary differences	**4**	2
Income tax credit reported in the consolidated income statement	**5**	2

18.2 Factors affecting tax credits

A deferred tax credit of £21m was recognised in the year to March 2014 in relation to the retirement benefit surplus as a proportion of this surplus was considered to be recoverable through future contributions. An equal and opposite entry was recognised through equity. In the half year to September 2014 the proportion of the surplus recoverable through future contributions increased and therefore a deferred tax credit of £4m has been recognised to account for the deferred tax effect of this.

The Group (POL and subsidiaries) has significant tax losses that are available for offset against future taxable profits. It also has unrecognised deferred tax assets relating to fixed asset timing differences. These tax losses/deferred tax assets could be recognised in the future should suitable taxable profits arise. The tax losses/unrecognised deferred tax assets means that the Group should not incur any tax charges for the foreseeable future.

Post Office Limited

2014/15 Audit Planning Report

For the period ended 29 March 2015

10 November 2014

Building a better working world

EY
Building a better working world

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INVESTOR IN PEOPLE

Private and confidential

6 November 2014

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

Dear Members of the Audit and Risk Committee

Audit Planning Report – FY2014/15

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 2014/15 audit, but also to align our audit 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 ('POL'), 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.

We have also been engaged to perform a review on the interim condensed financial statements of POL in accordance with guidance contained in International Standard on Review Engagements 2410 (UK and Ireland) 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity', issued by the Auditing Practices Board, this planning report will also outline the review procedures that we have performed and the conclusions we have reached.

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 10 November 2014, as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

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

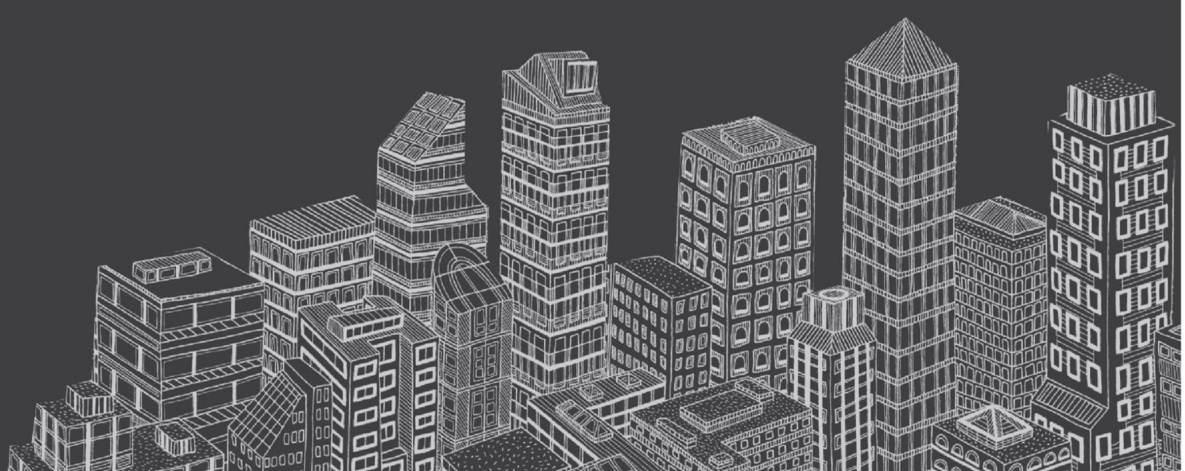
POL00026973

The contents of this report are subject to the terms and conditions of our appointment as set out in our engagement letter of 27 October 2014.

This report is made solely to the Audit Committee, Board of Directors and management of Post Office Limited in accordance with our engagement letter. Our work has been undertaken so that we might state to the Audit Committee, Board of Directors and management of Post Office Limited those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Audit Committee, Board of Directors and management of Post Office Limited for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.

POL00026973

Contents



POL00026973

Executive summary

POL00026973

Executive summary

1. Introduction

The Post Office continues with its significant projects such as the Network and Crown Transformation, having transformed a total of 3,134 branches at 28 September 2014; 1,076 of those were completed in the last 6 months, and the Post Office is aiming to complete an additional 574 branch conversions by the end of this financial year.

POL achieved a milestone this half year by implementing the POL-CFS accounting system which went live on the 1 September. Fiscal 2015 continues to promise many more operational challenges such as the continued roll out of the IT and Network Transformation projects.

In light of these major changes, we have continued to challenge our audit strategy for the coming 2014-15 financial year to meet the needs of a changing business.

In order to identify the key drivers of audit risk, we analyse the risks inherent in the public, mails and retail sectors, the markets in which POL operates, the key strategic, operational and finance risks for POL you have identified through your own risk assessments and our knowledge of other internal and external 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 assurance procedures and feedback are more relevant to your business.

Key financial statement risks

- Revenue recognition across diverse range of revenue streams*
- Classification of exceptional items relating to Network Transformation*
- Risk of management override around estimates and judgements*
- Pension valuation and accounting
- VAT
- Horizon Subpostmasters claim
- SAP CFS accounting system implementation

**Significant risk as defined by auditing standards and professional judgment*

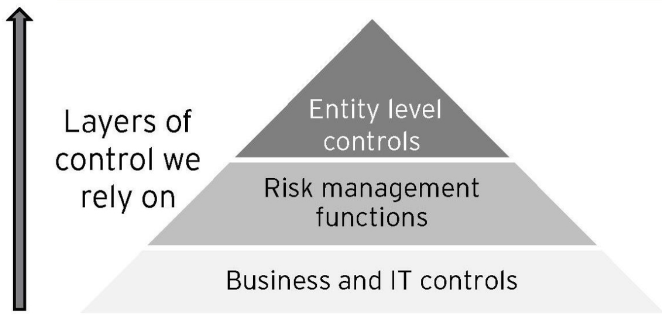
Our audit approach is designed to appropriately respond to these risks. We will continue to focus on the key areas where we believe there is higher inherent risk to the integrity of the financial statements due to the nature and level of judgement involved. We will also consider changes in financial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

POL00026973

Executive Summary (cont'd)

2. Controls based audit

External audit



A controls based approach

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.

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.

Reliance on controls

We will test controls for POL's payroll, purchasing, cash settlement, revenue and fixed assets processes.

- 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.

- We will continue to 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 entity level controls and IT general controls.
- POL was using SAP ESFS for the first 5 months of FY14-15 and then SAP CFS for the remainder. This means that both systems will need to be reviewed as part of the FY14-15 audit.
- We aim to continue to place reliance on the ISAE 3402 report, which opines on the design and operating effectiveness of POL's third party IT provider Fujitsu's controls, for the duration of POL's contract with Fujitsu during the year and subject to the opinion expressed in the report.
- We may need to perform additional independent testing procedures on POL's new third party IT provider, Atos if reliance cannot be placed on the ISAE 3402 report.

3. Service delivery

Your audit team

- The POL engagement team is led by Angus Grant from our London office, who has been the Lead Engagement Partner for the six years and is ultimately responsible for all audit-related services provided to POL by EY. As a Senior Partner in the Banking and Capital Markets, Angus' insight and expertise challenge us to adapt our audit approach to the latest industry and business issues, particularly focusing on financial services activities. Angus is supported by Steve Lyon as Senior Manager who has very relevant and diverse experience from auditing many clients across the EY network.
- We have established our engagement team with the principle of providing the right blend of industry and technical experience to execute the audit and deliver on our commitments to you. Our audit team continues to be supported by specialists Partners covering areas such as pensions, VAT and tax.
- In addition, we recognise how important continuity of key EY team members is to your organisation.

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 & Observation' report' to share insights picked up from the audit.

POL00026973

01 Risk based approach

POL00026973

Risk based approach

Risk based approach | Controls based audit | Audit scope and execution | Service delivery

Through our risk assessment approach, we analyse the risks inherent in a government funded entity, the markets in which you operate, the key strategic, financial and operational 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 2014-15.

Risk assessment

Market

Economic

- UK Government austerity measures, impacting future funding & assistance in growing new sub-revenue lines
- The UK economy
- Rate of e-substitution in mailing services impacts customer buying behaviours & Post Office impact
- Product offering does not meet market needs
- Changes in the financial services sector

Environmental and social

- Post Office as a 'brand' in its own right, with a distinct corporate identity
- Corporate responsibility
- Ethical and reputational

Business

People

- Build and maintain talent pipeline
- Develop entrepreneurial culture
- Relationship with the Communication Workers Union

Growth

- Continue to develop revenue streams capable of sustainable growth, including development of financial services business.
- Monitor profit margins on key revenue lines to ensure the 'right' price is charged
- Go through successful Network Transformation to develop the 21st century Post Office.

Post Office Limited

Operational

Operational excellence

- Achieve benefits of transformation
- Pace & impact of transformation
- Industrial action
- Supply chain management
- Quality of service

Technology

- IT transformation project
- CFS implementation
- Transition of IT service provider Fujitsu

Finance

Process & Governance

- Managing stakeholder/public expectations
- Commercial finance and business intelligence
- Cash flow forecasting and cash optimisation
- Cost of transformation and restructuring

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*	► 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.
Classification of exceptional items relating to Network Transformation & utilisation of government grant*	► Assessing the classification of exceptional costs arising from the Network Transformation programme, and the utilisation of government grants against such costs and in accordance with terms agreed with the Government.
Risk of management override around estimates and judgements*	► We have identified management override of controls as a significant risk, particularly in relation to the identification of exceptional items and provisions. The classification of income statement items as exceptional is highly judgemental, and the high volume of transactions in relation to the Network Transformation programme gives rise to the risk that some transactions may be inappropriately classified as exceptional rather than operating costs to deliver expected operating profit targets.

** Indicates that the financial statement risk has been considered by our audit team as a significant risk and a fraud risk by auditing standards for the purposes of this audit.*

Risk of misstatement due to fraud and error

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

Management has the primary responsibility to prevent and detect fraud. It is important that management, with the oversight of those charged with governance, has put in place a culture of ethical behaviour and a strong control environment that both deters and prevents fraud.

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. As auditors, we approach each engagement with a questioning mind that accepts the possibility that a material misstatement due to fraud could occur, and design the appropriate procedures to consider such risk.

Based on the requirements of auditing standards our approach will focus on:

- Identifying fraud risks during the planning stages.
- Inquiry of management about risks of fraud and the controls put in place to address those risks.
- Understanding the oversight given by those charged with governance of management's processes over fraud.
- Consideration of the effectiveness of management's controls designed to address the risk of fraud.
- Determining an appropriate strategy to address those identified risks of fraud.
- Performing mandatory procedures regardless of specifically identified fraud risks.

POL00026973

02 Areas of audit emphasis

Areas of audit emphasis

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.

Significant area of emphasis	Summary of planned audit procedures
Revenue recognition across diverse range of revenue streams POL sells a large variety of products/services across a number of distribution channels, 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 dependent on their underlying contracts. 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. 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.	► 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 analyse 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. ► We will perform cut-off testing procedures to give further comfort that revenue has been recorded in the correct period and we will carry out substantive testing of accrued and deferred income that involves investigating any estimates made and comparing this to the actual amounts received subsequent to period-end for any material differences. ► We will assess the risks around Managements use of third party data and Managements oversight of this data and carry out additional testing where appropriate.
Classification of exceptional items relating to Network Transformation, utilisation of government grant POL has been executing a Network Transformation on all of its existing branches in order to modernise them as part of the overall strategy to make the Post Office competitive for the future, a one-off programme which is expected to continue until FY2017-18. Management note that the costs of network transformation are exceptional in nature given that a branch modernisation programme of this scale has not been carried out before. As such, management believe this requires separate presentation on the face of the income statement to allow a better understanding of financial performance in the year. In addition, the Department of Business, Innovation & Skills ('BIS') also awards grants of POL to be offset chiefly against network transformation expenditure and related capital expenditure, subject to terms set out in their designation letter. POL offsets this government grant against the related expenses in the exceptionals section of their P&L, in line with IAS 20 *Government Grants*. Network Transformation related costs make up the largest element of exceptional costs in the income statement. Risks include: ► 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 trading profit.	► We will confirm receipt of the government grant and review any updates to the terms and conditions of the funding agreement. ► We will revisit the appropriateness of classifying such costs as exceptional, and make inquiries of management to understand how these costs are distinguished from normal operating costs, and the nature of the costs classified as exceptional costs. ► 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 trading profit projects and meet with the requirement under IAS 1 to be presented as exceptional costs in the financial statements. We will review and challenge whether the costs should be recognised within exceptional items or not.

POL00026973

Areas of audit emphasis (cont'd)

Accounts with significant risks (cont'd)

Significant area of emphasis	Summary of planned audit procedures
Risk of management override around estimates and judgements* We have identified management override of controls as a significant risk, particularly in relation to the identification of exceptional items and provisions. The classification of income statement items as exceptional is highly judgemental, and the high volume of transactions in relation to the Network Transformation programme gives rise to the risk that some transactions may be inappropriately classified as exceptional.	► We will perform testing on the appropriateness of journal entries and other adjustments made in the preparation of the financial statements. ► We will review accounting estimates used in provisions for evidence of management bias. ► For all significant new provisions and exceptionals we will review whether they have been appropriately identified and meet the requirement of IAS 37 and IAS 1 respectively. ► In addition to the above we will focus on evaluating the business rationale for significant unusual transactions around estimates and judgements.

