

Post Office Limited

**POST OFFICE LIMITED**  
**(Company Number 2154540)****Meeting of the AUDIT, RISK AND COMPLIANCE SUB-COMMITTEE**  
**to be held at 17.00 on Tuesday 19 November 2013**  
**by teleconference**

17.00	1	Minutes of the last meeting and matters arising <ul style="list-style-type: none"> <li>Minutes of the meeting held on 12 September</li> <li>ARC Status Report</li> </ul>	Alasdair Marnoch
17.05	2	Risk management – top company risks	David Mason
17.30	3	Corporate and Network Audit <ul style="list-style-type: none"> <li>Key principles for internal audit POL</li> <li>Implications for Network audit</li> <li>IT Transformation</li> </ul>	Malcolm Zack
17.55	4	IT Audit Findings – Software Licensing and Identity Access Management	Malcolm Zack/ Lesley Sewell
18.05	5	Project Sparrow and Prosecuting Authority	Chris Aujard
18.25	6	Interim Report review and Ernst & Young Half Year Review findings	Chris Day/ Sarah Hall / Jeremy Midkiff
18.40	7	Financial Services Update, including Bank of Ireland (UK) plc capital & liquidity	Nick Kennett
18.55	8	Any other business	Alasdair Marnoch
	9	Papers for noting: <ul style="list-style-type: none"> <li>Information Security and Assurance Group Specific Update on Brands Database</li> <li>Internal Audit activity update, Status of Agreed Actions</li> <li>ARC Governance Review</li> </ul>	
		Dates of Next Meetings Proposed dates for 2014	Alwen Lyons

**CLOSE**

Post Office Limited

PRESENT: Alasdair Marnoch (Chairman)  
Neil McCausland (Non-executive director)  
Tim Franklin (Non-executive director)

SECRETARY: Alwen Lyons (Company Secretary)

IN ATTENDANCE: Alice Perkins (Company Chairman)  
Paula Vennells (Chief Executive)  
Chris Day (CFO)  
Malcolm Zack (Head of Internal Audit)  
David Mason (Head of Risk Governance)  
Sarah Hall (Head of Financial Control and Compliance)  
Jeremy Midkiff (Senior Manager, Ernst & Young) (Item 6 only)  
Lesley Sewell (Chief Information Officer) (Item 4 only)  
Chris Aujard (General Counsel) (Item 5 only)  
Nick Kennett (Financial Services Director) (Item 7 only)



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**POLARC13 (5<sup>th</sup>)**  
**13/27-13/35**

**POST OFFICE LIMITED**  
(Company no. 2154540)  
(the **Company**)

**Minutes of a meeting of the AUDIT, RISK AND COMPLIANCE SUB-COMMITTEE held  
on Thursday 12 September 2013 at 148 Old Street, London, EC1V 9HQ**

**Present:**

Alasdair Marnoch	Chairman of Committee
Neil McCausland	Senior Independent Director
Tim Franklin	Non-Executive Director

**In attendance:**

Alice Perkins	Company Chairman
Paula Vennells	CEO
Chris Day	CFO
Alwen Lyons	Company Secretary
Hugh Flemington	Head of Legal
Malcolm Zack	Head of Internal Audit
David Mason	Head of Risk Governance
Julie George	Head of Information Security (item 13/31 only)
Sarah Long	Financial Accounting Governance Manager (item 13/32 only)

**POLARC**  
**13/27**

**INTRODUCTION**

A quorum being present, the Chairman of the Committee opened the meeting and welcomed all those present.

**POLARC**  
**13/28**

**MINUTES OF THE LAST MEETINGS AND MATTERS ARISING**

- (a) The Committee approved the minutes of the meetings held on 20 March, 21 May and 5 June 2013 for signature by the Chairman of the Committee. He thanked the CFO and those involved in producing the Annual Report and Accounts, and congratulated them on the document.

**ACTION:**  
**CFO**

- (b) The Committee noted the actions list dated 5 September 2013, and asked that action A2 concerning Business regulatory risk be clarified to include the regulatory regime for financial services.
- (c) The Committee received and noted an update from Susan Crichton, General Counsel, on the key issues covered by the Risk & Compliance and Regulatory Risk Committees.

**POLARC**  
**13/29**

**RISK MANAGEMENT**

- (a) The Committee received a paper and presentation on the Risk Management Strategy 2013-2014 from the CFO and David Mason, Head of Risk Governance, highlighting the current status of the Enterprise Risk Management (ERM) framework in the Company. The Committee sought assurance that the work would capture cross functional risks and the CFO explained that cross business risks were captured by a PMO as well as at the Executive Committee level.

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- ACTION:**  
**CFO/DM**
- (b) The Committee recognised the work that had been done to date and asked the Business to have the risk identification work completed by the next ARC meeting in November. The Committee recommended that the focus be on identifying the few (possibly 10-12) higher level risks which were critical for the Business.
- ACTION:**  
**ARC**
- (c) The Committee noted the paper and that more detailed work would be reviewed by the ARC in November before a discussion at a subsequent Board.
- POLARC**  
**13/30**
- INTERNAL AUDIT**
- ACTION:**  
**AVDB**
- (a) The Committee received updates on the Company's Internal Audit from Malcolm Zack, Head of Internal Audit. This included the outcome of the final audit activity conducted by Royal Mail Group Internal Audit on behalf of the Company, the Company's internal audit activity and the planned, requested and proposed audit and advisory work for the third quarter of the year.
- (b) The Committee discussed the current Branch Audit function which currently carries out branch audit and training work. Malcolm Zack explained that the audit work focussed on cash and stock reconciliation and he believed that there was an opportunity to make the team more professional and efficient. The CEO explained the history of the existing structure and agreed that changes needed to align with the business support process review being carried out by Angela Van-Den-Bogerd, Network Change Operations Manager. The Committee questioned the reporting line and asked for this to be considered as part of the review.
- (c) The CEO suggested that Angela Van-Den-Bogerd should attend the November ARC to give an update on her work and its impact on business risk.
- ACTION:**  
**CFO/MZ**
- (d) The CFO thanked the Committee for their input and agreed to conclude the branch audit work and report back changes at the November ARC.
- ACTION:**  
**MZ**
- (e) The Committee received and noted the status of agreed internal audit actions and asked that this information be incorporated into the Board performance pack.
- ACTION:**  
**MZ**
- (f) The Committee questioned the SPMO audit and wondered if the report should have had a red status as the risk highlighted was fundamental to the SPMO delivering their role. Malcolm Zack defended the findings but agreed to ensure reports were rigorous and challenging.
- ACTION:**  
**MZ**
- (g) Malcolm Zack was asked to confirm via a note to the Committee when the two overdue actions highlighted in the audit tracker would be complete.
- (h) Malcolm Zack also presented a technical update for the Committee. The update covered Financial Reporting Council updates to the direct use of internal audit resources and increasing transparency of external audit work and the new codes of guidance from the Chartered Institute of Internal Auditors for internal auditing standards in the financial and public sectors. Malcolm Zack was asked to circulate the document to the
- ACTION:**  
**MZ**

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Committee.

- ACTION:**  
**CFO**
- (i) The Committee noted these updates and endorsed Internal Audit's suggested approach to these changes. The CFO was asked to organise a short "teach in" for the ARC on all current recent accounting changes and the implications for the Business, in time for the Company's year-end (financial quarter 4). He was also asked to produce a summary note for the Board.

POLARC  
13/31**INFORMATION SECURITY UPDATE**

- (a) The Committee welcomed Julie George, Head of Information Security, to the meeting.
- (b) Julie George presented an update on developments, progress and future plans for Information Security. She informed the Committee that she had received confirmation that the Business had achieved ISO27001 Certification for Front Office of Government Services, and was on schedule for renewal of its PCI certification at the end of September.
- (c) Julie George explained that the Business had developed a standard on Information Security and Data Protection, which would need to be met in any new supplier contract. The Committee asked how these standards were being enforced and audited in existing contracts and asked the Business to progress the issue with existing suppliers.
- (d) The CEO asked whether the Brands Database would comply with the new standards, as this was by far the largest database used by the Business and in her mind the greatest risk. Julie George reported that the supplier knew that they were failing to meet the required standards and the Business would need to move to a different supplier if they did not improve. The Chairman asked for a follow up note to the Committee assessing the Brands Database risk and explaining how the Business was planning to mitigate it, including what could be achieved by the end of the calendar year.
- ACTION:**  
**JG**
- (e) The Committee noted the good progress made in Information Security to date and the key areas of focus for the next three months. They agreed that an update should be provided to the ARC by mid-December, including the plan and timescales for the contract changes.
- ACTION:**  
**JG**

Julie George left the meeting.

POLARC  
13/32**THE INTERIM REPORT**

- (a) The Committee welcomed Sarah Long, Financial Accounting and Governance Manager, to the meeting.
- (b) Sarah Long invited the Committee to review the template for the Company's Interim Report for the half year ended 29 September 2013 (the Report) and to consider the key messages, highlighted in Section 3.3 of the Interim Report Committee Paper, which the Report should contain.
- (c) The Committee discussed the options for the interim report and agreed that the CFO would include a recommendation in his Financial

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**ACTION:**  
**CFO/MD**

presentation at the September Board which would enable input from the Board and final view by the end of September. The Committee asked the CFO to taking into account the views expressed and work with Mark Davies, Communications Director, to feed in the expected communications environment at time of publication.

(d) Sarah Long left the meeting.

**POLARC**  
**13/34**

**DATES OF NEXT MEETINGS**

(a) Date of next meeting: Wednesday 6 November 2013 14.00 -16.30.

(b) The Committee discussed the proposed meeting dates for 2014 and the Company Secretary proposed moving the ARC to the eve of the main Board meeting. The Committee agreed in principle and asked the Company Secretary to check availability.

**ACTION:**  
**COSEC**

**POLARC**  
**13/35**

**CLOSE**

There being no further business, the meeting was declared closed.

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**POST OFFICE LIMITED  
AUDIT, RISK AND COMPLIANCE COMMITTEE  
STATUS REPORT AS AT 13 NOVEMBER 2013**

<b>No.</b>	<b>REFERENCE</b>	<b>ACTION</b>	<b>BY WHOM</b>	<b>STATUS</b>
A1	November 2012 POLARC12/13(f)	<u>Governance of Eagle Contract</u> The Committee asked NK to provide an interim update on the regulatory position in September 2013, 6 months after the changes had taken effect.	<b>Nick Kennett</b>	To first FS Board Sub Committee meeting
A2	November 2012 POLARC12/13(g)	The Chairman noted that it would be useful at the same meeting to look at scenarios in which Post Office would need to respond to a termination event relating to the Eagle Contract.	<b>Nick Kennett</b>	To first FS Board Sub Committee meeting
A3	February 2013 POLARC13/3	Committee to review Regulatory Risk Framework later in the year once the risk appetite work had been completed.  Consider the need for Professional Indemnity cover as it moved into the area of financial services advice.	<b>Chris Aujard/ Alasdair Marnoch</b>  <b>Chris Aujard</b>	Review to be scheduled in for Feb 2014 ARC meeting  This action relates in particular to the fact that we are planning to expand our FS activities (e.g. advised mortgage sales as of April next year rather than just introductions).  Our current PI has arisen in response to various contracts we have entered in to in the past. So we have £10m TWiMC with a £250k excess. Plus cover for DVLA etc.  Charles Colquhoun from POL met with our brokers Miller yesterday on this to kick off discussions on what coverage we may need going forward. Those discussions are in progress and still need to land.

1. Minutes of the last meeting and matters arising

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1. Minutes of the last meeting and matters arising

A4	February 2013 POLARC13/5	Business to ensure it had enough focus on the major transformation programmes in both Network and IT within the internal audit plan for 2013-14.	<b>Malcolm Zack</b>	The Transformation Programme focus will be subject to detailed planning and on-going terms of reference. This will commence after the relevant Internal Audit Manager has been recruited and inducted. <i>UPDATE Sept 2/13. IT audit programme underway, IT Audit manager now an attendee to the IT Transformation Delivery Board. Audit work in NTP yet to be planned. Focus is currently on FRP. Audit Work on SPMO has been completed.</i> <i>UPDATE Nov 11/2013. Audit programme being reviewed to enable transfer of resource from planned audits to cover more of transformation work. Risk review being considered.</i>
A5	20 March 2013 POLARC13/12(d)	Review of allocation and focus of internal audit resource.	<b>Malcolm Zack</b>	<i>UPDATE Sept 2/13 – 3 person Team in place since June 2013. 2013/14 audit plan underway since April 2013. Completed</i>  <i>A review of the Branch audit capability has been completed in mid August. After consultation with Chris Day a paper to the ExCo is being drafted for October ExCo so a business view can be discussed with the Nov ARC. Verbal update to September ARC.</i>  <i>UPDATE Nov 11/2013. Audit report completed. Paper for ExCo reviewed and discussions</i>



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1. Minutes of the last meeting and matters arising

