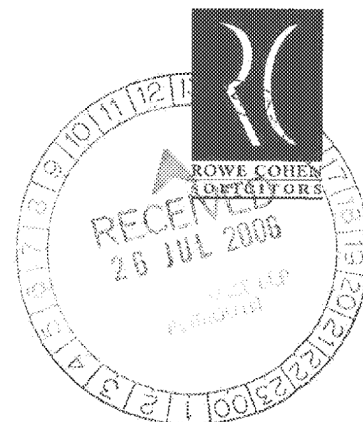


Date: 25 July 2006
Your ref: SJD3/FAC1/348035.134
Our ref: MDT.113969
Please ask for: Mark Turner
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DX 8251
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Dear Sirs

Post Office Limited -v- Mr L Castleton

Following disclosure, our client has been reviewing the transaction logs disclosed by your client. We understand from paragraph 2(c) that these documents constitute a full audit trail. By that, we understand that these logs are intended to show an item-by-item statement of all transactions carried out at Marine Drive Post Office for the particular days shown in the logs.

Mr Castleton has carried out a manual reconciliation of all transactions recorded in the log for Week 42. Since this is a time-consuming exercise, we have for the time being limited the analysis to that week, although in light of what we say below we envisage that it will be necessary for each of the following weeks in which it is alleged shortfalls arose. Week 42 was chosen for this initial analysis as it was the first week in which an apparent discrepancy arose and therefore the starting figures going into Week 42 are undisputed and provide an uncontentious benchmark against which to judge the movements during Week 42.

Mr Castleton's analysis of the transaction logs for Week 42, and a comparison with the cash accounts for that week appears to show a number of inconsistencies. According to the final cash account generated at Marine Drive Post Office for Week 42, total receipts of £176,291.15 were paid in during the course of Week 42. The end figure carried over from Week 41 was £54,170.49. As a consequence, it can be seen that, apparently, £122,120.66 was received during Week 42. However, a manual reconciliation of the figures contained in the transaction log for this week gives a figure for monies received of £125,013.90, an apparent difference of £2,893.24.

Similarly, an analysis of the figures relating to payments (i.e. monies leaving Marine Drive Post Office during Week 42) also shows a discrepancy. The figure for stock carried over from Week 41 was £92,374.74. If this is deducted from £176,291.15, this leaves a figure of £83,916.41 in respect of payments made. Again, however, a manual reconciliation of all of the transactions showing in the transaction log gives a figure of £83,707.07. This difference is not allocated in the Week 42 cash accounts.

It would further appear that there is £1,706.64 in unallocated cash shown as being paid out of Marine Drive Post Office. The computer system then seems during the end-of-week balancing to have offset this unallocated cash against the £2,893.24 figure, along with some further giro bank transactions, and produced an apparent cash shortfall figure of £1,103.13. This is of course the figure that our client was required to make good.

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Our client has not been able to reconstruct precisely how Horizon arrived at the figure of £1,103.13. He surmises that the system has sought to offset the £1,706.64 and other unallocated giro bank transactions against the £2,893.24 figure set out above. We would invite your client to undertake its own analysis of the transaction logs and provide an explanation for how that figure has been derived, in order that this discrepancy can be explained and any possible flaw in our client's methodology in carrying out the manual reconciliation brought to light as quickly as possible.

This represents an analysis of the figures at their most basic level. Mr Castleton's findings seem on the face of it to be entirely consistent with his assertion since this dispute first arose, namely that the figures provided by the Horizon computer system are incorrect. At the very least, it raises question marks about how a system that relies in essence on double-entry book-keeping can give rise to such discrepancies.

Our client then proceeded to review the Week 42 transaction log in more detail. It would appear that a number of the transactions recorded are incomplete – that is to say, only one half of a given transaction has been recorded by Horizon, with no corresponding entry. Ordinarily, one would expect to see two “halves” of a transaction. For example, a sale of £10 worth of stamps would show a £10 reduction in stock and a corresponding £10 increase in cash. In a number of cases, the log shows apparent transactions with only one “half” having been recorded by Horizon, and no corresponding other “half” to balance it.

In practice, this cannot happen. We understand from Mr Castleton that the Horizon system is configured in such a way that in order to complete a transaction on screen a valid method of payment must be selected. As such, the system would not process a transaction unless there had been a corresponding second “half” (or, in the case of payments, a corresponding first “half”) to it.

The obvious inference to be drawn is that, if the system cannot be operated to only create half of a transaction, Horizon is not recording the apparently missing “half”. Again, this is consistent with our client's supposition that transactions have not been fully recorded (or recorded at all) as a result of problems in communication between the two computer nodes used at Marine Drive Post Office.

Our client's firm belief is that if half of a transaction were to be lost, the effect would only show in relation to cash because Horizon looks for everything and the remainder is cash. If the first “half” of a transaction were lost, it would show as having no effect on stock but would only be noticeable in terms of movement in the cash figure. This also rather begs the question of whether whole transactions can be “lost” (i.e. not recorded by Horizon) if it is possible to “lose” halves of transactions.

We appreciate that this is, of course, something that is going to have to be addressed in expert evidence. It will also be necessary to undertake the same reconciliation in relation to the other weeks in which losses apparently arose. However, at this stage, we would invite you to conduct your own analysis of the figures for Week 42 and consider these anomalies with your client, and then provide an explanation for them.

Yours faithfully

GRO

ROWE COHEN