Areas of audit emphasis (cont'd)

Other areas of audit emphasis

The other areas of audit emphasis are set out below:

Other areas of audit emphasis	Summary of planned audit procedures
Pension valuation and accounting Following the implementation of the Pension Solution and the accounting of the transfer of the RMPP in the prior year, we no longer assess pensions valuation to be a significant risk. However, given that the pension related disclosures may continue to be politically sensitive due to the number of stakeholders involved, including the Government and the Communications Workers Union, we assess pensions as an inherent risk area during the current year audit. 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 in consultation with its actuaries.	► We will audit the accounting treatment in line with IAS 19(R) and IAS 1. ► Reviewing the significant assumptions used. This includes meeting with the Companies' actuaries and reviewing their key inputs and understanding the methodologies utilised to arrive at key assumptions, such as discount rates, inflation rates and expected rate of return on plan assets. We will involve our own actuarial specialists who are established members of our audit team. ► Benchmark POL assumptions against peers. We will assess and provide insight into the relevant position of the treatment adopted. ► Involving our technical specialists to review the note disclosure and communicate best practice to the finance team. ► Review changes in terms of pension schemes and the related accounting treatment. ► Obtain evidence and support for the valuation of pension assets. ► Review the pension disclosures provided in the financial statements
Horizon Subpostmasters claim In the prior year there were a number of legal claims made against POL in relation to Horizon from Subpostmasters, who claimed they had suffered losses due to systemic problems within the HNGX system. In response, POL have sought legal advice from Linklaters to ascertain whether Post Office has a legal or constructive obligation in relation to these claims. Management have received written legal advice from Linklaters' which indicate that POL have no financial liability for any consequential losses suffered by the subpostmasters subject to there being no evidence to support systematic failing of Horizon, of which there is none based on management's interpretation to date. As such, no provision was recognised nor any contingent liability disclosed in prior year. We reviewed POL's legal advice and agreed with management's approach to not recognise any liability for the purposes of the FY2013/14 financial statements. As we continue to monitor any developments in this matter in FY2014/15 we assess this to be an inherent risk area during the current audit.	► We will discuss the Horizon subpostmaster claim with POL's legal counsel and financial controller. ► We will review any updates on the legal advice from Linklaters to ensure that the financial impact of POL's position is correctly accounted for and disclosed in the financial statements.

POL00026973

Areas of audit emphasis (cont'd)

Other areas of audit emphasis

Other areas of emphasis	Summary of planned audit procedures
VAT Accounting The POL VAT recovery ("partial exemption") method is a key area which could carry a material level of VAT risk. The business has agreed a new "special" partial exemption method which is relatively complex. Although the method itself is approved by HMRC, it is important that the calculation of the recoverable VAT is done in accordance with the agreed method. This can be a complex process. In addition, any errors in the calculation of the VAT recovery would carry the risk of significant penalties. It will also be important to ensure that the new financial system CFS (core finance system) which went live on 1 September is providing management with the correct information to fulfil its VAT accounting and reporting obligations. In particular, it will be important to ensure that the VAT is accounted for correctly during the transitional period.	► We will examine the VAT records, including the VAT return submissions and backing documentation to check the calculations are accurate. ► We will review the operation of the VAT partial exemption calculation to check if it is consistent with the method agreed with HMRC. ► We will discuss with the POL VAT team to understand the status of any significant VAT issues, and consider any VAT provisions which have been or should be made by POL. We will review the calculation of any provisions made to check whether they are robust, performing audit procedures wherever necessary. ► We will review any other special VAT agreements with HMRC, including any agreement in relation to alternative evidence for input tax recovery on standard rated supplies from Royal Mail, to check that they have been implemented correctly.
Implementation of SAP CFS (core finance system) Following the migration of the finance system SAP ESFS to SAP CFS which went live on the 1September 2014, it will also be important to ensure that the transfer of financial information from one system to another has happened correctly to ensure management is able to fulfil its accounting and reporting obligations. In particular, it will be important to ensure the integrity and completeness of the information during the transitional period.	► Our ITRA team will perform a post implementation review with a view of obtaining reasonable assurance that the transition from SAP ESFS to SAP CFS occurred without any significant deviations identified. ► We will obtain an understanding of the CFS with an emphasis on changes in key controls where we have planned a controls testing strategy for the related significant classes of transactions and significant disclosures. ► We will continue to consider where these activities will have an impact on the control environment, modifying our approach and conducting walkthroughs to understand the new environment as and when applicable. ► We will perform opening balances check to ensure that all audited closing balances in SAP ESFS have been correctly transferred to SAP CFS. ► We will be performing detailed testing on the new processes, working closely with management and building on the knowledge that the Royal Mail Group team had when the these processes were partially prepared and audited at RMG level.

Areas of audit emphasis

Summary

In determining our approach to the 2014/15 audit, we consider how the risks faced by POL 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 2014/15. The risks are largely consistent with the prior year.

Risks	Changes from prior year
Significant Risks (*also considered as fraud risks by auditing standards)	
► Revenue recognition across diverse range of revenue streams	No change from prior year; still considered a significant risk in the current audit.
► Classification of exceptional items relating to Network Transformation & utilisation of government grant.*	No change from prior year; still considered a significant risk in the current audit.
► Risk of management override around estimates and judgements*	In prior year we had associated the risk of management override with the classification of exceptional items; in the current year we have associated this risk against provisions as this is more aligned to estimates and judgments.
Inherent Risk	
► Pension valuation and accounting	No change from prior year; still considered an inherent risk in the current audit.
► VAT Accounting	No change from prior year; still considered an inherent risk in the current year.
► Horizon Subpostmasters claim	No change from prior year; still considered an inherent risk in the current year.
► Implementation of SAP CFS (Core Finance System)	New inherent risk in the current year. The CFS (Core finance system) went live at the end of August 2014 , replacing ESFS, which was previously managed by RMG. Since migration to CFS, POL now has full control over the Fixed Assets, AP and AR processes which were previously managed by RM. In addition, POL now has full control over the postings of all journals.
No longer considered inherent risk	
► Counterparty risk	The likelihood of the risk reduced as the Bank of Ireland has incorporated and is fully regulated in the UK, is in better financial health and counterparty credit risk is more closely monitored and managed by POL. We no longer consider this to be inherent risk.
► Risk of fraud/burglary arising from the logistics process and the cash center network	In all past years involvement in auditing POL we have never found or assessed that any known or reported fraud and/or burglary arising from the logistics process and the cash centre network would have materially misstated the cash balance and the financial statements, nor do we expect that if such an incident was to occur it would be material in the current year audit. This is because all of the network cash is spread across over 11,600 branches and cash centres cross the country and it is unusual and unlikely that fraud or burglary at any one of the branches will cause a significant financial impact. For this reason we no longer consider this to be inherent risk.
► Corporate Tax Accounting	This will be the second year that POL has complete responsibility for accounting for tax charges and related disclosures. Prior year this was seen as an inherent risk due to complexities in transitioning. In the current year we no longer consider this to be an inherent risk.

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03 Controls based audit

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Controls based audit

Gaining assurance through the control environment

Risk based approach → **Controls based audit** → Audit scope and execution → Service delivery

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 adopt a controls based approach in respect of IT, which is discussed in detail on pages 17 and 18.

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

As noted in last year's planning report to you, we are aware that the POL finance systems and control environment will continue to change. POL's new finance system, SAP CFS went live on 1 September 2014 and POL now has taken over all accounting processes and activities previously undertaken at Royal Mail Group level.

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.

POL00026973

Controls based audit (cont'd)

Gaining assurance through the control environment

Risk based approach	**Controls based audit**	Audit scope and execution	Service delivery

IT Control Testwork Planning – Background

IT underpins a significant proportion of POL'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 audit: HNGX, POLSAP, SAP HRP, SAP ESFS (31 March 2014 to 31 August 2014) and SAP CFS (1 September 2014 to 29 March 2015).

As part of POL's separation from Royal Mail Group (RMG) , SAP ESFS has been replaced by SAP CFS with effect from 1 September 2014. In addition, the IT support arrangements for SAP HRP are in transition from RMG to POL and we understand this will be completed in February 2015.

2014-15 IT Audit Strategy – key considerations

Separation from RMG

- One of the key considerations for the IT audit this year is POL's separation from RMG, which–directly affects the audit approach for two key systems operated by RMG that support POL's financially significant processes. These systems are SAP ESFS, which supports the processing of branch returns, fixed assets, purchasing and general ledger transactions, and SAP 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 RMG's key financial systems.
  - As part of the separation, POL has implemented a new system – 'Core Financial System (SAP CFS)' - to replace SAP ESFS, which went live on 1 September 2014. Between April and August 2014, RMG provided support for SAP ESFS, over which we anticipate requesting comfort from RMG's audit team. For September 2014 onwards, we plan to perform a review of CFS controls as part of the POL audit, working with third party service providers CGI, Atos and Steria. We anticipate performing independent audit procedures on key IT controls supported by the third parties given the lack of available ISAE 3402 reports.
  - Given the criticality of SAP CFS and its major impact on the FY14-15 audit, we have performed a pre-implementation review of the SAP CFS project. This included a review of the programme governance, solution integrity, data integrity, business and support readiness. Please refer to the SAP CFS implementation review section below for more details.

POL00026973

Controls based audit (cont'd)

Gaining assurance in the IT environment sphere

Risk based approach | **Controls based audit** | Audit scope and execution | Service delivery

2013-14 Audit Strategy – key considerations (cont'd)

- POL also transferred SAP HRP from an RMG supported environment to a POL owned and supported delivery model, under the 'Safe Haven' project. SAP HRP will continue to be supported by third party CSC through direct contractual agreements with POL. We understand the transition from RMG/CSC support arrangements to a POL/CSC support model will happen between October 2014 and February 2015. Our approach for SAP HRP between April and October 2014 is to continue to leverage the IT audit procedures for RMG's systems. We then intend to perform independent audit procedures in relation to the transition, including review of the controls over the new hardware platform. From February 2015, we envisage being able to continue to rely on CSC's ISAE 3402 subject to the report having appropriate coverage of the new POL owned SAP HRP environment. We may need to perform additional procedures if this is not the case.

HNGX and POLSAP

- Our understanding is that Fujitsu will again be commissioning an ISAE 3402 report.
  - We plan to continue to place reliance on the ISAE 3402 report to reduce our independent testing.
  - The extent of our reliance will be dependent on the opinion expressed in the ISAE 3402 report. We may need to perform additional procedures if the report notes any significant exceptions.
  - To support this approach we plan to follow the protocols agreed last year by the POL, Fujitsu, EY IT audit and EY ISAE 3402 teams to keep the parties updated with the progress of ISAE 3402 testing.

IT transformation

- POL continues to execute its IT transformation programme, and has already begun to implement the new IT service delivery model; we have been working with POL management to assess its impact on the audit.
  - We understand that a new supplier, Atos, provides the overall service integration support to POL and this impacts the applications in-scope for the IT audit this year. Therefore, we envisage relying if an ISAE 3402 report from Atos if this is available. We may need to perform independent audit procedures if there is no such report or if the services provided to POL are not covered by the report.
  - Whilst there are additional IT support services contracts being awarded to new suppliers during 2014, the transition will not be completed until after March 2015, and therefore we do not anticipate these to have a major impact on the FY 14-15 audit strategy.

Controls based audit (cont'd)

Gaining assurance in the IT environment sphere

Risk based approach → **Controls based audit** → Audit scope and execution → Service delivery

SAP CFS Implementation Review

- Given the nature of the SAP CFS implementation and the significance of the system to the audit, we have performed a pre-implementation review to review the design of some of the key controls we intend to test for the FY14-15 audit. This approach will enable POL to address any potential key design or implementation issues and correct them as soon as possible. This in turn will allow us to place as much reliance as possible on the system once SAP CFS is live and potentially avoid significant remediation procedures during the audit. Our EY IT audit team has been working closely with POL's Internal Audit team in reviewing the CFS implementation to identify areas where we can place reliance on their work and reduce our independent testing.
- We have completed the majority of the review procedures as of October 2014, however some remain in relation to data migration, design of the IT general controls, interfaces and the go-live decision. We intend to complete these remaining procedures in November 2014.
- Below is a summary of the key findings of our work to date. These points have been discussed with the SAP CFS project team and we understand they are in the process of performing their investigation and that detailed management responses and action plans have been recorded for each point to remediate and mitigate these :
  - A number of users have been granted the highly privileged SAP_ALL profile in the live which gives users unrestricted access to SAP, including the capability to process and approve any financial transactions within CFS. We do not consider it to be appropriate for users to have permanent access to this profile. It should be noted that our preliminary investigation disclosed that SAP_ALL has been assigned to CGI development and support users and not to POL end users which minimises the risk.
  - There are a number of generic user accounts belonging to CGI with powerful access rights in the live environment. Whilst we acknowledge CGI will require access to SAP CFS to support the system, we do not believe they should be granted unsupervised powerful access to POL's live data.
  - Finally, using EY's proprietary tool to analyse users' access, we identified a significant number of potential segregation of duties conflicts within SAP CFS. We understand from discussion with the CFS implementation team that the SOD violations are being investigated, risk assessed and appropriate actions are being considered to mitigate the risks.

POL00026973

04 Audit scope and execution

Audit scope and execution

Risk based approach | Controls based audit | **Audit scope and execution** | Service delivery

2014-15 EY services

There are no changes in the scope of services from 2013-14. Post Office Management Services Limited ("POMS") is a fully owned subsidiary of POL. POMS was incorporated on 25 March 2013, and has been dormant since. Management intends to commence trading on 1 December 2014. If this entity commences trading it will be subject to a full-scope audit in the current year audit.