				<i>underway. Paper for Nov ARC highlights shape of Internal Audit in future.</i>
A6	12 September 2013 POLARC 13/29(b)	Risk identification work to be completed by the next ARC meeting in November, to be focussed on identifying the few (possibly 10-12) higher level risks which were critical for the Business.	<b>CFO/David Mason</b>	
A7	12 September 2013 POLARC 13/29(c)	More detailed work on Risk Management to be reviewed by the ARC in November before a discussion at a subsequent Board.	<b>ARC</b>	
A8	12 September 2013 POLARC 13/30(b)	Consider the Branch Audit function reporting line as part of the business support process review.	<b>Angela Van-Den-Bogerd</b>	
A9	12 September 2013 POLARC 13/30(d)	Conclude the branch audit work and report back changes at the November ARC.	<b>CFO/Malcolm Zack</b>	November ARC
A10	12 September 2013 POLARC 13/30(e)	Internal audit actions to be incorporated into the Board performance pack.	<b>Malcolm Zack</b>	Format and content to be agreed. 11/11
A11	12 September 2013 POLARC 13/30(f)	Ensure that audit reports are rigorous and challenging.	<b>Malcolm Zack</b>	Done. Communicated to team.
A12	12 September 2013 POLARC 13/30(g)	Confirm via a note to the Committee when the two overdue actions highlighted in the audit tracker would be complete	<b>Malcolm Zack</b>	These will not be due until 2014, which was explained in the September paper.
A13	12 September 2013 POLARC 13/30(h)	Circulate the update on Financial Reporting Council updates to the direct use of internal audit resources and increasing transparency of external audit work and the new codes of guidance from the Chartered Institute of Internal Auditors for internal auditing standards in the financial and public sectors to the Committee.	<b>Malcolm Zack</b>	Done.
A14	12 September 2013 POLARC 13/30(i)	Organise a short "teach in" for the ARC on all current recent accounting changes and the implications for the Business, in time for the Company's year-end (financial quarter 4) and produce a summary note for the Board.	<b>CFO</b>	
A15	12 September 2013 POLARC 13/31(d)	Produce a follow up note to the Committee assessing the Brands Database risk and explaining how the Business was planning to mitigate it, including what could be achieved by the end of the calendar	<b>Julie George</b>	Note to November ARC

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1. Minutes of the last meeting and matters arising

		year.		
A16	12 September 2013 POLARC 13/31(e)	Update on Information Security to be provided to the ARC by mid-December, including the plan and timescales for the contract changes.	<b>Julie George</b>	
A17	12 September 2013 POLARC 13/32(c)	Take into account the views expressed by the Board on the Interim Accounts and work with Mark Davies to feed in the expected communications environment at time of publication.	<b>CFO/Mark Davies</b>	
A18	12 September 2013 POLARC 13/34(b)	Check availability to hold ARC meetings on the eve of the main meeting.	<b>Alwen Lyons</b>	Reviewing for next calendar year



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**POST OFFICE LTD AUDIT & RISK COMMITTEE**

**ExCo report on key risks – November 2013**

**1. Purpose**

The purpose of this paper is to:

1.1 Respond to the Audit & Risk Committee (ARC) request for:

- a snapshot of the ExCo's view of the current key risks facing PO Ltd in achieving its strategic objectives; and
- the timetable for developing this view over the next 12 months.

1.2 Obtain the view of the ARC on other risks for consideration.

**2. Background**

2.1 ExCo has been developing its assessment of key risks over the past 12 months through an iterative process of workshops. A paper was presented to the September ARC outlining the current state of this assessment.

2.2 The ARC acknowledged the progress that had been made in risk management and recently further requested a concise view of:

- the 'vital few' risks that face the organisation;
- the controls in place to manage these risks; and
- a view of any planned internal audit activity to inspect and test this management.

2.3 This paper provides a snapshot view of progress to date, acknowledging that this is an iterative process which will be refined over time.

**3. Current Situation**

3.1 The table at Appendix A is taken from the outputs of the series of workshops held by ExCo (facilitated by the Risk Function and Internal Audit) to identify and assess current risks. These workshops identified nine risks which were deemed to be 'critical' to the business. In particular the table sets out:

- The current view of the top five risks to PO Ltd based on impact and likelihood. These risks are those with the highest impact and a likelihood of 'possible' or 'probable';
- Four additional risks which are viewed as critical but unlikely at the present time.

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- 3.2 This risk assessment is the subject of quarterly sessions with ExCo.
- 3.3 ExCo will be further developing the assessment at the next scheduled session on 19<sup>th</sup> November 2013. The purpose of this session will be:
- To review the validity of the current 'critical' risks;
  - Describe the appetite for each of these risks; and
  - Develop action plans to achieve the target level of risk.
- 3.4 A further ExCo session will be held in February to assess progress and further refine the risk assessment. ExCo believe that this will provide an enhanced view of the risk landscape which will be presented at the February ARC meeting.
- 3.5 Progress in this development and action plans will be monitored by the Risk & Compliance Committee, supported by the Risk Function.
- 3.6 The table at Appendix B shows the high-level timeline for ExCo activity in relation to developing this view further.

**4. Recommendations**

The ARC is asked to:

- 4.1 Note the snapshot view of risks;
- 4.2 Note the update and actions set out in this paper;
- 4.3 Provide a view on other risks for consideration; and
- 4.4 Endorse and continue to support the roadmap for risk management in PO Ltd.

**Chris Aujard**  
**13th November 2013**

**Strictly Confidential****Appendix A: ExCo current view of significant risks**

<b>Risk</b>	<b>Owner</b>	<b>Current risk controls</b>	<b>IA Assurance</b>
<b>Critical and immediate risks</b>			
<b>Stakeholders</b> Plans are significantly hindered, redirected or otherwise changed by one or more major stakeholders e.g RM change of ownership, change of Govt strategy/support etc	Sue Barton	Regular stakeholder meetings in pace MDA agreement with RM Engagement of NFSP	
<b>Compliance</b> Non-compliance with regulatory framework or contractual obligations e.g. PPR, DPA etc	Lesley Sewell/Chris Day	Procurement governance process in place Regular compliance training across business Monitoring of network compliance KPIs	<i>Recent audit of software Licencing.</i>  <i>Plans for 2014/15 potentially include DPA and AML.</i>  <i>Contract Management review in Nov 2012 (RMG) – revisit for 2014?</i>
<b>Commercial</b> Dependency on small number of service or supply contracts	Lesley Sewell/Martin George	Regular performance meetings Penalty clauses available	Transition of SSID (Atos) commencing Nov 2013
<b>Competition</b> Failure to respond to competitive environment with pace	Martin George	Digital strategy Change management processes in place including Transformation Board	
<b>Transformation</b> Failure to fully engage operators in the plans for Network Transformation	Kevin Gilliland	NT Governance structure Transformation Board	
<b>Critical but unlikely risks (watch list)</b>			
<b>Counterparties</b> Failure of major counterparty e.g. BOI	Nick Kennett/Martin George	BOI monitoring by designated risk manager MDA contract management	Transition of SSID and Towers (2014-15)
<b>Suppliers</b>			

## 2. Risk management - top company risks

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Failure of major IT supplier	Lesley Sewell	Supplier management IT transformation & Transformation Board	As above
<b>Operations</b> Infrastructure failure or business continuity/disaster recovery failure	Lesley Sewell	Supplier management IT transformation & Transformation Board	Business Continuity – Readiness Assessment planned for Q4 but may move to 2014 to allow some risk assessment work on NTP/CTP
<b>Strategic</b> Risk that PO cannot pick up BOI business at end/break of Eagle agreement	Nick Kennett	Project Hawk	

**Strictly Confidential****Appendix B: Risk management roadmap**

<b>ExCo quarterly risk session</b>	<b>Content</b>
<b>November 2013</b>	Agree risk appetite for critical risks Establish risk treatment plans for critical risks
<b>February 2014</b>	Half-yearly review of risk map with focus on: <ul style="list-style-type: none"><li>• critical risks</li><li>• risk assessment</li><li>• risk controls</li><li>• action plans &amp; progress</li></ul>
<b>May 2014</b>	Critical risk update Review of major risk appetite and treatment
<b>August 2014</b>	Half-yearly review of risk map with focus on: <ul style="list-style-type: none"><li>• critical risks</li><li>• risk assessment</li><li>• risk controls</li><li>• action plans &amp; progress</li></ul>

**POST OFFICE LTD AUDIT RISK AND COMPLIANCE COMMITTEE****Internal Audit****1. Purpose**

The purpose of the paper is to:

- 1.1 Outline the principles of internal auditing options for the future shape of Internal Audit (IA) in POL based on the recent review of network auditing, current internal audit focus, the risk management needs of the business and the current Three Lines of Defence model. This is an interim paper as the business is discussing its internal audit strategy and the necessary structure of the function to support that strategy.

**2. Principles**

- 2.1 To be effective, the Post Office Internal Audit capability needs to maintain independence, apply professional standards and ways of working, focus on assurance and the management of risk and control, and these attributes should be applied and operate across the organisation.
- 2.2 As an independent assurance function Internal Audit should:
  - Assess the efficiency and effectiveness of the overall risk management framework as designed by the business, test the decisions and actions taken by management and conclude on the effectiveness of those actions to address the risks.
  - This should include, but not be restricted to,
    - Top risks as identified by management,
    - Key on going business risks as faced typically by most commercial organisations and
    - Risks identified by the internal audit function.
    - For example, strategic risks, financial risks, infrastructure and technology risks, regulatory risk, customer risk, market and competition risk, people and culture risk, supplier risk, operations and continuity risk and more focused areas including fraud risk and risks arising from major change, new products, brand and reputation
- 2.3 Within Post Office, assurance is undertaken by management and second line functions as well. (See the appendix).
  - Therefore the business and senior management should have a clear view of the level and type of assurance it receives from each of these functions. An assurance map should be constructed and maintained.
  - Assurance activity, outcomes and actions in these areas should be visible to top management and the board.
  - The Internal Audit function should have clear line of sight of those functions providing audit / risk type output and audit and assess their effectiveness periodically.

- Senior management should ensure that the level of resource applied to each line of defence is sufficient and in the second and third lines appropriately resourced and professionally trained.

### 3. Corporate and Field Auditing

- 3.1 To these ends Internal Audit should operate across corporate risks including major change programmes and risks in the network and the supply chain and be properly resourced to do so.
- 3.2 Within POL significant current corporate risk areas include:
- Company wide change programmes, transformation and transitions
  - Product development
  - Financial Services
  - Stakeholder Management
  - IT Infrastructure, Integrity and security of Information and IT supplier risk
  - A growing outsourcing risk as more capability, control and process is transferred to third parties across the organisation.
  - Reputational and brand risk including communications and growing social media methods.
  - Continued economic pressures heighten internal fraud risk.
  - Changing organisational structure, systems, process and business models creates on going continuity risk.

Therefore in summary, in the corporate space Internal Audit should be:

- |  |
|--|
| <ul style="list-style-type: none"><li>• Assessing the overall risk management framework</li><li>• Assessing the effectiveness of the other lines of defence</li><li>• Auditing the risks and controls within the listed areas, although the scope and intensity may change year on year.</li><li>• Assessing key on-going frameworks in fraud, continuity etc.</li></ul> |
|--|

- 3.3 A Corporate Audit Team needs to be skilled, professionally qualified and experienced and able to operate across most parts of Post Office. There is a need to cover not only the top risks and management concerns but also to “kick the tyres” and advise and challenge management on a day to day basis.
- 3.4 The branches are the main interaction for our customers where the brand and supply chain and network operations come together to meet customer needs.

POL significant network and supply chain risks include:

- Front of house: Customers (e.g. experience and behaviour), stock management (availability of product, visibility of forms), point of sale, merchandising, shelf edge pricing accuracy, shrinkage (loss of product and loss of attached sale). Self service operations (theft, non payment of packaging, efficiency of systems)
- Back office: – Cash and value stock remittances – interface with supply chain, (movements in and out and balances on hand), Horizon System operations and control, stock control (stock holdings vs. actual need), stock ordering, (min/max order levels), team organisation

## 3. Corporate and Network Audit

(coverage and cost management – e.g. balancing for busy and quiet days), monitoring of sales performance, physical security (safes and alarms).

- Commercial: - Business and financial performance, local economic conditions, competition, local product performance, effectiveness of incentives.
- Supply Chain Network The distribution of large quantities of cash, valued and operational stock presents risks in:
  - Management and control of cash, including foreign exchange at the depots and through the distribution network and impact on working capital.
  - Customer, delivery and reputational risks arising in the 3<sup>rd</sup> party cash collection and delivery business, many with high profile customers.
  - Security and bonding risks (Bank of England bond scheme) at the depots.
  - Continuity and stock management risks.
  - Criticality of the supply chain/vehicle network to supporting agency, multiple and crown locations on a day to day basis.

3.5 Therefore in summary, in the field, Internal Audit should be

- Assessing the overall efficiency effectiveness of the control environment across the branch network, identifying systemic issues, trends, themes and good practice.
- Assessing the effectiveness of compliance to key internal and external requirements.
- Assessing the effectiveness of the supporting supply chain practices, costs, and logistics.
- Understanding and verifying the key controls over the control of cash and cash assets including foreign exchange in branches and across the network.
- Testing the effectiveness of IT system roll outs/new product launches including trials.
- Working with significant third parties such as BoI Internal Audit and the audit functions of major multiple partners.
- Be responsive to the needs of the Security Department and Finance Service Centre for cash or security related reviews.

3.6 An effective Internal Audit team with focus on operations and retail environments needs a mix of qualified experienced professionals spread across the country that is flexible, able to build working relationships with senior operational management, empathy as well as challenge with agents and uses modern field based technology to report quickly to management and the centre.

