

Initial Complaint Review and Mediation Scheme

Provisional and draft

**Not approved by POL and not discussed by the
Working Group**

MEDIATION BRIEFING REPORT

PART TWO

Draft V2

Second Sight - 30 July 2014

**This report and accompanying documents are confidential and are not to be disclosed
to any person other than a person involved in the processing of Applicant's claims
through the Scheme**

1. Introduction

- 1.1. This report has been prepared by Second Sight, which is the trading name of Second Sight Support Services Limited, the company appointed to conduct an independent investigation into a number of matters raised by Subpostmasters, or former Subpostmasters.
- 1.2. Part One of the Mediation Briefing Report ('Part One'), issued on 22 May 2014, describes some aspects of Post Office branch operating procedures and related functions of the Horizon system.
- 1.3. The purpose of this report is to expand on the main common 'Thematic Issues' that have been raised by many Subpostmasters in their applications to the Mediation scheme. This has been done in the interests of efficiency and in order to avoid duplication of facts and conclusions across many cases.
- 1.4. The report structure follows a modular approach, with each Thematic Issue forming a separate section within the report, that will be added to as the document evolves.

2. The Contract between Post Office and Subpostmasters

- 2.1. This section deals with two separate issues. Firstly the impact on Subpostmasters of some of the terms and conditions set out in the Contract and secondly, issues relating to the notification to Subpostmasters of the terms of the Contract.
- 2.2. The following extracts are taken from the 'Standard Contract' (dated September 1994) between Post Office and Subpostmasters. This is a 114-page document, that now incorporates several post-1994 amendments. A copy of the entire document is available on request.
- 2.3. The Standard Contract contains a number of provisions, the most significant of which are set out below, especially those related to responsibility for losses and shortages. As a result of these provisions the contract transfers several financial and other risks to Subpostmasters who may not have understood or appreciated those risks, particularly if they failed to seek independent legal advice before taking up their post. Observations relating to the more significant of these clauses are set out more fully below.
- 2.4. The Standard Contract spells out the rights and responsibilities of both Post Office and Sub-Postmasters. The clauses most frequently referred to by Sub-Postmasters are as follows:
 - a) **Section 17:** (in the November 2002 amendment) which lists the *Key Products and Services* (also referred to as the core products and services).
 - b) **Section 15:** (in the November 2002 amendment) refers to responsibility for the training of the Subpostmaster and, in turn, of the staff employed in a branch. Under this section the *Post Office undertakes to provide the Subpostmaster with relevant training materials and processes to*

carry out the required training of his Assistants on the Post Office Products and Services... and the Sub-Postmaster accepts the responsibility to ensure the proper deployment within his Post Office branch of any materials and processes provided by Post Office Ltd and to ensure that his Assistants receive all the training which is necessary in order to be able to properly provide the Post Office Products and Services and to perform any other tasks required in connection with the operation of the Post Office branch.

Also... Post Office Ltd may request from time to time that where it has obligations as described above the Subpostmaster should conduct specific training (whether through written/distance learning that may require confirmation of completion or via presentations) in relation to certain Post Office Services (such as, but not limited to, money laundering). Failure by the Subpostmaster to arrange for such training to be properly applied will be deemed to be a breach of this Contract by him.

c) **Section 1, paragraph 10:** which requires three months notice of contract termination from the Sub-Postmaster to Post Office and allows Post Office to:

terminate a Subpostmaster's contract at any time in case of Breach of Condition by the Subpostmaster, or non-performance of his obligation or non-provision of Post Office Services, but otherwise may be determined by Post Office on not less than three months notice.

In section 12 of the Standard Contract there are a number of paragraphs, as set out below, addressing responsibility for losses and shortages. These paragraphs are at the heart of all of the cases being considered in the mediation process.

d) **Section 12, paragraph 12:**

The Subpostmaster is responsible for all losses caused through his own negligence, carelessness or error, and also for losses of all kinds caused by his Assistants. Deficiencies due to such losses must be made good without delay.

e) **Section 12, paragraph 13:**

the financial responsibility of the Subpostmaster does not cease when he relinquishes his appointment and he will be required to make good any losses incurred during his term of office which may subsequently come to light.

f) **Section 12, paragraph 14:**

surpluses may be withdrawn provided that any subsequent charge up to the amount withdrawn is made good immediately.

g) **Section 12, paragraph 17:**

Subpostmasters may exceptionally not be required to make good the full amount of certain losses at his office. If he feels entitled to relief in making good a loss he should apply to the Retail Network Manager.

h) Section 19, paragraph 12: deals with Enquiries by officers of the Post Office Investigation Division and states that:

The main job of the Investigation Division is to investigate, or help the Police to investigate, criminal offences against the Post Office, British Telecommunications and the Department of National Savings. The Investigation Division does NOT enquire into matters where crime is not suspected.

i) Section 19, paragraph 19: allows persons interviewed by Post Office's Investigators to have a friend present during the interview but that that person may not interrupt in any way, either by word or signal.

