

**Royal Mail – Strictly Confidential**

**ARC (11)6<sup>TH</sup>  
51 - 60**

**ROYAL MAIL HOLDINGS plc**

(Company no. 4074919)

**AUDIT AND RISK COMMITTEE**

**Minutes of the meeting held at 100 Victoria Embankment London on  
8<sup>th</sup> December 2011**

**Members of the Committee Present:**

Paul Murray	Non Executive Director, Chair of the Committee
Donald Brydon	Chairman
Nick Horler	Non Executive Director
Cath Keers	Non Executive Director – by Telephone
David Currie	Non Executive Director

**Apologies:**

Orna Ni Chionna	Non Executive Director
Les Owen	Non Executive Director

**In attendance:**

Derek Foster	Internal Audit & Risk Management Director
Moya Greene	Group CEO
Matthew Lester	Group CFO
Jon Millidge	Company Secretary
Mike Prince	Financial Director, Management, Control & Shared Services
Andrew Poole	Deputy Company Secretary
Catherine Doran	Group CIO
Chris Day	CFO – Post Office Limited
Lesley Sewell	Head of IT – Post Office Limited
Rod Ismay	Head of Product & Branch Accounting – Post Office Limited
Paul Meadows	Head of Risk & Compliance – Post Office Limited
Jeff Triggs	Interim General Counsel
Anne Fletcher	Group Compliance Director for ARC(11)56
Richard Wilson	Ernst &Young
Kath Barrow	Ernst &Young
Ben Marle	Ernst &Young

The Chairman welcomed everyone to the meeting.

**ARC11/51**

**MINUTES**

- (a) The minutes of the meeting of the 17<sup>th</sup> November 2011 were considered and approved as an accurate record of the meetings.

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**STATUS REPORT**

**ARC(11)51**

- (a) The Committee noted the status of actions from the previous meeting.

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**INTERNAL AUDIT & RISK MANAGEMENT UPDATE  
 ARC(11) 52 & 53**

- (a) Catherine Doran joined the meeting. Derek Foster introduced the Internal Audit & Risk Management report dated December 2011.
- (b) There had been a number of significant changes / enhancements to the Risk Management Framework in the period. These should improve governance, and increase the view of Royal Mail as an investable proposition from the perspective of robustness of risk management / governance processes. The key changes included strengthening of the Risk Management Committee, refresh of Top 25 Group Risks, articulation of sizing of top risks and of current controls and future mitigation plans, creation of list of key processes and critical underlying controls, design of an attestation programme to begin to give a separate and specific assurance on specific key risks and key controls, and re-issue of the risk management policy including specifying minimum standards expected from units / functions;
- (c) Of the 24 IA&RM assignments completed in the period, IA&RM highlight four that were significant and had specific line of sight to the Top 25 Risks. These were: Information Technology Environment: Information Security and IT Service Resilience; Project Benefits Recording and Monitoring and Protection of Revenue. In each case, the findings were significant and support the business positioning of the issue / risk as key. In each case an action plan had been developed as a proportionate response, and the action plans were underway;
- (d) IT: IA&RM had conducted a review of the Information Technology Environment. The Committee were updated on the most significant reviews undertaken in the period by IA&RM in relation to IT: Service resilience and information security. Catherine Doran gave her perspective and update on the issues of service resilience and IT security in the broader context of the IT challenges facing the Group. A major factor was the age and complexity of the systems in RMG, and the fact that the business had very little in-house IT capability, due to IT outsourcing activity. The business had embarked on a programme of improvement, but this would take over two years to complete. Paul Murray noted that this was a significant risk for the business and asked for regular updates at future meetings. Moya Greene said that she would bring the Improvement Framework back to the committee and would also consider incentives for key IT staff;
- (e) Revenue protection: The business, like every other postal operator, was reliant on customer declarations for the

**ACTION  
 Moya Greene**

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generation of account mail revenue and there was little or no incentive for a customer to ensure that their declaration and mail specification was accurate. Furthermore, for single piece mail the business relies on the sender paying the right amount of money (through smart stamps, stamps or meters) for the format and weight of the product they wish to use.

