POL00027138

Post Office Limited

Audit, Risk and Compliance Board Sub-Committee

Briefing Book

Half Year ended 29 September 2013

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1 Glossary review

Below is a listing of key abbreviations used throughout this document with the full meaning given:

Abbreviation	Meaning
AEI	Application Enrolment Identity
ATM	Automated teller machine
BIS	Department for Business Innovation & Skills
BOI	Bank of Ireland
CPI	Consumer Price Index
DVLA	Driver & Vehicle Licensing Authority
DWP	Department of Work & Pensions
Eagle	Deal in August 2012 to sell POFS to the Bank of Ireland, restructure commission rates for personal financial services and extend the contract to 2023
FOoG	Front Office of Government
FRES	First Rate Exchange Services
Gamma	A contract variation made in 2007 with POFS generating £100m cash and income over a number of years in return for a series of commitments through to 2020
Horizon	Horizon Next Generation- Counter system
LTIP	Long Term Incentive Programme
NBV	Net Book Value
NS&I	National Savings & Investments
NSP	Network Subsidy Payment
NTP	Network Transformation Programme
POCA	Post Office Card Account
PFS	Personal Finance Services
POFS	Post Office Financial Services
POOC	Project One Off Costs
RMPP	Royal Mail Pension Plan
RMSEPP	Royal Mail Senior Executive Pension Plan
RMDCP	Royal Mail Defined Contribution Plan
RBS	Royal Bank of Scotland
RPI	Retail Price Index
SGEI	Services of General Economic Interest
UKBA	United Kingdom Borders Agency

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2. Introduction

This Briefing Book has been prepared to explain the Post Office Limited results for the half year ended 29 September 2013. It is a summary of the key data, trends and analyses to be read in conjunction with the Interim Condensed Consolidated Financial Statements, which readers may find useful to further their own understanding of the results for half year 2013-14.

Most of the analyses are based on the comparison of this year's actual results to prior year.

Comparison against budget is discussed in the Monthly Performance Report presented to the Post Office Limited Board on a monthly basis.

3. Accounting policies

Post Office Limited has reported its results under International Financial Reporting Standards (IFRS).

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4. Primary Statements

4.1 Post Office Limited Interim Consolidated Income Statement.

Post Office Limited Interim consolidated income statement for the six months to 29 September 2013 and 23 September 2012

	Notes	**Half year to 29 September 2013** **Unaudited** **£m**	Half year to 23 September 2012 Unaudited £m
Continuing operations			
Turnover		**483**	501
Network Subsidy Payment	8.1	**100**	103
Revenue	6	**583**	604
People costs excluding restructuring costs	7.2	**(131)**	(128)
Other operating costs	7.3	**(422)**	(437)
Share of post tax profit from joint ventures and associates		**23**	22
Operating profit before exceptional items	5	**53**	61
Operating exceptional items	10.1	**132**	(10)
- government grant		**129**	35
- Royal Mail Pension Plan amendment		**102**	-
- restructuring costs		**(64)**	(24)
- other		**(35)**	(21)
Operating profit		**185**	51
Profit on disposal of property, plant and equipment	10.1	**2**	2
Loss on sale of associate		**-**	(30)
Profit before financing and taxation		**187**	23
Finance costs	11.1	**(1)**	(2)
Finance income		**-**	1
Net pensions interest		**2**	1
Profit before taxation		**188**	23
Taxation credit	18.1	**2**	18
Profit for the period from continuing operations		**190**	41

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4.2 Post Office Limited Interim Consolidated Cashflow Statement

Post Office Limited Interim consolidated cashflow statement for the six months to 29 September 2013

	Notes	29 September 2013 Unaudited £m	23 September 2012 Unaudited £m
Cash flows from operating activities			
Operating profit before exceptional items		53	61
Adjustment for:			
Depreciation and amortisation		-	-
Share of profit from joint ventures and associates		(23)	(22)
Pension operating costs		13	13
Working capital movements:		(6)	131
Decrease/(increase) in trade and other receivables		73	(10)
(Decrease)/increase in trade and other payables		(81)	143
Decrease/(increase) in inventories		1	(3)
Increase in non-exceptional provisions		1	1
Pension operating costs paid		(13)	(13)
Cash receipts in respect of operating exceptional items:		153	178
Government grant		215	200
Restructuring costs		(59)	(17)
Other		(3)	(5)
Net cash inflow from operating activities		177	348
Income tax recovered		10	11
Cash flows from investing activities			
Investment in associate		-	(11)
Dividends received from joint ventures and associates		-	-
Finance income received		-	-
Proceeds from sale of property, plant and equipment		3	2
Proceeds from disposal of associate		-	2
Purchase of non-current assets		(38)	(20)
Net cash (outflow) from investing activities		(35)	(27)
Net cash inflow before financing activities		152	332
Cash flows from financing activities			
Finance costs paid		(1)	(2)
Payments to finance lease creditors		(2)	(2)
Repayment of bank borrowings		(291)	(250)
Net cash (outflow) from financing activities		(294)	(254)
Net (decrease)/increase in cash and cash equivalents		(142)	78
Effect of exchange rates on cash and cash equivalents		-	-
Cash and cash equivalents at the beginning of the period		971	820
Cash and cash equivalents at the end of the period	11.2	829	898

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4.3 Post Office Limited Interim Consolidated Balance Sheet

Post Office Limited Interim consolidated balance sheet as at:

	Notes	**29 September 2013 Unaudited £m**	31 March 2013 Audited £m
Non-current assets			
Intangible assets		**-**	-
Property, plant and equipment	13.1	**11**	11
Investments in joint ventures and associates	14.1	**83**	60
Retirement benefit surplus		**145**	97
Trade and other receivables		**10**	10
Total non-current assets		**249**	178
Current assets			
Inventories	15.1	**7**	8
Trade and other receivables	15.2	**269**	352
Cash and cash equivalents		**855**	971
Financial assets – derivatives		**-**	1
Total current assets		**1,131**	1,332
Total assets		**1,380**	1,510
Current liabilities			
Trade and other payables	15.3	**(899)**	(874)
Financial liabilities - interest bearing loans and borrowings	11.2	**-**	(291)
- obligations under finance leases	11.2	**(1)**	(3)
Provisions	16	**(25)**	(19)
Total current liabilities		**(925)**	(1,187)
Non-current liabilities			
Financial liabilities – obligations under finance leases	11.2	**(4)**	(4)
Other payables		**(24)**	(24)
Provisions	16	**(5)**	(7)
Total non- current liabilities		**(33)**	(35)
Net assets		**422**	288
Equity			
Share capital		**-**	-
Share premium		**465**	465
Retained earnings		**(45)**	(179)
Other Reserves		**2**	2
Total equity		**422**	288