	Services and deliverables

Financial reporting	► **Express opinions on, and report to the Audit and Risk Committee the results of, our audits of:**
	  ► The consolidated financial statements of Post Office Limited (IFRS) and parent company financial statements (FRS101) for the period ending 29 March 2015.
	► We are required by the primary audit team of Postal Services Holdings Company ('PSH', formerly known as Royal Mail Holdings) to perform a full scope audit of POL for the period ended 29 March 2015 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:**
	  ► 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
	► **Perform a review in** accordance with ISRE 2410 *"Review of Interim Financial Information Performed by the Independent Auditor of the Entity"*, on the consolidated half year financial statements of Post Office Limited, prepared in compliance with IAS34 *Interim Financial Reporting*.

Internal control communications	► **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 management and the Audit and Risk Committee describing significant deficiencies and material weaknesses identified during our audit, if any
	  ► Following the year end audit board results report, we will separately issue a Controls Themes & Observations Report to 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	► **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:**
	  ► 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 ISAE 3000 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 an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. 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.

We will continue to use revenue as a basis for materiality, the amount we consider material at the end of the audit may differ from our initial determination. At this stage, however, it is not feasible to anticipate all of the circumstances that may ultimately influence our judgement about materiality. At the end of the audit we will form our final opinion by reference to all matters that could be significant to users of the accounts, including the total effect of the audit misstatements we identify, and our evaluation of materiality at that date.

Scope of audit procedures

Consolidation considerations

Our objective is to form an opinion on the group's consolidated financial statements under International Standards on Auditing (UK and Ireland).

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 EY team from London, except for the POL joint venture First Rate Exchange Services ('FRES') which is audited by PricewaterhouseCoopers. FRES is deemed significant reporting unit based on size and will be subject to a full scope audit, covering all significant accounts and processes using materiality levels assigned by EY's POL group team for purposes of the consolidated audit. Procedures are full-scope in nature, but may not be sufficient to issue a stand-alone audit opinion on the local statutory financial statements (as materiality thresholds support to the consolidated audit).

ISA 600 (UK and Ireland) requires that we provide you with an overview of the nature of our planned involvement in the work to be performed by the component auditors of significant reporting units.

Our involvement can be summarised as follows:

- We will instruct PricewaterhouseCoopers to report the results of their full scope audit to us, in line with our reporting timetable;
- Attend the planning event and closing meetings by conference call; and
- We will review their work papers relating to the significant audit areas through a site visit from the Group audit team at year end; and

Audit scope and execution (cont'd)

Regulatory Considerations

As POL is not a company with shares listed and traded on a public exchange, it is not formally required to report on its compliance with the UK Corporate Governance Code ('the Code'). Nevertheless in light of regulatory changes in the prior year the Post Office set principles for good governance which followed the provisions of the Code, so far as they can apply to a government-owned entity which has no private or institutional external Shareholders.

Since the year end the Financial Reporting Council issued an updated version of the Code in September 2014. The new code confirmed the proposal for boards to include a "viability" statement in the strategic report to investors. This statement is expected to improve the broader assessment of long-term solvency and liquidity. The code was also changed in relation to remuneration, whereby listed companies will need to ensure that executive remuneration is designed to promote the long-term success of the company and demonstrate the achievement of that in a clear manner to shareholders. These changes to the code will apply to for year ending 27 March 2016.

As POL remains committed to conducting its business ethically and in accordance with high standards of Corporate Governance we will continue to update management and the Audit Committee on evolving market practice in this area.

The following diagram summarises the Governance considerations to ensure full compliance with the Code and the required process and communication flows between key stakeholders.

There are certain practical implementation aspects that would need to be considered by POL with regard to:

- Communication protocols between management, boards, audit committees, auditors and others within the company, e.g., internal audit and risk functions;
- Reporting processes and timetables; and
- The audit committee's report within the Annual Report and Accounts.

Audit scope and execution (cont'd)

Cyber security

As indicated in the letter from the Department for Business, Innovation & Skills to Chairs and Audit Committee Chairs in the UK, the UK Government has launched an initiative, focused initially on the FTSE 350, in the form of a Cyber Governance Health Check, facilitated through client audit relationships, with the aim of helping to make the UK one of the most secure places in the world to do business. This initiative requires the completion of a Cyber Security Tracker and the undertaking of a Cyber Diagnostic to Cyber Security Healthcheck. We would be happy to support POL if you took the decision to voluntarily participate in this initiative in the current year.

POL00026973

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 2014-15 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 2015, 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.

	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June
Agree audit scope/planning									
▸ Agree service commitments									
▸ Develop audit strategy		1							
▸ Agree audit fees									
Interim reviews									
▸ Half year		1							
Process reviews									
▸ Review of key processes									
▸ Controls testing									
Year end substantive testing									
▸ Hard close procedures									
▸ Year end procedures									
▸ Results report to the audit committee								2	
▸ Control themes and observation report									3

Deliverables:

1 2014-15 Audit Planning & HY Results Review Report

2 2014-15 Year-end Results report

3 2014-15 Control Themes & Observations Report

POL00026973
POL00026973

05 Service delivery

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Service Delivery

Risk based approach → Controls based audit → Audit scope and execution → **Service delivery**

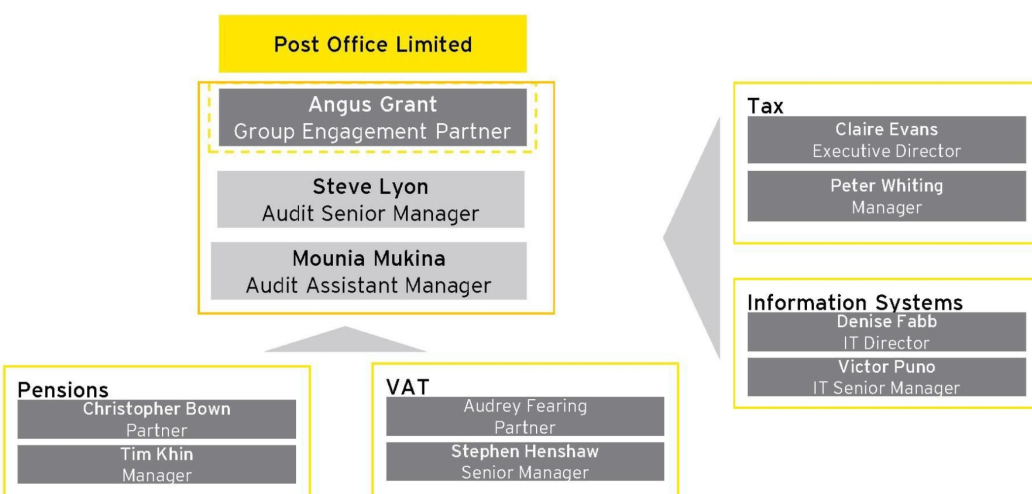
Your POL audit team

The POL engagement team is led by Angus Grant from our London office, who as the Lead Engagement Partner is ultimately responsible for all audit-related services provided to POL by EY, signing the consolidated and parent company Post Office Limited audit opinions and oversight of all other statutory and related work. This will be Angus' sixth year on the engagement.

Angus is supported by Steve Lyon as Senior Manager and Mounia Mukina as Assistant Manager. We have established our engagement team with the principle of providing the right blend of industry 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 EY team members is to your organisation.

Specialists & Advisory Partners

As you are aware from experience in prior years, our audit strategy relies significantly on testing IT systems and controls. Denise Fabb (Executive IT Director) will continue to oversee delivery of the IT element of the audit. Our Pension specialists, who have assisted us both at the prior year end and during the current half year, will continue to be headed by Christopher Bown (Pensions Partner). Claire Evans also continues to take responsibility for the audit of POL tax, supported by Peter Whiting. Our audit team will also be supported by the EY VAT specialists, headed by Audrey Fearing and supported by Steve Henshaw.



POL00026973

Appendices

Appendix A

IAS 34 Half year review

Introduction

Post Office Limited ('POL') intends to issue interim consolidated financial statements for the period ended 28 September 2014, in compliance with IAS 34 Interim Financial Reporting. We have been engaged to perform a review under ISRE 2410, the standard that covers interim reporting procedures.

Objective of our review

The objective of our review is to provide comfort to the Audit & Risk Committee whether, on the basis of the procedures performed, anything has come to our attention that causes us to believe that the interim consolidated financial statements have not been prepared in all material respects in accordance with IAS 34 *Interim Financial Reporting*, as adopted by the European Union.

Review process

Our review of the Group's financial information for the 6 months ended 28 September 2014 was performed in accordance with ISRE 2410 (UK and Ireland) *'Review of Interim Information performed by the Independent Auditor of the Entity'*, as adopted by the Auditing Practices Board (APB) in the United Kingdom.

A review is substantially less in scope than an audit, because it does not include:

- Tests of accounting records by inspection, observation, or confirmation
- Obtaining corroborative evidence in response to enquiries
- Application of certain other procedures normally performed during an audit, such as tests of controls and verification of assets and liabilities.
- Our work therefore consisted primarily of making enquiries of POL's accounting and finance staff, executive management and applying analytical review and other review procedures.

Management anticipates that the half year results will be announced in early December 2014.

Status of review

At the time of issuing this report, our review of the Interim Results is on-going with the following items outstanding:

- Review of final interim report including Directors narrative.
- Receipt of the Letter of Representation from the Directors.
- Subsequent events procedures, to be completed through the date of us concluding our review (matters to be updated include: management enquiries, review of latest management accounts, and board minute review to date of signing).

We continue to work with management in order to complete these procedures and will provide a verbal update at the Audit & Risk Committee meeting.

In the following pages, we set out a summary of the Half Year procedures performed and the results of our review.

Appendix A

IAS 34 Half year review (cont'd)

Half year review results

Procedure	Findings
Scoping, review differences & anticipated conclusion	
Interim materiality and evaluation of misstatements	We calculated an interim review in order to: ▸ Determine the extent of analytical and other review procedures to perform and evaluate the results. ▸ Evaluate errors of misstatement or judgmental differences. ▸ Come to a conclusion that the interim financial information is prepared, in all material respects in accordance with IAS 34 'Interim Financial Reporting'. ▸ Determine what matters of governance interest should be brought to your attention. ▸ Our determination of interim materiality requires professional judgement and takes into account qualitative as well as quantitative considerations implicit in the definition.
Review of primary statements numbers and support	▸ 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 exceptionals was £23m, down by £30m on the same time last year. Operating profit for the period was £20m (29 September 2013: £185m, which included the gain of £102m arising on the change to the terms of the Royal Mail Pension Plan, which was reported under exceptional items). ▸ Based on our discussions with management, including the 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 28 September 2014. As a result of our procedures, we have not identified any previously unidentified risks of material misstatement due to fraud.
Summary of review adjustments	▸ We identified two review differences netting to £1m, which reclassifies debit balance from trade payables to trade receivables. We also identified a review difference of £738k to decrease Homephone revenue in line with the billing provided by Fujitsu, the net impact of this adjustment to profit is nil because it was fully provided for. ▸ . ▸ There were no other amounts that we identified that are individually or in aggregate material to the presentation and disclosures of the interim consolidated financial statements for the six months ended 28 September 2014.
Conclusion	▸ Based on work carried out to date, no adjustments have come to our attention that are individually or in aggregate material to the presentation or disclosures of the interim consolidated financial statements for the six months ended 28 September 2014.