- 2.5. Having considered the Standard Contract in some detail we are of the opinion that the terms of the contract appear to be biased in favour of Post Office and can, in some circumstances, operate to the detriment of the Subpostmaster. Also, we have not seen any evidence that Post Office either advises or requires the Subpostmaster to seek independent legal advice before taking up their post. We are also unaware of any cases where Post Office was prepared to vary the terms and conditions of the Standard Contract at the request of the Subpostmaster.
- 2.6. The Standard Contract transfers financial and other risks to Subpostmasters who may not have properly understood or appreciated those risks, particularly if they failed to seek independent legal advice. Consequently, there is a risk that appropriate risk mitigation measures may not have been implemented by the Subpostmaster. Post Office has the power to require Subpostmasters to implement new products and services and failure to do so represents a breach of contract that could give rise to suspension or dismissal. The risk here is that Post Office could implement decisions from which it reaps the benefits (such as by reducing operating costs) while the risks (and therefore the costs) fall onto the shoulders of the Subpostmasters who have no choice other than to accept the decision.
- 2.7. Post Office controls the Horizon Infrastructure including back-office accounting functions. A consequence of this is that Post Office may hold Subpostmasters accountable for shortages that they are unable to easily investigate. A Subpostmaster has very limited options in these circumstances and often have to make good losses, where the underlying root cause has not been established.
- 2.8. Many Subpostmasters are unaware that, under Section 19, Paragraph 12 of the Standard Contract, the Post Office Investigation Division ('POID') does not have a mandate to provide general investigative support to Subpostmasters. There is therefore no general investigative function readily available as POID would only act where suspected criminality had occurred.

2.9. We also note that when a POID criminal investigation is in progress, the interviewee is not allowed to be legally represented, although they may be accompanied by a 'friend', which could be considered as being unfair.

2.10. We have been told by many Subpostmasters that they were not given a copy of the 114 page Standard Contract until long after they had committed to purchase their sub-post office; or long after they had started work as a Subpostmaster, or even at all. We are advised that in some cases, copies of the Standard Contract were not provided until Post Office commenced litigation. Post Office has stated that its standard operating procedures require that Subpostmasters are provided with a copy of the Standard Contract no later than the day that they start work. We have, as yet, seen no example where any Subpostmaster at any point signed the Standard Contract itself. Rather, the practice seems to have been for new Subpostmasters to sign an 'Acknowledgement of Appointment Letter' which includes the following text: *"I accept the Appointment as Subpostmaster at: XXXXX Branch and agree to be bound by the terms of my contract; and by the rules contained in the book of rules and the instructions contained in those postal instructions issued to me"*.

2.11. It is worth noting that, in many cases, evidence of the provision of the Standard Contract (and of any document having been signed by the Subpostmaster) has not been retained by Post Office.

3. Automated Teller Machines (ATMs)

3.1. Part One provides, in sections 5.23 to 5.29, background information on the installation and operation of Automated Teller Machines ("ATM").

3.2. When a Post Office branch is equipped with an ATM it can be located either within or external to the branch premises. The installation of an ATM at a branch is often desirable as it can result in greater footfall and, as a consequence, increased sales of Post Office products and services.

3.3. Of the 150 applicants to the Mediation Scheme, approximately 20% have referred to problems with ATMs. The reported problems have included both small and large shortages that were charged back to Subpostmasters by Post Office. In other cases large surpluses occurred, which caused concern to some Subpostmasters.

3.4. Most of the reports that we have seen relate to Bank of Ireland ('BoI') ATMs and some to HANCO, as well as other, ATMs.

3.5. The normal cash dispensing process on BoI ATMs involves electronic interaction between the Branch's ATM; Wincor Nixdorf (the service and maintenance provider); the LINK platform and the customer's bank. The ATM cash balancing/reconciliation process involves electronic and also manual interaction between the Branch's ATM; the Branch's Horizon system; Post Office's Financial Service Centre (the 'FSC'); and BoI. This is a more complex arrangement, requiring greater human intervention at the end of the business day, than that typically deployed by most

high street and other banks whose ATMs are seamlessly connected to their own computer systems.

- 3.6. One notable problem, reported by several Applicants using Bol ATMs, seems to relate to the manual (rather than electronic/automatic) extraction and use of the 'cash dispensed' figures from the 'Bank Totals' receipt that Subpostmasters are required to obtain each day from their ATM and the daily input of 'cash declarations' into Horizon. This is sometimes referred to as "a problem with the 'air gap' between the ATM and the Horizon system".
- 3.7. In February 2008, Post Office issued an 'Operations Manual interim'. Post Office stated that it was issuing new instructions because "a number of non-conformance issues are still affecting the processes for ATM reconciliation and settlement and to explain the correct end-to-end accounting processes relating to Bank of Ireland ATMs."

- 3.8. The Introduction to the Operations Manual interim stated:

The Bank of Ireland, via the LINK network, extracts a 16:30 -16:30 'cash dispensed' figure automatically from your ATM each day. This figure forms the basis of a settlement to Post Office. This figure is the value of cash dispensed from your ATM from 16:30 the previous day until 16:30 on the current working day." In other words; the amount of cash dispensed to customers, from each branch's ATM during the previous 24 hours (or during the previous 72hrs between Friday at 16:30 hrs and Monday at 16:30 hrs), would be available to Bol and that data would be extracted by Bol from each ATM.

- 3.9. The Operations Manual interim goes on to say:

In order to meet the required business accounting standard, branches are required to obtain each day the 16:30 - 16:30 'cash dispensed' figure from the 'Bank Totals' receipt which is available from the Bank of Ireland ATM, and to enter this figure on the Horizon system on a daily basis... The Manual later describes that as needing to be done each day after 16:30 but before 19:00 hrs...

