

**Royal Mail - Strictly Confidential
DRAFT**

ARC 03/36 TO ARC 03/45

ROYAL MAIL HOLDINGS plc

(Company no. 4074919)

AUDIT AND RISK COMMITTEE

Minutes of the meeting held at 148 Old Street on 11 November 2003

Members of the Committee Present:

Rosemary Thorne	Non Executive Director, Chair of the Committee
John Neill	Non Executive Director
Bob Wigley	Non Executive Director

In attendance:

Allan Leighton	Chairman
Elmar Toime	Executive Deputy Chairman
Adam Crozier	Chief Executive, Royal Mail Holdings plc
Marisa Cassoni	Chief Financial Officer
Jonathan Evans	Company Secretary
Derek Foster	Internal Audit and Risk Management Director
Frank Schinella	Director, Financial Management & Control
John Lappin	UK Finance Director, for minute ARC03/41
David Lindsell	Ernst & Young
Rachel Harper	Ernst & Young
Andrew Poole	Notes

ARC03/36

MINUTES

The minutes of the meeting of the 11 September 2003 were considered and approved subject to the following drafting changes being made.

- (a) ARC03/30(h): that a guest speaker would be attending a future Board Meeting to reassure the directors that appropriate audit trails were in place to demonstrate that action was being taken to ensure compliance with the Health & Safety requirements and to provide an assessment of the procedures currently in place.
- (b) ARC03/31(d): that any issues arising in Information Technology Security would be addressed through Prism alliance.

The minutes of a meeting of the Corporate Risk Management Committee held on 23 October 2003 were noted. It was agreed that future minutes of the Corporate Risk Management Committee would be clarified by expanding the commentary where necessary to reflect the broader

ACTION

**Royal Mail - Strictly Confidential
DRAFT**

Derek Foster

circulation and by placing the action points after the minute.

ARC03/37

STATUS REPORT

The status of actions from the meeting held on 11 September 2003 was noted, in particular:

- (a) ARC03/27 it was clear from the results highlighted in the progress report on key actions to improve Safety performance and in the report on the current position of the Vital Few Controls that level of compliance remained an issue. This position was unacceptable and the Company will hold people accountable for non-compliance however it was recognised that this would require a significant change in cultural behaviour;
- (b) ARC03/29(d) the Committee asked what measures could be taken to improve the focus on Vital Few Controls and allow for clear performance management at the highest level. It was agreed that the number of controls would be reviewed and that a smaller number of key measures, ideally around 10 per Unit, would be identified and approved;
- (c) that a Corporate Social Responsibility Committee had been established under the Chairmanship of Mike Hodgkinson and that a action plan was now in place to tackle many of the outstanding issues;
- (d) a report would be produced for the next meeting setting out the actions that management had taken to address these issues and agreed that key control measures would be presented to the Holdings Board for approval.

ACTION
Derek Foster

ACTION
Derek Foster

ARC03/38

HALF YEAR REPORT AND EXTERNAL AUDIT REVIEW

Frank Schinella introduced a paper presenting the Interim Report for review and for recommendation to the Board Accounts Sub Committee to approve and sign the report. The Committee noted: -

- (a) the Interim Report, including the Chairman's Statement, Financial Review, relevant Financial Statements and applicable notes;
- (b) a summary of key accounting developments and issues, which had arisen during the period, including the treatment of exceptional loss, impairment and accounting implications of the latest Pensions Plan valuation;

Royal Mail - Strictly Confidential
DRAFT

- (c) an analysis of performance against prior year and the balance sheet movements from the year end;
- (d) a draft Letter of Representation addressed to the external auditors.

After proper consideration, the Committee:-

- (a) reviewed the Interim Report for the 2003-04 half -year and agreed that the proposed amendments since the version presented to the Holdings Board be made to the Interim Report;
- (b) noted the accounting issues;
- (c) agreed the content of the Letter of Representation for issue to the auditors on behalf of the Board;
- (d) endorsed the Interim Report for approval by the Board Accounts Sub Committee.