POL00026973

Appendix A

IAS 34 Half year review (cont'd)

Half year review results (cont'd)

Procedure	Findings
Significant areas of audit emphasis	
Revenue recognition	As part of our half year review procedures, we held meetings with management review and made enquires in relation to managements detailed revenue schedule, which splits out the performance for every individual sub-revenue line. We carried out a detailed analytical review on POL's revenue lines, whilst also completing analytical reviews on POL's deferred and accrued revenues as disclosed in the Balance Sheet. During our review of contracts, we noted that a provision had been made in respect of an error in the charging for revenue under the DWP PoCa contract. POL charges the DWP based on the number of active PoCa accounts, for which the source data is provided by JPMorgan (POL banking partner for running the PoCa accounts). When an account holder dies and POL is notified of the death, the account should be moved from active status to Death Notified Account (DNA) status. In such instances, POL should cease to charge for these accounts as active accounts but should charge them as dormant. However, the information provided by JPMorgan has included DNAs within the active accounts (as JPMorgan billing includes DNA accounts). The result is that POL has been overcharging the DWP since 2009, estimated to be £11m in total. POL management has provided for this amount as it has an obligation as a result of a past event and therefore has a liability to DWP. We note that the contract is currently being negotiated and therefore a commercial settlement may be reached. We agree with managements conclusions at the half year. During the half year to 28 September 2014, POL continued to work with Fujitsu to resolve revenue recognition issues in respect of Telephony products. Since year end Fujitsu has carried out a review and issued a report to POL in relation to the dispute and has identified total under-billing of £302k. Management continues to take the view that the billing data provided by Fujitsu is incomplete and although the report has some merit, POL still continue to work with Fujitsu to resolve the dispute. Management fully wrote down the receivable due from Fujitsu as at 28 September 2014 being the recoverable amount offered in the report of £302k. We have proposed an adjustment, which has been adjusted for in the financial statements, to decrease revenue for the 6 months to 28 September 2014, in line with the billing provided by Fujitsu. For Revenue to be recorded under IAS 18, it has to be probable the economic benefits will flow to POL. Therefore management have recognised the net impact within the Revenue line item in the income statement (Decrease in Revenue of £738k). This adjustment has a net nil impact to the profit of POL during the period as this revenue was fully provided for. No other issues were noted during the course of our review.
Classification of exceptional costs	Continuing the trend from the previous year, POL continues to have increasing and significant exceptional items relating to network transformation & restructuring (£107m in the current year to date) and impairments (£66m in the year to date). These were offset by the utilisation of the full government grant for the year of £170m, which management has treated as an offsetting exceptional gain. We recognise that management have recognised the grant on a consistent basis with the prior year, being matched to the direct costs attributed to the Transformation. We note that achieving the appropriate matching of Grants to cost is a subjective , however POLs accounting falls in line with the accounting standard. As a result of the substantial transformation spend, the full grant has be utilised and offset cost in the first half of the year, therefore resulting in a net impact of £3m expense being recorded in exceptional items. We noted that there is still significant spend anticipated during the second half of the year for which POL has no grant available to offset, the result of which will be a negative impact on the second half year results. We do not take exception to the accounting treatment however we have highlighted to management that prorating the grant across the anticipated spend for the year, would remove significant volatility in the half year reported earnings. We would encourage management to ensure there is transparency in the front and back half of the accounts and that the users of the half year financial statements are able to form a view of the company's first half year performance and performance against targets and objectives for the full year The items included within network transformation costs and restructuring costs are consistent with those reported as exceptional in prior years and continue to meet the Group's definition of exceptional costs and guidance from the accounting standards. The only new type of addition to exceptional costs during the year to date is the Business Transformation Programme (BTP) (£1m), relating to a wide reaching programme which is tasked with delivering £300m of cost savings and as such is expected to radically transform the structure of the business. The BTP has begun its work and has already identified medium term costs saving opportunities of £100m. which, owing to the one-off nature of the events giving rise to them, were deemed appropriate by management to include as an exceptional item. POL also has a number of exposures that are reflected in the financial statements at each year end. Total provisions have increased from £78m to £86m in the half year ended. We reviewed the breakdown of provisions as at the current half year end, including movements since the prior year. From our discussions with management, we noted that the assumptions used remained appropriate for the half year accounts, noting no issues.

Appendix A

IAS 34 Half year review (cont'd)

Half year review results (cont'd)

Procedure	Findings
Other areas of audit emphasis	
SAP Core Financial System (CFS) implementation	POL's accounting system, ESFS, was replaced by CFS at the end of August 2014. Transactions data for the 12 months in FY2013/14, as well as the 5 months from March to August 2014, were transferred to CFS. We have checked that all balances have been correctly transferred from ESFS to CFS. The implementation of CFS was complementary to POL gaining ownership over the fixed assets, purchasing and accounts receivable processes, which were previously managed by Royal Mail. We also noted that CFS is now able to perform a three-way match for projects expenditure, although a two-way match is still performed for all other expenditure. We have performed walkthroughs over these processes and noted the changes and key controls in place. We will be performing full tests of controls over these processes for our annual audit of the financial statements, including tests of the ITGCs. We have further noted that the implementation of CFS has not resulted in a change in controls over the classification of exceptional items and the associated risk of management override, valuations of provisions, and revenue recognition.
Review of Corporation Tax	In the half year to 28 September 2014, POL recorded a deferred tax credit of £4m in the income statement and a deferred tax charge of £5m in OCI, both relating to movements on the element of the RMPP pension surplus expected to be recovered through a reduction in future contributions. POL does not expect to be in a tax paying position for the full year. Consistent with the position at 30 March 2014, POL has only recognised deferred tax assets up to the value of the deferred tax liability in respect of pensions, leaving a net deferred tax balance of nil. The remaining potential deferred tax asset balances are not recognised due to uncertainty around the availability of future taxable profits. We have reviewed the full year forecast tax calculations and the allocation of the deferred tax figures in respect of pensions, and made enquiries of management and Wilkins Kennedy, who assisted the POL finance team in the preparation of the figures.
Pensions	For the purposes of preparing their half year IAS 34 financial statements, management have obtained an IAS 19R valuation of the pension fund surplus for their RMPP scheme, for the period ended 28 September 2014. This valuation indicated a net pension surplus of £161m for the RMPP scheme, which is net of £20m withholding tax of 35% on the element of the surplus which is recoverable through a refund from the plans. POL also recognised a £2m net surplus relating to their RMSEPP at half year. Our review during half-year has included us involving our own actuarial specialists, who have been established members of our audit team since last year's audit. We reviewed the key assumptions that underpin the value of the pension obligation at 28 September 2014, and note that the discount rate of 4.1% (4.5% in March 2014), RPI 3.1% (3.3% in March 2014), CPI 2.1% (2.3% in March 2014) and the expected rate of non-promotional salary increases 3% (3.3% in March 2014) are within the range of assumptions that we would deem reasonable based on our experience
Provisions	We reviewed material movements in provisions as part of our half year review procedures. Material movements within provisions related mainly to utilisation of severance and agents' compensation provisions, as well as current year provisions in these two accounts for redundancies and agents' termination agreements made during the half year ended 28 September 2014. We further noted an £11.3m provision in respect of overcharges for the DWP PoCa contracts, as noted above. The material movements highlighted are in line with our expectations based on our knowledge of the business and discussions with management. We have discussed with management the current status in relation to fraud, legal matters, entity level controls, and the financial statements close process.

Appendix A

IAS 34 Half year review (cont'd)

Half year review results (cont'd)

Procedure	Findings
General review procedures	
Review all board meeting minutes in the half-year	► We have reviewed the meeting minutes for all board meetings up to the latest date at time of issuance of this Planning Report, being the Board meeting on 25 September 2014. No further issues to note. We will obtain meeting minutes for all board meetings up to date of releasing our review opinion for the half year financial statements.
Review of current material litigation & regulatory fines, compensation and accruals.	► 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 made enquiries of POL's legal counsel to gain an update of POL's litigation and compliance with laws and regulations since year-end, with no issues noted. ► We discussed the Horizon subpostmaster claim with POL's legal counsel and financial controller. POL's position has not changed since the prior year. It was noted that management has not been found legally liable to pay out any claims related to the Horizon subpostmaster claim post 31 March 2014 to date. Based on our discussion with management, we agree that their view remains reasonable and no reserve is required in respect of this claim. ► We also discussed the progress on the legal situation concerning POL potentially having to pay a separate business tariff on its ATMs in retail premises. A provision had been made in the March 2014 financial statements for £2m. Management and legal counsel continue to believe the likelihood of paying these backdated business tariffs is highly probable, and this provision remains at half year. Based on 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 all board meetings and sub-committees and noted there were no other material litigation claims or regulatory claims that management should consider providing for.

Appendix B

Management representation letter for IAS34 half year review

Angus Grant
Ernst & Young LLP
1 More London Place
London
SE1 2AF

xx November 2014

Dear Sirs

Post Office Limited

This representation letter is provided in connection with your review of the condensed consolidated balance sheet of Post Office Limited as of 28 September 2014 and the related condensed consolidated statements of income, changes in equity and cash flows for the six-month period then ended for the purposes of expressing a conclusion whether anything has come to your attention that causes you to believe that the interim financial information is not prepared, in all material respects, in accordance with International Financial Reporting Standards as adopted by the EU.

We acknowledge our responsibility for the preparation and presentation of the interim financial information in accordance with International Financial Reporting Standards as adopted by the EU.

We confirm, to the best of our knowledge and belief, the following representations:

a) The interim financial information referred to above has been prepared and presented in accordance with International Financial Reporting Standards as adopted by the EU.

b) We have made available to you all books of account and supporting documentation, and all minutes of meetings of shareholders and the board of directors.

c) There are no material transactions that have not been properly recorded in the accounting records underlying the interim financial information.

d) There has been no known actual or possible noncompliance with laws and regulations that could have a material effect on the interim financial information in the event of noncompliance.

e) We acknowledge responsibility for the design and implementation of internal control to prevent and detect fraud and error.

f) We have disclosed to you all significant facts relating to any known frauds or suspected frauds that may have affected the entity.

g) We have disclosed to you the results of our assessment of the risk that the interim financial information may be materially misstated as the result of fraud.

h) We believe that the effects of any unadjusted review differences, summarised in the accompanying schedule, accumulated by you during the current audit and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

i) We confirm the completeness of the information provided to you regarding the identification of related parties.

POL00026973

Appendix B

Management representation letter for IAS34 half year review (cont'd)

j) The following have been properly recorded and, when appropriate, adequately disclosed in the interim financial information:

- Related party transactions, including sales, purchases, loans, transfers, leasing arrangements and guarantees, and amounts receivable from or payable to related parties;
- Guarantees, whether written or oral, under which the entity is contingently liable; and
- Agreements and options to buy back assets previously sold.

k) The presentation and disclosure of the fair value measurements of assets and liabilities are in accordance with International Financial Reporting Standards as adopted by the EU. The assumptions used reflect our intent and ability to carry out specific courses of action on behalf of the entity, where relevant to the fair value measurements or disclosure.

l) We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities reflected in the interim financial information.

m) We have no plans to abandon lines of product or other plans or intentions that will result in any excess or obsolete inventory, and no inventory is stated at an amount in excess of realizable value.

n) The entity has satisfactory title to all assets and there are no liens or encumbrances on the entity's assets.

o) We have recorded or disclosed, as appropriate, all liabilities, both actual and contingent.

To the best of our knowledge and belief, no events have occurred subsequent to the balance sheet date and through the date of this letter that may require adjustment to or disclosure in the aforementioned interim financial information.

Chris Day

Chief Financial Officer

POL00026973

Appendix C

Audit fees

A fair fee reflecting a changing business

A summary of EY's proposed fees for the period ending 29 March 2015 is set out on the following page.

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

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

- With respect to the cost of the IT audit, the cost assumes no significant exceptions requiring mitigation work. Any additional time required to mitigate exceptions will be flagged and agreed in advance prior to carrying out the mitigating procedures.

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

Appendix C

Audit fees (cont'd)

A fair fee reflecting a changing business

	Standard Cost (£)	Fee (£)	One off fee(£)
FY13/14 audit costs	784,363	313,745	
FY13/14 IAS34 consolidated accounts (Half Year Review)	100,000	40,000	
Total FY13/14 Audit Fee (including IAS34 accounts)	884,363	353,745	
Changes in scope			
Additional process work for main audit for the CFS implementation	30,000	12,000	*12,000*
Review of the implementation of the CFS from a VAT perspective	15,780	6,312	*6,312*
CFS known issues from IT pre-implementation review	10,419	4,168	*4,168*
Increase time on review of ISAE 3402 reports (from 1 prior year - Fujitsu, to an additional 2 this year – Atos and CSC)	15,620	6,248	
Unremediated and/or late remediation of 2014 IT issues	38,205	15,282	*15,282*
SAP HRP re platforming	12,198	4,879	*4,879*
Total One off Fee			***42,641***
Recurring changes in scope			
CFS ITGC testing (ISAE 3402 review)	7,000	2,800	
Market factors			
Inflation *	44,218	17,687	
Total Audit Fee (including IAS34 accounts)	1,057,803	423,121	*42,641*
***less* – continued efficiencies to partially offset inflation**	(22,574)	(9,030)	
Total 2014/15 audit costs**	1,035,694	414,278	*42,641*
Additional recurring cost If no ISAE 3402 report can be obtained from CGI			
Independent testing audit procedures for CFS ITGC testing	64,650	25,860	
Total 2014/15 audit costs***	**1,100,344**	**440,138**	**42,641**

** Inflation calculated as like-for-like cost base to prior year, uplifted by 5% ((£884,363) x 5%)).*
***Total audit fee assumes that we will be relying on an ISAE 3402 report from Atos (if report is not available, we will perform independent testing)*
**** Total audit costs/fee assuming no reliance in an ISAE 3402 from Atos.*

Appendix C

Audit fees (cont'd)

Non audit services

The following table is a summary of all non-audit fees for the FY14-15 year. None of these fees have contingent fee arrangements.

	Standard Cost (£)	Fee (£)	One off fee(£)
Note Circulation Scheme ISAE 3000 Report*	195,000	78,000	
BIS Agreed Upon Procedures Report*	30,000	12,000	
DVLA Agreed Upon Procedures Report*	32,500	13,000	
Total non audit services 2013/14 fee	257,500	103,000	
One off scope change			
CFS implementation review	175,500	70,200	*70,200*
Market factors			
Add - Inflation **	12,875	5,150	
less – continued efficiencies to fully offset inflation	(12,875)	(5,150)	
Total 2014/15 non audit services fee	433,000	173,200	

- *** Inflation calculated as like-for-like cost base to prior year, uplifted by 5% ((£257,500) x 5%)).*

Appendix D

Independence report

Introduction

In order to carry out our duties and responsibilities as auditor, EY 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 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 Ethical Standards, as revised in December 2010, require that we communicate formally both at the planning stage and at the conclusion of the audit, as well as during the course of the audit if appropriate. The aim of these communications is to enable us in giving you full and fair disclosure to you on matters in which you have an interest.