The Manual continues:

In Product and Branch Accounting (P&BA) a comparison is made between the LINK generated figure and the figure you enter on Horizon. If the totals differ, they are queried with Bank of Ireland and may result in a Transaction Correction sent to your branch. If you do not enter the daily 16:30 - 16:30 'cash dispensed' figure on Horizon, this means that the settlement figure by Bank of Ireland cannot be confirmed. In this case the two sets of figures are automatically reported as differing, resulting in reconciliation problems.

- 3.10. In addition to obtaining the cash dispensed figures from their ATM and entering it into Horizon at the right time of day, Subpostmasters were also instructed to make a daily cash declaration (and do this every day including on days when the branch closed before 16:30 hrs) through their Horizon terminal. Specifically:

You must make a daily cash declaration on the Horizon system for the separate stock unit you have set up for ATM transactions (including days when you close before 4.30pm (16:30 hours) and you have logged on to the ATM stock unit). Unlike cash declarations for your counter stocks, however, you do not need to make a physical count of the cash contained in the ATM in order to complete the declaration.

You must make the declaration before 7pm (19:00 hrs) and you must include all funds stored in your official safe that you have received on a Remittance specifically for your ATM.

- 3.11. It would appear that some Subpostmasters either misunderstood the complex instructions or were told by Helpline staff that *the problem would sort itself out* (though it did not) and subsequently found that the Helpline's advice was later countermanded. This comment and other similar ones referring to Helpline advice is found in nearly every instance where there were problems with the operation of an ATM.

- 3.12. A consequence of getting things wrong with the ATM cash dispensed figures was that an *out-of-sync* situation could develop where the branch's ATM would be expected (by Bol and by Post Office) to have an amount of cash in its cassettes different from the cash figure that the Subpostmaster had entered into Horizon.

- 3.13. This *out-of-sync* situation and associated reconciliation difficulties, became, it seems, commonplace in some branches prior to the February 2008 release of the Manual Update.

- 3.14. Indeed, the Manual says:

If following the instructions contained in this workaid means that the way you will now enter data on Horizon and balance your ATM cash will change (for example, if you have previously entered figures which are not based upon the 16:30 - 16:30 figures or if you have not completed this task daily, moving to the correct process is likely to result in a cash balancing difference).

If this is the case, P&BA will issue a Transaction Correction, to address the cash balancing differences, and will try to provide clear evidence and as much information as possible to help with correcting transactions. The correction assumes that all previous ATM dispensed figures have been recorded on Horizon accurately and that branch cash has been correctly declared.

- 3.15. Many Applicants have commented on the complexity of the processing of transactions by Horizon and the general lack of clarity and hence ease of use of the guidance and instructions issued by Post Office. The February 2008 instructions represent a good example of this complexity and the following extracts demonstrate how easy it might have been for some Subpostmasters to make mistakes, even after the new instructions were released:

From the paragraph titled *Loading cash into the ATM*:

Always enter in the ATM the number of notes loaded in the machine, not the value

Ensure that you enter the number of notes you are loading, not the amount already in the ATM

Please remember: At the weekly balance all figures are cleared. Therefore, you will need to enter all amounts in total when you reload the machine next.

- 3.16. The following extract is from the paragraphs dealing with *Weekly balancing and recording figures on the Cash Management Sheet*:

You must make a physical count of the cash in your ATM at least once a week and record the figures on the Cash Management Sheet before removing the cassettes for your physical check of the cash. You must not enter any of the figures on the Horizon system. The weekly balance can be carried out on any day of the week, even at the end of a Branch Trading period as long as your premises are closed to the public. It should be completed at any time after 16:30 hrs when the Disp 16:30 – 16:30 figure has been entered.

Please note: You do not have to reconcile the cash in your ATM with the cash declaration you make on Horizon. The ATM is balanced using the Cash Management Sheet as described below. If the Cash Management Sheet balances, your ATM has balanced.

... and the following extract is from the paragraphs dealing with If the Cash Management Sheet balances, but there is a discrepancy on Horizon:

The Horizon system should not be recording a discrepancy in the ATM stock. If a discrepancy is not rectified, it will give you a wrong carried forward figure and the problem could be compounded. If there is a discrepancy on Horizon but the Cash Management Sheet balances, you could have entered incorrect figures on the Horizon system.

Go back through your receipts and double check that the 16.30-16.30 'cash dispensed' figures for each day have been entered correctly on Horizon

Check that any ATM cash originally remitted into a counter stock has been transferred into the ATM stock

Check that the transfer into the ATM stock has been accepted

Double check that the daily cash declaration has been completed accurately

If you cannot resolve the discrepancy, do not phone the Wincor Helpdesk; please phone the NBSC for advice.

- 3.17. The Subpostmasters, in virtually every case that we have reviewed, state that they had no idea what was causing the *out-of-sync* situation. Of potential significance is whether the problems reported occurred before or after the February 2008 Manual update as the new instructions should have reduced or eliminated the potential for errors. If the branch's ATM was operating after the 16:30 hrs Bol 'cut-off' time during the week and/or at weekends (as would clearly be the case with externally located ATMs), then the transaction volumes and associated accounting entries on the following Monday would include all cash dispensed in the

preceding 72 hrs between 16:31 hrs on the previous Friday afternoon and 16:30 hrs on the following Monday afternoon.

