

**Royal Mail – Strictly Confidential**

**ARC(09)4<sup>TH</sup>**  
**ARC09/32 - 46**

**ROYAL MAIL HOLDINGS plc**

(Company no. 4074919)

**AUDIT AND RISK COMMITTEE**

**Minutes of the meeting held at 100 Victoria Embankment London on**  
**21st October 2009**

**Members of the Committee Present:**

Paul Murray	Non Executive Director, Chair of the Committee
Andrew Carr-Locke	Non Executive Director
David Currie	Non Executive Director - by telephone for ARC 09/32-39

**Apologies:**

Richard Handover	Non Executive Director
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**In attendance:**

Donald Brydon	Chairman
Ian Duncan	Group Finance Director
Doug Evans	General Counsel
Jonathan Evans	Company Secretary
Derek Foster	Internal Audit & Risk Management Director
Mick Jeavons	Financial Management & Control Director
Sarah Hall	Chief Accountant
Richard Wilson	Ernst &Young
Alison Duncan	Ernst &Young
Ben Marles	Ernst &Young
Andrew Poole	Deputy Company Secretary
Matthew Rose	Director Group Taxation for item ARC09/40

**ARC09/32**

**MINUTES**

- (a) The minutes of the meetings of the 6<sup>th</sup> May and 13<sup>th</sup> July 2009 were considered and approved as accurate records of the meetings;
- (b) the Committee noted the minutes of the GLS Group Audit & Risk Committee dated 13<sup>th</sup> February 2009, 27<sup>th</sup> April 2009 and 16<sup>th</sup> October 2009 and the minutes of the Corporate Risk Management Committee held on 15<sup>th</sup> July 2009.

**ARC09/33**

**STATUS REPORT**

**ARC(09)24**

- (a) The Committee noted the status of actions from the previous meetings. In particular:
- (b) ARC (09)17(a): the Technology organisation continued its transformation programme. A core part of this related to improvements in IT Governance. At previous Audit and Risk

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Committees, snapshots had been provided to gauge Royal Mail's progress against Price Waterhouse Coopers' view of accepted good practice in this area. The summary was last produced in May 2009. It had now been superseded by internal tracking of the Technology organisation's progress against strategic governance goals;

- (c) ARC(09)/20(c): a paper from Doug Evans, General Counsel on the lessons learnt from Project Hurst, and noted further that the actions already planned by the business would help to deliver an improvement in controls that would reduce the opportunity for such events to occur again.

ARC09/34

### PROJECT Q & REVIEW OF REGULATORY CONTROLS & ASSURANCE ARC(09)25

- (a) The Committee noted a letter from the Project Q Steering Group to the Chairman of the Audit & Risk Committee ("ARC") dated 7 October 2009 together with a review of Regulatory Controls and Assurance highlighting key areas at risk of Postal Licence non-compliance;
- (b) there was considerable focus on minimising the risk of non-compliance with the Licence conditions through internal control mechanisms which RM must be able to evidence when questioned by Postcomm. The acceptable level of internal controls could sometimes be a subjective assessment and a source of disagreement between Postcomm and RM. To help close the gap and recognising that internal controls alone - even if fully deployed – could not eliminate the risk of non-compliance, there would be further improvements made in compliance training and in the whistle-blowing policy and procedures where controls may deliberately be by-passed;
- (c) the Committee noted the issues highlighted in the report and confirmed that it would be appropriate for the Committee to continue to review regulatory controls and compliance on an annual basis, and that the management of regulatory risks was a management responsibility to be undertaken in the ordinary course of business. The Committee further agreed that it would be appropriate to keep the Project Q Steering Group live until such time as the Committee was satisfied that the matter had been concluded;
- (d) a paper would be brought to the next meeting setting out the procedures and policies relating to regulatory controls and explaining how compliance with these policies would be reported.