Required communications	
Planning stage	**Final stage**
▸ The principal threats, if any, to objectivity and independence identified by EY including consideration of all relationships between the you, your affiliates and directors and us; ▸ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality Review; ▸ The overall assessment of threats and safeguards; ▸ Information about the general policies and process within EY to maintain objectivity and independence.	▸ A written disclosure of relationships (including the provision of non-audit services) that bear on our objectivity and independence, the threats to our independence that these create, any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed; ▸ Details of non-audit services provided and the fees charged in relation thereto; ▸ Written confirmation that we are independent; ▸ Details of any inconsistencies between APB Ethical Standards and your policy for the supply of non-audit services by EY and any apparent breach of that policy; and ▸ An opportunity to discuss auditor independence issues.

In addition, during the course of the audit, we are required to communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of safeguards put in place, for example, when accepting an engagement to provide non-audit services.

We also provide information on the amounts of any future services that have been contracted, and details of any written proposal to provide non-audit services that has been submitted.

We will also make sure that the total amount of fees that EY and our network firms have charged to you for the provision of services during the reporting period, analysed in appropriate categories, are disclosed.

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Appendix D

Independence report (cont'd)

Relationships, services and related safeguards

We are not aware of any relationships between EY and the Company that may reasonably be thought to bear on our independence as of the date of this report. 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.

Other required communications related to independence matters

The APB Ethical Standards require total fees you have paid us in the period ending 29 March 2015 to be communicated to you. Details of all fees are provided to the Audit and Risk Committee as part of our year-end results board report.

Listed on the following page are EY'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.

Relating to our audit of the financial statements of Post Office Limited for the year ending 29 March 2015, for the year to date we are independent with respect to the Company within the meaning of regulatory and professional requirements, including the requirements of International Standard on Auditing (UK and Ireland) 260 *Communication of audit matters to those charged with governance*; UK APB Ethical Standards; the independence and Rule 3520 of the PCAOB. We will provide a further update as part of our year end reporting.

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 later in November 2014.

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)

Firmwide policies

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 EY for maintaining objectivity and independence:

Service	Timing
Financial interests	Our partners and client facing (technical) staff are prohibited from investing in any audit client around the World. 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. New starters are required to confirm their compliance with the firm's independence policies on commencement of their employment.
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	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. As with other firms, EY'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.
Business relationships	EY 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. In addition, all new business relationships must be notified and approved by the lead audit or client service partner before committing the firm.
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. EY has also established the EY/Ethics hotline which will allow any person, inside or outside of EY, 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 EY's established policies and Code of Conduct.
Non-audit services	Our audit engagement partners must approve any non-audit services offered to their clients. This allows them to: ► 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. Where no satisfactory safeguards exist we do not carry out the non-audit service.

Appendix E

Required communications with the Audit and Risk Committee

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

	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			
Overview of planned scope and timing of the audit		✓	Discussed within this report.
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 2014-15 year end audit report.
Unrecorded misstatements considered by management to be immaterial		✓	This will be included, as necessary, within our 2014-15 year end audit report.
Expected modifications to the audit report		✓	If applicable, this will be included, as necessary, within our 2014-15 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 2014-15 Audit and Risk Committee report.
Disagreements with management	✓		This will be included, as necessary, within our 2014-15 year end audit report.
Consultations with other accountants	✓		This will be included, as necessary, within our 2014-15 year end audit report.
Serious difficulties encountered in dealing with management when performing the audit	✓		This will be included, as necessary, within our 2014-15 year end audit report.
The adoption of, or a change in, an accounting policy	✓	✓	This will be included, as necessary, within our 2014-15 year end audit report.

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 2014-15 year end audit report.
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 2014-15 year end audit report.
Sensitive accounting estimates		✓	This will be included, as necessary, within our 2014-15 year end audit report.
Consideration of laws and regulations		✓	This will be included, as necessary, within our 2014-15 year end audit report.
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 2014-15 year end audit report.
Significant matters arising during the audit in connection with the entity's related parties		✓	This will be included, as necessary, within our 2014-15 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 2014-15 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 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 ► 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		✓	An overview of the planned approach for the audit is included within this report. We will report on any further items with our year end audit report.
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 2014-15 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
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 2014-15 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 2014-15 year end audit report.
All material alternative accounting treatments discussed with management		✓	This will be included in our 2014-15 year end audit report.
Fees		✓	Discussed within this report and within our 2014-15 year end audit report.
Other material written communications with management		✓	We will provide our 2014-15 year end audit report.
Communication of independence matters		✓	This will be included in our 2014-15 year end audit report.
Other findings or issues regarding the oversight of the financial reporting process		✓	This will be included, as necessary, within our 2014-15 year end audit report.
Additional communications required on audits that are subject to (or that voluntarily apply) the UK Corporate Governance code			
Any information that we believe will be relevant to the Audit Committee and the Board of Directors to enable them to fulfil their responsibilities in relation to specific provisions of the 2012 UKCG Code ie C1.1; C2.1; C3.2 and C3.4		✓	This will be included, as necessary, in the 2014-15 year end audit results board report.

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Notes

Notes

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1. Interim Report review and Ernst & Young half year review findings

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POLARC14 (4th)
14/31 - 14/36

POST OFFICE LIMITED
(Company no. 2154540)
(the **Company**)

Minutes of a meeting of the AUDIT, RISK AND COMPLIANCE SUB-COMMITTEE held on 21 October 2014 by conference call.

Present:

Alasdair Marnoch	Chairman of Committee
Neil McCausland	Senior Independent Director
Tim Franklin	Non-Executive Director

In attendance:

Alwen Lyons	Company Secretary
Chris Aujard	General Counsel (GC)
Chris Day	CFO
David Mason	Head of Risk Governance
Malcolm Zack	Head of Internal Audit
Gavin Lambert	Chief of Staff

POLARC 14/31 **INTRODUCTION**

A quorum being present, the Chairman of the Committee opened the meeting and welcomed all those present.

POLARC 14/32 **MINUTES OF THE LAST MEETINGS AND MATTERS ARISING**

(a) The Committee approved the minutes of the meetings held on 15 May 2014 and 16 September 2014 for signature by the Chairman of the Committee.

(b) The Committee noted the actions list dated 17 October 2014.

POLARC 14/33 **RISK APPETITE STATEMENTS**

(a) The GC introduced the risk appetite statement and explained that the Business intended to have the necessary systems in place before the end of the financial year to enable it to comply with the UK Code of Corporate Governance as it applies to risk management and report this in next year's Report & Accounts. The enterprise wide risk management system incorporating the risk appetite would be used to understand and highlight risks as the Business moved in business transformation.

(b) The GC noted the importance of providing metrics and tolerance ranges for each element of the risk appetite statement as a practical guide for the Business, and recognising that the statement provided was only the first draft, asked the committee members for their input.

(c) The ARC was encouraged by the developing risk management framework, but still had concerns about the time taken to get all the components established in Post Office.

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(d) Specifically around the risk appetite statement the business was asked to:

1. Focus on more actionable statements with clear metrics behind each element.
2. Ensure the overall framework was established before populating each individual dimension
3. Reconsider the ratings used as 'Receptive' was considered too neutral for the 4th rating, and 'cautious' and 'minimal' were too similar to enable clear differentiation .

(e) The Committee members considered the risk categories in the statement and suggested 'customer', 'commercial partners' and 'change' could also warrant consideration as separate categories. They proposed that the high level general statement of appetite needed to be supplemented by more detail.

(f) The Committee gave the following specific feedback for each area:

Markets**:** They suggested that 'markets' should be differentiated to show more detail for the different markets in which the Business operates as well as any proposed new markets. The Business should be keen to take on risk in the markets in which it is established (either 'receptive' or 'hungry') but it should be much more cautious when entering new markets. They agreed that the Business should focus on their existing markets rather than committing investment to diversify. Lower profits would be acceptable to maintain revenue in mature markets, but not to the extent that this would be loss-making. The Committee understood why the Business would be neutral about Government contracts, given the recent history, but still felt enthusiastic about this market if conditions were right.

Financial**:** The Committee agreed that the sub categories were too narrow and that the Business should consider wider financial risk. It suggested highlighting appetite for asset/liability management; cost reduction; efficiency; and anything which might drive profitability through financial constraints or measures. It was thought that this was an area where the Business could be much more specific. All three members were 'hungry' to be free of subsidies.

Legal/regulatory**:** There was general support for this area although simpler language would be helpful when describing high profile matters.

People: The Committee recommended inverting the statements. For example 'hungry' for getting the right people with the right skills. They also asked the Business to consider including a specific reference to unions within the people section of the risk appetite.

Technology**:** There was general support for this area but the Committee though that as a business incorporating financial services, the risk appetite for any data inaccuracies should be 'averse'.

Operations**:** no comments.

Stakeholder**:** Impressed by statement around the potential to 'lose engagement of a key stakeholder' and considered this one of the best statements in the paper.

Corporate affairs: they acknowledged the importance of this dimension over the coming months and had no concerns with the wording.

(g) The Committee agreed that the draft appetite statement was a good starting point and directionally correct. The Chairman suggested that the Business take the specific feedback from the Committee, but to focus on a detailed redraft of the Market dimension for presentation at the November ARC meeting.

ACTION: DM/GC

(h) The Committee agreed to bring the risk appetite statement to the January Post Office Board Meeting.

ACTION: GC

(i) The GC reminded the Committee that PwC were undertaking a review of the risk framework and business change management capability. Their report would be tabled at the Business' Risk and Compliance Committee in November. The change management assurance would be incorporated into the Business Transformation work for the November Board.

(j) GC also reported that the Business would review its top risks again in January.

POLARC 14/34 **INTERNAL AUDIT UPDATE**

(a) The Committee received an update on the Post Office Internal Audit activity and key outcomes from June to September 2014.

(b) Malcolm Zack reported that there were no major issues with the implementation of the new finance system which went live in September. The remaining written assurance report on IT General Controls would be provided at the final programme board. He stated that the programme aimed to formally close down in the next week, although internal audit would continue to monitor.

(c) Malcolm Zack reported that the audit of Benefits Realisation had found no serious issues, but had highlighted a number of process points specifically around tracking financial and non-financial benefits through to conducting PIRs. The CFO agreed that the report raised valid concerns around the culture of the business and accountability. He assured the committee that the Business was working to tag benefits to programmes and ensuring the right people were accountable

(d) Malcolm Zack reported on the audit of the Business Continuity planning and noted that the overall plan was not yet complete. He explained that work was on-going and needed the business continuity manager to brief the ExCo and SLT, so that they were aware of the key steps to take in an emergency. The business aimed to address this by the end of the calendar year. The GC would bring an updated on the major incident/disaster recovery timetable to the ARC in January. It was agreed that the ARC would continue to monitor.

ACTION: GC

(e) The Committee noted the outcomes of the recent audits and reviews and the current and upcoming work.

(f) The Committee noted the amended Internal Audit 2014/15 plan.

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ACTION: MZ

(g) The Committee noted the status of audit recommendations and actions and requested that where actions were rebased that the new timeline be included to show a more accurate RAG status.

(h) The Committee asked if internal audit were considering a value for money audit of Network Transformation. Malcolm Zack stated that this was not currently in the plan. The CFO assured the Committee that he was in on-going discussion with the NAO to ascertain if they were likely to audit BiS, which they are not, and how the Business could best evidence value for money.

(i) The Committee was given assurance that the Internal Audit resource with the addition of PwC support was adequate providing the financial level of PwC support was maintained as per the co-source arrangement.

(j) David Mason and Malcolm Zack left the meeting.

ACTION: GC

(k) The GC explained that Malcolm Zack had handed in his notice and would be leaving the Business on the 31st December. It was agreed that the possible interim replacement be invited to attend the next ARC. It was agreed that when a new candidate is identified that they would meet the Chairman of the ARC as part of the interview process.

POLARC 14/35 **DATE OF NEXT MEETING**

The date of the next meeting is 10 November 2014.

POLARC 14/36 **CLOSE**

There being no further business, the meeting was declared closed.

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POST OFFICE LIMITED
AUDIT, RISK AND COMPLIANCE COMMITTEE
STATUS REPORT AS AT 4 November 2014

No.	**REFERENCE**	**ACTION**	**BY WHOM**	**STATUS**
A1	15th May 2014 POLARC 14/21(d)	Provide an update on the forensic audit on the Homephone revenue data, completed with Fujitsu	**CFO**	Update due in January
A2	15th May 2014 POLARC 14/22(f)	Provide a short summary of the July Board explaining the proposed management actions following the data centre procurement.	**Chris Aujard**	Update to follow
A3	15th May 2014 POLARC 14/23(e)	The Business was asked to consider identifying a 'response team' to deal with crisis management (in the event of another Sparrow)	**Chris Aujard**	Update to follow
A4	15th May 2014 POLARC 14/25(d)	Provide an update on the Video Mystery Shopping for Life Insurance	**Nick Kennett**	Update attached.
A5	21 October 2014 POLARC 14/33(g)	Focus on a detailed redraft of the Market dimension for presentation at the November ARC meeting.	**Dave Mason/General Counsel**	November ARC
A6	21 October 2014 POLARC 14/33(h)	Bring the risk appetite statement to the January Post Office Board Meeting.	**General Counsel**	January Board
A7	21 October 2014 POLARC 14/34(d)	The GC to bring an update on the major incident/disaster recovery timetable to the ARC in January.	**General Counsel**	January
A8	21 October 2014 POLARC 14/34(g)	Where actions are rebased in the IA status of agreed actions report the new timeline should be included to show a more accurate RAG status.	**Malcolm Zack**	Incorporated into the status of agreed actions.