- 3.18. We have also been told that when ATM-related reconciliation and out-of-sync problems were reported to the Helpline, Subpostmasters were often told to *ignore the shortfall because it will sort itself out*. This advice runs the risk of allowing a large shortfall to build up, whilst awaiting the possible issue of a Transaction Correction, rather than dealing with the underlying problem. Inadequate and possibly inappropriate advice, particularly prior to the 2008 Manual update, appears to have been frequently provided which may have resulted in Subpostmasters eventually giving up trying to understand and resolve problems and hence coming under pressure to *falsely account* as part of a temporary solution to an as yet unresolved problem.
- 3.19. Many Subpostmasters have commented on the apparent impact on ATMs of power and communication failures. Although there are standard processes in place to deal with power cuts and a loss of connection that should reduce the potential for data loss the need in such circumstances for an ATM to require restarting by the Subpostmaster, or remotely by Bol could introduce this possibility depending upon the point in the process at which such failure occurred.
- 3.20. There have been many reported instances where a cash withdrawal cannot be completed due to a problem occurring during a transaction. Depending on when the problem arose it is possible for cash that should have been dispensed to the customer to be withheld by the ATM but the customer's bank account nevertheless debited.
- 3.21. In addition when cash is dispensed by an ATM, but there is a delay in the customer physically removing the cash from the ATM, then after a set period the ATM will retain the cash. This is known as a retract.
- 3.22. In addition to a customer innocently delaying retrieval of cash it is also possible that some of the large discrepancies reported could also include losses due to external theft using sophisticated methodologies such as retract fraud or the more advanced transaction reversal fraud. The risk and consequences of this and the need to take remedial action have been discussed at length with Post Office although action on this has only been taken quite recently.

4. Motor Vehicle Licences

- 4.1. Not all branches are authorised to issue Motor Vehicle Licences ('MVL') and only a small number of Subpostmasters have reported problems with MVL processing. We have seen however, repeated instances of a particular problem. This relates to V11C forms that were misprinted with an incorrect bar code. This seems to have resulted in Horizon recording the sale of a 12 month tax disc, when in fact a 6 month tax disc was sold.
- 4.2. If this error is not immediately noticed at the Horizon terminal, a discrepancy, being the price difference between the 6 and 12 month MVL Tax Discs, will occur. In branches issuing large numbers of MVLs this may become a significant amount.

5. National Lottery

- 5.1. Not all branches sell Lottery tickets or Lottery Scratch Cards. Where these items are sold, they are usually sold from the co-located shop's retail counter, rather than from the Post Office counter, even though they have to be accounted for using the Horizon terminal at the Post Office counter.
- 5.2. There is often a significant difference in the opening hours of the counter in the retail shop and the Post Office counter. The retail counter will therefore be selling Lottery tickets/Scratch Cards outside the hours where the Horizon system is operating at the Post Office counter. Since branches are not allowed to sell National Lottery products other than through the Post Office, all ticket sales have to be recorded, each day, in Horizon. Also, before any Lottery Scratch Cards can be sold, they must first be '*Activated*' on the Camelot terminal and then '*Remmed in*' to Horizon.
- 5.3. We have received many reports where Subpostmasters have stated that their branch's Horizon system would get '*out-of-sync*' with the quite separate Camelot system, thereby generating material surpluses or deficiencies that were eventually corrected by Post Office Issuing Transaction Corrections ('TCs') through the Horizon system. The average Lottery-related TC was approximately £650 and many of these TCs were for amounts that were exactly divisible by £160, that being the value of a full pack of Scratch Cards.
- 5.4. These problems appear to have been most serious and frequent between 2005 and February 2010, when Post Office made a significant change to its standard operating procedures that made it impossible, after that date, to have packs of inactive Scratch Cards recorded in Horizon at the same time as in the Camelot system. A further important improvement was made in February 2012 when Post Office introduced a system change that finally eliminated the possibility of synchronisation errors between the Horizon and Camelot systems.
- 5.5. We have also been told that, before these important system improvements were introduced, inconsistent and sometime conflicting advice was provided by the Helpline which further exacerbated the problem.
- 5.6. The *out-of-sync* problem was particularly relevant in branches where the retail shop sold Lottery tickets late into the evening, after the Post Office counter had closed. A further complication often occurred on those Wednesday evenings marked the end of the monthly Trading Period. Subpostmasters were required to reconcile the Horizon/Camelot figures first thing on a Thursday morning, rather than at 17:30 hrs on the Wednesday, but this requirement was not always advised by the Helpline. It is not clear whether the training that Subpostmasters received covered this important point.
- 5.7. A specific example of the Camelot/Horizon synchronisation issue is described in *Appendix 4* to 2nd Sight's Interim Report dated 8th July 2013 and this provides further important information about this matter.

6. Limitations in the Transactional 'Audit Trail'

- 6.1. Many Applicants have claimed that they were unable to determine the root causes of discrepancies (both shortfalls and surpluses) reported by Horizon, because the underlying transaction data was not made available to them.
- 6.2. The concerns fall broadly into two areas:
- a) data that isn't available even on the day of the transaction; and
 - b) data that was only available for 42 days after a transaction occurred (later increased to 60 days following a system change by Post Office).