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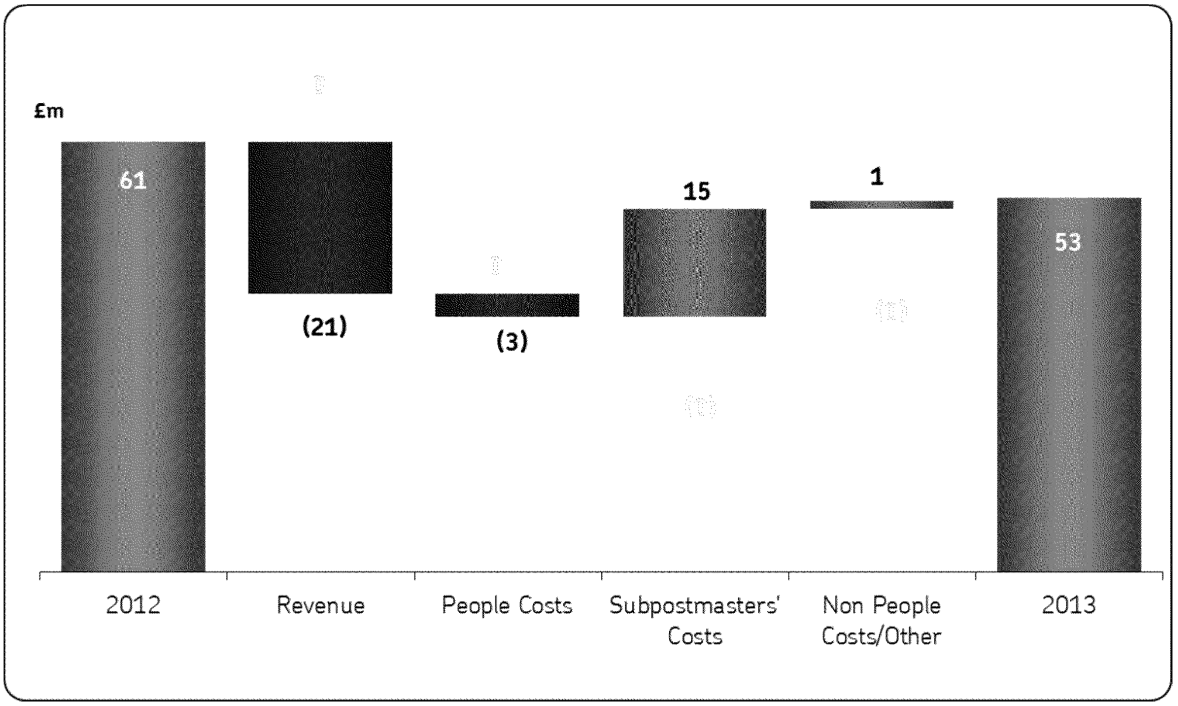
5. Operating profit

5.1 Operating profit bridge analysis



5.2 Explanations for key movements are as follows:

- Revenue - section 6.
- People costs – section 7.2
- Subpostmasters – section 7.3.1
- Non People Costs / Other – section 7.3.2 to section 7.3.11

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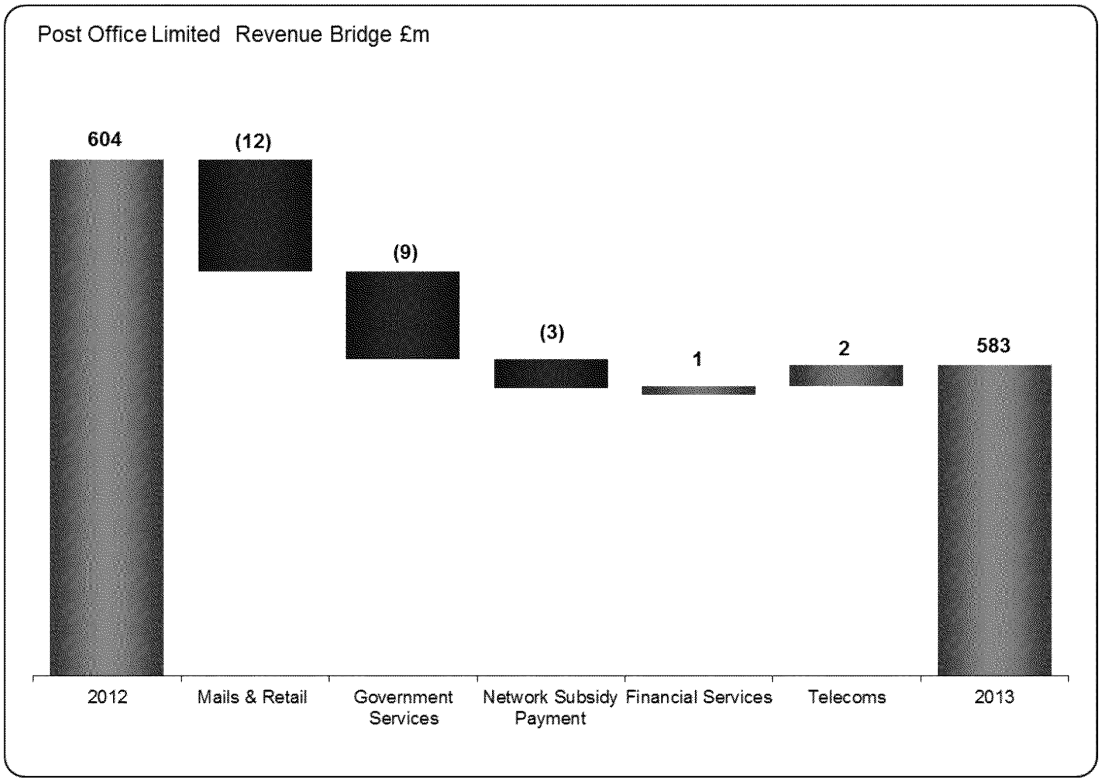
6. Revenue

	29 September 2013 £m	23 September 2012 £m	Variance £m
Turnover	483	501	(18)
Network Subsidy Payment	100	103	(3)
Total Revenue	583	604	(21)

6.1 Post Office Limited – Revenue analysis



The decrease in year on year total revenue of £21m (3.6%) to £583m (2012 £604m) is driven by the £3m decrease in the Network Subsidy Payment, and a decrease of £18m in like for like income.

The following commentary gives further detail on the revenue variances by category:

6.1.1 Mails

The £10.2m (6.0%) decrease in Mails Revenue is driven by volume reductions following the Royal Mail price changes implemented this year and the unusually high comparative prior year figure due to the buy forward of stamps before the May 2012 price increase.

- Approximately £9.6m was driven by volume decreases, (mainly stamps, labels and parcels) and the remainder by price increases.

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- The new Mails Distribution Agreement resulted in an on-going reduction of the fixed fee with a £0.4m impact in the first half of this year.

