

Royal Mail – Strictly Confidential

ARC (08)2ND
13 - 25

ROYAL MAIL HOLDINGS plc

(Company no. 4074919)

AUDIT AND RISK COMMITTEE

Minutes of the meeting held at 148 Old Street on 7th May 2008

Members of the Committee Present:

Helen Weir	Non Executive Director, Chair of the Committee
Richard Handover	Non Executive Director
Margaret Prosser	Non Executive Director

In attendance:

Adam Crozier	Chief Executive
Ian Duncan	Group Finance Director
Jonathan Evans	Company Secretary
Doug Evans	General Counsel
Derek Foster	Internal Audit & Risk Management Director
Mike Moores	Financial Management & Control Director
Sarah Hall	Chief Accountant
Alison Duncan	Ernst & Young
Will Rainey	Ernst & Young
Anup Sodhi	Ernst & Young
Andrew Poole	Deputy Company Secretary

ARC08/13

MINUTES

- (a) The minutes of the meeting of the 6th March 2008 were considered and approved as an accurate record of the meeting;
- (b) the minutes of the GLS Audit & Risk Committee dated 4th March 2008 were noted.

ARC08/14

STATUS REPORT

ARC(08)14

The Committee noted the status of actions from the previous meetings. In particular:-

- (a) ARC08/03(m) GLS Risk Assessment: Ian Duncan reported that the GLS Audit Committee had met on the 30th April. Succession was one of the key issues for the business and was under active consideration by GLS. This was an area of concern and Helen Weir said that she would report on this matter at the Holdings Board;

ACTION
Derek Foster

- (b) ARC08/07(c) Tax issues: the Committee noted the progress in recruiting for a new Tax Director and that temporary resource was being sought to strengthen the department. An

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update would be given on the Tax department Control Environment at the September meeting;

ACTION
Derek Foster

ARC08/15

- (c) ARC08/11(b)IA&RM Questionnaire: responses to the questionnaire were being collated and the results would be shared with the Committee at the next meeting.

2007- 08 YEAR END ARC(08)15 - 16

- (a) Group Accounts: the Committee noted the draft Press release, Preliminary Statement and set of Royal Mail Holdings plc Group Accounts including the draft Chairman and Chief Executive's Statement, draft Annual Review, Directors' Report, Directors' Remuneration Report, Operating and Financial Review and parent company accounts;
- (b) Briefing Book: the Committee further noted the Briefing Book providing an analysis of performance against prior year and the balance sheet movements year-on-year. The analysis had been provided to facilitate understanding of the numbers disclosed in the Accounts. An analysis of performance against budget for the year had been presented to the Board in the scorecard process for March 2008. There had been no movements in operating profit since that presentation;
- (c) the Audit and Risk Committee reviewed the Accounts for 2007-08 and endorsed the Accounts for approval by the Board;
- (d) Letters of Representation : the Committee agreed the content of the Letters of Representation included in the Ernst & Young report for issue to the auditors on behalf of the Board and delegated authority to the Board Sub Committee to sign the letter;
- (e) E&Y Report: the Committee noted the audit results report for the year ended 30th March 2008. In particular Will Rainey asked that the preliminary statement be clearly marked as unaudited. The Audit work had been accelerated to ensure that the primary statements and all notes to the accounts that tied into the primary statements were completed by the 7th May. The ability to accelerate the publication of the Group's annual results had been supported by a strong financial close process including a hard P11 close that had been well executed by the business;
- (f) E&Y confirmed that they concurred with the directors' conclusion that both the RMH Group and RMG accounts should continue to be prepared on a going concern basis. E&Y further confirmed that it would be appropriate to remove the emphasis of matter statement from the POL accounts;
- (g) on the basis of the work undertaken so far E&Y confirmed that they had not identified anything which would lead them to believe that they would not be able to issue an unqualified.

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audit report in respect of the Group financial statements and related notes;

- (h) Tax: Alison Duncan noted the issues that had arisen in relation to VAT and to the changes of personnel within the tax department – this had meant that a high level of attention had been given to this area. The Group would bolster the capability in the tax department especially with regard to VAT by the use of temporary consultants. E&Y noted that this was a critical area for the business and acknowledged that the right course of action had been taken to deal with the issues;
- (i) IT audit: following the challenges experienced in performing the IT audit in prior years, the audit process was greatly improved, as the ownership for managing third party suppliers and delivery of audit information was much clearer and individuals were more accountable. The most significant finding had been the unlimited access to the SAP system by third party programmers. The findings were consistent with the broad themes and challenges in relation to the Group's IT environment presented to an earlier meeting of the Committee;
- (j) POL: due to the current demands arising from Funding and the Government Review the POL close process at the centre had not improved to the same degree as Chesterfield. This was an area that was currently being reviewed by POL management;
- (k) 2007-08 Non-audit fees: the Committee noted a summary of the non-audit services provided by Ernst & Young during the last financial year.

ARC08/16

INTERNAL AUDIT & RISK MANAGEMENT QUARTERLY REPORT ARC(08)17

- (a) Derek Foster introduced a report summarising the activity of IA&RM for the period March 2008 to April 2008. The Committee noted:-
- (b) twenty-one reports had been issued in the period with 9 rated as not satisfactory or medium risk. The number of agreed recommendations overdue for completion had decreased from 10% at January 2008 to 6% in February 2008;
- (c) the Committee noted the quarterly IA&RM report dated May 2008.