ARC03/39

EXTERNAL AUDIT - PROPOSALS FOR AUDIT AND FEES

David Lindsell introduced the Auditors report to the Audit and Risk Committee covering the results of the Half Year Review, in particular the Committee noted:

- (a) publishing the Interim Report for the half year ended 28 September marked the halfway point in the three-year renewal plan;
- (b) progress was being delayed by the Unions, but that Management were taking decisive action to recover lost ground by accelerating other initiatives and by appealing directly to the workforce;
- (c) the real impact on return to profitability would not be seen until the year-end as much of the workforce downsizing was forecast to happen in the second half. Another determining factor would include the outcome of Postcomm's review of Access pricing;
- (d) the funding implication of the Pension Fund deficit was now understood and the first half reflected an increased SSAP24 pension cost. The Auditors warned against letting the focus on the cash funding deficit (i.e.£2.5 billion) undermine the accounting treatment;
- (e) whilst there was clearly room for judgement on the issue of Provisions the auditors were content with the current position and confirmed that they had seen reasonable justification for the figures included in the Half Year Review;

Royal Mail - Strictly Confidential
DRAFT

ACTION
Frank Schinella

- (f) the Letter of Representation to the Auditors and suggested that it would be helpful to have a similar letter signed off by each Divisional Finance Director, it was agreed that this process would be adopted for the year-end and, due to the timescales, an interim arrangement adopted for the Interim Report;
- (g) the proposed external audit fees of £850,000 for UK based work was presented and agreed in principle together with a £14,000 overrun on the Interim Report, it was further agreed that Frank Schinella would provide further detailed analysis by hours worked by key audit crew and present his findings to the next meeting of the Audit Committee.

ACTION
Frank Schinella

ARC03/40

INTERNAL AUDIT AND RISK MANAGEMENT QUARTERLY REPORT

The Internal Audit & Risk Management Report for the period September to October 2003 was received, and in particular the following was noted:

- (a) external pressure on the control environment had continued to increase and internally the strike action had diverted Management attention from the core activities;
- (b) the business had recognised the importance and scale of the risks and control issues, and had taken significant steps to address a number of specific issues. Evidence in the period indicated that there remained a significant amount to do and that the internal and external pressures meant that the control environment did not protect the Organisation at certain times;
- (c) 71% of rated audits in the period showed 'no' or 'limited' assurance ratings. 35% of Vital Few Controls reviewed were not effective at the date of review;
- (d) Internal Audit had recently carried out a review of the Organisation's Security and Vetting Recruitment Procedures. No assurance could be provided over the adequacy or deployment of the procedures for the recruitment of both permanent and casual staff;
- (e) quarterly assessment of business continuity against industry benchmark showed a score of 71%, which represents a positive result;
- (f) the issue of non-compliance was a serious problem for the business and the Committee's view was that this was unacceptable. The need to address this issue was accepted;
- (g) the Internal Audit function was currently six people short, this

ACTION
Derek Foster

Royal Mail - Strictly Confidential
DRAFT

impacting ability to deliver to plan, and that action was being taken to fill the vacancies;

- (g) a number of significant risks had been identified with the Single Daily Delivery Programme and these were highlighted in the report.

ARC03/41

CONTROLS- SINGLE DAILY DELIVERY

John Lappin was welcomed to the meeting to introduce a paper on the Financial and Operational Control framework for Single Daily Delivery. The Committee noted;

- (a) targets had been established using a bottom up approach, with each Delivery Office Manager (DOM) advising the level of savings to be realised in each individual unit;
- (b) that once the Unit had fully deployed the revision, the monitoring process commenced to assess whether the target was being achieved and whether payment of the pay supplement was warranted. Once the target had been achieved for four consecutive weeks the pay enhancement would be consolidated into basic pensionable pay;
- (c) a Post Implementation Review would be undertaken in each of the 1400 units and a report provided to the Management Board on a monthly basis;
- (d) it would be necessary to carefully monitor and control 'backfilling' in order to prevent such occurrences from happening.

ARC03/42

SECURITY REPORT

The Security report for November 2003 was received, and in particular the following was noted:

- (a) Royal Mail personnel related crime cost the business approximately £26 million per year. In 2002/03 the Company had prosecuted 324 People, formally cautioned 108 others, recommended 47 cases to the Procurator Fiscal and taken legal action in a further 43 cases. These were noted as minimum figures, since there may also be cases where local action is taken to deal with offenders;
- (b) there had been a significant increase in the number of viruses observed over the last two months. The figure for September suggested a figure of 423 individual attempts per day.

**Royal Mail - Strictly Confidential
DRAFT**

ARC03/43

GLS GOVERNANCE STRUCTURE

Elmar Toime introduced a paper covering the proposed GLS Governance arrangements. The Committee noted the contents of the Governance paper and recommended that the document be presented to the December Holdings Board for approval.

ACTION
Elmar Toime

ARC03/44

ANY OTHER BUSINESS

Bob Wigley asked if the Company had adequate Whistleblowing procedures in place. Jonathan Evans agreed to review the current process, including the communication aspect, and confirm at a future meeting of the Audit Committee what action had been taken.

ACTION
Jonathan Evans

ARC03/45

DATE OF NEXT MEETING

The Committee noted that the date of the next scheduled meeting of the Committee was Thursday 18 March 2004.