Data that isn't available even on the day of the transaction

- 6.3. Applicants' concerns principally relate to transaction types where Horizon produces, at the end of day, only an *aggregate amount* and *volume* for that day's transactions e.g.: *Transactions: 35, Value: £17,112.55*.
- 6.4. This occurs, for example, where customers have paid for goods and services by Debit or Credit Card.
- 6.5. In the event of an end-of-day discrepancy for this transaction type, and without the benefit of a disaggregation of a total amount into its constituent transactional components, Subpostmasters found it difficult, if not impossible, to identify the individual transaction(s) that brought about the discrepancy.
- 6.6. Typically, a Subpostmaster will need to find items:
- a) that should be, but are not, included in the aggregate total; or
 - b) amounts that have been incorrectly entered such as £50.00 entered as £500.00, £39.00 entered as £93.00, etc.; or
 - c) amounts that form part of the aggregate total, but should not have been included in that total at all.
- 6.7. Only by finding those errors and omissions can the Subpostmaster begin the process of correction and loss mitigation. That may sometimes involve contacting the relevant customer but in order to do that, he needs not only to identify the incorrect or missing *transaction*, but also know the name, and perhaps also the address, of the relevant customer.
- 6.8. Many Subpostmasters have told us that prior to the introduction of Horizon it was easy to do this since the paper dockets retained to evidence each transaction provided this information. It is regrettable that the Horizon system does not provide the same functionality as the previous manual system.

Data that was at first available, but after 42 days (later extended by Post Office to 60 days) is no longer available

- 6.9. The main concern expressed about data availability is the need to go back to a previous period in the event that delayed Transaction Corrections ('TCs') are issued by Post Office. If the delay in issuing the TC exceeds 42 days (now 60 days), the Subpostmaster has little choice other than to accept the TC. Requests for supporting evidence that would enable the substance of the TC to be validated were routinely rejected by Post Office, usually on cost grounds. Also, the difficulty in both printing out and examining Horizon's 8cm wide 'till rolls' was a significant issue in isolating discrepancies.

7. Transactions not entered by the Subpostmaster or their staff

- 7.1. Many Applicants have reported that Horizon transactions have been entered, or cash or stock balances changed, when the branch was closed and no one had access to any of the Horizon terminals. Evidence has also been provided of transactions apparently occurring after a Subpostmaster was suspended and had no access to the relevant systems. Enquiries on these matters are continuing.
- 7.2. Post Office has confirmed that it is its understanding that it is not, and never has been, possible for anyone to access Branch data and amend live transactional, cash or stock figures without the knowledge of the Subpostmaster or their staff. However, we are aware that certain error recovery and correction processes can result in transaction reversals that carry the System Identities ('IDs') of the branch employee who entered the originating transaction that the system itself is automatically reversing (see 'Automatic Transaction Reversals').

8. Automatic Transaction Reversals

- 8.1. As mentioned above, a number of Applicants have reported transactions that appear to have been input when the branch was shut and no one had access to the Horizon terminals.
- 8.2. Also in some instances 'ghost' transactions appear to have contributed to shortfalls for which the relevant Subpostmaster was later held accountable. 'Ghost' transactions are genuine transactions that for some reason appear multiple times in the Horizon records. We briefly dealt with this issue in our Interim Report (see Spot Review 01). In that example, the Horizon system had automatically reversed a transaction which was only partially completed. Although the Subpostmaster had entered the original transaction, *he had not entered the reversal of that transaction*. Rather, the Horizon system had automatically generated a transactional reversal after suffering a telecommunications interruption.
- 8.3. The transaction identity assigned by Horizon to that reversal was that of the Subpostmaster, rather than a system-generated ID. We note that this appears to fail to differentiate between entries genuinely made by a User and those that are system generated. We regard this as a systems design error.

- 8.4. This misuse of User IDs for system generated transaction reversals appears to be inconsistent and not yet fully understood. Various assurances and evidence have been provided by Post Office and further enquiries are continuing.
- 8.5. This matter was also highlighted in a report by Helen Rose, Post Office Security - Fraud Analyst - dated 12 June, 2013:

"... it is just that I don't think that some of the system based correction and adjustment transactions are clear to us on either credence or ARQ logs."...

"However, my concerns are that we cannot clearly see what has happened on the data available to us and this in itself may be misinterpreted when giving evidence and using the same data for prosecutions."

N.B. 'Credence' is a Post Office Management Information Reporting System and 'ARQ logs' is a reference to a request for Horizon information archived through the 'Audit Retrieval Query' process.

9. Cash and Stock Remittances ('Rems') in and out of the branch

- 9.1. A number of Applicants have raised issues concerning 'Rems'.
- 9.2. 'Rems' are inward and outward remittances of stock or cash (including foreign currency). Large amounts of cash and stock are routinely sent to and from branches using this process. Robust procedures are in place to ensure that the process normally operates reliably and that errors, or theft, are rapidly detected.
- 9.3. Occasionally branches will report that a Rem 'pouch' was not received or that it contained fewer items, or lower value, than the sender claimed. Post Office deals with these discrepancies by issuing 'Transaction Corrections' (TCs) that show the details of the shortfall or overage. Because such discrepancies relate to physical items it is necessary to rely on witness statements and other documentary evidence as to the exact content of Rem packages.
- 9.4. Some Applicants have described instances of foreign currency shipments being accidentally sent to the wrong branch. We are aware that some of these errors have occurred due to Post Office's Business Partner for Foreign Currency ('First Rate') using an incorrect delivery address.