**ACTION**  
**Doug Evans**

ARC09/35

### GROUP COMPLIANCE REPORT ARC(09)26

- (a) Luke March introduced the Group Compliance Report providing an overview of compliance issues in 2008/09 and the status of current compliance matters;

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- (b) throughout 08/09 and so far this financial year the Group Compliance team had been focusing on responding to Postcomm activity in dealing with alleged anti-competitive behaviour and service quality related investigations, responding to complaints from external 3<sup>rd</sup> parties, ensuring regular returns were provided to timescales and responding to significant RFI activity. Also via meetings with Postcomm and in hosting visits by them to units, Royal Mail had aimed to explain to, and influence, Postcomm on contentious issues. Additionally the Compliance team had been involved in the deployment of new complaint handling regulations, the setting up of the new consumer body, deploying training programmes throughout the organisation and improving internal compliance controls (including deploying web-based testing software);
- (c) the Committee noted the key activity during 2008/09 and so far in 2009/10, the issues raised in the report and compliance focus for the current year and agreed that it would be appropriate to hold a strategic discussion with the Regulator on future regulation.

ARC09/36

## INTERNAL AUDIT & RISK MANAGEMENT QUARTERLY REPORT & GROUP RISK PROFILE ARC(09)27 & 28

- (a) Derek Foster introduced a report summarising the activity of IA&RM for the period April to August 2009. The Committee noted that twenty-three IA&RM reports had been issued in the period, with the two most significant being:-
- (b) Overtime & Allowances for OPG's: the cost of overtime and allowances in 2008/09 was £539m. Management had expressed concerns in this area and requested IA&RM to undertake a review of procedures and controls. The Committee noted a number of actions being taken to address the weaknesses identified in the report;
- (c) Credit Policy: credit turnover in 2008/09 was £3.8bn and bad debt write-offs was low at circa £6m. The debt management processes continued to be effective and kept bad debt write offs to a low level;
- (d) Derek Foster referred to the IA&RM forward plan in the report. He noted that the IA&RM plan for the year had included more assignments on POL than its scale in the Group would indicate, and that this was because of judgement around risk levels. He highlighted the items in the forward plan that were POL-focussed, and in particular the Client Reconciliation work, which had been partly triggered by concerns identified in the 08/09 year-end process;
- (e) Group Risk Profile: the Committee noted the current Group Risk Profile including the analysis and actions being taken to address the selected corporate risks.

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**ARC09/37**

**FINES COMPENSATION AND MATERIAL LITIGATION  
ARC(09)29**

- (a) Doug Evans introduced a paper providing an update on potential fines, quality of service compensation and current material litigation;
- (b) no regulatory accruals had been held at the end of 2008/09. During the first half of this year an accrual of £2 million had been made in respect of a provision raised for current Postcomm investigations and £10 million provision raised for Project Q resulting in at the half year an accrual of £12 million;
- (c) the Committee noted and agreed the amount for accruals for fines and compensation and provisions held for material litigation at October 2009.

**ARC09/38**

**HALF YEAR INTERIM REPORT      ARC(09)30**

- (a) Ian Duncan introduced a paper inviting the Committee to review the 2009-10 half year Trading Statement and to approve the Auditors Engagement Letter;
- (b) the Committee had agreed that a Trading Statement was appropriate for the 2008-09 half year at its meeting in September 2008 and the same format had been used for the 2009-10 half year. The Royal Mail Holdings Board had delegated authority to a Board Sub-Committee to approve and publish the Trading Statement for 2009-10 following a review by the Audit and Risk Committee;
- (c) the Trading Statement had been drafted and Ernst & Young carried out limited audit procedures as reported separately to the Audit & Risk Committee. The Statement focused on trading performance i.e. revenue and operating profit (pre-exceptionals) and was a single document organised around two sections - an overview section followed by Financial Highlights. The income and profit performance was consistent with the flash results presented to the Board on 7th October. The Trading Statement was reviewed and an update on content of the overview section provided to the meeting. The Chairman felt the balance was not quite right in the current draft of the Statement in that by concentrating on operating profit performance, it failed to clearly convey the message that the business was financially stressed. Any further comments from members on the Trading Statement were to be passed to Ian Duncan or Sarah Hall directly, and the Statement would be reviewed by the Board Sub-Committee taking all comments into account, together with the need for the Statement to reflect the position of the business at the time of publication;
- (d) the Committee noted that from November 2009, a 36 month