Mails & Retail Income is analysed in the table below:

	2013-14 £m	2012-13 £m	Variance £m	Volume £m	Price £m
Special Delivery	25.2	25.7	(0.4)	(0.2)	(0.2)
Parcelforce 24/48	5.3	3.6	1.7	4.2	(2.5)
Labels	44.6	47.9	(3.3)	(5.5)	2.2
Stamps	12.1	17.1	(4.9)	(4.7)	(0.2)
Royal Mail Parcels	0.0	2.8	(2.8)	(2.8)	-
International Priority & Standard	15.5	15.9	(0.3)	(1.1)	0.7
Other Parcel Force	3.8	3.6	0.2	0.1	0.1
Other Royal Mail	18.5	17.8	0.6	0.3	0.3
Total Variable Income	125.0	134.2	(9.2)	(9.6)	0.4
Fixed Fee	36.2	36.6	(0.4)	-	(0.4)
Total Mails	161.3	170.8	(9.6)	(9.6)	0.0
Lottery	19.1	19.8	(0.7)	(0.7)	-
Retail	4.0	5.4	(1.4)	(1.4)	-
Total Mails & Retail	184.3	196.0	(11.7)	(11.7)	0.0

6.1.2 Retail & Lottery

Retail and Lottery revenues have decreased by £2.1m:

- Lottery is £0.7m lower than last year, driven by fewer rollovers.
- Retail is down by £1.4m due to lower sales than last half year as the prior year included revenue from collectibles from the Olympic and Paralympic games, as well as the Diamond Jubilee.

6.1.3 Government Services

The £9.2m (11%) decrease in Government Services revenue is principally due to:

- £6.8m lower DVLA revenues due to new contract related lower price and lower volumes.
- £3.6m adverse from falling numbers of POCA accounts, through natural attrition, migration of customers to bank accounts.

This was offset by

6.1.4 Telecoms

The Telecoms Services pillar includes the Post Office Homephone and Broadband services, as well as mobile top-up services and phonecards.

Telecoms Services revenue of £65m (2012: £63m) has increased by £2.3m. Income from the Post Office Homephone and Broadband product rose by £3.5m, primarily due to higher average revenue per user.

More attractive packages were introduced in May 2012 to attract and retain higher value customers. Income from mobile top-ups was £1m below prior year, as transaction volumes

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declined due to the mobile networks actively migrating customers away from pre-pay, and also reducing their transaction fees. Despite this reduction in income, Post Office is still a significant player in the top-up market. Our share of the retail market has been maintained at around 5%.

6.1.5 Financial Services

Financial Services income has increased by £1.0m year on year. This continues the trend of increases in new products offsetting the decline of traditional products. Overall PFS (defined as Post Office savings, insurance, travel, mortgages and transaction services) is up by £11.0m (23%) year on year. By product the main variances are:

- a £8m increase in savings products mainly Growth Bonds £3.1m, Reward Saver £2.8m, ISA £2.1m. These increases follow the completion of the 'Eagle' deal in September 2012.
- a £1.3m increase in Mortgages as this a new product,
- a £1.1m increase in Insurance revenues driven by the new BOI contract and better rates,
- a £0.8m increase in MoneyGram driven by higher volumes, and
- a £0.7m increase in ATM revenue, driven by increased volumes as machines reach maturity.

This was offset by

- a £4.5m decline in NS&I revenues driven by the new contract. Revenue is from Premium Bonds only as NS&I look to provide most of their products through their own direct channel,
- a £4.5m net decrease in Banking revenue from:
    - a £2.7m decrease in business banking revenues due to rate reduction from renegotiated contract,
    - a £2.2m fall from the DWP exceptions (cash cheques and green giros). This work has now ceased, offset by
    - an increase of £0.5m in personal banking.
- A £1.8m decrease from Payment Services due to:
    - a £1.1m decrease in Postal Order income as the product is in decline, and
    - a £0.7m decline from bill payments, as utilities and other bill payment clients continue to migrate customers to other payment methods such as direct debit and online.

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7. Costs and People

This section discusses expenditure, excluding exceptionals.

7.1 Total Costs Analysis (excluding exceptionals)

The following provides a breakdown of costs for the half year ending 29 September 2013 compared to the half year ending 23 September 2012

		2013-14	2012-13	Variance	
		£m	£m	£m	
Expenditure - (pre- exceptional)	Notes				
Wages & Salaries		88	89	1	1%
Overtime		5	5	(0)	(3%)
Productivity/Bonus		11	7	(4)	(51%)
Employers NI		10	9	(1)	(7%)
Pensions		14	13	(1)	(9%)
Projects (temp people resource)		1	1	0	7%
Temporary Resource		2	4	2	45%
PEOPLE COSTS	7.2.1	131	128	(3)	(2%)
Subpostmasters' costs	7.3.1	220	235	15	7%
Collection, Delivery & Conveyance Charges	7.3.2	0	0	0	100%
Compensation	7.3.3	1	1	(0)	(9%)
Property Facilities	7.3.4	3	3	(0)	(11%)
Property Maintenance	7.3.5	4	3	(1)	(25%)
Vehicles	7.3.6	1	1	0	12%
Computers & Telephones	7.3.7	38	36	(2)	(5%)
Consultancy, Marketing & Legal Fees	7.3.8	15	12	(3)	(29%)
Staff & Agent Related Costs & Consumables	7.3.9	0	0	(0)	36%
Finance	7.3.10	12	9	(3)	(30%)
Cost of Sales	7.3.11	57	58	1	2%
Other Operating Costs	7.3.12	9	10	1	5%
Depreciation	7.3.13	0	0	0	60%
Interbusiness Expenditure	7.3.14	40	41	1	3%
Group Overheads	7.3.15	7	7	0	6%
Projects (excluding temp people resource & IB)	7.3.16	13	21	7	36%
Projects Interbusiness		2	0	(2)	-
Total Other Operating Costs	7.3	422	437	15	4%
TOTAL EXPENDITURE (Pre Exceptionals)		553	565	12	2%

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7.2 People Costs (2013 £131m vs 2012 £128m)

7.2.1 People costs (2013 £131m vs 2012 £128m)

People costs have increased in total by £3.3m (2.6%) to £103.9m, representing 23.7% (2012 22.5%) of the cost base.
The number of people employed increased by 87 to 7,999 at 29 Sept 2013 (2012 7,912), primarily due to the Network Transformation Programme. NTP people costs are included within exceptional costs. The transfer to exceptional costs is done by a move of the 'fully loaded' staff cost (including NI and pensions) from the wages and salaries line. This maintains the integrity of pensions and NI for disclosure purposes but means that variances across the categories need to be viewed in aggregate.

The people cost movement comprises:

- Wages and Salaries have decreased by £1.1m (1.3%), but as noted above, must be viewed in conjunction with the increase in NI of £0.6m (6.8%) and an element of the pension costs increase as the movement of Network Transformation staff costs to exceptionals encapsulates all 3. When viewed in this way, the variance is broadly flat year on year.

- Pension costs have increased by £1.2m (9.1%), driven primarily by the increase in the IAS19 pension rate from 18.2% to 20.6%.

- Productivity costs have increased by £3.6m (51%), and are predominantly due to productivity costs under accrual of £1.5m in 2012-13 and a £1.1m increase in the LTIP accrual as none was booked in 2012-13 following an over provision in 2011-12.

- Overtime has increased by £0.1m (2.7%).

  Temporary resource costs have decreased by £0.8m (22%), as a result of reduced recruitment and lower agency labour in Network.