#### 4. Action

4.1 The ARC is request to consider the risks and general audit approaches proposed and direct as necessary.

Malcolm Zack  
Head of Internal Audit

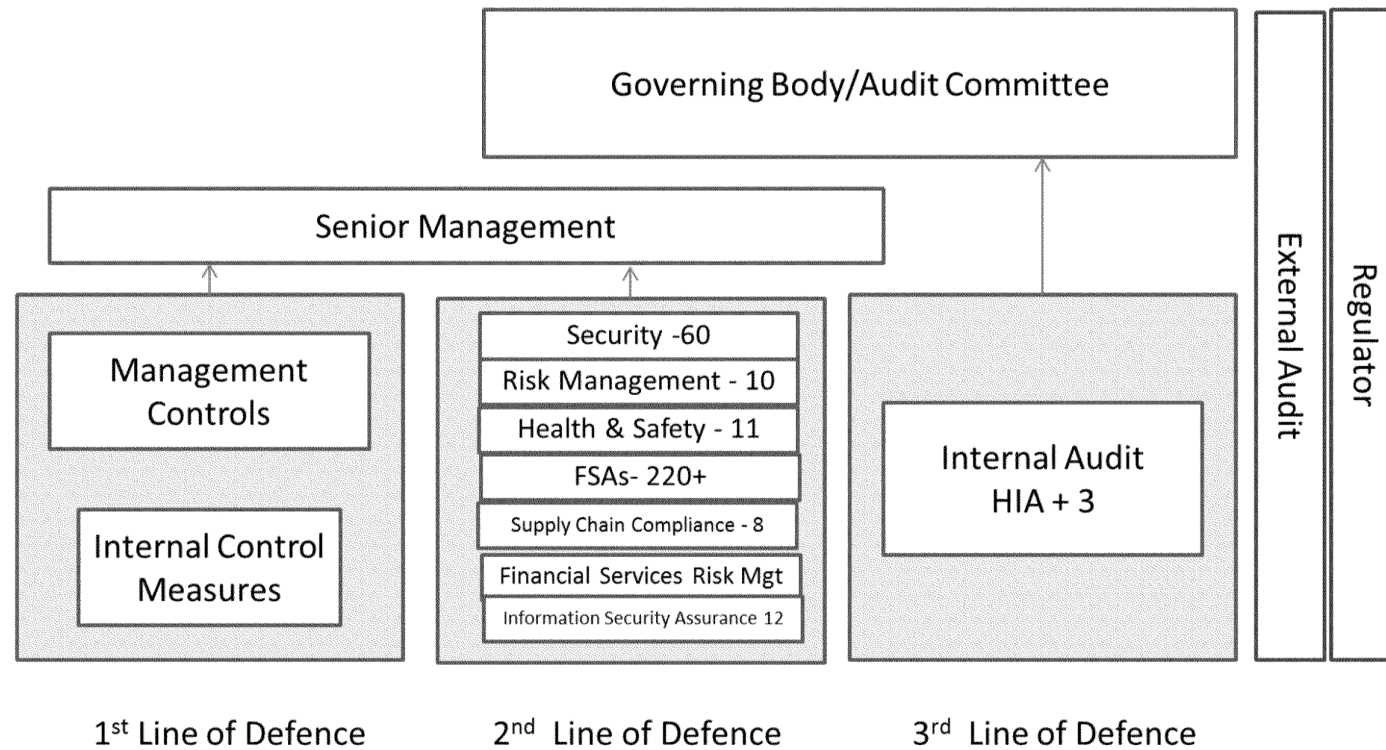
Internal Audit

Malcolm Zack

November 19 2013



Appendix - Three Lines of Defence – (headcount numbers are approximate as at September 2013)



**POST OFFICE LTD AUDIT RISK AND COMPLIANCE COMMITTEE****Internal Audit - IT Transition Projects****1. Purpose**

The purpose of the paper is to:

- 1.1 Outline the recently commenced on-going review of the transition of the IT services and the longer term plans into 2014/15
- 1.2 Highlight the resource requirement and proposed sources.

**2. Current transition to the new System Integrator/Support Desk organisation**

- 2.1 The ARC members recently agreed through correspondence to amend the original IT audit plan to expand the proposed work on the Governance and transition as part of the tower model.
- 2.2 Atos was awarded the contract in September 2013. The terms of reference have been drafted and discussed with management and subject to final approval week commencing November 11 2013.
- 2.3 The draft terms of reference are in the appendix to this paper. In outline the key risks to review are:
  - The Transition Execution Programme's goals are not achieved because key stakeholders fail to deliver the contractual obligations.
  - Roles and responsibilities on expected deliverables are not clearly defined for the SISD and Post Office.
  - The decision making process is not supported by an adequate information flow between the SISD and Post Office.
  - Transition risks are not adequately managed and shared between SISD and Post Office.
  - Transition activities overrun in terms of cost and timing which will have an impact on the overall strategy benefits achievements.

The ExCo level Risks impacted is:

The current identified ExCo risks impacted by risks in this review include: *'Reliance on small number of service contracts, and failure of a major IT supplier'*.

- 2.4 The scope of the review will include
  - Transition Execution Programme Governance (including programme structure, reporting lines for example).
  - Transition Execution Programme Risk Management.
  - Design of the new IT organisation.
  - Post Office IT Governance and Assurance structure to govern the SISD.

**3. Future IT transitional projects**

- 3.1 Over 2014 and into 2015, the IT organisation will transition into a number of towers. These will include
- Service Desk (Atos)
  - The Data Centre
  - End User Computing
  - Applications and Infrastructure
  - Networks
- 3.2 Each of these is currently in tender stages so transitions will not take place until 2014 and into 2015. However these present significant risk to the organisation and audit/assurance work will be planned in for the 2014/15 internal audit plan.
- 3.3 The retained in-house IT organisation will need to ensure it has governance and assurance processes over the suppliers who run the above towers. This will be included in the proposed plan for 2014/15

**4. Implications for independent auditing/assurance**

- 4.1 The IA team has an IT Audit Manager who is currently engaged in the transition work having recently completed the IT audits on software licencing and identity and access management to the LAN. They are also supporting the IT audit work needed on the new CFS Finance system.
- 4.2 Some technical resource could be sourced using the recently implemented co-source arrangement with PwC. This is capped at £100k p.a. running up to July 2016 but is used only as needed without a commitment to the full spend. The co-source arrangement is designed to provide support where IA needs it so has to be available to support other audit work.
- 4.3 The commitment to oversee the Transitional projects will, under current resources limit the capability to audit other IT areas during the transition.

**5. Action**

- 5.1 The Committee is requested to note the planned and proposed scope of work in this area and direct as necessary.

Malcolm Zack  
Head of Internal Audit  
November 19 2013.



## Terms of Reference

**SISD Governance and Assurance Design review****Audit Area**

Post Office is currently undergoing a strategy change, which include changes in the current IT model. The Transition Execution Programme “is the catalyst to enable Post Office to transition from its existing IT Operating and Service Delivery Model and current IT Supply Chain to the new IT Operating and Service Delivery Models”.

The Transition Execution Programme is led by the System Integrator/Service Desk (SISD) provider, who has been appointed at the end of September 2013, as part of the New Operating Model. However the programme requires a considerable workforce from Post Office.

The programme's workstreams are: 1) Operating Model Execution, 2) Supplier Management and Assurance, 3) Incumbents management, 4) Transition Planning and Transition Procurement Support, 5) Programme benefits, 6) Stakeholder & Communication, 7) Technical and Service Design Authority, 8) Assurance, 9) Security.

**Key Risks**

- The Transition Execution Programme's goals are not achieved

- because key stakeholders fail to deliver the contractual obligations.
- Roles and responsibilities on expected deliverables are not clearly defined for the SISD and Post Office.
- The decision making process is not supported by an adequate information flow between the SISD and Post Office.
- Transition risks are not adequately managed and shared between SISD and Post Office.
- Transition activities overrun in terms of cost and timing which will have an impact on the overall strategy benefits achievements.

**ExCo level Risks impacted:**

The current identified ExCo risks impacted by risks in this review include: *'Reliance on small number of service contracts, and failure of major IT supplier'*.

**Scope**

- Transition Execution Programme Governance (including programme structure, reporting lines for example).
- Transition Execution Programme Risk Management.
- Design of the new IT organization.

- Post Office IT Governance and Assurance structure to govern the SISD.

**Exclusions**

- This review covers the *design phase* of the way Post Office will work with SISD in the Future Operating Mode. The effectiveness of the actual governance of the SISD will be reviewed as part of the 2014/15 internal audit plan once the process has transitioned.

**Review methods:**

- Participating to Programme delivery board meetings.
- Analysing Programme documents.
- Interviews with key persons involved in the Programme.

**Reporting**

We will start the assurance work the week of the 04<sup>th</sup> November 2013 and it will be an on-going review of the Transition Execution Programme until the Future Operating Mode will be in place (expected to be in place in July 2014).

Regular reports will be issued to management and summaries to the relevant ARC and to the Chief Executive.

**Audit Team**

Elena R. Nistor – IT Audit Manager.

Version 0.1	To:	Lesley Sewell, Dave Hulbert	Chris Taylor
Lead Auditor: Elena R. Nistor	Copies for Information:	Chris Day, Susan Barton	

## **POST OFFICE LTD AUDIT RISK AND COMPLIANCE COMMITTEE**

### **Internal Audit - Highlights of recent IT Audit reports**

#### **1. Purpose**

The purpose of the paper is to:

- 1.1 Summarise the findings of the recently cleared internal audit reports on Identity and Access Management and Software Licensing.
- 1.2 The ARC is advised that this paper is an extract from the full Internal Audit Activity report which for this meeting has been published for noting only. The activity report also includes results from the assurance work on the new finance systems.

#### **2. Outcomes**

- 2.1 The two audits were Software Licensing Management and Access and Identity Management (LAN) which were agreed with the ARC as part of the 2013/14 internal audit plan.
- 2.2 The main outcomes are summarised in the table overleaf followed by the Executive Summary from the full report for each. Full copies of the reports are available upon request.
- 2.3 An action plan owned by management is in place. The actions are being tracked and followed up by Internal Audit as they fall due over the next few months.

#### **3. Requested Action**

The Committee is requested to note the outcomes and direct as necessary.

Malcolm Zack  
Head of Internal Audit  
November 19 2013



Business Area reviewed	Assurance	Outcomes (Actions)	Key Risks impacted
<p><b>Software Licensing Management</b></p> <p><i>The committee is directed to the Executive Report Summary in the Appendix</i></p> <p>This is a significant risk which management is now engaged on including the issues arising from the privatisation of Royal Mail under which the licences originally operated and were managed.</p> <p>This is part of the Separation programme and needs to reflect the transition of IT services to the System Integrator (ATOS) and Towers model.</p> <p>Overall there were 11 agreed actions of which 7 were rated as red and 4 as amber. The major actions agreed are shown here.</p>	Low	<p>As a result of the audit, the business, under the direction of the CIO will:</p> <ul style="list-style-type: none"> <li>Define its own software licensing policy and include clear roles and responsibilities for POL and the Service Integrator and Service Desk (SSID) - recently awarded to Atos.</li> <li>Assign the ownership and governance of Software licensing immediately to POL's Support and Service function.</li> <li>Ensure that Atos will apply the key operational requirements for managing software licenses once Atos is fully on board.</li> <li>Ensure that POL Procurement will remind the business that <u>all</u> software licences must be procured via the Procurement teams and not directly by the functioning department.</li> <li>Define a governance and management process to gain on-going day to day assurance over software licensing.</li> <li>Deploy that process over the SSID</li> </ul>	<p>Operational, and Regulatory risks.</p> <p>IT &amp; Change Level risks impacted (Based on current risk map – Sept 2013)</p> <p>- Not specifically identified.</p> <p><u>Executive Level Risks impacted:</u></p> <p>(based on current risk map)</p> <p>Non compliance with regulatory or contractual obligations.</p>

Business Area reviewed	Assurance	Outcomes (Actions)	Key Risks impacted
<b>Local Area Network – Access and Identity Management</b>  <i>The committee is directed to the Executive Report Summary in the Appendix.</i>  As security on POLSAP and Horizon was heavily examined both internally and externally in 2012/13, the POL IA Audit plan focused on how access to the local area network (laptops, desktops etc.) was managed and controlled.  Overall 21 specific actions were agreed. Of these 13 were rated as red and 9 as amber.	Low to Medium	<ul style="list-style-type: none"><li>• The Information Security Assurance Group will work with HR to better define the access rights based on roles and job needs for access via the LAN</li><li>• A process will be installed to ensure access rights will be reviewed when employees change function/role.</li><li>• A periodical review of users LAN access rights will be put in place.</li><li>• Leavers access will be disabled on a timely basis and a process to confirm recent leavers and check access will be implemented.</li><li>• The governance of the IAM process will be defined as part of the Future Operating model, defining clear roles and responsibilities for POL, SISD and towers (e.g. EUC).</li></ul>	Information Security Risks (Confidentiality, Integrity, Availability)

## Software Licensing Management

Overall Assurance: LOW

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### Audit Highlights and Opinion

- Software Licensing Management (SLM) is a structured and systematic approach to managing the full lifecycle (from purchase to disposal) of software licences in an on-going, proactive basis.
- As part of RMG, POL has been following a RMG SLM process run by CSC and currently POL is going through a transition phase to separate from RMG.
- The audit purpose was to assess POL's SLM current risks and to identify the actions to be taken to ensure POL will be in the position to manage software licences in an effective way after the separation. The review was agreed with the ARC as part of the 2013/14 internal audit plan. The SLM risk was highlighted by the CIO during the audit annual planning.
- The review, occurred between August and September 2013, and included input from the Separation programme Manager and the Procurement team:
- *Limitations:* The audit focused on forward looking process and governance issues. POL IA does not have audit rights over CSC, therefore it could not independently verify the current completeness and accuracy of the licence estate.

