

In Strictest Confidence

POLB04(8TH)
POLB 04/109 – 04/129

Post Office Limited

(company no.: 2154540)

Minutes of the meeting of the Board
held at 80-86 Old Street, London
on December 15th 2004

Present:

Sir Michael
Hodgkinson
David Mills
Ian Anderson
Peter Corbett
Brian Goggin
David Miller
Gordon Steele

Non-executive Chairman
Chief Executive
Human Resources Director
Finance Director
Chief Executive, Bank of Ireland
Chief Operating Officer
Sales & Marketing Director

In attendance:

Alan Barrie

Operations Support Director, Royal Mail Group (for
POLB04/129)

Jonathan Evans

Company Secretary

Neil Owen

Notes

Kevin Seller

Head of Banking and Financial Services Clients

David Smith

Delivery Director (Acting IT Director)

Clare Oldstein

Investment Director, Group Finance (for POLB04/122)

Patrick Waldron

Chief Executive, Post Office Financial Services (for
POLB04/122)

Apologies:

Allan Leighton
Graham Halliday

Chairman, Royal Mail Holdings
Banking & Financial Services Director

POLB04/110

MINUTES OF PREVIOUS MEETING POLB(04)8TH

- (a) The Board approved the minutes of the Board meeting of 13th
October 2004.

Irrelevant

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Irrelevant

- (e) Card Account Article: Although the article explaining the reasons for Card Account outage had not appeared in the December issue of The Subpostmaster, agreement had been reached that it would feature in the January issue;

Action:
David Miller

- (f) Civil Orders: In the event of fraud against the company, David Miller would ensure that the pensions of fraudsters were targeted to help ensure the Company was reimbursed.

POLB04/112

CHAIRMAN'S BUSINESS

- (a) Sir Michael Hodgkinson reported the following matters to the Board:

Irrelevant

POLB04/113

CHIEF EXECUTIVE'S REPORT

- (a) David Mills reported the following matters to the Board:
- (b) Alun Michael - Defra: A letter had been received from Alun Michael and a dialogue would continue to promote sustainable rural communities;
- (c) Nigel Leese: David Mills had written to Nigel Leese to refute

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allegations regarding the conduct of Post Office Ltd in the handling of closures and franchises. Leese had also advised of changes at the DTI. More of the relationship would be controlled by Christina McComb;

- (d) Trade and Industry Select Committee: The meeting had gone well and had attracted minimal publicity. David Mills thanked David Miller and Sir Michael Hodgkinson for their contribution;
- (e) Strategic Plan: The strategic plan had been agreed with the Royal Mail Holdings board. The targets for next year would be very stretching;
- (f) Diversity Training Part 2: The second part of the diversity training programme had been undertaken;
- (g) Move of Headquarters: The Royal Mail Holdings Board had decided against moving headquarters, primarily due to issues of negative perception;
- (h) EC Off-site: An EC off-site meeting had taken place on 13th December, which had proved very productive.

POLB04/114

**BUREAU CREDIT AND DEBIT CARD ACCEPTANCE
POLB(04)91**

- (a) Gordon Steele presented the Board with a paper on debit and credit card acceptance. The Board noted the paper, and in particular that:
- (b) foreign exchange transactions were conducted in Post Office Ltd branches in partnership with First Rate Travel Services (FRTS), a joint venture between Bank of Ireland and Post Office Ltd;
- (c) Post Office Ltd had offered card payment for foreign exchange transactions for 8 years via a system provided by Natwest. Changes to banking rules now required mandatory conversion to the Chip and PIN system. Consequently, Natwest were unwilling to supply this service beyond November 2005 without changes to the infrastructure to include 'pin-pads' and Chip and PIN capability;
- (d) IT development was proposed as part of the planned Horizon S90 software release, planned for October 2005;
- (e) the total investment was £4.3m (£3.0m from FRTS and £1.3m from Post Office Ltd).
- (f) The Board agreed to the investment of £4.3m subject to the successful conclusion to the negotiations with FRTS to ensure a £3m contribution.

In Strictest Confidence**POLB04/115****AUTOMATED OUTPAYMENTS POLB(04)92**

- (a) Gordon Steele presented the Automated Outpayments investment case to the Board. The Board noted the paper, and in particular that:
- (b) the proposal consisted of a £5m investment over 3 years to develop an Automated Outpayment capability on the Horizon system;
- (c) the automation would simplify and enhance Postal Order and NS&I warrant transactions, enable development of the Moneygram® product; and remove legacy systems;
- (d) Group Investment Appraisal's comments on the case had not yet been obtained.
- (e) The Board considered the benefits of the investment, including the estimated £7.6m return over 5 years and the positive overall effect that a modern payment method would have on the customer experience. The Board agreed that:
 - (i) authority to approve the final investment case, including £250,000 for the replacement of the Postal Order trace reader at Chesterfield, would be delegated to the Executive Committee;
 - (ii) this authority would be subject to the Group Investment Committee endorsing the business case.