**ACTION  
All**

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cash forecast would be prepared by Group Finance and reviewed by the GET each month, with a quarterly review at the Holdings Board. This would provide a vehicle for management regularly to monitor the future cash headroom and covenant position, and allow any required mitigating actions to be taken with sufficient lead time;

- (e) Assumptions for Pension Disclosure: an approximate IAS19 valuation of the pension deficit may be included in the Trading Statement at £8.0bn (March 2009 £6.8bn). A consistent approach had been taken with previous half year valuations. The Committee approved the assumptions and approach used for the pension deficit quoted in the Trading Statement;

The Committee further:-

- (f) Going Concern: noted and approved the Going Concern approach and requested an early view of Going Concern for the year-end;
- (g) Engagement letters: approved the engagement letters as set out and delegated authority to Ian Duncan to sign them. Andrew Carr-Locke noted that E&Y had earlier confirmed that they understood that the Regulatory Accounts had been produced on a basis agreed with the Regulator. E&Y confirmed that it sometimes proved difficult to get documented confirmation from the Regulator on format or methodology changes to the audited Regulatory Financial Information.

ARC09/39

## E&Y REPORT ON INTERIM REPORT ARC(09)31

- (a) Results of P6 Audit: E&Y noted that the Trading Statement was not compliant with IAS 34 and that E&Y were not required to perform a review under ISRE 2410. However at the request of management, E&Y had accelerated certain elements of the 2009-10 year end audit work. This was designed to provide some level of comfort to management and the Audit & Risk Committee on the Statement and was broadly similar to the procedures E&Y would have performed on specific balances for a half year review. This work however did not represent either a half year review or a full audit. The Committee noted the E&Y findings of the review as detailed in the report;
- (b) 2009-10 Audit approach: Alison Duncan outlined the approach proposed for the year ended 28 March 2010 noting that the most significant area of audit focus in 2009-10 would be the ongoing transformation of the business post Project Rose. During the audit E&Y would also focus on progress made in areas that required additional audit effort in 2008-09 such as the POL control environment and SAP IT Controls;
- (c) E&Y Fees: the audit fee for the UK statutory and regulated



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audit had been agreed at £1,395,000 representing a reduction of 7.5% on 2008-09 base fees. The fee would include £60,000 of E&Y time to cover the Fujitsu controls previously billed as out of scope, together with the additional time spent on POL;

- (d) the GLS audit fees had been separately negotiated by E&Y and GLS management. These fees had been presented to and agreed by the GLS Audit & Risk Committee. The fees approved by GLS were €1,083,000 for 2009-10;
- (e) the Committee noted and approved the E&Y Audit fees for 2009-10.

ARC09/40

## VAT AND TAX ISSUES UPDATE      ARC(09)32

- (a) The Committee noted a paper to further update the Committee on the progress made by the Group as regards VAT and tax issues following the Internal Audit Review of early 2008 and update given at the March 2009 meeting. The paper also included the actions proposed and sought the Committee's support for such actions where appropriate;
- (b) it had been identified in late 2007/early 2008 that the Royal Mail Group had a number of systems, procedures and personnel weaknesses in the VAT accounting and return process. This had led to a significant financial settlement of over £30m with HM Revenue & Customs in connection with the tax years from 2004/5 to 2007/8 as well as assurances given that a significant review of the key VAT compliance processes and controls would be undertaken. This VAT Compliance Improvement Project had been initiated as a result;
- (c) in January 2009 a new Group Taxation Director and Head of VAT joined and in June 2009 the Group Taxation Director became a direct report of the Group Finance Director, reflecting the increased visibility of the Department and importance of the Group's tax issues;
- (d) the Committee noted the significant improvements and that progress continued to be made on VAT issues. A wider proposal on Group Tax resources (including staff) had recently been submitted to the Group Finance Director for approval, which included the identification of systems improvements and necessary staff arrangements, as well as a formal Strategy and Policy paper;
- (e) a range of IT improvements would be executed over time to provide better functionality and information within accounting systems for tax reporting purposes within the UK business;
- (f) there would be a range of legislative developments that would continue to affect the tax position of the Group and the need for ongoing focus on controls, systems and procedures

ACTION

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**Ian Duncan**

and that an update on these matters would be provided by March 2010;

**ACTION  
Ian Duncan**

- (g) the Committee requested that GLS be asked to provide an update on tax matters in GLS.