### Opinion

- Based upon the audit work undertaken a low assurance is given over the current software management (SLM) process. This conclusion is mainly based on the lack of overview POL has on the owned and used software licenses and due to the current missing SLM process. Management is aware of the licence issues and risks within the current changing context for IT.

### Strengths

- 1) The Separation programme will provide POL with an overview of all software licences in use and needed.
- 2) Actions are ongoing, within the Separation programme, to identify the right type of licenses required for POL, which gives an opportunity to align license types to business needs.

### Weaknesses (Ambers)

- 1) There is currently no overview of all licences and licence types POL has and uses. POL is currently at a higher level of risk from sanction should an external software audit take place.
- 2) Licences can currently be purchased by different parts of the business. There is currently no overall control by the Procurement team on the software purchase and change process.

### Top Priority Agreed Actions

#### Short term actions

- 1) A software licensing policy will be defined by POL, and will include clear roles and responsibilities for POL and SISD.
- 2) Software licensing governance and assurance ownership is assigned to POL Support and Service
- 3) POL will include the agreed recommendations in the requirements for the SISD SLM process . The SISD will define the SLM process.
- 4) POL Procurement will remind the business that software licences must be procured via the Procurement teams.

#### Medium – Long term actions:

- 1) A software licensing assurance and governance process will be defined by POL.
- 2) POL will deploy the assurance process over the SSID SLM process.

### Top Concerns (Reds)

- 1) The SLM process is not yet defined.
- 2) POL software licensing assurance and governance process is therefore also not yet defined.
- 3) Currently there is insufficient expertise in house to define the best fit for purpose and cost effective licenses holistically for the company needs.

Executive Responsible	Lesley Sewell
Distribution (date)	Dave Hulbert, Brian Deveny cfi: - Chris Day, Paula Vennells , Roger Middleton – Status – FINAL Ver 2.0 CONFIDENTIAL
Prepared By:	Elena-Raluca Nistor Reviewed By Malcolm Zack



As at 25 September 2013

## Risk and Control Dashboard

Risk that software is not appropriately obtained or managed resulting in possible financial or legal sanction

## Key Sub Risks to Manage

Key Controls		Key Controls		Key Controls	
<u>Process governance</u> Risk of inadequate software licensing management and non-compliance with licence agreements.		<u>Process governance - risk management</u> Risk that the business might be disrupted or will have increased penalties' costs due to inadequate licences.		<u>Process design and deployment</u> Risk that the business procures software licences that are not fit for purpose or cost effective.	
Software licensing management (SLM) is identified as corporate process (cross business and IT) and a clear approach to managing software licences is in place (approving, reviewing, monitoring, updating, etc.), ensuring that the process from procurement until monitoring is managed at all levels.		Risk of non compliance with copyright and licences contractual agreements have been identified and they are part of an overall corporate risk register.		An asset register (e.g. systems and applications requiring) is in place, containing an overview of all assets and their licences and it is periodically updated.	
The process is documented and related procedures/guidelines have been defined, approved and they have been communicated to relevant users involved in the process.		Criteria to measure the efficiency of the SLM process have been identified.		A review of all existing licences is periodically performed.	
Other process responsibilities have been identified and assigned: e.g. resources within the organisation to control and monitoring software licences in each directorate or centrally.		Mitigating controls for SLM risks have been identified. Additional monitoring/assurance controls are in place to ensure the mitigating controls are operating effectively.		The procurement of licences is managed with a central oversight to ensure it is cost-effective and fit for purpose.	
Software licensing compliance (with contractual agreements) process has been defined and is performed periodically.		The SLM process is periodically evaluated to ensure it is fit for purpose (covers the identified risks).		A process owner has been identified and his/her roles and activities clearly defined and understood.	

## Key

controls not in place	
Controls not fully covering the risks, improvements required	
Controls in place sufficiently address risk	
Not yet assessed	

## Local Area Network – Identity and Access management

Overall Assurance: - Low



## Audit Highlights and Opinion

- Identity and access management (IAM) is a cross-function process to manage who has access to what information over time. The audit focused on the IAM process on the Local Area Network (LAN) (including access to POL network, SharePoint, File Share). The review was part of the 2013/14 audit plan agreed with the ARC
- SAP and Horizon systems were out of scope.
- POL currently applies the RMG IAM process which for the local area network is managed by CSC.
- The review was focused on the IAM process steps performed by POL and took place between August and September. The purpose of the audit was to identify current process gaps, eventual access risks and mitigation actions to be taken in consideration in the 'to be' IAM process after the separation.
- Limitations: POL IA does not have full audit rights to CSC since formal separation so technical LAN security tests were limited. The review focused on forward looking issues as IT transfers to the SSID and tower model

## Opinion

- Based upon the audit work undertaken a low to medium level of assurance is given over the IAM process for the local area network. This is based on the lack of process definition and end to end overview of process steps within POL. Furthermore the business has no overview of users' access rights to the local area network (shared drives, applications, SharePoint, etc.) and potential segregation of duties conflicts.

## Strengths

- 1) Identity is managed based on unique used IDs.
- 2) LAN accounts are locked (for 30min) after a defined number of unsuccessful logon attempts (e.g. 10).
- 3) An authorisation process is in place for creating new accounts and granting them access rights.
- 4) An IT process governance exercise is on-going (under the IT Transformation umbrella) to identify the 'to be' IT process and IAM ownership, roles and responsibilities are considered to be assigned.

## Weaknesses (Ambers)

- 1) IAM tools, including a provisioning system, which would allow a full overview of all accounts access rights and their management are not in place.
- 2) Unauthorised access attempts to LAN are not reported to POL Information Security team.
- 3) Examples noted of LAN accounts 'passwords being shared which is contrary to company policy

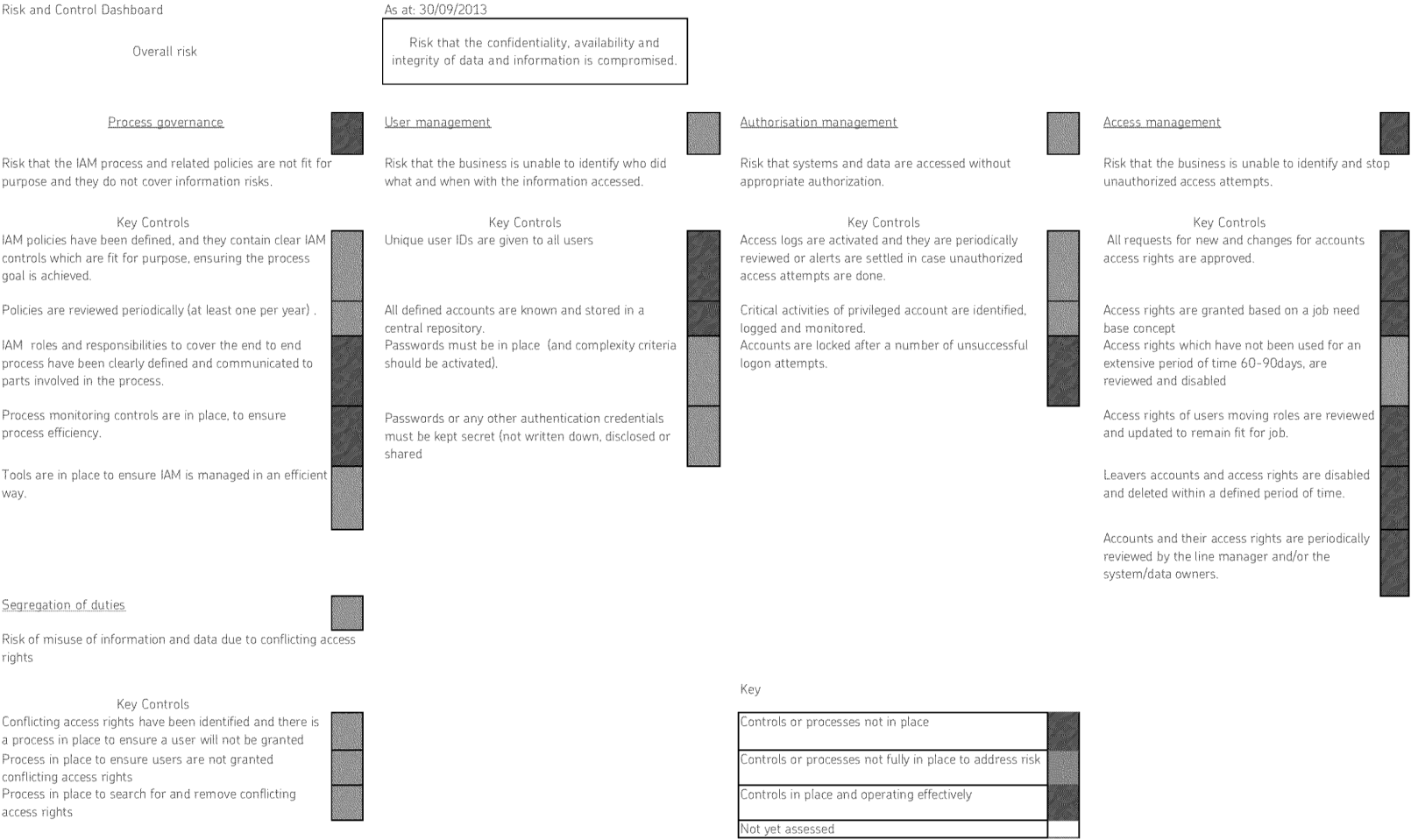
## Top Concerns (Reds)

- 1) There is no overview of all local area network accounts access rights.
- 2) Access rights are granted on a 'mirroring with a similar account role' base instead of a fit for job principle.
- 3) Movers' access rights are not reviewed and updated to remain fit for job.
- 4) Leavers accounts are not systematically disabled in time and there is no control.
- 5) No review of accounts access rights is in place.

## Top Priority Agreed Actions

- 1) Role based access rights (on LAN) will be defined jointly by ISAG and HR.
- 2) Access rights will be reviewed when employees change function/role.
- 3) A periodical review of users LAN access rights will be put in place.
- 4) Leavers access will be disabled on a more timely basis and a process to confirm recent leavers and check access will be implemented.
- 5) The governance of the IAM process will be defined as part of the Future Operating model, defining clear roles and responsibilities for POL, SISD and towers (e.g. EUC).

Executive Responsible	Lesley Sewell
Distribution (October 31 <sup>st</sup> 2013)	Julie George, Dave Hulbert, Fay Healey, Joe Conner, Cfl Chris Day, Paula Vennells
Prepared By:	Elena-Raluca Nistor
Reviewed By :	Malcolm Zack
Status:	Final ver 1.0



**Strictly Confidential – Subject to Legal Privilege – DO NOT FORWARD****POST OFFICE AUDIT, RISK AND COMPLIANCE COMMITTEE****Prosecutions Policy****1. Purpose**

1.1 The purpose of this paper is to:

- update the ARC with respect to certain aspects of Project Sparrow;
- seek the ARC's (directional) views on potential changes to the prosecutions policy; and
- seek the ARC's views on the further work we are proposing to undertake prior to a formal recommendation being put to the ARC with respect to a new prosecutions policy.

**2. Background**

- 2.1 In the last (October) CEO report to the Board, an update was given on Project Sparrow in which it was noted that ".... a paper [will be submitted] to the November ARC reviewing our overall policy for investigating and prosecuting future cases."
- 2.2 Since that update, Brian Altman QC has prepared two separate reports, one commenting on "[POL's] strategy and process for reviewing past and current criminal prosecutions in light of Second Sight's Interim Report" (the "backward looking report") and the other making recommendations as to the future approach to the conduct of prosecutions (the "forward looking report"). This second report did not seek to comment on whether continuing with prosecutions was itself a sensible course of action, either from a business or reputational perspective, simply whether it was an effective use of resources from a criminal law perspective, and if so, whether there was scope for improvement.
- 2.3 The headline conclusion of the backward looking report is that the "...review [of the cases that had been prosecuted over the last few years] is fundamentally sound" and that no "systemic or fundamental flaws in the review process" were detected. In addition, a number of relatively small procedural recommendations were made regarding matters such as document retention etc.
- 2.4 The forward looking report is similarly positive in tone, with Brian Altman commenting that he had "..... seen no evidence to suggest that Post Office Ltd exercises its investigations and prosecution function in anything other than a well-organised, structured and efficient manner, through an expert and dedicated team of in-house investigators and lawyers, supported by Cartwright King solicitors and their in-house counsel..." That said, it was noted that "Post Office Ltd's prosecution role is perhaps anachronistic...", and that "POL is the only commercial organisation (albeit Government owned) I can think of (apart from RMG who retains a residual prosecuting function) that has a prosecution role, and it is, to that extent, exceptional if not unique."