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POST OFFICE LTD AUDIT & RISK COMMITTEE

Video Mystery Shopping

1. Purpose

The purpose of this paper is to:

1.1 Complete the ARC action from 15th May 2014 and provide an update on the performance of Video Mystery Shopping (VMS) for Life Insurance.

2. Background

2.1 In 2013 we implemented VMS as a core business tool to demonstrate our ability to deliver on customer outcomes and sales process.

2.2 Following the introduction of VMS and it was evident that we were not completely our sales process compliantly, as was demonstrated through the volume of red VMS. Red mystery shops represented circa 50-80% of all VMS.

2.3 In Q1 2014 an action plan was implemented by Post Office Financial Services to improve Video Mystery Shopping results.

2.2 A target of achieving 24% of Video Mystery Shops graded red with a tolerance up to 34% as long as performance demonstrated significant month on month improvements. Results need to be achieved by 30th September 2014.

2.4 Targets were set across Savings, Credit Cards and Term Life products.

3 Current Situation

3.1 We have now assessed performance against these targets, with the following results:

- Savings target has been achieved, result is 23%

SAVINGS - LAST 40 SHOPS								
	Red	**Amber**	**Green**	**Total**		**Red**	**Amber**	**Green**
Aug	2	3	9	14	**Aug**	14%	21%	64%
Sept	7	9	10	26	**Sept**	27%	35%	38%
Total	**9**	**12**	**19**	**40**		**23%**	**30%**	**48%**

- Credit Cards target has been achieved, result is 10%

CREDIT CARDS								
	Red	**Amber**	**Green**	**Total**		**Red**	**Amber**	**Green**
Oct	3	11	16	30	**Oct**	10%	37%	53%
Total	**3**	**11**	**16**	30		**10%**	**37%**	**53%**

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- Term Life target has not been achieved, result is 42%

	Red	Amber	Green	Total		Red	Amber	Green
June	11	3	7	21	June	52%	14%	33%
July	6	0	11	17	July	35%	0%	65%
Aug	1	1	1	3	Aug	33%	33%	33%
Sept	3	1	5	9	Sept	33%	11%	56%
Total	**21**	**5**	**24**	**50**		**42%**	**10%**	**48%**

3.1 We have therefore demonstrated a significant improvement in VMS performance and met targets for both Savings and Credit Cards. For Life Insurance we have demonstrated a significant improvement albeit we have not achieved the target.

4 Proposal/Next Steps

4.1 Given that we have not achieved the targets with respect of Life VMS we are taking a number of further actions.

4.2 We are re-training and re-accreditation a number of Specialists in the following area:

- Specialists with red VMS results for Term Life in the last 2 quarters, unless they had a subsequent green/amber Term Life result;
- Specialists with no life sales in the quarter July – September.

4.3 In addition to this we will be re-training all Financial Services Area Managers and re-training/re-accrediting any further Specialists who receive a red VMS for Life from October.

5 Commercial Impact/Costs

5.1 Potential loss of sales may impact the overall growth and income strategy.

5.2 Costs will be incurred for the re-training and reaccreditation program.

6 Key Risks/Mitigation

6.1 If further improvements are not made to the VMS performance for term life BoI may ask us to withdraw the accreditation/licences for all Specialists. This risk will be mitigated by the training and accreditation program and further validation through VMS.

7 Conclusion

7.1 Video Mystery Shopping is a fundamental key performance indicator of the Specialists and Supervisors competence and therefore will continue to be a focus of our attention. Further goals have been set to help us achieve the final target of an overall result of 24% of shops graded red by 31st December 2014.

8 Recommendations

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The Board/ExCo is asked to:

8.1 Note the update and actions set out above.

Jeremy Law
Head of Sales – Financial Services
3 November 2014

POST OFFICE LIMITED AUDIT, RISK & COMPLIANCE COMMITTEE

RISK SESSION (Risk Appetite)

1. Purpose

The purpose of this paper is to invite the Audit & Risk Committee (ARC) to consider, and approve for inclusion in the Company's inaugural risk appetite statement (as and when it is formally approved), the following:

- A modified risk appetite rating based on a 4 points scale, not a 5 point scale; and
- An updated, more granular, narrative relating to market' risk appetite statement.

2. Background

The committee will recall that at its meeting on 21st October a detailed discussion on risk appetite took place during which the committee provided feedback on both the risk appetite model and the detail of the content under each of the risk headings. The ARC requested, amongst other things, that the ExCo further develop the 'market' risk statement and table this for review at the meeting of the ARC on 10th November.

By way of context it might be helpful to recall that this discussion at the ARC was the outcome of a process of development beginning in August 2014 when ExCo received a presentation setting out the purpose of defining risk appetite and outlining a high level plan for the development of a risk appetite statement. Working with the risk function ExCo developed a first draft set of risk appetite statements, covering a number of dimensions of risk which was presented for discussion to the ARC last month.

3. Development

The feedback from ARC relating to market risk and the rating scale was considered last week by the Commercial Committee, the sub-group of the ExCo responsible for managing the revenue and associated risks of the business. After a detailed discussion, the Commercial Committee agreed that the five point scale set out in the original paper could be improved. The risk function have reviewed common practice across a range of organisations and provided specialist input to the Commercial Committee with the result that the scale has been recalibrated as a four point scale with a stronger focus on recognised risk terminology. This revised scale is set out in some detail at appendix A.

With respect to the content of those aspects of the risk appetite that relate to market risk, the direction given by ARC was to provide specific statements for each product pillar, alongside more generic statements about pricing and diversification of the business. This feedback was also considered by the Commercial Committee and revised wording agreed, which have been incorporated into the revised statements, also set out at Appendix A.

4. Recommendation

The ARC is invited to agree the revised risk appetite rating score and the updated risk appetite statements pertaining to 'market' risk.

POL00026973

5. Next steps

The risk function is working with the ExCo to finalise all the risk statements on the basis of the feedback provided by ARC and is liaising with CoSec to bring the updated statements through the appropriate committees in a timely manner.

David Mason
Head of Risk Governance

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Draft Risk Appetite Statements:

Category of Risk	Risk Appetite Statement	Potential metrics/indicators	Proposed Owner
<u>**Market**</u> Exposure to market changes, competitor activity, reputational or brand damage	POL has: • ***Risk tolerant*** attitude to pricing to drive revenue growth, but not to the point at which it becomes non profitable • ***Risk seeking*** attitude in the mails market where we will take on competitors in markets and accept reduced margin to defend market share • ***Risk neutral*** attitude in government services and telephony market where we will price competitively to retain market share • ***Risk seeking*** attitude in financial services • ***Risk averse*** attitude when it comes to diversifying Post Office's product portfolio or for business initiatives that may have adverse reputational or brand impact.	Market share data Spread/margin data Competitive price position Proportion of investment cases rejected/approved	• Martin George • Nick Kennett • Kevin Gilliland

Risk Appetite Approach	Risk seeking	Risk tolerant	Risk neutral	Risk averse
Risk taking vs. reward	Post Office actively encourages risk taking	Post Office is willing to take greater than normal risks	Post Office takes a balanced approach to risk taking	Post Office actively discourages risk taking
Objective/negative impact relationship	Willing to accept a significant negative impact in order to pursue objective	Willing to accept some negative impact in order to pursue objective	Potential negative impact and objective given equal considerations	Not willing to accept any negative impact

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POST OFFICE LTD AUDIT, RISK AND COMPLIANCE COMMITTEE

Annual Self Assessment and Terms of reference review – Noting paper

1. Purpose

The purpose of this paper is to:

1.1 Establish the committee's annual self assessment of its performance

1.2 Commence the annual review and approval of the committee's terms of reference and the annual review and approval of the Internal Audit Charter.

2. Annual Requirement

2.1 Section 2.4 of the terms of reference states that the committee;

- Review and update its terms of reference annually.
- Conduct a self-assessment of the performance of its duties and responsibilities annually, and to discuss the results with the Board of Directors.

2.2 Internal Audit aligns its activities with the International Professional Practices Framework of the Global Institute of Internal Auditors.

- One of the requirements is that the function should have a charter that outlines its responsibilities and mode of operation and that this should be annually reviewed and approved by the organisation's audit committee.

2.3 The terms of reference and internal audit charter will be circulated to committee members incorporating proposed changes and comments from management, E&Y and those arising from the recent risk review conducted by PwC. These will be circulated during November.

2.4 The self assessment questionnaire will follow a similar format to the one used in 2013. This will be despatched shortly after the November 10th committee meeting.

2.5 The results of the self-assessment and the feedback on the terms of reference and the Internal Audit Charter will be formally be considered at the next ARC meeting in 2015.

3. Action Requested

3.1 The committee is asked to note the above requirements and to complete the assessments and reviews accordingly.

Malcolm Zack
Head of Internal Audit
November 10th 2014

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POST OFFICE LTD AUDIT, RISK AND COMPLIANCE COMMITTEE

Internal Audit – Status of Agreed Actions – Noting Paper

1. Purpose

The purpose of this paper is to:

1.1 Update the committee on the status of agreed actions arising from formal audit and advisory activity

1.2 The committee is requested to note and provide directions as necessary.

2. Process and Summary

2.1 As outlined in previous ARC papers, the actions arising from IA activity are tracked and reported. The report highlights period movements since the last ARC (or since July 2014, since the previous Board), analyses overdue items and highlights any high risk items for attention.

2.2 The original agreed target dates are set by management. These are retained in the log even though it may be agreed between management and internal audit to subsequently re-set the target date. It is important for the business to remain aware that risks identified from audit work have yet to be addressed if an action date is changed.

2.3 As requested at the October 21st 2014 ARC, the long standing items that have been rebased are reported in a separate analysis below

3. Overall position as at 31st October 2014

ARC members are directed to the standard one page report that is now issued bi-monthly to the board.

<u>3.1 Implementations</u>

- Including items brought forward from the transition from Royal Mail at June 30th 2013, the current log holds **197** agreed actions, of which **134** have been implemented since then. This is POL's second year under the revised internal audit tracking approach.
  - Overall Implementation rate has gradually increased from 54% (February 2014) to 66% by April 2014 and 75% by end of June. (70% and above deemed acceptable levels).
  - A slight decrease was reported at end of August of 73% and 68% as at end of October 2014. This is due to the timing of new actions agreed with management, twenty of which are not due as at 31st October and the known rescheduling of IT actions.

<u>Opinion:</u> - Overall Implementation performance by management is generally satisfactory expect for known issues within IT, and some minor items in HR. The decline in pace

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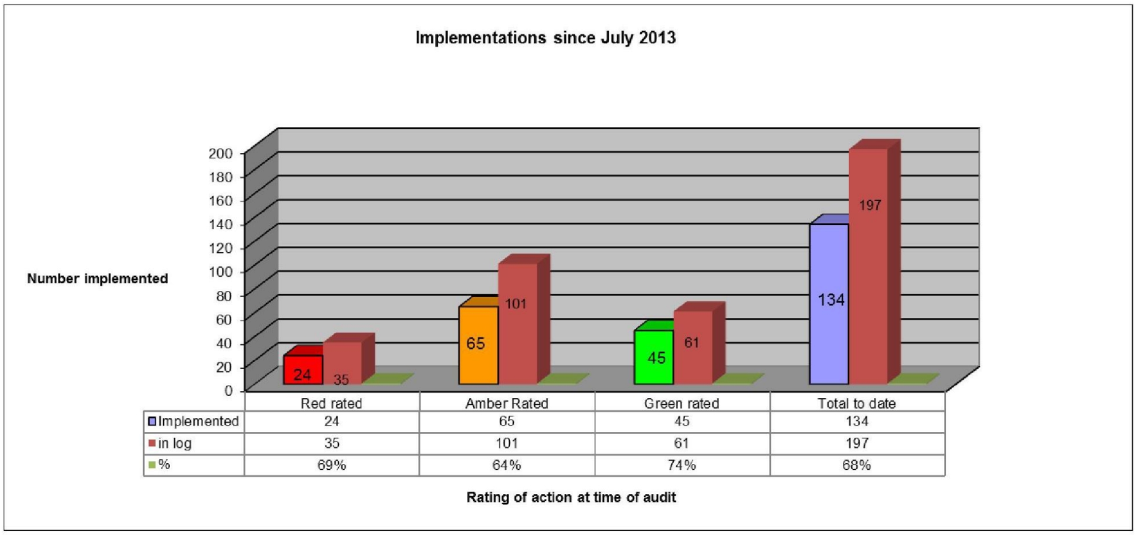
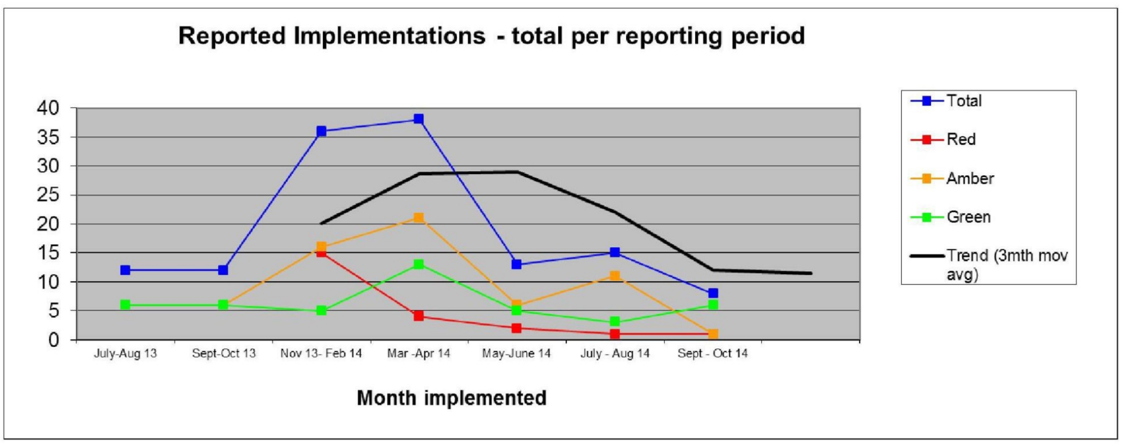
should reverse in the New Year as recent new items are implemented but this needs to be monitored.





