

**Post Office Limited – Strictly Confidential**

**POLARC12 (2<sup>nd</sup>)  
POLARC12/8-15**

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

**Minutes of a meeting of the AUDIT, RISK AND COMPLIANCE SUB-COMMITTEE  
held on Tuesday 13 November 2012  
at 2pm at 148 Old Street, London EC1V 9HQ**

**Present:**

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

**In attendance:**

Alice Perkins (AP)	Chairman, Post Office Limited
Chris Day (CD)	CFO
Paula Vennells	CEO (item 12/11 only)
Sarah Hall (SH)	Head of Financial Control and Compliance
Nick Kennett (NK)	Financial Services Director (item 12/13 only)
Alwen Lyons (AL)	Company Secretary
Hugh Flemington (HF)	Head of Legal Services (item 12/11 only)
Lesley Sewell (LS)	Chief Information Officer (item 12/11 only)
Malcolm Staite (MS)	Interim Head of Risk Governance
Malcolm Zack (MZ)	Head of Internal Audit

Stephen Collins (SC)	Audit Manager, Royal Mail Group Internal Audit (item 12/12 only)
Angus Grant (AG)	Audit Partner, Ernst & Young (item 12/12 only)
Jeremy Midkiff (JM)	Audit Manager, Ernst & Young (item 12/12 only)

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**INTRODUCTION**

- (a) A quorum being present, the Chairman of the Committee opened the meeting and welcomed all those present.
- (b) The Chairman noted that the Committee would not be able at this meeting to discuss Risk Management in detail, as the executive team were still working through the processes and the necessary recruitments had not yet been completed. The approach to risk management would be a matter for particular focus at the next meeting in February.

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**GOVERNANCE**

- (a) The Chairman asked MZ to talk through the new format proposed for the Terms of Reference of the Committee, including an outline schedule of matters to be discussed and a form of standing agenda.

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- ACTION: Company Secretary**
- (b) Following discussion, it was agreed that the revised Terms of Reference for the Committee, dated November 2012, are approved and adopted subject to an amendment in 2.1 to clarify that the HR & Corporate Services Director and the General Counsel were the same role.
- (c) These Terms of Reference would be included in the pack of corporate governance documents to be approved by the Board in January 2013.
- ACTION: CD**
- (d) The Committee requested that the banking and treasury delegated authority limits discussed at the Board meeting on 23 October 2012 should return to the ARC in February for discussion and that outstanding balances and any breaches by counterparties be brought to the attention of the ARC.
- ACTION: MZ**
- (e) The Committee asked for sight of the internal audit reports completed since April 2012, and a status report on the audit actions to be presented at the February meeting.
- (f) The Committee requested discussion at the February meeting on:
- (i) the policies in place to mitigate against key business risks (a paper to be produced by the Head of Risk Governance); and
- (ii) the process for establishing and ensuring compliance by the Business with those policies and with regulatory requirements. It was recognised that this exercise would take some time, with priority areas starting to become clear over the course of 2013.
- ACTION:MZ/SC**
- (g) The CFO and HR & Corporate Services Director would then lead a session at the Board to give comfort that the Business understands its regulatory risks and has the policies in place to monitor and mitigate.
- ACTION: CD/SC**

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**ANNUAL REPORT AND ACCOUNTS AND HALF YEAR TRADING STATEMENT**

- (a) CD presented the latest draft of the half-year trading statement. It was noted that the DVLA decision had now been announced and could therefore be included in the statement.
- (b) It was noted that the trading statement had not been reviewed formally by Ernst & Young but it was confirmed that the basis of preparation was consistent and that there had been no major changes in accounting policies or practice.
- (c) The proposed date for release of the statement to the press and general public was 22 November 2012. Discussions would be held separately with the Shareholder.
- (d) The Committee discussed the tone of the statement and the comments received to date from members of the Board and it was agreed that final comments would be input by 14 November, after which the statement would be re-circulated to the Board for final approval.
- ACTION: CD**