7.2.2 People Numbers

The following analysis shows the movements in the number of people employed during the half year.

The People numbers were as follows:

	Period end employees		**Average employees**	
	29 Sept 2013	23 Sept 2012	**2013**	2012
Total employees	**7,999**	7,912	**7,946**	7,867

7.2.3 Average Cost Per Employee

The 2013 average number of employees for the half year ending 29 Sept 2013 was 7,946 (2012 7,867). The average annual cost per employee (excluding exceptional costs and exceptional heads) based on these averages has increased by £1,730 (5.2%) to £35,085 (2012 £33,355), but this is distorted by the increase in productivity costs. Excluding the

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productivity impact, the averages has increased by only £632 (2.0%) to £32,217 (2012 £31,584) due to pay awards (Supply Chain) and the pension rate.

7.3 Other Operating Costs (2013 £422m vs 2012 £437m)

7.3.1 Subpostmasters costs (2013 £220m vs 2012 £235m). Total subpostmasters costs decreased by £15.0m (7%). £9.3m of this was due to lower sales, including the impact of Mails buy forward last year pre the May price increase. £2.2m due to lower fixed pay from unfreezing the Core Tier Payment and roll out of Locals and £2.7m relating to the DVLA rate reduction accrual impact.

The average annual cost per subpostmaster branch (excluding VAT and NI) is £40,549 (2012 £42,892). This is a 5.5% decrease on the prior year and reflects the higher income last year relating to stamps buy forward.

	2013-14 (P6)	2012-13 (P6)
Agency Branches (incl. Mains and Locals)	10,269	10,389
MAIN	610	33
LOCAL	463	233
Outreach	1,076	1,037
Crown	372	373
Total Branches	11,717	11,799

7.3.2 Collection, Delivery & Conveyance costs have decreased by £0.5m due to ATM replenishment costs, which were paid to an external company, now being fulfilled by internal Supply Chain staff.

7.3.3 Property Facilities costs have increased by £0.3m, due to an increase in the provision for the extension of business rates to ATM's.

7.3.4 Property Maintenance costs has increased by £0.7m, due to the Network Transformation Programme.

7.3.5 Computers and Telephones costs have increased by £1.9m, mainly due to Horizon Fujitsu Costs of £1.2m and software licences of £0.6m.

7.3.6 Consultancy, Marketing & Legal Fees have increased by £3.5m year on year. £1.1m of this is offset with the staff and agent related costs line below for Skills group off charges for project activity. £1.6m relates to increased marketing costs, prior year rebranding was within project one- off costs, £0.6m relates to increased consultancy costs for SPMO Operating model and mutualisation and £0.5m increased legal costs relating primarily to separation. The remainder relates to decrease in database management and Estate fees.

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7.3.7 Finance costs have increased by £2.7m, driven by the ceasing of the Bureau rebate of £2.2m (ceased October 2012) and increased bank charges of £0.4m. The remainder is losses related.

7.3.8 Cost of Sales has decreased by £1.4m (2.4%), driven by lower Retail costs due to Olympic and Jubilee collectables. The main reasons are detailed below:

Cost of Sales

	29 September 2013 £m	23 September 2012-13 £m	Variance £m		Comments
Telecoms	40	40	0	-	
Government Services	15	15	0	-	
Mails & Retail	2	3	1	45%	Decreased Sales due to collectable products for Jubilee and the Olympics
Financial Services	1	1	0	-	
Total	57	58	1	2%	

Other Operating costs have decreased by £0.5m (5.4%) primarily due to reduced cheque processing costs.

7.3.9 Interbusiness expenditure have decreased by £0.8m due to reduced property costs and is detailed below:

Interbusiness	2013-14 £m	2012-13 £m	Variance £m
Offical Mail	8	8	0
Call Centres	2	2	0
Facilities Management	7	7	0
Vehicle Services	3	3	0
Romec	3	4	1
Property	16	16	0
Other	0	0	0
Total Interbusiness	40	41	1
Projects Interbusiness	2	0	(2)
Total Interbusiness including projects	42	41	(1)

7.3.10 Group overhead expenditure has decreased by £0.4m due to separation as work transfers over to the Post Office.

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7.3.11 Project expenditure (excluding temporary people resource and IB) has decreased by £7.4m to £13m. The £13m spent on projects is analysed below:

2013-14 Project Expenditure	£m
Customer Engagement (Brand Campaign)	5
Financial Services (Portfolio)	0.5
FOoG (DVLA Enhancements & Home Office Development)	1.3
Telephony (Fixed Line Tender, Contract negotiations and Migration)	1.5
Mails (Collections & Returns, Small, Medium Business Proposition)	0.8
Finance (Road Map)	0.3
HR & Compliance (Recruitment, Training & Data Protection & Freedom of Information)	0.7
IT Delivery (Saleforce Licences & RMG Small App Migration (UEX Phase 2)	0.5
Property (Crown Network)	0.2
Supply Chain (North West Cash Centre & Swindon Barcode Scanners & Printer)	0.4
Security (Fraud Software Analysis)	0.8
Digital (Digital & Multi-Channel)	0.4
Network	0.1
Total Projects (excluding temp people resource & IB)	13
Projects (IB)	2
Projects (temporary resource)	1
Grand Total	16

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8 Quality of Earnings

Post Office Limited (consolidated)	Notes	2013-14 £m	2012-13 £m	Growth £m	%
Operating profit before other exceptional items		53	61	(8)	(13%)
Network Subsidy Payment		(100)	(103)	3	3%
Project one off costs	7.3.11	16	22	(6)	27%
Operating (loss) before project one off costs, exceptional items and NSP		(31)	(20)	(11)	(55%)

Each item in the table is explained further below:

8.1 Network Subsidy Payment

The Network Subsidy Payment decreased from £210m for 2012-13 to £200m for 2013-14. The Network Subsidy Payment has been accounted for as a government grant in both years and has been recognised evenly through the year.

8.2 Project one off costs

Project one off costs are non exceptional costs of project activity in the year. They increased in 2012-13 as the pace of implementation towards the new plan continued but have decreased in 2013-14. These costs do not form part of the underlying business as usual performance of the company.

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9. Pensions

9.1 Background

The Post Office participates in pensions schemes and detailed below:

Scheme	Eligibility	Type
Royal Mail Pension Plan (RMPP)	UK employees	Defined benefit
Royal Mail Senior Executive Pension Plan (RMSEPP)	UK senior executives (closed)	Defined benefit
Royal Mail Defined Contribution Plan (RMDCP)	UK employees	Defined contribution

On 1 April 2012 almost all of the assets and liabilities of the Royal Mail Pension Plan (RMPP) were transferred to HM Government. On this date the RMPP was also sectionalised with Royal Mail Group Limited and Post Office Limited responsible for their own sections. Royal Mail Group Limited is the principal employer in the Royal Mail Senior Executive Pension Plan (RMSEPP) and the Royal Mail Defined Contribution Plan (RMDCP). Post Office Limited became a participating employer in both with effect from 1 April 2012. Royal Mail Pensions Trustees Limited manages the main defined benefit scheme Royal Mail Pension Plan (RMPP) which has around 5,200 Post Office active members.