10. Missing Cheques

- 10.1. As with outward Remittances (see **Cash and Stock Remittances ('Rems') in and out of the branch** above) sub post offices 'Rem' to Post Office's main processing centre (in Chesterfield) all cheques that the branch has taken in each day. These are put together into 'Stripey' envelopes and collected by the Royal Mail after each day's cut-off point.

- 10.2. For almost all of the many cheques that Post Office handles each day, everything normally goes smoothly, but some cheques do get lost or accidentally spoiled either within the branch or at Chesterfield, while some get lost in transit.
- 10.3. We have been informed that it is possible for cheques to get damaged in Post Office's cheque processing equipment and subsequently not be processed. In such cases, if the cheque is so badly mutilated as to be unreadable, the possibility arises that a branch might be charged, through the TC process, for a missing payment. Also, where a customer's cheque 'bounces', these will be charged back to the branch if the branch staff has failed to follow standard operating procedure. Post Office will attempt, where possible, to obtain a replacement cheque from the customer.
- 10.4. Assertions have been made by some Applicants that customers' cheques (received in exchange for goods or services rendered at the counter) never cleared and they were held accountable for the value of those missing cheques. Post Office asserts that there have been no examples of this occurring and, as the mediation process develops, Post Office will have an opportunity to respond to several specific examples cited by Applicants.
- 10.5. Some Applicants have complained that the TC process was sometimes so slow (in regard to cheques) that, by the time they had been advised that a cheque had been lost, mutilated or returned by the paying bank, all chances of them mitigating their loss were gone.

11. Pensions and Allowances

- 11.1. A small number of Applicants (eleven) have reported problems with Pensions and Allowances. Some of these cases include allegations of fraudulently manipulating pension and/or allowance payments, for example by showing amounts as having been paid out when they were not ("overclaims") or by allowing a green GIRO cheque to be re-used ("reintroductions"). Several of these Applicants were accused of and some of those charged with offences of fraudulently processing overclaims and/or reintroductions and we have asked Post Office to help us gain a deeper understanding of the cases that were investigated and the subset of those that were prosecuted in order to find out why so few of those cases seem to have resulted in convictions. We will only be able to develop a properly evidenced view on this subject when we have examined more of the relevant cases.
- 11.2. Enquiries on these issues are continuing.

12. Post Office's Data Retention Policy

- 12.1. We have been told that Post Office has a 7 year Data Retention Policy. This Policy applies to not only Horizon transactional data (held by Fujitsu) but also to all other business records including emails, letters, memos, interview recordings and transcripts, Audit and Investigation Reports and Legal Files on cases that have been concluded.

- 12.2. The application of this Policy would be understandable if an Applicant had never mentioned to Post Office the need for assistance in order to find out, or to obtain the data needed, to determine how a discrepancy arose, or had remained silent since the matter first surfaced. Post Office's assertion that, absent evidential proof, a claim should be rejected might now be viewed as unreasonable in instances where it can be shown that the Applicant has repeatedly, during the intervening years, sought Post Office's help in establishing facts and where, during those intervening years, the relevant records were routinely deleted.
- 12.3. Many Applicants and their Professional Advisors assert that it is unreasonable that the burden of proof should fall on the shoulders of the Applicants to prove that the (acknowledged) events did cause actual losses, particularly when Post Office had access to all of the necessary data and far greater investigative resources.
- 12.4. In many instances Applicants have been unable to directly link their claimed losses with specific incident(s) and it has not been possible, for either Post Office or Second Sight, to conclusively prove or disprove their claims. Post Office has typically stated that *"the time periods of these complaints are now outside normal document retention periods. There is therefore very limited information now available."*
- 12.5. Although many of these cases were closed (to Post Office's satisfaction) more than seven years ago, many of the Applicants had made it clear to Post Office that, to them, it was not a closed matter.

13. Cash withdrawals (accidentally) processed as deposits and other counter-errors that benefit customers at the expense of the Subpostmaster

Cash withdrawals accidentally processed as deposits:

- 13.1. Mistakes can occur if the counter clerk accidentally touches the 'DEPOSIT' icon on the screen instead of the adjacent 'WITHDRAWAL' one thus generating a deficit of twice the size of the customer's withdrawal. Such errors can be difficult to isolate from the system-produced totals of card transactions (see **Limitations in the Transactional 'Audit Trail'** above).

Other counter errors that benefit customers at the expense of the Subpostmaster:

- 13.2. Several situations have been encountered where Subpostmasters have been held accountable for shortages that seem to have arisen through errors made at the counter and where customers have profited at the expense of the Subpostmaster.
- 13.3. Where a customer has received cash or goods and later discovered that their bank account has not been debited or their card account has not been charged, it is quite possible that they may keep quiet about it, leaving the Subpostmaster to be held accountable for the resultant shortfall.