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- 2.4 An important, and previously little-appreciated, finding to emerge from the 2 reports is that **Post Office does not have any special statutory power to bring prosecutions**; rather it brings prosecutions in a purely “private” capacity further to section 6(1) of the Prosecution of Offences Act 1985, which gives all individuals and companies the right to bring a private prosecution. Prior to Brian Altman’s review it was believed in many parts of the organisation that the Post Office had been given special powers by parliament to prosecute. In reality, no specific legislation or regulation currently requires Post Office to undertake prosecutions, nor is there any current legislative policy that mandates that prosecutions should be brought.
- 2.5 The fact that prosecutions are conducted on a private basis does not mean that the standards of evidence are in any way reduced, or that the process is less rigorous than would be the case with a public prosecution. It simply means that Post Office steps in to assume a function that typically would be undertaken by the CPS, after the referral to it of a case by the police.
- 2.6 The reasons why Post Office developed a private prosecutorial capability are historical; reasons given for its retention include:
- It serves as a “deterrent” i.e. it provides a clear signal to the whole network that offences of dishonesty will be taken seriously;
  - It assists Post Office with its relationship with insurers; and
  - It re-assures employees that “securing the company’s assets will be taken seriously”.
- No empirical evidence has been given in support of the above, though from first principles it would seem doubtful that the cost of, or the terms on which, insurance can be obtained would be materially impacted by the existence, or non-existence, of a prosecutorial capability.
- 2.7 In addition, it has been said that one consequence of using the criminal process against sub-postmasters is that the associated debt recovery actions (done under the Proceeds of Crime Act) are quicker and “more efficient”. This is clearly true, though the criminal recovery process, albeit very efficient, is a fairly blunt and sometimes brutal process that involves the forcible sale of assets against the backdrop of a criminal conviction and possible prison sentence. In the case of sub-postmasters that are in financial distress, this may well involve the sale of their main residence.
- 2.8 A similar outcome could be achieved using the civil recovery process, though making claims through the civil courts is a more cumbersome process, and the ability to obtain orders “freezing” assets ahead of trials is much more restricted than it is in criminal cases (in criminal cases, a “prosecuting authority” has the right to request a judge to make an order freezing the defendant’s assets once the investigation has commenced, but before it has gone to court).

**3. Activities/Current Situation**

- 3.1 Typically, some 250 investigations are conducted each year into cases of suspected fraud or unexplained loss. In turn, this leads to around 50

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prosecutions being brought all of which result in the conviction of either a sub-postmaster (or very occasionally) an employee. The most common charge is “false accounting”, itself a very serious offence carrying a maximum tariff (7 years) not dissimilar to theft (10 years); this offence of false accounting is technically committed every time the end-of-day return is made on the Horizon system declaring that the sub-postmaster’s books balance when the sub postmaster knows they do not. Indeed, more often than not, criminal investigations are started when the books have not balanced. The internal “Network Support/Audit and Training” team (a team of around 200, some of whom are charged with responsibility for undertaking stock-takes in the network) identifies the fact that there is an unexplained cash or stock shortfall, and that the books don’t balance. In turn that team then notifies the security team which mounts an investigation and decides whether or not prosecute.

- 3.2 Prosecutions, however, are only brought to the extent that they fit within the internal prosecution policy. This policy focuses on 2 factors: sufficiency of evidence and likelihood of conviction – latterly a third factor has been added, which is the quantum of the loss (amounts below £5k are now not pursued). The highest “risk” group of offenders appears to be those sub-postmasters who have been in post for less than 5 years but more than 18 months. Amounts involved are generally less than £20,000, though there are a handful of high value cases involving outright theft of cash or very large stock deficiencies.
- 3.3 Immediately following the Second Sight report, work was done to rationalise and consolidate the pre-existing prosecution policy. That said, the consolidated policy is in substance no different to that which has been applied previously; in any event, it has in essence been held in abeyance and no further prosecutions have been initiated.

**4. Options Considered**

- 4.1 At a practical level, there are a number of alternatives to mounting our own criminal investigations and undertaking private prosecutions. In particular, most companies when faced with theft from employees, or agents, would simply contact the police, and if fraud were a persistent problem, develop processes for engaging with them.
- 4.2 Alternatively, it is open to companies (effectively) to bypass the police and go directly to the local prosecuting authority (e.g. the CPS in England and the Procurator Fiscal in Scotland); indeed for technical reasons, this is the approach that is adopted by Post Office in Northern Ireland and Scotland. The experience in those 2 jurisdictions, however, is that there is reluctance to prosecute all but the most serious, or the most clear-cut, cases, as to some extent it is seen by them as a debt recovery (i.e. civil) matter. We have been advised by Brian Altman that should Post Office go down the route of referring matters to the police or the CPS, there would be a limited appetite to prosecute, even if all the preparatory work (witness statements, fact finding etc.) had been done by Post Office in house.
- 4.3 In light of the above, four broad options were considered:

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- a) **Preserving the status quo** – i.e. retaining prosecutorial capability and continuing with a prosecutions policy that is not dissimilar to that which has been used in the past;
- b) **Pursuing a prosecutions policy focussed only on high value cases/cases involving vulnerable members of society**, and engaging with the police in relation to other matters;
- c) **Ceasing all prosecutorial activities** but instead actively involving the police/CPS etc where it is felt that they are likely to take matters forward; and
- d) **Ceasing all prosecutorial activities as per option c) BUT coupled with work** (as yet not formally defined but some of which has already started as part of Project Sparrow and NT):
  - **to gather better MI from the network;**
  - **to improve the overall control framework around the branch network; and**
  - **to provide more support to sub-postmasters.**

This last option is perhaps closest to that adopted by banks and other organisations facing serious losses through fraud and criminal activity.

- 4.4 As part of the evaluation process, however, consideration was given to broader policy factors, including:

- Post Office's brand image;
- whether undertaking prosecutions is consistent with a commercial franchisor-franchisee relationship; and
- the overall drive to develop better stake-holder engagement and a more mature working relationship with sub-postmasters.

In light of these considerations:

- Option a) above was felt to be, at best, sub-optimal and was not explored to any great extent, other than to ask the question of Brian Altman whether it was "efficient" in terms of the criminal process (which it is).
- Option b) carried with it the risk that any residual prosecutions undertaken by Post Office would be conducted so infrequently (probably only a handful each year) as to mean that it was not efficient to maintain an internal team to handle them. Accordingly, it too was discounted for the time being; and
- Option c) was rejected as carrying an unacceptable risk of fraud and loss given the scale of the "losses" currently suffered through theft and false accounting.

## 5. Proposal

- 5.1 Option d) is the favoured way forward. That said, before a final recommendation can be made, further work needs to be done. Accordingly, it is proposed that:

- Work now commence to ascertain the scope, and the cost, of the additional work that would need to be undertaken to gather better MI from the network

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(including MI as to the “deterrent” value of the current policy), improve the overall control framework, and provide better support to sub-postmasters whilst protecting public funds. Part of this work will also be focussed on exploring additional (non-criminal) sanctions that could be used as a deterrent against sub-postmasters who have deliberately committed fraud.

A programme director and sponsor has already been identified for this work, which will in part build upon work that has already been done as part of Project Sparrow and some of the work that has started in the Audit team;

- The Communications team develop a strategy for effectively delivering messages about any change in prosecutions policy, given that any move to change our prosecutions policy, once in the public domain, could:
  - i. attract significant comment in the media and amongst stakeholder groups, with potential for an adverse impact on brand and reputation; and
  - ii. be perceived as an ‘admission’ that past prosecutions are somehow flawed.
- A deeper analysis is undertaken of the financial impact of adopting option d). In particular, this will look at:
  - i. the ways in which civil proceedings (as opposed to criminal proceedings) can be used more effectively to reduce the financial impact once Post Office becomes unable to continue to use the Proceeds of Crime Act to recover money that has been mis-appropriated; and
  - ii. any headcount savings that may be available.

5.2 This last piece is important. Under the terms of the sub-postmasters’ contract, sub-postmasters are liable to Post Office for all “losses” of stock/cash etc. Accordingly, a “fraud” involving the loss of stock or cash gives rise to receivable in the hands of Post Office, which if not recovered leads to a bad debt. Although there is a dedicated team that keeps track of bad debts that arise in the normal course of events, and the recovery for them, anecdotal evidence from the criminal prosecutions team suggests that once matters are handed to them, around 75% of all bad debts are recovered. The evidence further suggests that around £1.5m is recovered annually. As noted above, it is likely that a civil recovery process would lead to a slower, and slightly lower, recovery rate. We will therefore need to consider and monitor closely the potential impact any policy change may have on the “deterrent effect” of the existing policy.

**6. Commercial Impact/Costs**

6.1 See 5.1 and 5.2 above. There may well be an offsetting impact on the headcount in certain areas, in particular the security team and the legal team, though this has yet to be quantified. However, there will be additional costs associated with enhancing the MI and control framework. These too have not yet been quantified, but should to some extent fall within BAU budgets (for example to the extent that they form part of the audit function, they may be part of that budget). Indeed, some of the work referred to in para. 5.1 above is already being undertaken given its importance to Post Office’s brand and wider business



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objectives, and therefore has a value which is independent of the issues discussed in this paper.

**7. Key Risks/Mitigation**

- 7.1 These pertain mainly to the potential increased risk of fraud, and being seen to be “soft” with public money, but should be capable of being addressed by enhanced MI and improvements to the control framework etc.

**8. Long term considerations – horizon scan**

- 8.1 Not taking action now in relation to the prosecutions policy could lead to, or exacerbate, the impact of further adverse publicity regarding Post Office’s treatment of sub-postmasters.
- 8.2 Taking this action may assist in developing better stakeholder engagement.

**9. Communications Impact**

- 9.1 The communications team is already heavily involved in Project Sparrow, and it is proposed to manage the communications of the above through that channel. A key issue will be to ensure that any change of policy is properly positioned with MPs, the JFSA and the wider Network.

**10. Recommendations**

The ARC is asked to:

- 10.1 note the update set out above; and
- 10.2 approve the proposals set out in paragraph 5.1 above.

**Chris Aujard**  
**13 November 2013**

**Strictly Confidential****POST OFFICE LIMITED AUDIT, RISK & COMPLIANCE SUB-COMMITTEE****Interim Report and Condensed Financial Statements for 2013-14****1. Purpose**

The purpose of this paper is to:

- 1.1 Invite the Post Office Limited Board Audit Risk and Compliance Sub-Committee to review the Post Office Limited Interim Report and Condensed Financial Statements for the 2013-14 half year.

**2. Background**

- 2.1 The Post Office prepared a full Annual Report and Financial Statements for the 2012-13 year to the standard of a listed plc. The ARC agreed at its September meeting to continue to report to this standard for the half year but requested that the reporting be relatively succinct.
- 2.2 The following documents are attached to this paper:
  - Draft Interim Report and Condensed Financial Statements (incorporating Board, Royal Mail, Shareholder Executive and EY comments);
  - ARC briefing book to aid understanding.

**3. Interim Report and Condensed Financial Statements approach and plan**

- 3.1 As set out to the Board, the Interim Report is currently anticipated for publication in the first week of December following Royal Mail's planned announcement at the end of November. The context remains a challenging macroeconomic environment which continues to put pressure on margins, and discussions with Government around future strategy and related post-2015 funding.
- 3.2 The Condensed Financial Statements have been prepared by Finance and the Ernst & Young audit work is now complete. In 2012-13, for the first time, the Post Office prepared consolidated annual Financial Statements under International Financial Reporting Standards (IFRS) which is in line with a majority of listed public limited companies. The draft Interim Report and Condensed Financial Statements have therefore also been prepared in accordance with IFRS, consistent with the interim reporting of listed PLCs. An ARC briefing book is attached. This provides a more detailed analysis of the first half results to aid understanding of the financial statements.
- 3.3 The current timeline is:
  - October – initial draft of front half circulated to Board
  - 24 October – Board papers include updated Interim Report incorporating Board comments
  - 28 October – further comments from Board submitted

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- 31 October – Board meeting to approve the Interim Report and delegate responsibility for finalising it
- 8 November – draft supplied to Royal Mail and Shareholder Executive for comment
- 13 November – Royal Mail and Shareholder Executive comments incorporated and circulated with ARC papers
- 19 November – ARC review
- Late November – Board subcommittee to approve and sign Interim Report
- Early December – Announce results

**4. Review process**

- 4.1 The comments following the first review by Board members last week have been considered and addressed. In addition we have asked an investment bank – Rothschild – to review the report from a 'PLC/investor relations' perspective. The material outputs of both have been addressed and were discussed at the Board meeting on 31 October.
- 4.2 Since the Board meeting, the draft has been shared with Royal Mail and the Shareholder Executive. Royal Mail requested one minor wording change which has been accommodated. The Shareholder Executive feedback was considered and has largely been incorporated. Most changes were minor wording refinements and there was a strengthening of the content regarding Government Services on pages 3 and 5.

**5. Format**

- 5.1 We will produce an electronic copy of the Interim Report in-house and make this available via the website. It will be similarly styled to the Annual Report.

**6. Going Concern and Funding**

- 6.1 The ARC reviewed Going Concern at its 2013 March meeting and this work has been refreshed at the half year. A summary of the analysis is included in Section 12 of the ARC Briefing Book attached to this paper. Based on the analysis in this paper there is headroom remaining until March 2016, and until March 2017 assuming continuation of the working capital facility, and it is believed that Post Office Limited will be able to meet its liabilities as they fall due in the foreseeable future. The Post Office Limited directors consider it appropriate to continue to prepare the financial statements on a Going Concern basis.
- 6.2 If the post 2015 funding is announced before the Interims are published there will be a number of changes required. These are:
- To consider adding reference to the introductory statement;

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- To amend the going concern note to refer to the funding but note that it is still subject to State Aid approval (page 11);
- To amend the risks and uncertainties paragraph similarly as this is an update from the position at year end (page 11);
- To add a Post Balance Sheet Event to note 9 (page 16).

**7. Audit**

- 7.1 The audit work on the Interim Report and Condensed Financial Statements is complete. No significant issues have arisen to date.

**8. Recommendation**

- 8.1 The Post Office Limited Board Audit Risk and Compliance Sub-Committee is asked to:
- Review the Interim Report and Condensed Financial Statements and provide final individual comments to Chris Day and Mark R Davies by noon on Monday 18 November.