At the September 2013 half year the emphasis has been on the RMPP plan, as the movements in the 7% share of RMSEPP are considered not to be significant to the Interim Report. However, the RMSEPP has been reviewed and Post Office 7% share of the RMSEPP surplus has increased by £1m to £2m driven by an improvement in asset values. An actuarial gain of £1m has therefore been recognised in the period.

9.2 Assumptions

IAS 19 revised requires a number of assumptions. The choice of assumptions used for the calculations is the responsibility of the Directors, based upon advice given by an independent actuary. The key assumptions for the half year to 29 September 2013 are set out in the table below.

Towers Watson has confirmed that the assumptions have been determined in a manner consistent with those used for the disclosures at 31 March 2013, and any relevant adjustments to 29 September 2013 have been made. Conversations with Royal Mail management confirm that it is their intention to adopt the same assumptions. The rate of increase in pensionable salaries has been adjusted from RPI +1% to RPI to reflect the impact of the change to terms arising from Project Robin as explained in paragraph 9.3.

% pa Nominal	**September 2013**	March 2013 (for comparison)
Inflation (RPI)	**3.3**	3.3
Inflation (CPI)	**2.3**	2.3
Rate of increase in Pensionable salaries	**3.3**	4.3
Discount rate (i.e. bond rate)	**4.6**	4.8

Demographic assumptions, for example mortality, remain unchanged from those made in March 2013.

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9.3 Movements in the defined benefit surplus

The movement in the RMPP defined benefit surplus during the six months to 29 September 2012 is detailed below. Scheme assets are assessed at fair value at the balance sheet date. For example, quoted equities are valued at the latest 'bid' price. Scheme liabilities are discounted using a high quality corporate bond rate. The IAS 19R surplus/deficit is usually therefore different to the cash funding surplus/deficit (the "actuarial" valuation) assessed by the Trustees, for which the scheme liabilities are discounted using the expected returns available on scheme assets.

Sectionalised RMPP	**Half year ended 29 September 2013 £m**	Year ended 31 March 2013 £m
Opening net retirement benefit surplus/(deficit)	**99**	(205)
Royal Mail Pension Plan amendment	**102**	-
Transfer of pension deficit to government	**-**	286
Current service cost	**(13)**	(24)
Curtailment costs	**-**	(2)
Net financing credit	**2**	2
Employers contributions	**11**	25
Actuarial (losses)/gains	**(37)**	17
Closing net retirement benefit surplus before IFRIC 14 adjustment	**164**	99

During the period there was a consultation exercise with members of the defined benefit Royal Mail Pension Plan on proposed changes to the terms (Project Robin). These changes were agreed and implemented on 15 October 2013. The key change was to the definition of pensionable pay which broadly will increase in line with RPI (capped at 5%) in future regardless of actual pay growth. The changes have resulted in a one-off exceptional gain of £102 million.

The current service cost is intended to represent the amount by which the liabilities will increase due to employing active members for one more year. The current service cost, expressed as a percentage of pensionable pay is 20.6% for RMPP (2012 18.2%). The charge in the income statement for the defined contribution scheme was £1m in the half year to 29 September 2013, and payments of £11m were made in respect of RMPP future service contributions at a rate of 17.1% (2012 17.1%).

The net financing credit of £2m, a non-cash item, is reported under finance income and reassessed annually.

Actuarial gains and losses are recorded directly in the statement of changes in equity (and not the income statement). The actuarial loss of £37m during the half year arose primarily due to a greater than expected decrease in assets as a result of changes in market conditions.

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9.4 Assessment of recoverability of surplus under IFRIC 14

In order to recognise a surplus it is necessary to prove that the Post Office could recover the surplus either through lower future contributions or through a refund. [redacted] Towers Watson has calculated that Post Office Limited would be able to recover £103 million of the £164 million surplus in RMPP through lower contributions and the remaining £61 million could therefore be recovered through a refund. The element of surplus that is recoverable through a refund would be subject to a 35% withholding tax and therefore the overall surplus on the balance sheet has been reduced by £21 million to £143 million. The element that is recoverable through lower contributions has resulted in a deferred tax liability of £21m, which is consistent with the deferred tax credit recognised in the year to 31 March 2013 and therefore no further tax consequence has been recognised in the half year to 29 September 2013.

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10. Exceptional Items and Provisions

This section discusses the exceptional items on the income statement together with movements in the related balance sheet provisions/payables.

10.1 Exceptional items summary

The following exceptional items were recognised in the consolidated income statement for the half years ended 29 September 2013 and 23 September 2012

10.2

Exceptional items	Notes	**2013-14 £m**	2012-13 £m
Operating Exceptionals:			
Royal Mail Pension Plan amendment		**102**	-
Government Grants	10.2	**129**	35
Restructuring costs including Subpostmasters compensation	10.3	**(64)**	(24)
Impairments		**(35)**	(21)
Total operating exceptionals		**132**	(10)
Non operating exceptionals:			
Profit on disposal of property		**2**	2
Net Exceptional gain/ (costs)		**134**	(8)

Government Grants – In April 2013 the Post Office received grants totalling £215m from the Government, (April 2012 £200m) to fund capital projects and transformation.
Amounts utilised in the respective half years are as shown with the 2013/14 utilisation including £31m relating to network and IT transformational costs incurred in 2012/13 for which there was insufficient grant in that year.

10.3 Restructuring costs - include the costs (£55m) of delivery of a major change in the network. Network Transformation introduces new style agency offices and seeks to improve fundamentally the profitability of the Crown network. The IT Transformation programme will create the IT infrastructure appropriate for an independent group with ambitious growth plans and incurred a further £5m. Other costs included are business separation of £2m and redundancy of £2m.

Network Transformation comprises costs of £15m for Subpostmasters' compensation and £40m programme costs. The £40m spent on Network Transformation is analysed below:

Network Transformation	£m
Branch Fit Out (Inc. Signage /Scales etc)	9
Horizon Implementation	3
Legal-New Operating Model Contracts	1
Management Consultancy	3
Marketing	1
Crown Transformation: pilot design/scoping	5
Professional Fees -Site Survey	5
Staff	10
Skills Group Internal Consultancy Resource	1
Project Management (Roll Out)	2
Total	40

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11. Interest, Cash, Debt, Funding and Hedging

11.1 Net finance costs Sept 2013 £1m vs Sept 2012 £1m

Finance costs & investment income	**29 September 2013 £m**	23 September 2012 £m
Interest received on investments – UK	-	1
Total finance income	**-**	1
Interest charged on Government borrowings	-	-
Interest payable on finance leases	-	(1)
Other finance costs	(1)	(1)
Total finance costs	**(1)**	(2)
Net finance cost	**(1)**	(1)

Interest payable on the BIS Loan fell last year as the average borrowing volume significantly decreased due to funding receipts attributable to transformational programmes. This position continued with £200m received in 2012-13 and £215m in 2013-14.