ARC08/17

INTERNAL AUDIT & RISK MANAGEMENT PLAN ARC(08)18

- (a) Derek Foster introduced a paper setting out the proposed Internal Audit & Risk Management Department Plan for 2008/09;

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Derek Foster

- (b) the plan had been prepared using a risk-based approach to identify key business areas of coverage. It focused on specific areas of concern expressed by senior management and the Board. The approach also took into consideration the Group Risk Profile; the results of the rolling Risk and Control Self Assessment process (RCSA) undertaken by the business units; key areas of significant change, business areas which had not been subject to review for some time and results of previous internal audit reviews. In addition, both Postcomm's Forward Work Plan 2008-11 and the Audit Director Roundtable 2008 Audit Plan Hot Spots had been considered when preparing the plan;
- (c) the Committee asked that the reporting of audit activity against Plan include the activity covered by the GLS Audit team. The talent management work would cover the entire Group and not only the Letters business. Adam Crozier said that Internal Audit would accelerate the audit work in relation to the Network Reinvention programme;
- (d) the Committee approved the Internal Audit & Risk Management Department Plan for 2008/09.

ARC08/18**ANNUAL COMPLIANCE REPORT****ARC (08)19**

- (a) The Committee noted a report covering the compliance unit activity throughout the 2007 / 2008 financial year;
- (b) inevitably Royal Mail Letters was and would remain the key focus of the regulatory framework with Postcomm likely to increase their activity throughout the current Price Control. It would therefore be important that the current restructure activity was managed very carefully to ensure it did not raise unnecessary licence risks;
- (c) although this has been a challenging year the Compliance Director had no reason to doubt management's commitment to compliance, and was broadly satisfied with the progress carried out in Royal Mail in 2007 / 2008. The current Compliance Team headcount of 7 was unlikely to be sufficient in 2008 / 2009;
- (d) the Committee noted the contents of the report and thanked Luke March for his report.

ARC08/19**IT CONTROL ENVIRONMENT REVIEW****ARC(08)20**

- (a) A presentation was provided in response to the request from the Committee following their meeting in March asking for an assessment of the current IT control environment. In response to this request, PwC had been commissioned to provide an indication of the existing IT control environment using existing Control reports; and a benchmark report against other large UK Consumer Products and Service Companies;

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- ACTION**
Robin Dargue
- (b) there were several key areas, where the Company anticipated that improvements would be achieved through work that was progressing as part of improvements in the Service Delivery and Business Partnering particularly in IT performance management, Desktop/laptop security, changes to existing systems, Service Delivery, IT project management and third party management;
 - (c) the Committee noted the work in progress and acknowledged that firm conclusions could not be made about the control environment until the IT strategy had developed further. The Committee requested that Robin Dargue update the Committee at the September meeting.

ARC08/20**BUSINESS CONTINUITY UPDATE ARC (08)21**

- (a) The Committee was updated on the status of Business Continuity within Royal Mail and on the programme to develop Business Continuity capability further;
- (b) to meet these requirements Royal Mail had in place a Business Continuity policy, framework and deployment guidelines that were maintained by the Group Business Protection Manager. Deployment was via Business Unit and Support Function Business Continuity leads who ensure that each Business Unit considers their business critical activities and that plans are prepared to mitigate the impact of disruptions to these activities;
- (c) the Committee noted the update.

ARC08/21**POST OFFICE LIMITED COMPLIANCE REPORT
ARC(08)22****ACTION**
Derek Foster

- (a) The Audit & Risk Committee noted the Compliance report for May-2008;
- (b) the Committee agreed that Financial Services needed a higher profile and therefore the POL compliance report that was regularly presented to the Risk Committee would come to the Audit & Risk Committee for noting.

ARC08/22**REVIEW OF GROUP TREASURY COUNTERPARTY
LIMITS ARC(08)23**

- (a) The Audit & Risk Committee noted a paper informing the Committee of the recent review of the counterparty limits conducted by Group Treasury and approved by the Group Finance Director. Although the annual review of bank counterparty limits would not normally be notified to the Committee, it was thought that in the light of the present climate of the credit markets the Committee would want to be aware of the actions taken;

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- (b) the Committee noted the review of counterparty limits.

ARC08/23

ASSESSMENT OF RISK MANAGEMENT AND INTERNAL CONTROL SYSTEMS ARC(08)24

- (a) The Audit & Risk Committee noted that under Principle C.2 of the Combined Code, the Royal Mail Holdings Board (the Board) was required to establish a sound system of risk management and internal control to safeguard Shareholder's investment and the Group's assets. The system should provide reasonable but not absolute assurance that the Group would not be hindered in achieving its business objectives;
- (b) the Committee noted that when concluding on whether there was an appropriate and ongoing process for the identification, evaluation and management of significant risks facing the Group; that the process had been in place for the year under review and up to the date of approval of the Annual Report and Accounts; that reports and other outputs generated through the process had been regularly reviewed by the Board; and that it accorded with the Revised Guidance for Directors on the Combined Code.

ARC08/24

ANY OTHER BUSINESS

- (a) Regulatory Accounts: the Audit & Risk Committee noted a paper providing an outline of the process for the production and publication of the 2007-08 regulatory financial statements. The Committee was asked to approve the proposed year end process, and to agree that the Chair of the Audit and Risk Committee, in conjunction with the Group Finance Director, approve the final regulatory financial statements on behalf of the Committee;
- (b) the Holdings Board would be asked to delegate authority to a sub committee of Adam Crozier and Ian Duncan to approve and sign the final regulatory financial statements. The Committee noted and agreed the proposed process for the production and publication of the 2007-08 regulatory financial statements; and
- (c) the Committee agreed that the Chair of the Audit and Risk Committee, in conjunction with the Group Finance Director, would approve the final regulatory financial statements and the Letter of Representation on behalf of the Committee;
- (d) Ian Duncan confirmed that the Audit & Risk Committee meeting previously scheduled to be held on the 4th June 2008 was no longer required.

ARC08/25

DATE OF NEXT MEETING

The date of the next meeting of the Committee was Wednesday 3rd September 2008.