POLB04/116**PRODUCT ANALYSIS POLB(04)93**

- (a) Peter Corbett presented a financial analysis of Post Office Ltd products for 2004/05 Year to Date Period 7. The Board noted the report.

POLB04/117**SOLVENCY POLB(04)94**

- (a) Peter Corbett reported to the meeting the current financial position of the Company. In particular, it was highlighted that, unless appropriate new financial support arrangements were put in place, the Strategic Plan showed the company would become insolvent in 2006/07. It was also reported to the Board that he had attended yesterday with officials from the Department of Trade and Industry regarding the Company's financial position and the availability of support going forward;
- (b) Having discussed the position in detail, the Directors agreed that, on the basis of the report and the discussions held to date with the Department of Trade and Industry, they believed that the Company did have a reasonable prospect of avoiding insolvent liquidation and that, accordingly, the Company could

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continue to trade on that basis. It was further agreed that the solvency of the Company should be carefully monitored and reviewed regularly on an ongoing basis and that, in particular, any material new financial commitments should be considered very carefully;

- (c) Peter Corbett further explained the situation concerning impairment. The Company had been working on the assumption that it would no longer have to impair its fixed assets. However, the financial situation was such that the Company may need to continue to impair up to £20m of assets, although this could be neutralised by utilisation of the proceeds of asset disposals, critically reviewing all non-essential Capital Expenditure and reversing the surplus severance provisions. After discussion the Board agreed that a decision on impairment should not be taken until nearer the time of the closure of the accounts. The impact of the compensating action should be avoided if possible as they would be unhelpful for the Company's progress towards its strategic plan objectives.
- (d) The Board was reminded that discussions were taking place at Royal Mail Group level with the DTI about re-casting the Group's balance sheet, including that of Post Office Ltd. The Board saw possible advantages in the Post Office Ltd Board making its concerns known directly to the DTI about the funding difficulties of the Company, but only to the extent that such an approach supported the discussions taking place between Royal Mail Group and DTI.
- (e) The Board agreed that:
- (i) discussions should continue with the Department of Trade and Industry and with other companies in the Royal Mail Group with a view to agreeing appropriate financial support arrangements going forward;
 - (ii) Jonathan Evans would draft a letter to Patricia Hewitt informing her of the financial prospects of the company, and would seek advice from Royal Mail Group about the appropriateness of sending it;
 - (iii) the latest [REDACTED] would be circulated to the Board with the minutes of the meeting;
 - (iv) the Board would review the Company's Profit and Loss, balance sheet and cash flow projections at each future Board meeting

Action:
Jonathan Evans

Action:
Jonathan Evans

Action:
Peter Corbett

Irrelevant

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Irrelevant

POLB04/119

RISK AND COMPLIANCE COMMITTEE POLB(04)96

- (a) Peter Corbett provided a short presentation on to highlight the work of the newly formed Risk and Compliance Committee. The Board noted that:
- (b) the Risk and Compliance Committee was chaired by Sir

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Michael Hodgkinson, Graham Halliday and David Miller regularly contributed to it;

- (c) the scope of its activity included audit, compliance and legal issues;
- (d) its primary aim was to ensure the service and conformance elements of the business were working together properly. Rod Ismay (Head of Risk and Control) was working closely with Lynn Hobbs (Head of Network Reinvention) and Tony Marsh (Sales and Service Programme) to help ensure this is achieved;
- (e) the next quarterly meeting would be held on 5th January 2005 to discuss Branch Control, Vital Few Controls, Audit Reports, Anti-Money laundering measures, Crime and Fraud and the work of the Group Audit Committee;
- (f) the Risk and Compliance Committee had found that although the overall trend of losses due to fraud had fallen from an annual rate of £29m to £20m, this area still represented a significant risk. Brian Goggin informed the Board that as banking controls had tightened, fraudsters had become more sophisticated in response. The banking business had found the risk of fraud perpetrated by employees particularly difficult to manage. A fraud migration risk existed with the advent of chip and pin;
- (g) controls assurance and self-assessments were taking place within Post Office Ltd this month, and an assurance testing plan would be agreed with the units.
- (h) The Board agreed that David Smith and David Miller would investigate the possibility of arranging a dummy Bureau transaction with a Natwest Card (so that the PIN was utilised) to avoid the risk on bureau transactions. Graham Halliday would continue to investigate whether an exemption on credit card acceptance could be obtained for bureau transactions.