**Chris Day  
November 2013**



6. Interim Report review and Ernst & Young Half Year Review findings



**Our year so far...**  
Interim report 2013  
29 September 2013  
Post Office Limited : Registered number 2154540





6. Interim Report review and Ernst & Young Half Year Review findings





# Building a thriving business for the years ahead



**Alice Perkins**  
Chairman



**Paula Vennells**  
Chief Executive

There is no more powerful demonstration of the transformation of the Post Office than the sight of a freshly refurbished branch. The first six months of the 2013/14 financial year have seen another 588 of these branches open, with longer opening hours and more modern environments. It means that since the start of the programme more than 1,100 post offices have been transformed, with the benefit of this transformation to customers at a time when our network is at its most stable for decades.

This achievement highlights the determination we have to continue to be at the heart of modern communities as the largest retail network in the UK. Longer opening hours, faster service and increased retail sales for our customers will ensure that we have a modern, sustainable Post Office network fit for the 21st century.

That is the backdrop to what has undoubtedly been a challenging period. Our operating profit, which includes £100 million (2012 £103 million) of the Network Subsidy Payment received from Government to support our branch network, before exceptional items decreased by £8 million (2012 £15 million). Our comparative performance was also affected by changes in the prior year, which we have explained in more detail below. We remain optimistic about the future of the business.

Our strategy is to build a business that is resilient to economic downturns and to deliver a dramatic improvement in our operating performance. We are investing in our network, our people and our services to bring it to the forefront of the retail industry. We are committed to building a business that is able to deliver a range of services to our customers and other businesses.

The first challenge we have faced is the reduction in the Network Subsidy Payment from £103 million to £100 million. We have taken steps to address this, expanding the Drop & Go service which provides an efficient prepaid service for small businesses, online sellers and anyone sending mail regularly.

Working with Royal Mail, we have also announced the launch of the UK's largest Click & Collect network, which will allow us to support online retailing growth by providing a great choice of convenient parcel delivery and return options for online retailers and their customers.

Both of these initiatives are part of our strategy to ensure that we continue to be a relevant and accessible Post Office that is in tune with the needs of our customers and their shopping habits.

We are able to report a strong performance in building our Financial Services business, which has increased by £1 million year on year. Our Financial Services revenue (including Post Office branded savings, lending, insurance and travel products) is up 23% from the comparative period. This area of the business is critical to our ambition to grow and further develop as a credible alternative to the high street banks, an ambition underlined through our pilot of current accounts in East Anglia.

In Government Services, we face challenges but remain optimistic for the future, particularly in relation to the role the Post Office can play in supporting the Digital by Default agenda. Our unrivalled physical network can be the perfect partner to this work, providing the vital face to face services – such as Identity Assurance and

which are not yet online to access digital services. We will still be required in a digital age. Our Annual Report and Financial Statements for 2012/13, the Post Office is a unique business, a commercial business with a social purpose. We have served the nation for over 150 years and we provide access to services that are vital to their lives.

Our network also provides a crucial connection point for businesses and communities and we are absolutely committed to maintaining these critical links. We have been working hard in the last six months to continue to deliver on our purpose into a single statement. This is part of a programme which could see the Post Office become a mutual business in the future, has seen us engage the public through a major research programme, the results of which we expect to announce in the next few months.

The other element of our strategy is our determination to develop ways of working which meet the test of a mutual business – ensuring that we listen and learn from all stakeholders involved with the business. Significant progress is being made in this area.

It is now 18 months since we began operating as an independent business. We continue to enjoy a strong relationship with Royal Mail, underpinned by contractual agreements, which provides a solid foundation for many years to come. We are combining this with an ambitious strategy in other areas which we are confident will ensure a thriving Post Office business in the years ahead.



## Business review

### Key performance figures

six months ended 29 September 2013

#### Summary Group Profit and Loss Account

	2013 £m	2012 £m	Variance £m	Variance %
Turnover		501	(18)	(3.6)
Network Subsidy Payment		103	(3)	(2.9)
<b>Revenue</b>		604	(21)	(3.5)
People costs		(128)	(3)	(2.3)
Other operating costs		(437)	15	3.4
Share of post tax profit from joint ventures and associates		22	1	4.5
<b>Operating profit before exceptional items</b>		61	(8)	(13.1)
Operating exceptional items		(10)		
Profit on disposal of property, plant and equipment		2		
Loss on sale of associate		(30)		
<b>Profit before financing and taxation</b>		23		

#### Revenue by pillar

	2013 £m	2012 £m	Variance £m	Variance %
Mails and Retail		196	(12)	(6.1)
Financial Services		138	1	0.7
Government Services		84	(9)	(10.7)
Telecoms		63	2	3.2
Other		20	0	0
<b>Turnover</b>		501	(18)	(3.6)
Network Subsidy Payment		103	(3)	(2.9)
<b>Revenue</b>		604	(21)	(3.5)

#### Key Financial Performance Indicators

Turnover (£m)	Operating profit before exceptional items (£m)	Operating loss before exceptional items and Network Subsidy Payment (£m)	Operating cash flow (£m)
<b>483</b>	<b>53</b>	<b>(47)</b>	<b>(142)</b>
2012: 501	2012: 61	2012: (42)	2012: 78

The Post Office's revenue has declined by £21 million, including a £3 million reduction in the Network Subsidy Payment. Turnover decreased from £501 million in the first 6 months of the prior year, to £483 million this half year with encouraging growth in the Financial Services and Telecoms businesses more than offset by decline in the Mails and Retail and Government Services businesses. The Network Subsidy Payment is government grant revenue towards the costs of maintaining the Post Office network. This payment decreased by £3 million from the previous year to £100 million consistent with the Government Funding Agreement. This will reduce further in 2014-15 as set out in the current funding agreement with the government.

Mails and Retail revenue of £184 million decreased by £12 million (2012-£196 million). Of this, turnover in relation to Royal Mail products decreased by £10 million, driven primarily by lower consumer parcel volumes through the Post Office and lower stamps revenue due to the sales peak ahead of the price rise at the end of April 2012. In addition, retail turnover decreased by £1 million, as the comparative figure last half year included revenue from the collectibles relating to the Diamond Jubilee and Olympics memorabilia. Revenue derived from sales of lottery tickets declined by £1 million.



The Financial Services offering continues to grow, using our position at the heart of communities to offer products that are simple, fair, accessible and transparent, and value for money.

Financial Services revenue in the first half of the year increased by £1 million to £139 million (2012-£138 million). Personal Financial Services revenue rose by 23%, driven by strong growth in savings products (particularly Growth Bonds and Reward Saver) and the growth of the new mortgage products. Revenue from traditional financial services products, including bill payment services and Postal Orders, continued to decline. This was due to the increasing provision of electronic alternatives to paper-based products and the increasing use of alternative payment methods.

The Department for Work and Pensions contract for cash cheques and green giros has ceased, and National Savings and Investments' (NS&I) decision to provide most of their products through their own direct channel has resulted in a further reduction in revenue.

Government Services revenue of £75 million declined by £9 million (2012-£84 million) due to a lower volume and rate per transaction for DVLA motoring work and a reduction in the number of active Post Office Card Account (POCA) accounts. Revenue from the Passport Check & Send service increased by £1 million due to an increased share of a growing market.

Two major new contracts have been signed with Government Departments. Her Majesties Passport Office has signed a contract under the Front Office Counter Services framework that will allow for the continuation of the popular Passport check and send service. A contract has also been signed with Government Digital Service for the provision of Identity Assurance services.

Telecoms revenue of £65 million represented an increase of £2 million (2012-£63 million). Revenue from HomePhone and Broadband rose driven by an uplift in our average revenue per user following the introduction of more attractive packages last year. Revenue from our Mobile top-up business was lower than the previous half year, as more customers continue to migrate away from pre-pay services onto contracts. Despite this reduction in income, the Post Office is still a significant provider in the top-up market, and its share of the retail market has been maintained at around 5%.

People costs of £131 million have increased compared to the first 6 months of the prior year by £3 million mainly due to higher pension costs and historical pay agreements.

Other operating costs have decreased by £15 million to £422 million mainly due to lower sales volumes.

The share of profit from the joint venture, First Rate Exchange Services Holdings Limited, increased by £1 million to £23 million.

Operating exceptional items include the costs of delivery of major change and the impairment of non-current assets. These are offset by Government grant funding, received towards the transformation programme and recognised to match the associated costs. In addition a gain of £102 million arose on the change to the terms of the Royal Mail Pension Plan. In the half year Network Transformation resulted in costs of £55 million. Costs of £5 million relate to the IT transformation programme which will create the appropriate IT infrastructure for the future. Government grant funding of £129 million has been recognised to offset the costs as appropriate including £31 million to cover costs incurred in 2012-13 but not covered by the 2012-13 grant.

There has been an operating cash outflow of £142m during the period in contrast to the comparative half year which saw a net cash inflow of £78m. This change in cash flow is driven by differing working capital movements due to the timing of Easter relative to the March 2013 and March 2012 year ends. The cash position of the business remains strong, with cash and cash equivalents of £829m (2012-£898m).

## Interim condensed consolidated income statement

	Notes	Half year to 29 September 2013 Unaudited £m	Half year to 23 September 2012 Unaudited £m
<b>Continuing operations</b>			
Turnover			501
Network Subsidy Payment			103
<b>Revenue</b>	3		604
People costs excluding restructuring costs			(12)
Other operating costs			(437)
Share of post tax profit from joint ventures and associates			22
<b>Operating profit before exceptional items</b>			61
Operating exceptional items	4		(10)
- government grant			35
- Royal Mail Pension Plan amendment			-
- restructuring costs			(24)
- other			(21)
<b>Operating profit</b>			51
Profit on disposal of property, plant and equipment			2
Loss on sale of associate			(30)
<b>Profit before financing and taxation</b>			23
Finance costs			(2)
Finance income			1
Net pensions interest			1
<b>Profit before taxation</b>			23
Taxation credit	5		(1)
<b>Profit for the period from continuing operations</b>			41

## Interim condensed consolidated statement of comprehensive income

		Half year to 29 September 2013 Unaudited	Half year to 23 September 2012 Unaudited
	Notes	£m	£m
Profit for the period from continuing operations			41
Other comprehensive income:			
Remeasurements on defined benefit surplus	6		(32)
Income tax effect	5		(11)
Total comprehensive income/(expense) for the period			(2)

There are no other comprehensive income items that will be reclassified to the profit and loss in subsequent periods.



## Interim condensed consolidated statement of cash flows

	Notes	Half year to 29 September 2013 Unaudited	Half year to 23 September 2012 Unaudited
		£m	£m
<b>Cash flows from operating activities</b>			
Operating profit before exceptional items			61
Adjustment for:			
depreciation and amortisation			-
Share of profit from joint ventures and associates			(22)
Pension operating costs			13
Working capital movements:			131
decrease/(increase) in trade and other receivables			(10)
(decrease)/increase in trade and other payables			143
decrease/(increase) in inventories			(3)
Increase in non-exceptional provisions			1
Pension operating costs paid			(13)
Cash receipts in respect of operating exceptional items:			178
Government grant			200
Restructuring costs			(17)
Other			( )
<b>Net cash inflow from operating activities</b>			348
Income tax recovered			11
<b>Cash flows from investing activities</b>			
Investment in associate			(11)
Proceeds from sale of property, plant and equipment			2
Proceeds from disposal of associate			2
Purchase of non-current assets			(20)
<b>Net cash (outflow) from investing activities</b>			(27)
<b>Net cash inflow before financing activities</b>			332
<b>Cash flows from financing activities</b>			
Finance costs paid			(2)
Payments to finance lease creditors			(2)
Repayment of bank borrowings			(2' 0)
<b>Net cash (outflow) from financing activities</b>			(2' 4)
<b>Net (decrease)/increase in cash and cash equivalents</b>			78
Effect of exchange rates on cash and cash equivalents			-
Cash and cash equivalents at the beginning of the period			820
<b>Cash and cash equivalents at the end of the period</b>	7		898

## Interim condensed consolidated balance sheet

at 29 September 2013 and 31 March 2013

	Notes	29 September 2013 Unaudited £m	31 March 2013 Audited £m
<b>Non-current assets</b>			
Intangible assets			-
Property, plant and equipment			11
Investments in joint ventures and associates			60
Pension benefit surplus	6		97
Trade and other receivables			10
<b>Total non-current assets</b>			178
<b>Current assets</b>			
Inventories			8
Trade and other receivables			32
Cash and cash equivalents			971
Financial assets - derivatives			1
<b>Total current assets</b>			1,332
<b>Total assets</b>			1,510
<b>Current liabilities</b>			
Trade and other payables			(874)
Financial liabilities - interest bearing loans and borrowings			(291)
Financial liabilities - obligations under finance leases			(3)
Provisions			(19)
<b>Total current liabilities</b>			(1,187)
<b>Non-current liabilities</b>			
Financial liabilities - obligations under finance leases			(4)
Other payables			(24)
Provisions			(7)
<b>Total non-current liabilities</b>			(35)
<b>Net assets</b>			288
<b>Equity</b>			
Share capital			
Share premium			46
Retained earnings			(179)
Other reserves			2
<b>Total equity</b>			288

## Interim condensed consolidated statement of changes in equity

-or the half year ended 29 September 201£

	Notes	Share premium £m	Retained earnings £m	Other reserves £m	Total equity £m
<b>At 1 April 2013 (unaudited)</b>					
Profit for the period					
remeasurements on defined benefit surplus	6				
Income tax effect	-				
<b>At 29 September 2013 (unaudited)</b>					

-or the half year ended 2£ September 2012

	Notes	Share premium £m	Retained earnings £m	Other reserves £m	Total equity £m
At 26 March 2012 (unaudited)		46*	(12)	47	(40)
Profit for the period		-	41	-	41
remeasurements on defined benefit surplus		-	(32)	-	(32)
Transfer of pension deficit to government		-	286	-	286
Sale of interest in associate		-	4*	(4*)	-
Income tax effect	-	-	(11)	-	(11)
At 23 September 2012 (unaudited)		46*	(223)	2	244

## Notes to the interim condensed consolidated financial statements

**1. Accounting policies**

The interim condensed consolidated financial statements of Post Office Limited and its subsidiaries (collectively "the Group") for the half year ended 29 September 201£ were authorised for issue in accordance with a resolution of the directors on XX November 201£.