The ability to tackle the root cause of revenue leakage was restricted by a number of competing strategies and priorities (e.g. 'Easy To Do Business With' initiative, maintenance of Quality of Service) and a lack of punitive measures to enforce compliance. There was a need for an overall strategy and accountability for the protection of revenue in the business, specifically to: set the strategic direction for the control environment for the protection of revenue; establish a risk appetite for revenue leakage; and, coordinate activity in the business impacting revenue leakage. Work was in hand by the Finance team to find methodologies such as "paper work on collection" and the further use of automation to help improve the position on Revenue protection. The meeting agreed that until all mail processing was automated (which in theory would mean that every bulk mail piece was identified using a bar code which highlighted the sender) revenue protection was an inherent risk.

- (f) Project benefits recording: The project benefits recording and monitoring process was designed to capture modernisation frontline staff costs by unit and by project. At a detailed level, this was achieved by means of the Integrated Finance Report (IFR) / Business Warehouse (BW) tools. The Strategic Plan assumed a reduction, from seven programme strands and forty-three active projects, of £1.4bn per annum in the cost of operations by 2016/17, as compared to 2009/10. The objective of the review was to assess whether robust processes were in place to record and monitor frontline benefit savings. The key conclusions were that the absence of a standard operating procedure, incorporating a documented end-to-end process with accountable benefit owners, resulted in Regions and Programme Teams designing their own approach to benefits recording and monitoring. This resulted in a lack of confidence in unit generated submissions, and Programme teams and central finance created their own monitoring tools, creating dual reporting with differing numbers. In addition, reasons for under/over achievement of benefits were not always captured to improve future deployments. Information produced for senior management did not contain a level of granularity that would allow effective monitoring of the successful achievement of benefits and remedial action where required. The key specific issues were consistency of benefits recording in IFR/BW, granularity of reporting, completion of post implementation reviews (PIRs), and communication of Standard Operating Procedures;
- (g) the methodology for calculating the frontline staff benefits for Walk Sequencing, Delivery Methods and Packet Simplified

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Sort Architecture projects had been documented, which accounted for 87% of total frontline staff benefits. The methodology for Collection projects and Mail Centre projects was still work in progress.

The roll-out of the benefits calculation methodologies, which includes forecasting, had been supported by a series of “training day” visits to Regions which is ongoing. Seven of the Regions had had their training days so far with a further three planned for November. Follow-up visits and ongoing support would also be provided to ensure the methodologies were fully understood.

**ACTION  
Derek Foster**

- (h) The Committee noted the report and the actions being taken and planned to mitigate these risks. Derek Foster would include a summary of all ‘not satisfactory rated’ audit reviews in future reports to the Committee.

**ACTION  
Matthew Lester**

- (i) Group Risk Profile: The Committee noted the update to the Group Risk Profile dated December 2011. Matthew Lester would revert to the Committee at the March meeting with more detail on the residual risks and risk appetite for the business.

**ARC11/54**

**POST OFFICE LIMITED    ARC(11) 54**

- (a) Pension overpayment: The Committee noted a paper providing an update on the progress made in Post Office Limited (POL) on the recent pension overpayments issue. The update included the quantification of the issue and the steps taken to resolve it;
- (b) In July 2011 the business became aware of errors in the POL pensionable pay records. Non pensionable bonus payments in relation to the 2008 Unite CMA pay award had been incorrectly included in final salary pension calculations. Further investigations found additional errors and, as a result, a number of employees and former employees have been issued with incorrect benefits illustrations and a number of POL pensioners have been overpaid and, indeed, underpaid. The financial cost of the error has now been confirmed at £261k (subject to minor refinement);
- (c) The Committee noted the findings on the pensions overpayments issue and that the actions taken have contained the issue; and noted the further steps being pursued to ensure the issue would not arise again; and noted that an update would be provided to the POL Board.
- (d) Update on Horizon controls and relationship with Fujitsu: The Committee noted that unlike other RMG major IT suppliers, Fujitsu does not have a SAS70 or equivalent report on its controls, and the consequence of this is that Ernst & Young (EY) needs to do full testing of all systems which are integral to the financial results as part of the RMG annual audit

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process. A number of IT control issues were identified during the 2010-11 year end audit, which were largely centred on Fujitsu. Overall EY was satisfied that the control systems were reliable but they had to perform additional audit work to make this conclusion, and they made certain recommendations in the management letter following the audit for improvements which have been implemented. The IT control issues identified during the audit did not relate to the integrity of accounting data in the system. Rather, EY made recommendations about the documentation and authorisation of changes to systems and about opportunities for streamlined assurance;