Action:
David Smith and
David Miller

Action:
Graham Halliday

Irrelevant

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Irrelevant

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Irrelevant

FUNCTIONAL REPORTS

POLB04/123

FINANCE REPORT POLB(04)100

- (a) The Board noted the report and in particular that:
- (b) The new business plan targeted closing the gap left in 2005/06 by the loss of benefits income – profit impact next year £140 million – to keep next years results on the same level as this year – a loss from operations excluding rural funding of £75million. A further £50 million profit improvement was projected over the life of the plan through 2009/10. The current draft excluded a solution to rural funding post 2008;
- (c) Period 8 profit from operations was a loss of £12.7m, £4.4m adverse to budget. The variance was due to a £5½ million provision for the irrecoverable VAT issue on banking back office processing costs. The YTD profit from operations was a loss of £62.3, £1.3m (2%) adverse to budget. The full year forecast remained at £3.8m favourable to budget. The operation of Card Account was effectively providing a £5½ million benefit to Government at Post Office Ltd's expense. The Board agreed that this unreasonable situation should be addressed

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Action:
Graham Halliday

immediately. Graham Halliday would draft a suitable letter to send to Adam Sharples requesting the issue be escalated to Ministers through MISC19. The letter would contain a warning stating the issue would be escalated to the highest levels if a satisfactory resolution could not be agreed.

POLB04/124

OPERATIONS REPORT POLB(04)101

The Board noted the report. The Board further noted that:

- (i) Directly Managed Strategy: Union discussions had reached a difficult stage. The CWU were clearly prepared to contemplate a significantly reduced directly managed network but had high expectations of the 'price of their cooperation'. The Board agreed that this matter would now feature as a regular item on the Board agenda;
- (ii) Christmas Closing Times: Christmas Closing times were proving to be a very difficult issue. In response to competitors' closing times, and because three heavy days POCA payments would fall due on Christmas Eve, Post Offices would stay open until 16:00. The CWU had called for a ballot on a one-day strike despite the significant risk of adverse publicity. NFSP had reflected back the concerns of their members at smaller offices in being asked to stay open when there were no customers. The line was being held that for our customer requirements to be met, Post Offices should remain open until 16:00;
- (iii) OFT Complaint: The OFT were considering a complaint from the Association of Convenience Stores concerning Post Office Ltd's restrictions policy. The Board agreed that David Miller would contact Nigel Leese to advise of the potential significant impact on the franchise and brand.

Action:
David Miller

Irrelevant

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Irrelevant

POLB04/127

IT REPORT POLB(04)104

- (a) - The Board noted the report. The Board further noted:
- (b) Chip and Pin: The release to introduce Chip and Pin and replace the IBM Banking Engine was now deep into implementation. Streamline and LINK accreditation and certification having been successfully achieved. A Chip and Pin pilot for retail (debit card) transactions had run successfully for nearly three weeks. Software distribution to the network was nearly complete. Migration of banking transactions to the new Fujitsu engine from the legacy IBM engine was underway with the full load of LINK transactions being routed via Fujitsu. Residual issues from testing meant that plans remained tight but achievable;

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- (C) Christmas Eve: Three days of POCA transactions would occur on Christmas Eve. Work was underway with Fujitsu to understand how the system would perform at extreme transaction levels;
- (d) Audit of EDS / JPM Systems: the first phase of the audit commissioned in the aftermath of the service problems on the 23rd August was now complete and the brief for the second phase agreed. The audit would now concentrate on the areas of weakness identified during the first phase and would report early in the New Year. The indications were that the service interruption occurred because JPM feared that the database had been corrupted rather than there being hard evidence that corruption had occurred. Processes for escalation and managing change were also lacking. No evidence had been produced to show the system had been unstable.

Irrelevant

POLB04/129

ANY OTHER BUSINESS

- (a) Alan Barrie: In recognition of his excellent service to Post Office Ltd as IT Director, the Chairman presented Alan Barrie with an inscribed picture frame featuring four commemorative Scottish Stamps. Alan Barrie thanked the Board for the valuable experience he had gained during his directorship at Post Office Ltd.

POLB04/130

CLOSE

- (a) There being no further business, the meeting was closed.