The information for the year ended £1 March 201£ does not constitute statutory accounts as defined in section £4 of the Companies Act 2006. A copy of the full statutory accounts for that year has been delivered to the Registrar of Companies. The auditors' report on those accounts was unqualified and did not draw attention to any matters by way of emphasis and did not contain a statement under section 498(2) or (£) of the Companies Act 2006.

**Basis of preparation**

These interim condensed consolidated financial statements for the half year ended 29 September 201£ have been prepared in accordance with IAS £4 "Interim Financial Reporting" as adopted by the European Union. This report should be read in conjunction with the Group's Annual Report and Financial Statements 2012-1£ which have been prepared in accordance with IFRSs as adopted by the European Union.

**- undamental accounting concept - going concern**

After careful consideration of the plans for the coming years the directors continue to believe that Post Office Limited will be able to meet its liabilities as they fall due for the foreseeable future. Accordingly on that basis the directors consider that it is appropriate that these interim condensed consolidated financial statements have been prepared on a going concern basis.

The Group has net assets at 29 September 201£ and is reporting a profit before exceptional items. A funding agreement with the Government was announced on 27 October 2010 which provided for:

- funding of £410 million for 2012-1£
- funding of £415 million for 201£-14
- funding of £££0 million for 2014-15
- Extension of the existing working capital facility with the Department for Business, Innovation & Skills (BIS) of £1.15 billion up to £1 March 2016

State Aid approval for the funding for 2012-1£ to 201415 was received on 28 March 2012 and it was also recognised that the working capital facility was no longer deemed State Aid. £40 million was received on 2 April 2012 and £415 million was received on 2 April 201£.

This investment will take the form of a Government Grant and enable the Group to modernise the branch network and the continuation of the Network Subsidy Payment recognises the major social value that Post Offices provide to communities. New main and local branches are currently being rolled out across the United Kingdom. Customers are beginning to benefit from a much better retail experience including extended opening hours. This programme is designed to make the Post Office network more self-sustaining and over time less dependent on direct subsidy. This programme will not involve branch closures.

The directors are satisfied with the continued progress made towards modernisation during the half year ended 29 September 201£ and that the plans in place and the substantial

investment secured will enable the Group to continue to modernise and to secure its future. However they note that the scale of change required remains significant so not without risk.

**New standards interpretations and amendments adopted by the Group**

The interim condensed consolidated financial statements have been prepared in accordance with the accounting policies set out in the Group's Annual Report and Financial Statements 2012-1£ except for the adoption of new standards and interpretations effective as of 1 April 201£.

The Group applies for the first time IAS 19 (revised 2011) Employee Benefits. This has not required restatements of previous financial statements as the effect of the application of IAS 19 is not material in the opinion of the directors. IAS 19 includes a number of amendments to the accounting for defined benefit plans including actuarial gains and losses that are recognised in other comprehensive income (OCI) and permanently excluded from profit and loss which is consistent with the existing policy of the Group. expected returns on plan assets that are no longer recognised in profit or loss instead there is a requirement to recognise interest on the net defined benefit asset in profit or loss calculated using the discount rate used to measure the defined benefit surplus. Other amendments include new disclosures such as quantitative sensitivity disclosures.

In the case of the Group the transition to IAS 19 and the difference in accounting for interest on plan assets and unvested past service costs has not had a material impact on the net defined benefit plan surplus. The Group has not early adopted any other standard interpretation or amendment that has been issued but is not yet effective.

**2. Risks and uncertainties**

The principal and other significant risks and uncertainties affecting the Group were identified as part of the Performance Review set out on pages £4 and £5 of the Group's Annual Report and Financial Statements 2012-1£. These risks remain relevant for the remaining six months of the current financial year

## Notes to the interim condensed consolidated financial statements

## E. Segmental reporting

The Group's operating segments have been identified as Mails & Retail, Financial Services, Government Services, Telecoms and Other. The performance of these segments in the half year ended 29 September 2013 has been discussed further in the Business Review on pages 4 and 5. Performance is assessed based on net revenue. This is calculated using segmental revenue less the directly attributable costs of delivering the service or product. Assets and liabilities as recognised on the Group balance sheet are not considered to be segmental assets or liabilities but rather are managed by the Group's central functions.

	Half year to 29 September 2013		
	Revenue £m	Directly attributable costs £m	Net revenue £m
Mails & Retail			
- Financial Services			
- Government Services			
Telecoms			
Other			
Sub-total			
Network Subsidy Payment			
<b>Total</b>			

	Half year to 23 September 2012		
	Revenue £m	Directly attributable costs £m	Net revenue £m
Mails & Retail	196	(3)	193
- Financial Services	138	-	138
- Government Services	84	(13)	69
Telecoms	63	(40)	23
Other	20	-	20
Sub-total	401	(43)	358
Network Subsidy Payment	103	-	103
<b>Total</b>	<b>504</b>	<b>(43)</b>	<b>461</b>

A reconciliation between underlying segment net revenue and profit before taxation is provided below:

	Half year to 29 September 2013 £m	Half year to 23 September 2012 £m
Underlying segment net revenue		461
Indirect costs		(43)
Share of post-tax profit from joint ventures and associates		22
<b>Operating profit before exceptional items</b>		<b>61</b>
Operating exceptional items		(10)
<b>Operating profit</b>		<b>51</b>
Profit on disposal of property, plant and equipment		2
Loss on sale of associate		(30)
<b>Profit before financing and taxation</b>		<b>23</b>
- Finance costs		(2)
- Finance income		1
Net pensions interest		1
<b>Profit before taxation</b>		<b>23</b>



## 6. Interim Report review and Ernst &amp; Young Half Year Review findings

1£

## Seasonality of operations

Due to the seasonality of the Mails & Retail segment higher revenues are usually expected in the second half of the year. This is mainly attributed to the effect of the Christmas period. This information is provided to allow for a better understanding of the results however management has concluded that this does not constitute 'highly seasonal' as considered by IAS £4

## 4. Operating exceptional items

These are items of income and expenditure arising from the operations of the business which due to the nature of the events giving rise to them require separate presentation on the face of the income statement to allow a better understanding of financial performance.

	Half year to 29 September 2013 £m	Half year to 23 September 2012 £m
Government grant		3*
Royal Mail Pension Plan amendment		-
Network transformation including subpostmasters' compensation		(14)
Restructuring - severance		(6)
Restructuring - other		(4)
Impairment of intangible assets		(10)
Impairment of property, plant and equipment		(11)
<b>Total operating exceptional items</b>		<b>(10)</b>

For further information in relation to the Royal Mail Pension Plan amendment refer to note 6. Due to ongoing operational losses (excluding Network Subsidy Payment) the carrying value of intangible assets and all property, plant and equipment other than freehold and long leasehold property has been impaired to the recoverable amount.

## 5. Taxation

The overall taxation credit in the income statement is calculated by applying the tax rate that would be applicable to the expected total annual earnings to the reported interim profit.

The major components of income tax in the interim condensed income statement are:

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

## Notes to the interim condensed consolidated financial statements

## 6. Pensions

The Group participates in pension schemes as detailed below.

Name	Eligibility	
Royal Mail Pension Plan ("RMPP")	UK employees	defined benefit
Royal Mail Senior Executive Pension Plan ("RMSEPP")	UK senior executives	defined benefit
Royal Mail Defined Contribution Plan ("RMDCP")	UK employees	defined contribution

The charge in the interim condensed consolidated income statement for the defined contribution scheme and the Group contributions to this scheme was £1m in the half year to 29 September 2013 and payments of £11m were made in respect of future service contributions nearly all relating to RMPP. The regular future service contributions for RMPP expressed as a percentage of pensionable pay has remained at 17.1%.

The following disclosures reflect the Post Office Limited sectionalised RMPP scheme which is independently operated by the Group. Disclosures in relation to Post Office Limited's approximately 7% share of RMSEPP (which is operated by Royal Mail Group Limited) have been excluded as they are not considered to be significant to the interim condensed consolidated financial statements.

During the period there was a consultation exercise with members of the defined benefit Royal Mail Pension Plan on proposed changes to the terms. These changes were agreed and implemented on 15 October 2012. The key change was to the definition of pensionable pay which broadly will increase in line with CPI (capped at 5%) in future regardless of actual pay growth. The changes have resulted in a one-off exceptional gain of £102 million.

IAS 19 has been applied retrospectively from 26 March 2012. Expected returns on plan assets of defined benefit plans are not recognised in profit or loss. Interest on net defined benefit surplus is recognised in profit or loss calculated using the discount rate used to measure the net pension surplus. The impact of transition to IAS 19 retrospectively is not material to the Group and therefore no restatement has been required.

## a) Major long-term assumptions

	At 29 September 2013 % pa	At 31 March 2013 % pa
Rate of increase in pensionable salaries		4.3
Discount rate		4.8
Inflation assumption (CPI)		3.3
Inflation assumption (CPD)		2.3

Demographic assumptions for example mortality remain unchanged from those made in March 2012.

## b) Plans' assets and liabilities

The plan assets and liabilities were:

	Market value at 29 September 2013 £m	Market value at 31 March 2013 £m
<b>Sectionalised RMPP</b>		
Fair value of assets		
Present value of liabilities		
<b>Surplus in plan before IFRIC 14 adjustment</b>		
Less IFRIC 14 adjustment		
<b>Surplus in RMPP plan after IFRIC 14 adjustment</b>		
Surplus in plan for the Post Office Limited share (at approximately 7% of RMSEPP)		
<b>Total retirement benefit surplus</b>		

**c) Movement in plans' assets and liabilities**

Changes in the present value of the defined benefit pension surplus are analysed as follows:

	Half year ended 29 September 2013 £m
<b>Se- tionalised RMPP</b>	
<b>Opening net retirement benefit surplus/(defi- it)</b>	
oyal Mail Pension Plan amendment	
Transfer of pension deficit to government	
Current service cost	
Curtailment costs	
Net financing credit	
Employer's contributions	
Actuarial (losses)/gains	
<b>Closing net retirement benefit surplus before IFRIC 14 adjustment</b>	

**7. Cash and cash e• uivalents**

-or the purposes of the cash flow statement" cash and cash e• uivalents comprise the following:

	At 29 September 2013 £m
Cash e• uivalents	
Bank overdrafts	

## 6. Interim Report review and Ernst &amp; Young Half Year Review findings

16

## 8. Related party disclosures

All related party transactions were in the ordinary course of business. The transactions entered into and the balances outstanding as at 29 September 201£ were as follows:

Half year to September	Sales/re-charges to related party		Purchases/re-charges from related party		Amounts owed from related party including outstanding loans		Amounts owed to related party including outstanding loans	
	2013 £m	2012 £m	2013 £m	2012 £m	2013 £m	2012 £m	2013 £m	2012 £m
Royal Mail Plc				18		-		9
Midasgrange Limited				1		28		1
First Rate Exchange Services Holdings Limited				81		6		4

For further information in relation to Royal Mail plc refer to note 9. The sales to and purchases from related parties are made on normal market prices. Balances outstanding at the half year end are unsecured interest free and settlement is made by cash.

The group trades with numerous government bodies on an arm's length basis. Transactions with these entities are not disclosed owing to the significant volume of transactions that are conducted. Separately the group has certain loan facilities with government and receives a government grant and the Network Subsidy Payment from government. There were no material transactions or balance between the group and its key management personnel during the half year ended 29 September 201£.

## 9. Post balance sheet events

On 15 October 201£ Royal Mail was listed on the London Stock Exchange as Royal Mail plc. From this date Royal Mail group Limited ceased to be a subsidiary of Royal Mail Holdings plc which is Post Office Limited's immediate and ultimate parent company. The contractual relationships between Post Office Limited and Royal Mail group Limited have not changed.

The directors confirm that these condensed set of interim financial statements have been prepared in accordance with IAS £4 'Interim financial reporting' as adopted by the European Union.

By order of the Board

**P A Vennells**  
Chief Executive

**C M Day**  
Chief Financial Officer

xx November 201£

## The Board of Directors to Post Office Limited

### Introduction

We have been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 29 September 201£ which comprises the interim condensed consolidated balance sheet of Post Office Limited and its subsidiaries (the "group") and the related interim condensed consolidated statements of income, comprehensive income, changes in equity and cashflow statement for the six month period then ended and the explanatory notes. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the company in accordance with guidance contained in International Standard on Review Engagements 2410 (UK and Ireland) "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the company for our work for this report or for the conclusions we have formed.

### Directors' responsibilities

The half-yearly financial report is the responsibility of and has been approved by the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the accounting policies set out in note 1.

As disclosed in note 1 the annual financial statements of the group are prepared in accordance with International Accounting Standard £4 "Interim Financial Reporting" as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with those policies.

### Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

### Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly we do not express an audit opinion.