- (e) Fujitsu Services have committed to covering the cost to implement a SAS70 approach for POL for 2012-13 with EY carrying out this work so we expect a reduction in audit costs for 2012-13. The activities completed during the 2011-12 audit will provide the foundations for a SAS70. EY has ratified the approach we have taken for this year's audit and the planning is underway for the 2012-13 audits.
- (f) Challenges to Horizon: POL has, over the years, had to dismiss and prosecute a number of sub-postmasters and Crown staff, following financial losses in branches. A small number of these have defended the prosecution on the basis that they were not guilty of the charges made but that Horizon was faulty. Some former subpostmasters had defended civil debt recovery action by POL on the same basis. The Committee noted the update on this matter.
- (g) Update on POL Financial Services Compliance: The Committee noted an update on the progress made in Post Office Limited (POL) with regard to Financial Services compliance and to raise one issue with regard to a breach of data protection legislation;
- (h) In November 2010 BOI transferred its joint venture agreements to BOI (UK) plc (a wholly-owned subsidiary of BOI), incorporated in the UK. BOI (UK) is regulated by the FSA. Customers are, where applicable, protected by the Financial Services Compensation Scheme (FSCS). POL is an Authorised Representative of BOI (UK) and is not directly regulated by the FSA. BOI assumes responsibility for any regulatory failure by POL but POL will, in certain circumstances, be liable to compensate BOI for any loss resulting from any such failure;
- (i) POL Compliance has continued to focus on delivering improved compliance, by building on the outputs of the 2010 RMG Internal Audit. The 2010 POL Organisation Review provided an opportunity to re-shape the POL Compliance team which was re-launched at the start of 2011 as the Risk & Compliance (R&C) team, with a new structure. The strategy for the new team focuses on building a 'culture of compliance'; driving business accountability for compliance,

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with support from the R&C team; and providing tools and support to ensure focus on key risk areas. The new team has also developed a closer collaborative relationship with the BOI compliance function;

- (j) In 2006 POL was investigated by the Information Commissioner's Office (ICO) for a breach of the data protection principles (a bag of sensitive waste had been left outside a branch for waste collection). In lieu of the ICO taking enforcement action, POL agreed to an audit of waste disposal process in branches and signed a formal undertaking in 2007. Any further similar breach would be considered in light of this situation; any breach of the undertaking may lead the ICO to issue an Enforcement Notice;
- (k) A data protection breach occurred on 25 September 2011 when the Sub-Postmaster at the Portland Road, Hove agency branch left six boxes of waste outside his premises for collection the following morning by a waste company; two boxes included customer personal information. One box was found by two passers-by who informed the local press (The Argus) and the Police;
- (l) A message was issued to all Agency branches on 28 September confirming the requirement to follow confidential waste disposal procedures. A full investigation has been conducted and the customer information has been retrieved and analysed. A further Network communication is planned after the conclusion of the contract case. Next steps will then include an audit of Network compliance with data protection standards. The Committee noted the update.

**ARC11/55**

**GROUP TAX /SENIOR ACCOUNTING OFFICER  
 GOVERNANCE ARC(11)55**

- (a) Matthew Rose joined the meeting. The Committee noted a paper update for the Audit and Risk Committee ("ARC") on the Group's tax governance, particularly with regards to the "Senior Accounting Officer" ("SAO") compliance requirement;
- (b) Royal Mail's tax governance approach has been enhanced as a result of the work undertaken for SAO. This includes a greater awareness of process risks and a greater level of business involvement, including the sign off of tax sensitive processes. An internal sign-off letter and an awareness programme are in the process of being rolled out. There are a number of wider considerations that will be covered going forward. These include the future change to Royal Mail's operating structure and tax profile, potential tax resource constraints and the impact of moving out of the year 1 'light touch' SAO regime into the full regime;
- (c) the Committee noted that the Group had filed its first SAO

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certificate in September 2011 without qualification. This was done with support from EY; the report from EY includes recommendations for further actions and considerations as we move into year 2;