Finance leases are nearing conclusion and both arrangements covering counter printers and the AEI equipment finish in 2014-15 – accordingly interest is reducing.

Other finance costs include commitment fees to BIS for the Post Office credit facility, and charges to RBS for their note sorting facility.

11.2 Cash, cash equivalents and debt within the balance sheet

Net cash/debt analysis	Section	**29 September 2013 £m**	31 March 2013 £m
Cash in the Post Office Limited network	11.3	**825**	870
Other cash at bank (overdraft)/deposits		**-**	9
Cash equivalent investments		**30**	92
Total cash and cash equivalents		**855**	971
Loans, repayable on demand or less than 1 year	11.4	**-**	(291)
Obligations under finance leases (current)	11.5	**(1)**	(3)
Total current financial liabilities		**(1)**	(294)
Obligations under finance leases (non-current)	11.5	**(4)**	(4)
Total		**824**	673

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11.3 Cash within the Post Office Limited network (Sept 2013 £825m vs March 2013 £870m)

The reduction in Post Office network cash from March 2013 levels is due to the year-end coinciding with Easter necessitating increased branch and cash centre holdings.

11.4 Loans and borrowings (Sept 2013 £nil vs March 2013 £291m)

Daily borrowing requirements in the first half of 2013/14 are significantly lower than the year end loan position on account of advanced government funding of both the £215m transformational funding and £200m Network Subsidy.

11.5 Obligations under finance leases (current & non-current) (Sept 2013 £5m vs March 2013 £7m)

The obligations under finance leases have decreased by £2m in the half year attributable to lease repayments in 2013-14. Lease types are shown in section 13.2.

11.6 Loan facilities

At half year the Post Office had no external (non Government) borrowing facilities in place.

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12. Going concern

Post Office Limited has net cash and cash equivalents of £855m (section 11.2) and a borrowing facility of £1,150m of which none (section 11.4) was drawn down at 29 September 2013.

12.1 Background

On 24 March 2010 a funding agreement was agreed that provided up to £180m for compensation for losses sustained in parts of the Network in 2011-12, as well as providing access to the working capital facility to 31 March 2016. These arrangements received State Aid approval on 23 March 2011 through the working capital facility was limited until 31 March 2012.

A further funding agreement with Government was announced on 27 October 2010 which provided for:

- Funding of £410m for 2012-13 (received 2 April 2012)
- Funding of £415m for 2013-14 (received 2 April 2013)
- Funding of £330m for 2014-15
- Extension of the existing working capital facility with BIS of £1.15bn up to 31 March 2016

State Aid approval for the funding for 2012-13 to 2014-15 was received on 28 March 2012. It was also recognised that the working capital facility was no longer deemed State Aid. However, no drawing under the facility may extend past the Final Maturity Date (31 March 2016).
The going concern analysis is based on the latest draft 2020 strategic plan financials presented to the Post Office Board in April 2013 and forming part of Government funding discussions.

12.2 Assessment for the Post Office

Post Office has finished implementing its 2005-11 strategic plan and has completed its closure programme. It posted an operating profit before exceptional items for the first time for a number of years in 2008-09 and has continued to do so, but still operates with a cash outflow with the exception of 2012-13. The 2011-15 plan is intended to reverse the trend of an increasing Network Subsidy Payment (NSP) with the draft strategic plan beyond 2014-15 continuing that reducing trend.

The 2011-15 strategic plan updated for latest views has been shown in Table 1 of this section, and shows that Post Office has sufficient cash headroom to continue to trade. The available facility has been defined to include network cash, ATM cash, ATM debtor, POCA debtor and SGEI cheques. Downsides have been applied that the funding for NSP and transformation post March 2015 is not available and that the growth and savings plans are not fully delivered. Subject to ceasing spend on transformation post March 2015, there could still be sufficient headroom to trade. It should be noted that there is a dependency on the working capital loan being extended beyond its current end date of 31 March 2016.
The one year funding deal for 2011-12 added the ability to borrow up to £50m from other sources, as well as the up to £50m in finance leases previously allowed, which would improve the headroom capacity shown if required.

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12.3 Summary conclusion

Based on the analysis there is available borrowing headroom until March 2016 and until March 2017 if it is assumed that the working capital loan can be extended for another year. Royal Mail Group Limited is a key trading partner with Post Office Limited and, in arriving at the conclusion that Post Office Limited is a going concern, the assumption is made that Royal Mail Group Limited is a going concern or that an alternative mails provider would work similarly with Post Office Limited providing a similar level of income.
It is believed that Post Office Limited will be able to meet its liabilities as they fall due in the foreseeable future. It is therefore expected that the directors will consider it appropriate to prepare the accounts on a going concern basis.

Post Office Limited Funding Analysis

Table 1 September 2013 £m (cumulative apart from free cash flow)	2012-13	2013-14	2014-15	2015-16	2016-17
Opening Funds	(336)	(204)	(220)	(316)	(559)
Borrowing facilities	1,150	1,150	1,150	1,150	1,150
Restriction due to level of network cash	(98)	(350)	(350)	(350)	(350)
Borrowing from other sources - finance leases, bank overdraft etc	14	9	4		
Latest plan free cashflow before assumed non NSP grant injection	(68)	(231)	(266)	(323)	(11)
Non NSP grant injection per October 2010 plan/ April 2013 plan	200	215	170	80	80
Closing Funds Headroom	862	589	488	241	310
Downside impact of no NSP beyond March 2015				(130)	(210)
Downside impact of no further grant injection beyond March 2015				(80)	(160)
Adjusted Headroom pre risk	862	589	488	31	(60)

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Table 2: Risks,with management actions					
£m (cumulative)	2012-13	2013-14	2014-15	2015-16	2016-17
Headroom pre risk (as above)	862	589	488	31	(60)
Risks					
Financial Services growth slower than plan		(3)	(8)	(18)	(60)
Mails revenue decline halted but not reserved (net of agents' cost saving)		(10)	(20)	(30)	(40)
Network Transformation benefits are not fully delivered		(2)	(6)	(9)	(12)
Crown Transformation benefits are not fully delivered		(5)	(10)	(25)	(40)
Pension contribution rates increase		(4)	(8)	(12)	(16)
Increase in cost as a consequence of stopping transformation post March 2015				(50)	(150)
Headroom post risks pre management actions	862	565	436	(113)	(378)
Management actions				309	524
Stop transformation post March 2015				145	263
Reduce capex to replacement only (£30m pa) post March 2015				164	261
Headroom post risk and management actions	862	565	436	196	146

Notes:

2012-13 shows the year end outturn and last years are the latest view of the strategic plan. Available facilities are defined as network cash, ATM cash, ATM debtor, POCA debtor and SGEI cheques.

Table 1

This table shows the 2020 strategic plan projections for 2014-15 and beyond. It demonstrates positive headroom throughout the plan period assuming funding post 2015 is agreed. If it is not there would be a need to take management action.