- 13.4. The difficulty in resolving such errors is demonstrated by the following description of the changes in the processing of Giro transactions.
- 13.5. In mid-2008 the method of processing receipts into Giro Bank accounts was changed. Previously, customers completed a two-part paying-in slip. One copy of the paying-in slip was retained by the customer, another was retained in the branch and cross-referenced to the entry made on Horizon. If, for example, the counter clerk accidentally keyed in £2,000 instead of £200 and did not spot that the error immediately then, when the next balance was carried out, Horizon would have reported that there should be £2,000 cash in the safe whereas in fact there was only £200 in it (i.e. there would be a £1,800 cash shortfall).
- 13.6. The Subpostmaster would have been able to identify that £2,000 cash had been entered onto the system relating to a customer whom, by cross-checking with the paying-in slip, in fact had only paid in £200. Hence, a correction could have been actioned and the branch's books brought into balance. In such a case, the apparent cash shortage would have been eliminated because the audit trail enabled the specific cause of the 'shortage' to be identified and corrected.
- 13.7. The Subpostmaster would have been able to identify that £2,000 cash had been entered onto the system relating to a customer whom, by cross-checking with the paying-in slip, in fact had only paid in £200. Hence, a correction could have been actioned and the branch's books brought into balance. In such a case, the apparent cash shortage would have been eliminated because the audit trail enabled the specific cause of the 'shortage' to be identified and corrected.
- 13.8. However, after the processing change, paying monies into Giro Bank accounts was actioned via swipe cards and one-part paying in books with no supporting documentation being retained in branch.
- 13.9. After that processing change, the counter clerk would swipe the card to access the account details and then key in the cash deposit. After inputting the deposit, the system printed out one copy of a receipt (which specifically states on it 'NOT TO BE RETAINED') and this was then passed back to the customer along with their swipe card and paying-in book.
- 13.10. If the counter clerk had accidentally input £2,000 instead of £200 into Horizon and did not immediately spot the error, the balance will show an £1,800 difference between the cash holdings on Horizon and the actual cash holdings (as in the previous example). However, after the processing change, there would be no supporting documentation available to either the Subpostmaster, or to Post Office centrally. Therefore neither the Subpostmaster nor the Post Office's central processing unit would be able to check whether or not the cash deposit entries on the system reflected the actual cash that was deposited.
- 13.11. The lack of an audit trail is a fundamental flaw in any accounting system and the revised process made it almost impossible to identify processing errors and action corrections.

- 13.12. Normally, when a business detects errors or fraud occurring repeatedly, investigative and analytical work will be carried out to determine whether changes to its standard operating procedures, to its hardware or software, or to its employee training, should be made so as to reduce the likelihood and/or seriousness of future recurrence. This process of investigation and analysis generates, over time, a '*Virtuous Circle*' of detection, loss mitigation and process correction/improvement which builds the entire system's robustness and efficiency.
- 13.13. Businesses are motivated to carry out such improvements when the projected Return on Investment shows that the savings (loss reductions) that will accrue from implementing those improvements will be well in excess of their initial and ongoing cost. If it looks as though the cost of reducing those losses will exceed the likely return by way of reducing them, the company may, quite appropriately, take a risk-acceptance decision to continue to absorb the losses. The skill, in Loss Management, is in finding the '*Sweet Spot*' where losses are minimised at the lowest possible cost.
- 13.14. Other than in regard to Lottery and Scratch Card processing, we have found little evidence that Post Office has evolved the above-mentioned investigation-led improvement processes. In not taking responsibility for "*errors made at the counter*", even where it is obvious that some of those errors have been systematically repeated in a branch, or even across the Network, Post Office seems not to have taken 'ownership' of finding ways to reduce (or manage) those errors. This is unsurprising in that the costs of those errors or fraud is, in Post Office's Business Model, generally borne by its franchisees, the Subpostmasters, rather than by Post Office itself.
- 13.15. This has led to a situation where Subpostmasters have been bearing cost of the losses caused by errors and fraud that could have been designed out of the system, while Post Office has benefitted from the savings it made by not implementing the improvements that would have reduced them. Since it was not Post Office that would save money by developing more error and fraud-repellent processes, the above-mentioned motivation, present in most businesses, has been absent.

14. Giro transactions

- 14.1. An issue has been raised by Applicants in regard to Giro transactions. The assertion is that, when Horizon goes into Recovery Mode (for example following power or telecommunications failures that result in the branch terminals freezing), it goes through a complete system reboot. Then, when the system has finally rebooted, a message appears on screen asking "*do you need to recover any giro transactions?*".
- 14.2. It is difficult to understand how Subpostmasters, when faced with this question, could know whether or not the system needs to recover any giro transactions before they have accessed the system to find out? If a Subpostmaster responds in the affirmative, the system asks for the details of the giro transactions that need to be recovered. As the Subpostmaster does not have any details as to whether or not any Giro transactions need to be recovered or, if

they do, which ones need to be recovered, the Subpostmaster is forced into responding in the negative and hoping that is the correct response.