**ARC09/41**

**REVENUE PROTECTION UPDATE ARC(09)33**

- (a) The Committee noted a paper providing an overview of the programme of work conducted across the Revenue Protection and Mails Verification (RP&MV) structure within the Letters Operation. The programme commenced in the Autumn of 2008, with recommendations endorsed by the Letters Executive Committee during November 2008. In January 2009 the strand of activities undertaken by the programme including project resource was transferred to John Manson, Head of Cost Efficiency, Revenue Protection and Traffic;
- (b) the 2008 Revenue Protection and Mails Verification structure comprised circa 200 people employed on Mails Verification and circa 700 on Revenue Protection including managers, administration staff and OPG's. The potential estimated revenue leakage for 2007/08, before taking into consideration revenue systems or manual controls, had been estimated at £366m with controls recovering £109m resulting in a net estimated £257m revenue leakage. The RP&MV structure covered circa c£160m of the estimated net leakage;
- (c) the Committee noted the progress to date to address the issues identified. However the Committee was unsure whether the actions currently being taken were sufficient to address the issue. Management were asked to provide assurance that this was being fully and effectively addressed.

**ACTION  
Alex Smith**

**ARC09/42**

**2009/10 ACCOUNTING STANDARDS UPDATE ARC(09)34**

- (a) The Committee received a paper providing a summary of the new and revised International Financial Reporting Standards (IFRSs) that become effective for Royal Mail during 2009-10, and explaining the impact of the standards on the Royal Mail Holdings plc Group accounts;
- (b) the new or revised International Accounting Standards all have an effective date for adoption of (accounting periods beginning on or after) 1 January 2009. The effective date for Royal Mail therefore becomes 30 March 2009, being the first day of the financial reporting year 2009-10. The adoption of the new and revised IFRSs would not impact significantly on the Royal Mail Holdings plc Group accounts. The standards would result primarily in additional disclosures, apart from the requirement to capitalise borrowing costs, which would require a reclassification of interest costs in the income statement when the costs relate to the construction or development of a major asset;

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- (c) the Committee noted the new and revised IFRSs and their impact on the 2009-10 Royal Mail Holdings plc Group accounts; and the proposed actions relating to the implementation of these standards in Royal Mail in 2009-10.

**ARC09/43**

**POL FINANCIAL SERVICES COMPLIANCE REPORT  
ARC(09)35**

- (a) The Committee noted the POL Compliance report dated October 2009. The report provided an update on current compliance risks and issues arising from POL's financial services activities and to report performance of relevant performance indicators from audit and mystery shopping activity;
- (b) Donald Brydon said the current level of compliance achieved by POL was unacceptable and asked what the plan of action was to address the situation. The Committee agreed that this compliance activity required urgent attention to raise the level of compliance in the business. The Committee requested that a senior member of POL attend the next meeting to explain the actions being taken, and to assure the Committee of their adequacy.

**ACTION  
Ian Duncan**

**ARC09/44**

**DIRECTORS EXPENSES ARC(09)36**

- (a) The Committee noted schedules (copied to Committee members only) providing a summarised total of Directors' expenses and individual directors' expenses incurred during 2008–2009. A summary was included with the schedule, highlighting details of individual internal hospitality received;
- (b) the Committee noted the Directors Expenses for 2008-09.

**ARC09/45**

**ANY OTHER BUSINESS**

- (a) The Chairman said that he was reviewing the schedule of business for the Audit & Risk Committee and would look at the possibility of holding a further meeting of the Committee in January 2010.

**ARC09/46**

**DATE OF NEXT MEETING**

To be agreed.