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POST OFFICE LTD BOARD

Risk Management Update November 2013

1. Purpose

The purpose of this paper is to:

- 1.1 update the Board on the ExCo assessment of risks facing Post Office in the achievement of its strategic objectives; and
- 1.2 update the Board on the progress made with implementing a risk management framework and developing a risk management culture in Post Office.

2. Key risks

- 2.1 ExCo has continued to refine its assessment of the key risks in achieving its strategic objectives through an iterative process of workshops, facilitated by the Risk Management function. As a result, ExCo has identified six critical risks which require top management attention. These are:

2.2 Allegations relating to the integrity of the Horizon system

ExCo Owner: Chris Aujard

There is a risk that the allegations relating to the integrity of the Horizon system, if not contained, could raise wider questions over the robustness of our core systems and our ability to operate, damaging (amongst other matters) current partnerships, new areas of expansion and public and government confidence.

Key Impacts: Reputational – Consumer Confidence | Long term brand damage | reduced brand strength with potential partnerships/joint ventures | political impact.

Key Controls & assurance: Project Sparrow and the related Business Improvement Programme | Sparrow lessons learned work | Risk Function to carry out review.

2.3 Failure to deliver top line growth in line with strategic plans

ExCo Owner: Martin George & Nick Kennett

Failure to meet our strategic imperative to protect channel income whilst growing our retail business will ultimately prevent our ability to reach commercial sustainability. In particular lack of growth in FS will have a detrimental impact on delivery of the strategic plan. Non delivery of growth targets will reduce the appeal of the franchise model impacting Network Transformation. There is an immediate threat that long term growth targets could become unachievable if we do not respond quickly to competitors.

Key Impacts: Inability to reach commercial sustainability | Reduces appeal of Franchise model

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Key Causes: Failure to respond to shifting consumer behaviour | Failure to respond to the competitive market with pace | Capability of people | Operational failures – process and systems | Brand damage/image, particularly significant to FS business (with a growth target of 70% by 2020) | Overly optimistic planning assumptions | poor industrial relations

Key controls & assurance: Quarterly performance reviews | Weekly Trading Board | Commercial plan in place

2.4 Operating Model fails to deliver requisite cost savings

ExCo Owner: Chris Day

Reduction of costs and sustained cost management are imperative if we are to generate the level of profitability required to make Post Office commercially sustainable. A multi-faceted programme of transformation coupled with challenging growth targets can conflict with a cost reduction programme.

Key Impacts: Inability to reach commercial sustainability

Key Causes: Failure/Pace of Network Transformation | Culture – not cost conscious | Conflict with other priority programme e.g. NT | Fixed cost creep as growth targets met | Union opposition

Key controls & assurance: Benefits realisation project | NAO value for money standard | external benchmarking

2.5 Inadequate people capability or capacity to deliver transformational change and the strategic plan

Exec Owner: Fay Healey

The capability of our people is critical to successful delivery of all facets of the strategy. There is a risk that we cannot retain; recruit and effectively performance manage our people to the level of capability required within the necessary timeframe. Additionally, as we continue to grow our capability there is a risk that the pool of existing talent is oversubscribed increasing pressure and reducing their effectiveness.

Key Impacts: Transformation unachievable

Key Causes: Inability to retain talent – through poorly conceived or poorly executed change management (overworked), Lack of engagement, lack of development | Inability to attract talent – brand, pay etc | Ineffective training and development

Key controls & assurance: tactical skills development | Talent development programme | FS Academy | performance management | Carry out gap analysis against the skills required to deliver the 2020 plan.

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Exec Owner: Kevin Gilliland

Short term issue regarding the successful engagement of the NFSP in supporting NTP.

In the longer term, failure to deliver network transformation in a timely fashion would result in a non-viable business model requiring additional subsidy from the Government or closure of branches, neither of which are sustainable options. There is an immediate risk that if we do not move quickly, we may find that we cannot secure the retail partners we need to secure the future of our network.

Key Impacts: Increased Costs | Reduced Income growth | Unable to meet Customer needs | Credibility of leadership.

Key Causes: Unattractive proposition | Poor project execution | Poor communication/engagement with agents | Non-delivery of growth.

Key controls & assurance: McKinsey & BIS reviews | stakeholder engagement plan | RM project audit | 2nd line risk review.

2.7 Strike action within supply chain could damage ability to distribute cash to network (IR/CWU)

Exec Owner: Kevin Gilliland

Whilst there are multiple controls, and back up plans, in place to mitigate the risk of a breakdown in cash distribution there is a risk that these will be insufficient to deal with a with continued strike action. The impact of branches not receiving the cash they need to serve our most vulnerable customers would be detrimental to the Post Office reputation.

Key Impacts: Reputational Damage

Key Causes: Poor communication/engagement with unions | Union demands at odds with strategic direction of becoming a commercially sustainable business

Key controls & assurance: internal & external communications plans | 3rd party contingency planning | Working group examining alternative carriers/ways of working.

2.8 In addition to the above risks, ExCo identified three further risks which require continuous monitoring, specifically:

- **the risk of regulatory action or reputational damage from FS mis-selling;**
- **the maintaining the security and integrity of Post Office data; and**
- **the successful delivery and operation following IT transformation**

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- 2.9 It is important to note that all nine of these risks are interdependent and should be viewed collectively to determine the overall impact on the strategic plan.

In addition to the controls outlined above, the management of these risks is reviewed by ExCo on a weekly basis to provide assurance that plans are delivering the required outcomes.

3. Progress on implementation of a risk management framework

- 3.1 The following activities are complete in respect of the delivery of the risk management plan:

- Recruitment of all current template roles is now finalised with two recruits already in post and the remaining two starting over the next few weeks, bringing the Risk Management function up to full strength;
- As referred to above, ExCo has carried out a risk identification and assessment session, together with two subsequent reviews to refine this assessment;
- Each directorate lead team (with the exception of Communications – scheduled for 28th Nov and Corporate Services) has conducted a similar risk workshop to identify risks at the next level down from the enterprise view;
- The Risk & Compliance Committee has been restructured to focus on management of risks in Post Office and to oversee progress against the plan;
- The Risk Function has started professional training in risk management to enhance their current experience and knowledge;
- On-going benchmarking with other organisations has been established; and
- A review of the risk management software has been completed.

- 3.2 By the end of the financial year it is expected that risk management will be active at tier 1 (ExCo) and tier 2 (directorate lead team) with continuous support from the Risk Function's business partners who will act as full-time risk champions to facilitate and monitor the approach. In this context, active means:

- Risks are regularly reviewed;
- Risks are owned by an accountable individual;
- Risk appetite and target levels of risk have been agreed;
- Controls and assurance measures for significant risks have been established; and
- Action plans are in place to manage risks and are regularly monitored for effectiveness.

- 3.3 In addition to the above, a road map for developing risk management in the Post Office will be submitted to the ARC for approval in February 2014, setting out the key milestones across a 1,3 and 5 year horizons.

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4. Recommendations

4.1 The Board is asked to:

- Note the update and actions set out above; and
- Provide feedback on the actions outlined above.

**Chris Aujard
General Counsel
21 November 2013**