15. One-sided transactions

- 15.1. Many Applicants have raised concerns regarding transactions involving debit or credit cards where Horizon has processed a transaction but the corresponding charge to the customer's bank account was not processed... or the opposite situation, where Horizon rejected (or appeared to have rejected) a transaction but the corresponding charge to the customer's bank account was processed.
- 15.2. One possible cause for this might be that telecommunications failures (as reported by many Applicants) have occasionally prevented one side of a transaction from going through whereas the other side of it has gone through properly. These sort of processing interrupts might result in customers being charged for goods that they have not received (for example deposits that don't get processed or bills that don't get paid) or customers receiving goods (or cash) for which they have not been charged.
- 15.3. These transaction processing failures would be less troublesome if they were always detected, at the counter ideally, or later by additional control and reconciliation processes carried out by the Subpostmaster or by Post Office itself.
- 15.4. It is however not yet clear whether Post Office's in-house (after-the-event) reconciliation processes can be relied upon to always detect any one-sided transaction that the Subpostmaster fails to detect.
- 15.5. Where a customer has been charged for something that he has not received, there is a very high likelihood that he will detect that and complain. On the other hand, where the opposite has happened, and a customer has received cash, or goods, and later discovers that his bank account has not been debited or his card account has not been charged, is it not perfectly likely that he will keep quiet about it, leaving the Subpostmaster to be held accountable for the resultant shortfall?
- 15.6. It is important to understand that, where that sort of Horizon-generated error occurs, no evidence of it is visible to the Subpostmaster *unless the customer discloses it*.
- 15.7. Post Office has asked for examples of one-sided transactions and several have already been supplied, with more coming in from Applicants whose cases have yet to be reviewed by Post Office. Greater clarity on this point will be gained as the mediation process continues and this section of the Part Two Report will be updated to reflect that.

16. Hardware issues

- 16.1. An examination of the hardware in use in a typical branch, reveals that the equipment appears to be very old fashioned and in some cases quite shabby. This is because the

hardware in use, developed over a decade ago by Fujitsu, seems no longer to be manufactured.

- 16.2. There seems to be no routine hardware maintenance. Instead, equipment known or suspected of being faulty is replaced as and when needed. This process is referred to as "kit swap outs" and principally involves the replacement of broken units with reconditioned items. Reports of several components or units being tried before a working one is found are not unusual. The most commonly raised issues concern printers, PINpads, touch screens and base units.
- 16.3. The possibility has yet to be eliminated, or proven, as to whether faulty equipment could be responsible for otherwise unidentified shortages has been raised by many Applicants.
- 16.4. Applicants have stated that they fear that printers may have sent messages to the main Horizon system telling it that postage labels have been printed when they have either not been printed at all or have been spoiled in such a way that the Subpostmaster is unable to claim the money back from Post Office. In regard to PINpads, the concern is that failures in those could result in partially-processed transactions (see **One-sided transactions** above), whereas the principal concern in respect of touch screens is that they are said to sometimes go out of alignment such that touching one icon can result in the execution of steps that are meant to be invoked from an adjacent icon (see, for example, **Cash withdrawals accidentally processed as deposits** above) or the accidental mis-keying of values that are ten times greater, or less than, the intended amount.
- 16.5. Where Applicants have cited Hardware issues and voiced their concerns that hardware failures (particularly transient ones) might have been the cause of mysterious shortfalls (and surpluses), Post Office has typically sought from them specific dates as to when devices stopped working and when the refurbished units were installed.
- 16.6. Second Sight has questioned why Fujitsu, which is the company that handles the call-outs and will have dealt with failures like inoperative base units, PINpads, screens, power packs, base units, etc., should not have been asked to supply a log of all call-outs/hardware replacements/refurbishments for any branch that refers to this problem.

17. Post Office Investigations

- 17.1. Assertions have been made by Applicants that Post Office's investigation team has, in many cases, failed to identify the underlying root cause of shortfalls prior to initiating civil recovery action or criminal proceedings, even in those cases where Subpostmasters brought to the Auditors' or Investigators' attention their own suspicions as to the underlying root causes.
- 17.2. Many Applicants, and almost all the Professional Advisors, assert that there was inadequate investigation prior to suspension (without pay); termination; or civil/criminal action.

- 17.3. In analysing these assertions it seems reasonable to consider that over the years the following has happened:
- 17.4. Post Office's investigators seem to have defaulted to seeking a False Accounting charge, evidence of which is easily obtained and, when confronted during interview with evidence of obviously over-stated cash figures, the accused person will often readily admit to several counts of falsifying the end of Trading Period Accounts. Since such interviews are carried out under 'PACE' Rules, there will normally be a digital recording of any admission and that will virtually always, trigger a 'Guilty' plea by the defendant. As a result, Post Office investigators learned over time that acquiring such recorded admissions of False Accounting was the key to achieving relatively rapid, and (to Post Office) inexpensive, asset recovery.
- 17.5. As a consequence of this, Post Office's investigators seem to have de-emphasized the importance of unearthing the true root cause of the "mysterious shortfalls" that Subpostmasters claimed to be suffering. Even when faced with requests, from Subpostmasters, for investigative help, none has been provided. This refusal to provide investigative support to Subpostmasters is also in line with the Standard Contract (see **The Standard Contract between Post Office and its Subpostmasters** above). Section 19, paragraph 12 of that Standard Contract states that Post Office's investigators will only engage "*when crime is suspected*".
- 17.6. Even in cases where the Subpostmaster suggested that the underlying root cause might be theft by one of his or her own staff, Post Office's investigators still refused to carry out any investigative work. This is unsurprising given that the investigators would realise just how difficult it is even to prove that theft has occurred, let alone to identify the individual who stole the cash or goods. The fact that every person in a branch would have known the IDs of all others there, and may well also have known their passwords, is also relevant here.
- 17.7. Since none of the Applicants had trained investigators available to them when the problems surfaced, no meaningful investigation work was ever carried out.
- 17.8. Post Office's instructions to (and training of) its Investigators apparently seems to disregard the possibility that the Horizon system can be in any way relevant to their investigations.