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- (e) A copy of the final statement and press release would be circulated to the Board.
- (f) The paper presented by SH, setting out an approach for preparation of the full year accounts for 2012/13, was considered.
- (g) After discussion it was agreed that:
  - (i) Post Office should not take advantage of the exemptions from being a wholly owned subsidiary of a UK parent producing group financial statements;
  - (ii) Post Office should continue to report under UK GAAP but the consolidated financial statements will be under IFRS;
  - (iii) the Post Office Annual Report and Financial Statements should be prepared as one formal document for lodging at Companies House;
  - (iv) Post Office should include the additional Business Review disclosures applicable to quoted companies where appropriate;
  - (v) Post Office should aim to meet the elements of the UK Corporate Governance Code and DTR disclosure requirements on corporate governance that are appropriate; and
  - (vi) Post Office should comply with legal requirements concerning the disclosure of directors' remuneration but would not seek to go beyond the statutory level of disclosure for the financial year 2012/3.

**ACTION: Company Secretary**

A full analysis of Post Office's compliance with the UK Corporate Governance Code was under way and would be provided for discussion by the Committee at its next meeting.

There appeared to be nothing which would prevent the Post Office from confirming that it upheld the principles of the Code, even if some of the detailed recommendations would not be applicable to a Government-owned organisation.

**POLARC12/11****RISKS – HIGH RISK CONTRACTS**

The CEO, LS and HF joined the meeting to provide an update on the information security issue which had recently been faced by the Post Office.

An approach to establishing the risk profile of customer data held within the Post Office had been set out in the paper from LS and this was discussed.

The Committee thanked the CEO and the Business for the rigour with which they had handled the issue and asked for a short update report in mid-December followed by a formal report on information security for the next ARC meeting in February, including a noting paper on High Risk Contracts.



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The Committee asked to be kept informed in the meantime of any actions necessary to mitigate against any actual or perceived liability on the part of the Post Office.

**ACTION:LS****POLARC12/12****INTERNAL AND EXTERNAL AUDIT**

- (a) SC, AG and JM joined the meeting.
- (b) MZ was introduced as the new Head of Internal Audit. He explained the future audit team he was recruiting for the Business and that going forward the audit plan would be based on the key risks which would be signed off by the ARC. He confirmed the activity in the Audit plan for 2012/13 and that Royal Mail's Internal Audit Team would assist Post Office up to 31 March 2012.
- (c) The Committee agreed that there may be a need to monitor the increased strategic risks driven by separation and transformation, but that there also needed to be a focus on compliance within the Network.
- (d) The Committee asked for a summary of the areas covered by RMG Internal Audit reports to be presented to the ARC in February.

**ACTION:MZ**

Stephen Collins left the meeting

- (e) AG, the Ernst & Young Audit Partner responsible for the Post Office external audit, reported that the previous year's audit had been finalised. He expected that 2012/13 would be a challenging year for the Business in several areas because of separation and major change, and that the audit would need to focus on separation, pensions, and taxation with an overlay of IT. He set out the proposed approach to external audit of the full year accounts and the outline timetable. The detailed focus of the audit would be:
  - (i) Revenue recognition and the accounting treatment across diverse revenue streams;
  - (ii) Counterparty risk;
  - (iii) Pension valuation and accounting;
  - (iv) Separation accounting risks; including pensions and treasury;
  - (v) Valuation of accounting provisions;
  - (vi) Risk of fraud/burglary in the Network and Cash operations;
- (f) The ARC was comfortable with the approach, alongside the separate ISAE 3402 IT audit which had been jointly commissioned by the Post Office and Fujitsu.
- (g) The Chairman asked at what level of materiality the E&Y team would report. AG explained that this would be similar to previous years. Although E&Y did put a figure on P&L materiality, they would propose to report any identified audit adjustments above £600k to the Committee and, as a general rule,



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insist on changes to the accounts for any single item or accumulation of items with an effect of over £5-6 million. This was accepted.