Table 2

This table sets out the impact of theoretical downside scenarios if the plan does not generate the income streams anticipated, the network programmes fail to deliver the benefits and if the pension scheme costs increase.

Management actions have been identified to manage the lack of future funding and downside risk within the headroom. There are further actions that could be taken but are not required. These include the sale of property and/ or tax losses.

However, it is required to assume that the loan is extended beyond March 2016.

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13. Property, plant and equipment and non-current assets held for sale

13.1 Net Book Values

The net book value (NBV) of land and buildings, plant and fixtures and intangible fixed assets at September 2013 was £11m (March 2013 £11m). Movements in the six months were as follows:

Movement in NBV	Land and buildings £m	Vehicles, plant and fixtures £m	Intangible fixed assets £m	Total £m
NBV at 31 March 2013	11	-	-	11
Add capital expenditure	2	15	18	35
Less disposals	-	-	-	-
Less depreciation	-	-	-	-
Less impairment	(2)	(15)	(18)	(35)
NBV at 29 September 2013	**11**	**-**	**-**	**11**

13.2 Assets held under finance leases

The value of equipment held under finance leases is £nil (March 2013: £nil) having been impaired in the years in which it was acquired. The two finance leases held are:

- Counter printers, capitalised and impaired in 2006-7 with an asset value of £10m, expires 2014-15;
- Identity equipment in branches, capitalised and impaired in 2010-11, with an asset value of £8m, expires 2014-15.

13.3 Capital expenditure

The following table summarises capital expenditure to 29 September 2013:

Capital expenditure analysis	Land & buildings £m	Vehicles, plant & fixtures £m	Intangibles £m	Total £m
Technology Roadmap	-	-	10	10
Network Transformation	-	11	-	11
Separation (from RMG) project	-	-	2	2
Finance Roadmap	-	-	1	1
FOoG Front Office of Govt	-	-	2	2
Vehicles	-	2	-	2
Property	2	-	-	2
Other (items <£1m)	-	2	3	5
Total	**2**	**15**	**18**	**35**

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14. Goodwill, investments and intangibles

14.1 Investments in joint ventures and associates

	29 September 2013 £m	31 March 2013 £m
Investment in joint ventures	**83**	60

Joint ventures

Post Office Limited's joint venture investment is a 50% interest in First Rate Exchange Services Holdings Limited, whose principal activity is the provision of Bureau de Change. The movement from the year end is £23m representing the share of post tax profit.

A dividend is anticipated from FRES during October 2013 – value not confirmed at time of writing – which will reduce the carrying value of the joint venture.

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15 Working capital

15.1 Inventories (September 2013 vs March 2013 £8m)

	29 September 2013 £m	31 March 2013 £m
Scratchcards	5	5
Retail	2	3
Total	7	8

15.1.1 Inventory written off

The provision for stock write downs and discrepancies has decreased to £0.4m in September 2013 from £0.5m in March 2013. Shrinkage and obsolete stock written off in September 2013 was £0.3m (March 2013 £0.4m).

15.2 Trade receivables

Receivables are tabulated below, followed by a detailed explanation of the various balances.

Receivables

	29 September 2013	31 March 2013
Trade receivables	56	32
Client receivables	156	240
Prepayments and accrued income	58	71
Other receivables (taxation)	(1)	9
Total	269	352

15.2.1 Trade receivables: Current (due within one year)

Trade receivables

	29 September 2013	31 March 2013
Sales ledger	27	18
Doubtful debt provision	(1)	(1)
Homephone debtors	22	14
Homephone provision	(6)	(6)
Subpostmasters debt	13	14
Subpostmasters debtors provision	(8)	(9)
POFS, FRES cost recovery	9	2
Total	56	32

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The increase in sales ledger is largely explained by the £5m debtor at September 2013 for DWP card account income (March 2013 DWP debtor: £nil). Mainly the DWP adhere to agreed terms and pay the month following invoice receipt though there are instances when the DWP settle in-month.

The increase in homephone debt is due to POL switching provider from BT to Fujitsu. Fujitsu are currently experiencing difficulties and have not invoiced customers for September 2013, increasing customer debt levels. Other variances largely net off,

Receivable balances in relation to former subpostmasters of £8m have been provided for in full in line with previous years. This is due to the difficulty in recovering these amounts. The remaining £5m of subpostmaster debt which is unprovided against relates to current subpostmasters debt which are usually settled through a deduction from remuneration. The balances are provided for when they reach 60 days old for single subpostmasters or 90 days for multiples.

A profile of the trade receivables is as follows:

Trade receivables

	29 September 2013	31 March 2013
DWP	5	-
Bank of Ireland (2012: POFS)	12	11
FRES	2	-
Partner banks	1	-
Bank of Ireland (ATM commission)	3	2
Bill payment partners	2	1
Subpostmasters	-	1
Others	2	3
Total	27	18

Ageing of trade receivables:

Debtors over 60 days overdue: September 2013 £4.6m (March 2013: £0.4m).

The Post Office does not have a general risk in relation to bad debts due to the agency nature of our client base. The main debt ageing at September 2013 is £4.5m Bank of Ireland.

15.2.2 Client receivables

Analysis of the significant client balances at year end is as follows:

Client receivables

	29 September 2013	31 March 2013
ATM (Bank of Ireland)	92	123
Card Account (JP Morgan)	30	76
Partner banks	22	29
Others	12	12
Total	156	240

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The reason for the significant difference in Client levels between September 2013 and March 13 is due to the coinciding of the March 2013 year end with Easter, which increased transactional activity and also temporarily extended settlements into 2013-14 because of the bank holiday.

15.2.3 Prepayments and accrued income September 2013 £58m (March 2013 £71m)

Accrued income represents the majority of this amount (September 2013: £39m, March 2013: £34m), and year on year the product components are similar. The larger accruals at September 2013 are: DWP card account income for September £7m, Homephone £6m and Bank of Ireland commissions £7m.

Additionally there are prepayments of £20m at September 2013 (March 2013 £36m). There are two main elements: a £12m (March 2013 £28m) advance payment to Fujitsu in respect of the 2013-14 managed service, and £4m (March 2013 £12m) – also to Fujitsu – for 2013-14 set-up costs for their take-on of the Telephony contract.

15.3 Payables: amounts due within one year

A summary of payables categories is:

	Section	29 September 2013	31 March 2013
Trade payables	15.3.1	25	43
Accruals and deferred income	15.3.1	99	110
Client payables	15.3.2	375	528
Advance customer payments		47	50
Capital payables		15	18
Social security		9	10
Business transformation		6	7
Amounts due to group companies		10	6
Government grant deferred income	10.2	188	102
NSP		100	-
Bank Overdraft		25	-
Total		899	874

15.3.1 Trade payables and accruals

Trade payables and accruals

	29 September 2013	31 March 2013
Trade payables	25	43
Accruals, GRNI	59	55
Agent, employee pay balances	10	24
Productivity, bonus schemes	10	16
Deferred income (Gamma)	12	7
Others	8	8
Total	124	153

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Manual accruals and GRNIs represent the material trade liabilities at any point and are consistent year on year, reflecting high levels of project activity commensurate with the Network Transformation programme.