- (d) Initial discussions with HMRC confirmed there have been significant improvements over the years but that a continued focus is needed to move towards “low risk” status and to be able to continue to file clean certificates; and
- (e) The Group is to provide training to senior Finance teams to enable them to provide internal certification to the Group CFO as part of the preparation for year 2;
- (f) The Committee supported the approach towards implementation of a number of the identified actions from Year 1 in the Consultants and Travel and Expenses areas as well as the above actions for Year 2 in terms of training and use of external assistance where needed;
- (g) the Finance, IT and Commercial teams continuing to support appropriate implementation of required actions to enable VAT to be correctly applied on postal services systems and the associated accounting systems supporting VAT compliance;
- (h) the focus on reducing the dependence on some bespoke tax systems and a small number of key individuals without significant cover within the Group Taxation environment
- (i) Investment Counterparty Letter to HMG: The Committee supported the proposed letter to be sent to BIS seeking agreement to the use by the Group of RBS plus continued use by POL and GLS of various counterparties subject to appropriate due diligence and on-going monitoring.

ARC11/56

**GROUP COMPLIANCE UPDATE ARC(11) 56**

- (a) Compliance Report: Anne Fletcher introduced a report updating the Committee on key compliance activity during 2010/11 and the first part of the 2011/12 financial year and highlights key priorities for the current year, following the ‘below the line’ report to the October Board;
- (b) Whilst there had been significant change in both the regulatory environment and the wider compliance environment, it was important that the business did not lose sight of business as usual compliance activity. The current period had been a very busy , with the need to respond to a number of RFIs, investigations and complaints whilst working with the business to strengthen compliance procedures to mitigate risks further;
- (c) The Committee noted the Compliance report dated December 2011 including the priorities outlined for 2011/12.

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- (d) Bribery Act Implementation Update: The report updated the Committee on key Anti-Bribery compliance activity from the 2010/11 financial year to date, and highlights key priorities for the remainder of this year. The Bribery Act came into force on 1 July 2011, in preparation we have strengthened our processes in key areas and this work continues. Our anti-bribery compliance programme had been based on the 6 principles underpinning the Ministry of Justice guidance on adequate procedures;
- (e) the Committee gave a strong and clear message that the Group Bribery policy would apply to Post Office Limited, GLS and other JV's where appropriate. E&Y would report on the adequacy of procedures at the year-end;
- (f) The Committee noted the update.

**ARC11/57**

**AUDIT APPROACH 2011-12 AND PROPOSED FEES  
ARC(11)57**

- (a) Kath Barrow introduced an update to their report presented at the 17<sup>th</sup> November meeting providing additional information in respect of the detailed audit approach for the year ended 25 March 2012. This included the impact of the auditors consideration of risk, the extent of the control testing and the use of analytical tools and techniques to identify anomalies in large populations of data;

**ACTION  
Kath Barrow**

- (b) Paul Murray agreed to attend an E&Y planning meeting;
- (c) The Committee approved the 2011-12 Engagement Letters and delegated authority to the CFO to sign them.

**ARC11/58**

**RMG COPORATE RESPONSIBILITY REPORT ARC(11) 58**

**ACTION  
Moya Green**

- (a) The Committee reviewed and approved the Corporate Responsibility Report for the financial year 2010/11, and that the report would be presented to the Disclosure Committee prior to publication; and
- (b) noted Management's recommendations for improving the reporting of Corporate Responsibility activities over the next 12 months.

**ARC11/59**

**DIRECTOR'S EXPENSES                      ARC(11) 59**

- (a) The Committee noted schedules (copied to Committee members only) providing a summarised total of Directors' expenses and individual Directors' expenses incurred during 2010–2011, together with hospitality received.

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**ANY OTHER BUSINESS**

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- (a) Data migration: Moya Greene reported that the business had recently suffered from a problem with data migration affecting on-line customers. Royal Mail had now contacted all Smartstamp customers whose payment cards had been debited twice and an additional payment of £25 had been made as a gesture of goodwill. The process would be complete in the next few days. Royal Mail continued to work closely with Capgemini, who manage the website on our behalf, to restore services to normal.
- (b) Euro crisis: Matthew Lester confirmed that whilst the business was not undertaking the recent formal testing that had applied to Banks; the business was however reviewing its working capital levels across the business and preparing appropriate contingency plans where necessary.
- (c) General Meeting: Jon Millidge reported that a General Meeting of Royal Mail Holdings Plc would be held immediately following the Audit & Risk Committee to approve amendments to the Articles of Association.

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### DATE OF NEXT MEETING

The scheduled January 2012 meeting was cancelled. The next meeting of the Committee will be held on the 22<sup>nd</sup> March 2012.