3.2 <u>Activity through the period from September through to October 2014:</u>

- **37** Actions were brought forward from 31st August 2014,
- **25 agreed** actions were added to the log through a mix of audit and advisory work that took place in that period.
- **8** actions were implemented by management or agreed as closed which brings the total to **134** risk and control improvements since the transition in June 2013.

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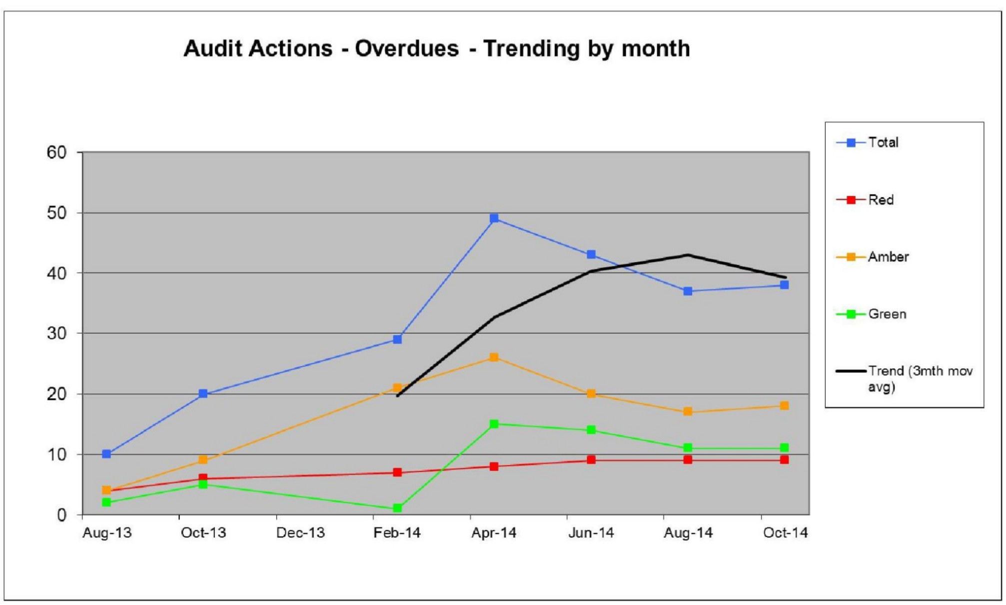
3.3 Items awaiting implementation.

Status as at October 31st 2014	**Total**	**Red**	**Amber**	**Green**
Total actions outstanding bfwd as at 31st August 2014	**37**	**9**	**17**	**11**
Implemented by Mgt - Sept- October 2014	**(8)**	**(1)**	**(1)**	**(6)**
Actions added (audits and advisory)	**25**	**3**	**13**	**9**
Superceeded/amended	**3**		**1**	**2**
Carried Forward as at October 31st	**57**	**11**	**30**	**16**
Analysis of Carried forward				
Overdue - yet to start	**0**			
Overdue - Work in progress	**37**	**9**	**18**	**10**
Not yet due	**20**	**2**	**12**	**6**
	57	**11**	**30**	**16**

3.3 Analysis of items carried forward as at 31st October 2014.

- Of the **57** items carried forward, **37** are overdue from original target dates but are in progress. 20 of these are in IT and are outlined in a further section below. **20** items are not yet due having target dates after October 31st. The overdue items reported as end of each of the last 3 reports have been steady at 37-38 which reflects the IT issue. Other areas of the business have generally addressed actions within target or shortly after target date.



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4. Review of recent implementations and key outstanding items

4.1 The 8 actions **implemented** in the period are summarised below.

Area	Actions implemented	Risks addressed/Benefits
Benefits Realisation (4) **Audit report issued in October 2014. Most actions not yet due, but 4 addressed during October by management.**	Changes to the Investment Business Case template to show the phasing of expected benefits to be clear.	Reporting and clarity of proposed benefits to aid approval/non approval of business case.
	Tolerance added for benefits to trigger revision of business cases in the guidance on completing the business case template	Keep the business case updated to reflect changes as project progresses. Enables revised benefits to be considered or where necessary to reassess the case for continued investment.
	Scheduled review of investment business case template.	Keep model up to date to reflect business changes.
	PIR Date agreement added to gating processes for Finance purposes.	Help ensure that PIRs are scheduled in at an appropriate date and undertaken
HR SAP – supporting processes (3)	HR processes compliant with Data Protection requirements. New forms on My HR site to capture information. These were significantly overdue from late but not of high risk.	Compliance risks for information gathering.
Business Continuity Planning (1) (Report issued in September 2014)	Supplier and colleague information added to Finance BCP. This was addressed shortly after raised in the audit.	Ability to contact key staff or third parties quickly as possible after invocation of plans resulting from a major incident.

4.2 Significantly overdue items

As reported in the March and May 2014 ARCs and in Board updates, a number of items that were outstanding were within IT. IT rebased a number of these with agreement of Internal Audit to reflect changing requirements and timelines of the SISD/Tower model.

- At the October 21st ARC, the committee requested an analysis of the rebased IT audit actions so that the current targets and pace could be assessed. Internal Audit will continue to monitor progress and will provide regular updates to the ARC members

Appendix 1 tabulates the status.

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- The IT Governance and Controls manager, who was appointed in January 2014, left the business in the summer and the role was not replaced. The ownership of the coordination of eventually passed to a more senior member of the CIO team (Roger Middleton) who monitors progress on behalf of the CIO.

- Remaining items were originally agreed in 2013 from the software licence and Identity Access Management audits but were partly dependent on the implementation of the towers. At that time the CIO anticipated the tower deployment to be much earlier than is now the case.

- The target dates for tower deployment have continued to change and the impact of the Business Transformation Programme is currently unknown. Therefore a number of the actions have been rebased more than once.

- Some items however are within the IT team's more direct remit and are significantly overdue and past their revised dates. We have noticed that changes in ownership for some of these items which have contributed to the delay. As at 30th of October, Internal Audit was notified that ownership of the EUC tower related actions had been passed to Roger Middleton.

Summary of overdue IT actions status

Risk rating at time of audit.	Past original date	Past revised target date	Note
Red	8	5	2 items have a second revised date, 2 items waiting revised target date.
Amber	11	4	1 item has a second revised date, 3 items awaiting revised dates.
Total	19	8	

Opinion

- Whilst the towers procurement have been the main cause of rebase of target dates, the slow progress on some other items within more direct IT control needs focus.

- Internal Audit has reiterated that progress in these areas needs firmer ownership and oversight by the senior CIO team.

- It is recommended that the CIO is invited to the ARC before the end of the financial year to provide a further update.

5 Action for ARC members

- The committee is requested to note the status and to provide direction as necessary.

Malcolm Zack
Head of Internal Audit
10th November 2014

Appendix – Table of IT outstanding agreed actions. (P 6-15)

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APPENDIX 1

IT - Outstanding Actions – Summary.

The table highlights the issues and actions that management are undertaking as part of the response. A comments and history column is provided for context. The original and current target dates are shown. Red if date passed, Green if yet to pass.

Issues and Agreed Action	***Risk Rating***	***Owner***	***Action added to log***	***Original Date***	***Revised Date (s)***	***Comments and history***
Identity Access Management on the Local Area Network. – Issued and cleared October 2013						
1. Management does not have an overall view of all users' access rights across the network. Therefore risks remain over inappropriate access, access higher than needed, potential conflicts and segregation of duties issues. <u>*Management Response and Action*</u> *The risk of having no overview of all users' access rights is accepted by the management for the current transition period, until IT & Change will adopt the Future Operating model (tower based).* *After the SISD and EUC tower is established, a feasibility study will be conducted into an appropriate solution; an appropriate decision will be made.*	***RED***	*Dave Hulbert/ SISD (Atos)/ EUC tower* *Roger Middleton (from November 2014)*	*30/10/2013*	*31-Jul-14*	***31-Dec-14***	*May 2014 – Requirements fed into EUC contract but action for completion could not be confirmed until the bidder was awarded and on board and contract signed. EUC contract expected completion by August.* *The overall governance of the IAM process and the definition of the roles and responsibilities between PO, Atos and EUC/application tower, is dependent also on towers implementation.* *June 2014 - EUC Contract is expected to be awarded mid September 2014. Date for action cannot be confirmed until Supplier has been awarded contract. So reforecast to 31st December 2014.* *August – no further progress* *October - Action reassigned to R Middleton.*

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Issues and Agreed Action	***Risk Rating***	***Owner***	***Action added to log***	***Original Date***	***Revised Date (s)***	***Comments and history***
2. The wide use of Executive PAs sharing User IDs and passwords is counter to POL company information security policy, and accepted practice. PAs to senior / executive management are aware of their managers' passwords (e.g. MS passwords, Orbit passwords) and in certain situations they use it to perform activities on the request of the manager. The 'back-up' PA knows the passwords for all the PAs whom she is replacing. Sharing passwords is in breach with the Information Security policies. <u>Management Comment and Action</u> *Due to increased cost associated with creating new accounts with CSC and the move to a EUC tower in the coming year the risk (PAs using SM accounts and passwords) is accepted by management for the moment, until the new IT Operating model is effective.* *Once the EUC tower is in place, unique PA's accounts with same access rights as for mangers; where required, can be created and these options will be evaluated for the new Ops model and future IAM process. Additionally it will be evaluated if the activities of these accounts can be logged and monitored.*	*AMBER*	*Dave Hulbert* *Transferred to R Middleton – Nov 2014*	*30/10/2013*	*31-Jul-14*	***31-Dec-14***	*May 2014 -update* *Fed into EUC bid requirements but cannot be actioned until contract signed.* *The governance of the IAM process and the definition of the roles and responsibilities between PO, Atos and EUC/application tower, is dependent also on towers implementation. As the EUC tower is still to be awarded (expected date August), Action retargeted for December 2014* *June 2014 update* *EUC Contract is expected to be awarded mid September 2014. Date for action cannot be confirmed until Supplier has been awarded contract.* *IA Update as at 31/08/14.* *No progress since last updates 24/06/14. However as noted, activity for this action will commence after the EUC Contract has been awarded.*
3. Remote access to POL intranet is granted, to end users, via a VPN Client connection using the Microsoft account and password (same as used for logging on to the PC). No additional security (code or RSA token) credential is used for remote logging on. This would normally be used to reduce the risk of unauthorised access from a remote location.	*AMBER*	*Julie George*	*30/10/2013*	*30-Apr-14*	***TBA***	*Original April target not met.* *IA Follow up in June 2014 indicated it had not been discussed within IT. IT Governance manager was to follow up but left the company.* *August - no progress. Issue sent to J George on September 5th R Middleton*

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Issues and Agreed Action	***Risk Rating***	***Owner***	***Action added to log***	***Original Date***	***Revised Date (s)***	***Comments and history***
<u>Management Response and Action</u> *Management (CIO) have accepted the risk, of limited remote access security, taking in consideration the IT changes on going at the present time. (October 2013)* *ISAG will perform a risks-cost–benefits analysis, based on industry remote access trends. Based on the analysis, appropriate actions will be discussed and agreed.*						*chasing.*
4. POL does not currently have its own fully defined and approved process for managing access to the local area network. It uses the Royal Mail (RM) processes. POL does not possess an end to end overview of the IAM process steps, roles and responsibilities of the different parts involved in the process (e.g. POL HR, line managers, CSC). Due to the Separation and IT Transformation POL needs to have its own defined policies and processes. Therefore the Information Security team defined an IAM policy which provides overall guidelines on identity and access management. An IAM process is expected to be defined once the SISD and EUC tower are in place in 2014. *<u>Management Response and action</u>* *The governance of the IAM process will be defined for the Future Operating Model, and it will include clear roles and responsibilities for the SISD, towers (e.g. EUC) and POL.*	*AMBER*	*Dave Hulbert* *R Middleton Nov 2014*	*30/10/2013*	*30-Apr-14*	*31-Dec-14*	*Same as items 1 and 2*

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Issues and Agreed Action	*Risk Rating*	*Owner*	*Action added to log*	*Original Date*	*Revised Date (s)*	*Comments and history*
5. Governance over the process for IAM for the SISD and each tower is needed. *POL needs to deploy the IAM process governance and control to get adequate assurance that the IAM risks are managed across all levels of the SISD and the towers.*	*AMBER*	***Dave Hulbert***	*30/10/2013*	*30-Jun-14*	*31-Dec-14*	*May - IT Governance manager suggested that the target date be moved to 31st December because the EUC tower was to be awarded by August 2014* *The governance of the IAM process and the definition of the roles and responsibilities between PO, Atos and EUC/application tower, is dependent also on towers implementation.* *June. Management requested that the original recommendation be split into 4, one for each tower to aid tracking.* ***This recommendation was split into 4; one for each of the Towers to allow for relevant tracking of progress according to anticipated Contract Award dates for each Tower.***
6. POL needs to deploy the IAM process governance and control to get adequate assurance that the IAM risks are managed across ***the EUC tower.***	*AMBER*	*Dave Hulbert* *R Middleton*	*30/10/2013*	*30-Jun-14*	***31 Dec 2014***	*June:* *EUC Contract is expected to be awarded mid to late September 2014.* *October update* *EUC Contract Award date has been pushed to end of October 2014.*
7. POL needs to deploy the IAM process governance and control to get adequate assurance that the IAM risks are managed across the ***Networks tower.***	*AMBER*	*Dave Hulbert* *R Middleton*	*30/10/2013*	*30-Jun-14*	*31 Dec 2014*	*IA Update 24/06/14.* *Networks Contract is expected to be awarded by end November 2014.*