**ACTION:AM/CD**

- (h) The Chairman informed the meeting that he would pick up the Ernst & Young fees with the CFO outside the meeting
- (i) The external audit plan was agreed. The external auditors left the meeting.

**POLARC12/13****MATTERS REFERRED TO ARC BY THE BOARD**Governance of the "Eagle" Contract**ACTION: NK**

- (a) NK joined the meeting.

He presented the paper and explained the governance processes now in place with the Bank of Ireland (BoI) following agreement of the new contract. The Committee was informed of the arrangements and the governance committees put in place to monitor performance. The Committee asked that the minutes of future Regulatory Risk Committees (RRC) be provided for the ARC.

- (b) NK noted the termination rights currently contained in the contract. BoI was obliged to provide certification within 15 days of each quarter end to assure Post Office that BoI was meeting its requirements in respect of:

- (i) Tier One Ratio and Capital buffers

- (ii) Liquidity

- (iii) NSFR requirement

and that it had not breached any of the terms of the contract creating a Termination Obligation.

- (c) The Chairman asked if this gave the Business sufficient warning of any problems. NK assured the Committee that the Bank was obliged to give Post Office early warning of any capital or liquidity problems and Post Office had a buffer above the regulatory and statutory requirements set by HM Treasury (HMT), the Bank of England (BoE) and the FSA.
- (d) Post Office had also established a system for tripartite meetings with HMT and BoE, to which the FSA was also invited. The purpose of this meeting was to give Post Office a medium to long term view of the banking environment and how any developments might affect the Post Office.
- (e) NK explained that the FSA would soon be splitting to form two organisations: the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). This should lead to a strengthening of regulatory relationships and give the Business more comfort.
- (f) The Committee asked NK to provide an interim update on the regulatory position in September 2013, 6 months after the changes had taken effect.

**ACTION: NK**

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- (g) The Chairman noted that it would be useful at the same meeting to look at scenarios in which Post Office would need to respond to a termination event.
- (h) NK reported that Post Office deposits had grown substantially above the planned £16.6 billion target agreed with the FSA. The parties were working together to agree a commercially sustainable position on pricing for BoI whilst ensuring protection for Post Office customer assets and the Post Office brand.

NK explained the securitisation of assets by BoI and noted that the new contract required consent from the Post Office to securitise any Post Office customers' assets. The terms were designed to ensure that Post Office customers' assets were managed effectively but also ring-fenced in the event that a transfer to an alternative provider became necessary.

NK then left the meeting.

**Uncommitted Credit Facilities****ACTION:  
CD/Company  
Secretary**

- (i) The CFO asked for the Committee's views on the proposals relating to uncommitted loan facilities which had been put forward to the Board. He noted that banking counterparties would require a resolution of the full Board.
- (j) The Committee discussed the proposals to enter into two loan facilities. CD confirmed that these proposals had been discussed with the Shareholder and no concerns had been expressed.
- (k) The Committee endorsed the following recommendations to the Board:
  - (i) approval for Post Office to enter into external borrowing facilities up to a maximum value of £100m, such that external borrowing of up to £50m may be drawn down at any one time;
  - (ii) approval for the CFO and Head of Corporate Finance to conduct negotiations with counterparties and sign and deliver the loan and related documentation
  - (iii) approval for the form of Board resolution included in the paper, subject to review by Susan Crichton (Head of HR and Corporate Services).

**POLARC12/14****ANY OTHER BUSINESS****ACTION:  
Company  
Secretary**

- (a) It was agreed that the schedule of meeting dates for 2013 should be revised to allow for meetings in February, May, September and November. The Company Secretary was asked to recirculate the dates.

**POLARC12/15****CLOSE**

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

**Alastair Marnoch**