Trade payables at March 2013 included a one-off entry for Clydesdale Bank of £7m. The remaining reduction in trade payables balances relates to the purchase ledger and Fujitsu and BT in particular where y/e invoice levels were high.

Within agent pay balances at March 2013 is a £3m one-off accrual for DVLA payments to agents and £7m product pay due on account of March being a five week period. (September 2013 equivalents: £nil)

15.3.2 Client payables

	29 September 2013	31 March 2013
Santander	139	183
NS&I	21	28
DVLA	53	107
Utility companies	9	24
Bank of Ireland	13	8
BACS	43	59
Others	97	119
Total	375	528

March balances were impacted by the Easter bank holiday coinciding with the Post Office's year end, having the effect of increasing the settlement timescale temporarily. The DVLA balance was most affected by the coinciding of year end with calendar month end.

During 2013/14 a new DVLA contract provides for changed settlement terms which has the effect of increasing the balance on hand and is cashflow positive for Post Office Ltd.

15.3.3 Client advances

This category also includes specific, non-client, creditors as follows:

Client advances

	29 September 2013	31 March 2013
Client advances, deferred income	21	23
Postal order liability	16	17
Homephone line rental advance payments	10	10
Total	47	50

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15.4 Payables: amounts due after one year

Payables due after one year

	29 September 2013	31 March 2013
Amounts due under finance leases	4	4
Bank of Ireland deferred income (Gamma)	24	24
Total	28	28

Bank of Ireland deferred income concludes in financial year 2022-23 and is recognised in line with an amortisation schedule. In addition to the above sum, there is £12m in current year trade payables and a further £7m remains to be invoiced in future years.

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16. Provisions

Provisions (September 2013 £30m vs March 2013 £26m)

	Crown Conversions Project £m	**Network Transformation £m**	**Other £m**	**Total £m**
At 31 March 2013	7	10	9	**26**
Charged/ (released) in operating exceptional items	(1)	15	3	**17**
Charged in operating costs		-	3	**3**
Utilisation	(1)	(11)	(4)	**(16)**
At 29 September 2013	5	14	11	**30**
Included within current liabilities				**25**
Included within non current liabilities				**5**

The Network Transformation provision relates to compensation payments due to subpostmasters who have signed up to the new contract terms or for a termination payment at September 2013.

Crown conversions relates to the contract with WH Smith for the original tranche of Crown outlets franchised. The new contract relating to these branches is not considered onerous and future income growth assumptions have been overlayed onto the existing provision, prompting the exceptional release of £1m. This provision effectively concludes in 2014/15.

Other provisions at September include onerous property lease obligations £3m, personal injury claims £1m, redundancy £2m, Bank of Ireland sales capability investment (Eagle provision) £3m and the ATM business rate provision £2m.

17. Litigation and Claims- Potential Claims regarding Horizon

17.1 Post Office Limited has received various claims from subpostmasters (SPMs) alleging defects in the Horizon system and Post Office Limited's internal processes.

These allegations were initially made in 5 claims brought through solicitors Shoosmiths. Similar allegations have been made through:

- SPMs' MPs;
- the "Justice for Subpostmasters Alliance" (JFSA);
- defences to court proceedings brought by Post Office Limited to recover debts from SPMs; and
- direct contact with Post Office Limited.

17.2 On 8 July 2013, Second Sight published an Interim Report finding shortcomings in Post Office Limited's internal training and support to SPMs on the Horizon system, but no systemic problems with Horizon itself.

17.3 Following the Second Sight Interim Report, on 27 August 2013 Post Office Limited launched a Mediation Scheme aimed at finally resolving individual complaints made about Horizon.

17.4 Sir Anthony Hooper has been appointed as Chair of the Working Group overseeing the Mediation Scheme. He will chair his first meeting on 25 October 2013.

17.5 The Mediation Scheme has received 64 applications from sub-postmasters since it was opened at the end of August, of which 44 have been formally accepted onto the scheme to date. Only 1 case has been excluded at this stage, on the grounds that it is subject to an ongoing legal process: all the other cases are either still being reviewed, are awaiting further information or need to go through Post Office Limited's normal investigation processes before they would be referred to mediation. The application closure date is the 18 November 2013. SPMs will then have a month to complete their full applications before Post Office Limited review the cases in detail. The aim is to get some cases into the mediation process before the end of 2013 with the majority happening between January and March.

17.6 Post Office Limited is also reviewing past and present criminal prosecutions brought against SPMs to ensure they continue to satisfy the evidential, public interest, and disclosure standards required for prosecutions. This review should be completed by the end of October 2013.

17.7 Post Office Limited's external firm of criminal solicitors, Cartwright King (CK), has now completed a review of 301 cases subject to past prosecution to identify whether Post Office Limited has a duty to disclose the findings of the Second Sight report and associated issues. CK has concluded that disclosure is appropriate in 10 of these cases, and a short letter has therefore been sent to each of the defence teams to bring their attention to the report. It is now a matter for the defence in each case to determine what action, if any, they might take in light of this additional information. Post Office Limited is also awaiting an unknown number of further historical prosecution files from Royal Mail, although at this stage Post Office Limited has no reason to believe these will substantially increase the number of actual disclosures. In view of the potential interest from the Criminal Cases Review Commission, Post Office Limited commissioned a review by Brian Altman QC of the prosecution

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procedures it has followed. He concluded that Post Office Limited is complying with its duties and that the approach adopted by the prosecution team was “fundamentally sound”.

17.8 Post Office Limited is not issuing any new criminal summons pending the instruction of a new, independent expert who can give evidence to support the Horizon system. The process of identifying this expert is under way.

17.9 To date, no claim has been made against Post Office Limited in the civil courts, and no appeal has been made to the Court of Appeal against any conviction obtained in the criminal courts.

17.10 Post Office Limited has instructed Brian Altman QC to undertake a second review, which will look at Post Office Limited’s prosecutions approach in the context of its wider business needs.

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18. Taxation

18.1 Income statement

A breakdown of the tax credit is shown in the table below:

	Half year to 29 September 2013	Half year to 23 September 2012
	£m	£m
Corporation tax credit for period	**-**	7
Tax under provided in previous periods	**-**	-
Current tax	**-**	7
Deferred tax credit relating to the origin and reversal of temporary differences	**2**	11
Income tax credit reported in the condensed consolidated income statement	**2**	18

18.2 Factors affecting tax credits

An additional deferred tax credit has been recognised in relation to the retirement benefit surplus on the balance sheet as the proportion of this surplus which is considered to be recoverable through future contributions moved in the half year to 29 September 2013. An equal and opposite entry has been recognised through equity.

The Group (POL and subsidiaries) has significant tax losses that are available for offset against future taxable profits. It also has unrecognised deferred tax assets relating to fixed asset timing differences. These tax losses/deferred tax assets could be recognised in the future should suitable taxable profits arise. The tax losses/unrecognised deferred tax assets means that the Group should not incur any tax charges for the foreseeable future.