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Issues and Agreed Action	*Risk Rating*	*Owner*	*Action added to log*	*Original Date*	*Revised Date (s)*	*Comments and history*
8. POL needs to deploy the IAM process governance and control to get adequate assurance that the IAM risks are managed across the ***Back Office tower.***	***AMBER***	*Dave Hulbert* *R Middleton*	*30/10/2013*	*30-Jun-14*	*31/12/2014* ***31/01/2015***	*June –* *Back Office Contract is expected to be awarded by mid January 2015.so target date changed from December 2014 to Jan 2015*
9. POL needs to deploy the IAM process governance and control to get adequate assurance that the IAM risks are managed across the ***Front Office tower****.*	***AMBER***	*Dave Hulbert* *RM*	*30/10/2013*	*30-Jun-14*	*31/12/2014* ***31/03/2015***	*June -* *Front Office Contract is expected to be awarded by mid March 2015.So target date moved from December 31st to March 31st 2015.*
10. Controls will be implemented to ensure that new accounts are granted access based on job description access requirements and appropriate authorisation.	***RED***	*Dave Hulbert* *RM*	*30/10/2013*	*30-Apr-14*	*31-Dec-14*	*As action number 1.*
11. A review of access rights granted and amended needs to be implemented. *The access rights review control will be deployed by Service and Support function. The access rights review shall be performed by information owners, or line managers.*	***RED***	*Dave Hulbert*	*30/10/2013*	*30-Jun-14*	*30/09/2014*	*August* *Ownership residing with Stephen Hayes.* *Service design to confirm tools for the job for individuals or various user communities. The process should include tools for the job and also cover ad hoc requests that are not included in the standard tools requirement.* *Policy to also be defined.* *Revised Completion Date suggested as 30/09/2014* *Still not completed as at 31st October 2014.*

POL00026973

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Issues and Agreed Action	***Risk Rating***	***Owner***	***Action added to log***	***Original Date***	***Revised Date (s)***	***Comments and history***
12. The Service and Support team (Dave Hulbert's area) will make sure that a mover's access review control is part of the 'to be' IAM defined and implemented process.	***RED***	*Dave Hulbert*	*30/10/2013*	*28-Feb-14*	*31-Dec-14*	*May* *HR and IT Services began work on providing/obtaining information regarding staff who have moved roles* *Date revised top 31st December to reflect EUC tower datelines.* *August* *Action reassigned to Andy Holt in IT. HR yet to have the process for movers and leavers developed. Andy to work with service design to get this process developed.*
13. Longer term action: *POL IAM process owner will perform a monitoring control (e.g. compare the HR leavers list with the EUC disabled accounts list) to ensure accounts have been disabled timely and to eventually spot the ones who have been missed.*	***RED***	*Dave Hulbert*	*30/10/2013*	*30-Jun-14*	*31/03/2015*	*August 2014* *New nominated owner to be Ian Thomas.* *Revised Completion Date suggested as 31/03/2015*

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Issues and Agreed Action	*Risk Rating*	*Owner*	*Action added to log*	*Original Date*	*Revised Date (s)*	*Comments and history*
Software licensing audit – Issued and Cleared October 2013						
14. POL does not have its own software licensing management policy. *POL will define a Software Licensing management policy, which will:* *- define clear roles and responsibilities for POL, SISD and towers involved in the SLM.* *- identify how POL will get adequate assurance that SLM process is managed effectively by SISD and the towers.* *- Define that the license procurement decision making process stays with POL.* *- define that all purchasers of licenses for POL go through POL procurement.*	***RED***	*Dave Hulbert*	*30/10/2013*	*31-Dec-13*	*28/02/2014* ***31/05/2014***	*December 2013* *Actions are overdue. New amended due date for 28th February, with CIO approval.* *May 14* *An SLM policy has been drafted by ISAG and is now under final internal review by procurement. New amended due date set for end May* *IA comment: pending receipt of PO SLM policy* *June 14* *A Draft Policy was provided by Brian Harrison in ISAG which required input from Procurement/IT for the development of supporting standards or procedure..* *August 2014 - Action reassigned to Antonio Jamasb in Service Design. Revised Completion Date suggested as* ***31/05/2015.*** *October – Still awaiting policy. IA now liaising with R Middleton.*

POL00026973

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Issues and Agreed Action	*Risk Rating*	*Owner*	*Action added to log*	*Original Date*	*Revised Date (s)*	*Comments and history*
15. The SISD will be required to manage software licenses on behalf of POL. The SISD is expected to defined the SLM process and discuss it with POL.	***RED***	*Dave Hulbert*	*30/10/2013*	*28-Feb-14*	*30 June 2014*	*May 2014* *The Atos Ops Manual, Section 6 Service Transition, 6.1 Service Asset configuration management refers to the SLM process that Atos will manage* *Process has been drafted and signed off within Atos and is included within the operations manual. But yet to be activated.as there was a dependency on the separation project.* *June – Text reviewed did not have all relevant information included so IA did not accept closure* *August 2014 – further discussions with Roger Middleton in September 2014.*
16. POL will define its assurance and governance process around the SISD SLM process. Clear key performance measurements on SLM process needs to be defined.	***RED***	*Dave Hulbert*	*30/10/2013*	*30-Apr-14*	*30th June 14*	*May 2014.* *As above in 15.*

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Issues and Agreed Action	***Risk Rating***	***Owner***	***Action added to log***	***Original Date***	***Revised Date (s)***	***Comments and history***
17. Assurance processes needed to be built in around SLM *As part of POL's assurance and governance process around the SISD SLM, POL will need to be informed and have an overview of the SLM risks and ensure the adequate controls are in place to mitigate risks.*	*AMBER*	*Dave Hulbert*	*30/10/2013*	*30-Apr-14*	*30/06/2014*	*May.* *Action on hold to await Atos to manage the process which has been reviewed. Assurance needs to wait until after full separation.* *Linked to the Separation programme. Once POL licences are separated then Atos will take ownership for management. The separation team suggest a due date for this would be April 2015 due to the time required to complete and then embed the new process.* *October 2014 No progress.*
18 A software licences management tool needs to be in place and to be kept up to date by all towers involved.	*AMBER*	*SISD (Atos) (transferred from Dave Hulbert)*	*30/10/2013*	*30-Jun-14*	*TBC*	*May 2014 - Atos has a SLM tool, but it is not switched on yet for operational management.* *August 2014* *No progress.* *October 2014 No progress.*

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Issues and Agreed Action	*Risk Rating*	*Owner*	*Action added to log*	*Original Date*	*Revised Date (s)*	*Comments and history*
Review the current IT processes and controls covered by the IT& Change organisation, and an assessment of how those activities and processes will be covered by the new organisation, are carried out at the moment. *The aim is to give an overview, independent of the Job Descriptions, of processes, controls and accountabilities and who is doing what within the new IT organisation.* *Once this first step is achieved a benchmark shall be done with the defined new JD (and eventually with Atos contractual requirements which need to be satisfied by PO) to identify if there are any gaps.*	*AMBER*	*Alistair Menzies*	*20/12/2013*	*31-Jan-14*	*TBC*	*February 2014. All critical processes required for 1st April (23 processes) have been agreed and will be completed by mid-March. IT Services owners for these processes will be agreed.* *October 2014 – action still outstanding.*

POL00026973

IA Audit Action Status Report Summary as at October 31st 2014 .xlsx

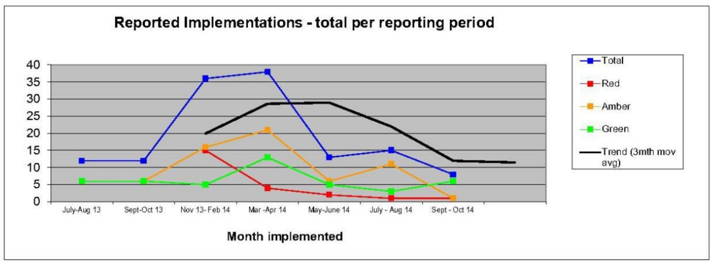
Status as at October 31st 2014

	Total	Red	Amber	Green
Total actions outstanding bfwd as at 31st August 2014	37	9	17	11
Implemented by Mgt - Sept- October 2014	(8)	(1)	(1)	(6)
Actions added (audits and advisory)	25	3	13	9
Superceeded/amended	3		1	2
Carried Forward as at October 31st	57	11	30	16

Analysis of Carried forward

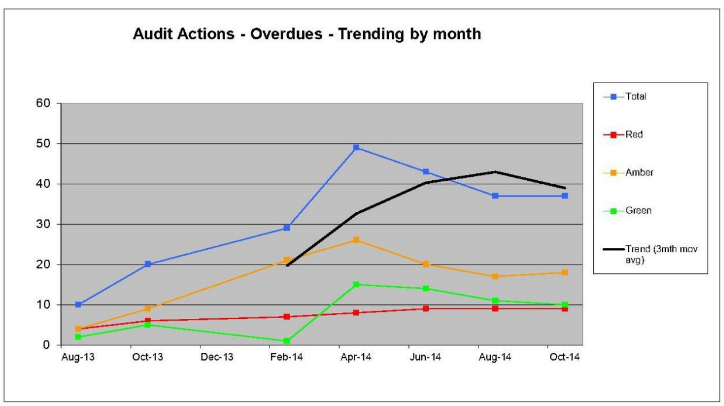
	Total	Red	Amber	Green	
Overdue - yet to start	0				
Overdue - Work in progress	37	9	18	10	
Not yet due	20	2	12	6	new
	57	11	30	16	

Trends



Reported Implementations	Total	Red	Amber	Green
July-Aug 13	12		6	6
Sept-Oct 13	12		6	6
Nov 13- Feb 14	36	15	16	5
Mar -Apr 14	38	4	21	13
May-June 14	13	2	6	5
July - Aug 14	15	1	11	3
Sept - Oct 14	8	1	1	6
Cumulative	134	23	67	44

Implementation down in period, mainly because of newer items that are not yet due and known revised target dates for IT actions.



Overdue as at	Total	Red	Amber	Green
31-Aug-13	10	4	4	2
31-Oct-13	20	6	9	5
20-Feb-14	29	7	21	1
30-Apr-14	49	8	26	15
30-Jun-14	43	9	20	14
31-Aug-14	37	9	17	11
31-Oct-14	37	9	18	10

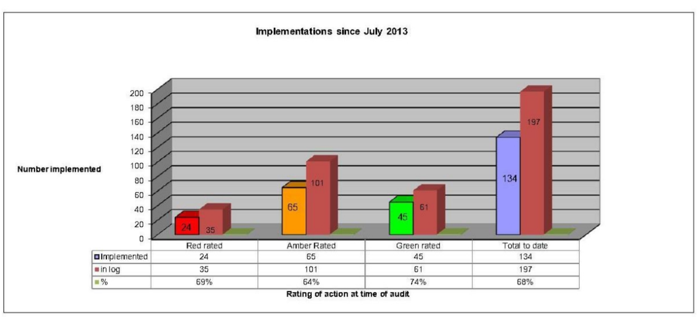
IMPORTANT NOTE - IT ACTIONS HAVE BEEN REBASED WITH NEW TARGET DATES LATE 2014 and into 2015 to reflect changes in expected implementations of towers

The IA recommendations log still retains the ORIGINAL target date so that the business is fully aware it is still aware of the risks identified in the audit and these are still in place.

Rebasing of dates for some IT actions due to later than planned tower implementations. Some items however in Identity and Access Management and software licensing are just overdue with delays in management action or changes in ownership.

The IT Governance and Controls manager position vacated in July 2014 has not been filled. Responsibilties passed to a senior member of the CIO team.

Implementations in period are within Benefits Realistion, Business Continuity and minor issues in HR



Implementations achieved (from June 2013)

	Implemented	Total in log	%
Red rated	24	35	69%
Amber Rated	65	101	64%
Green rated	45	61	74%
Total to date	134	197	68%

IA logs the total actions agreed with the business and tracks implementations since the final transition from Royal Mail IA in June 2013

The total implementation rate was above 70% during the summer, however there is a slight dip below ongoing target level due to the lower implementation rates in September and the addition of audit actions from recent audits. A number of these however (20) are not yet due. So implementation rate should recover above target line after the new year.

POL00026973

Post Office Ltd
ARC Meeting
10 November 2014

Location:

GRO

ATTENDANCE LIST

ATTENDEES	SIGNATURE
Alasdair, Marnoch	
Neil, McCausland	
Tim, Franklin	

Also in attendance

Alwen, Lyons	
Alice, Perkins	
Aujard, Chris	
Chris, Day	
Paula, Vennells	

Additional access

MacLeod, Jane	