### Conclusion

Based on our review nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 29 September 201£ is not prepared in all material respects in accordance with the accounting policies set out in note 1 which comply with International Accounting Standard £4 as adopted by the European Union.

Ernst & Young LLP  
London  
xx November 201£



6. Interim Report review and Ernst & Young Half Year Review findings

**Our pictures**

**Front cover**

Jonathan and Sarah Armstrong of Windmill Motorcraft, Brandon Bexhill of Apex was the independent Community Retailer of the Year trophy at the National Recognition in Retail Awards 2013. The trophy was purchased for their tireless efforts to make their Post Office branch the heart of their community.

**Page 2**

Our Grand new Crown Office in Milton Keynes which opened in July this year.

**Corporate information**

**Post Office Limited**

Interim Report for the half year ended 29 September 2013

**Registered Office and Group Head Office**

Post Office Limited  
148 Old Street  
London EC1Y 9HQ

Registered No: 2154940

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**Corporate website**

Additional corporate and other information should be seen on the following website ([www.postoffice.co.uk](http://www.postoffice.co.uk)). Information available on the website is not intended to be used should not be regarded as being part of the account.





**Post Office Limited**  
**Audit, Risk and Compliance Board Sub-  
Committee**  
**Briefing Book**  
**Half Year ended 29 September 2013**

<b>Section</b>	<b>Page</b>
1. Glossary	3
2. Introduction	4
3. Accounting Policies	4
4. Primary Statements	5
5. Operating profit	8
6. Revenue	9
7. Costs and people	12
8. Quality of earnings	17
9. Pensions	18
10. Exceptional items and provisions	21
11. Interest, cash, debt, funding and hedging	22
12. Going Concern	24
13. Property, plant and equipment and non-current assets held for sale	27
14. Goodwill. Investments and intangibles	28
15. Working Capital	29
16. Provisions	34
17. Litigation and claims- potential claims regarding Horizon	35
18. Taxation	37

**1 Glossary review**

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

<b>Abbreviation</b>	<b>Meaning</b>
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

## **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).



## 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

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

## 4.2 Post Office Limited Interim Consolidated Cashflow Statement

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

	29 September 2013	23 September 2012
	Unaudited	Unaudited
Notes	£m	£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

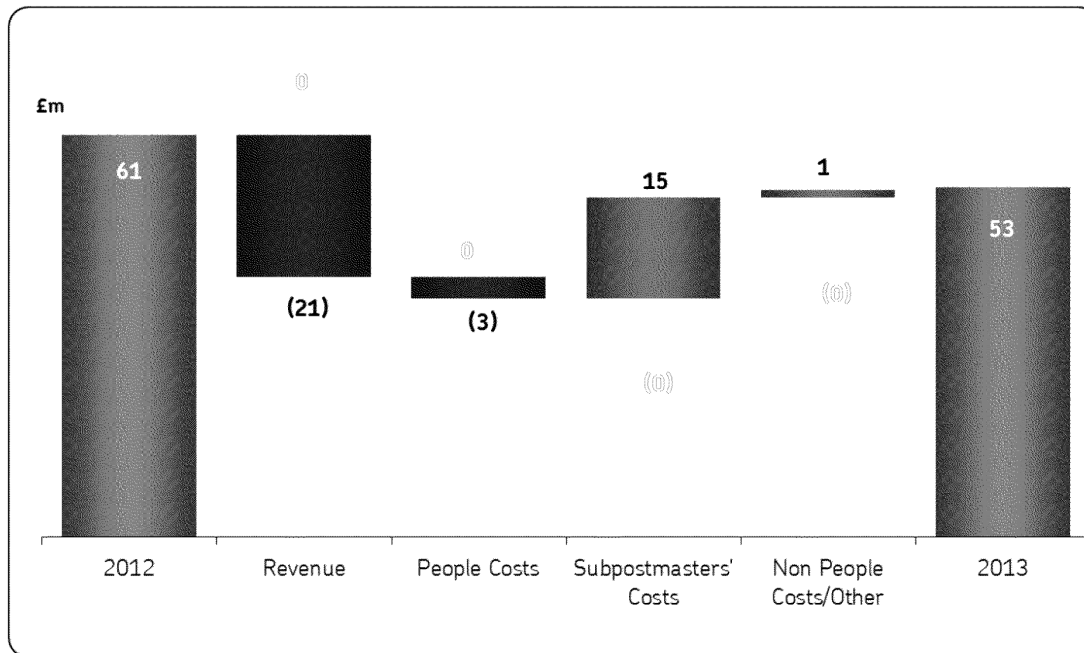
## 4.3 Post Office Limited Interim Consolidated Balance Sheet

**Post Office Limited Interim consolidated balance sheet as at:**

	Notes	29 September 2013 Unaudited £m	31 March 2013 Audited £m
<b>Non-current assets</b>			
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
<b>Total non-current assets</b>		<b>249</b>	<b>178</b>
<b>Current assets</b>			
Inventories	15.1	7	8
Trade and other receivables	15.2	269	352
Cash and cash equivalents		855	971
Financial assets – derivatives		-	1
<b>Total current assets</b>		<b>1,131</b>	<b>1,332</b>
<b>Total assets</b>		<b>1,380</b>	<b>1,510</b>
<b>Current liabilities</b>			
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)
<b>Total current liabilities</b>		<b>(925)</b>	<b>(1,187)</b>
<b>Non-current liabilities</b>			
Financial liabilities – obligations under finance leases	11.2	(4)	(4)
Other payables		(24)	(24)
Provisions	16	(5)	(7)
<b>Total non-current liabilities</b>		<b>(33)</b>	<b>(35)</b>
<b>Net assets</b>		<b>422</b>	<b>288</b>
<b>Equity</b>			
Share capital		-	-
Share premium		465	465
Retained earnings		(45)	(179)
Other Reserves		2	2
<b>Total equity</b>		<b>422</b>	<b>288</b>

## 5. Operating profit

### 5.1 Operating profit bridge analysis



### 5.2 Explanations for key movements are as follows:

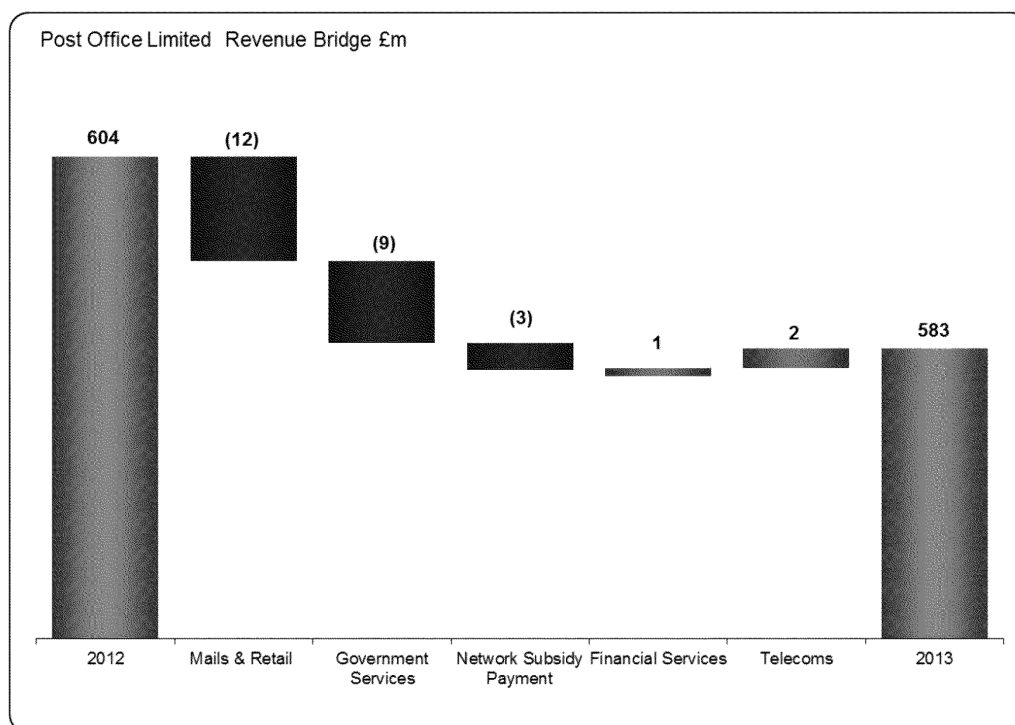
- Revenue – section 6.
- People costs – section 7.2
- Subpostmasters – section 7.3.1
- Non People Costs / Other – section 7.3.2 to section 7.3.11



## 6. Revenue

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

### 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.

## 6. Interim Report review and Ernst &amp; Young Half Year Review findings

- 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	2012-13	Variance	Volume	Price
	£m	£m	£m	£m	£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
<b>Total Variable Income</b>	<b>125.0</b>	<b>134.2</b>	<b>(9.2)</b>	<b>(9.6)</b>	<b>0.4</b>
Fixed Fee	36.2	36.6	(0.4)	-	(0.4)
<b>Total Mails</b>	<b>161.3</b>	<b>170.8</b>	<b>(9.6)</b>	<b>(9.6)</b>	<b>0.0</b>
Lottery	19.1	19.8	(0.7)	(0.7)	-
Retail	4.0	5.4	(1.4)	(1.4)	-
<b>Total Mails &amp; Retail</b>	<b>184.3</b>	<b>196.0</b>	<b>(11.7)</b>	<b>(11.7)</b>	<b>0.0</b>

## 6.1.2 Retail &amp; 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

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.

## 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 £m	2012-13 £m	Variance £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%
<b>PEOPLE COSTS</b>	<b>7.2.1</b>	<b>131</b>	<b>128</b>	<b>(3)</b>	<b>(2%)</b>
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)	-
<b>Total Other Operating Costs</b>	<b>7.3</b>	<b>422</b>	<b>437</b>	<b>15</b>	<b>4%</b>
<b>TOTAL EXPENDITURE (Pre Exceptionals)</b>		<b>553</b>	<b>565</b>	<b>12</b>	<b>2%</b>



## 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	<b>7,999</b>	7,912	<b>7,946</b>	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

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.

## 6. Interim Report review and Ernst &amp; Young Half Year Review findings

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.

- 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 (Salesforce 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



**8 Quality of Earnings**

Post Office Limited (consolidated)	Notes	2013-14	2012-13	Growth	
		£m	£m	£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.

## 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.

## 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
<b>Opening net retirement benefit surplus/(deficit)</b>	<b>99</b>	(205)
Royal Mail Pension Plan amendment	<b>102</b>	-
Transfer of pension deficit to government	-	286
Current service cost	<b>(13)</b>	(24)
Curtailment costs	-	(2)
Net financing credit	<b>2</b>	2
Employers contributions	<b>11</b>	25
Actuarial (losses)/gains	<b>(37)</b>	17
<b>Closing net retirement benefit surplus before IFRIC</b>		
<b>14 adjustment</b>	<b>164</b>	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.

#### 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]

[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.



## 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
	<b>Operating Exceptionals:</b>			
	Royal Mail Pension Plan amendment		102	-
	Government Grants	10.2	129	35
	Restructuring costs including Subpostmasters compensation	10.3	(64)	(24)
	Impairments		(35)	(21)
	<b>Total operating exceptionals</b>		132	(10)
	<b>Non operating exceptionals:</b>			
	Profit on disposal of property		2	2
	<b>Net Exceptional gain/ (costs)</b>		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

**11. Interest, Cash, Debt, Funding and Hedging****11.1 Net finance costs Sept 2013 £1m vs Sept 2012 £1m**

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

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**

<b>Net cash/debt analysis</b>	<b>Section</b>	<b>29 September 2013 £m</b>	<b>31 March 2013 £m</b>
Cash in the Post Office Limited network	11.3	<b>825</b>	870
Other cash at bank (overdraft)/deposits		<b>(26)</b>	9
Cash equivalent investments		<b>30</b>	92
<b>Total cash and cash equivalents</b>		<b>829</b>	971
Loans, repayable on demand or less than 1 year	11.4	-	(291)
Obligations under finance leases (current)	11.5	<b>(1)</b>	(3)
<b>Total current financial liabilities</b>		<b>(1)</b>	(294)
Obligations under finance leases (non-current)	11.5	<b>(4)</b>	(4)
<b>Total</b>		<b>824</b>	673

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.

## 12. Going concern

Post Office Limited has net cash and cash equivalents of £829m (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.



## 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)

## 6. Interim Report review and Ernst &amp; Young Half Year Review findings

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.

## 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:

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

## 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:

<b>Capital expenditure analysis</b>	<b>Land &amp; buildings £m</b>	<b>Vehicles, plant &amp; fixtures £m</b>	<b>Intangibles £m</b>	<b>Total £m</b>
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
<b>Total</b>	<b>2</b>	<b>15</b>	<b>18</b>	<b>35</b>

**14. Goodwill, investments and intangibles**

## 14.1 Investments in joint ventures and associates

	<b>29 September 2013 £m</b>	31 March 2013 £m
Investment in joint ventures	<b>83</b>	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.



**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
<b>Total</b>	<b>7</b>	<b>8</b>

**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.

<b>Receivables</b>	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
<b>Total</b>	<b>269</b>	<b>352</b>

**15.2.1 Trade receivables: Current (due within one year)**

<b>Trade receivables</b>	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
<b>Total</b>	<b>56</b>	<b>32</b>

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:

<b>Trade receivables</b>	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
<b>Total</b>	<b>27</b>	<b>18</b>

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:

<b>Client receivables</b>	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
<b>Total</b>	<b>156</b>	<b>240</b>

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	-
<b>Total</b>		<b>899</b>	<b>874</b>

#### 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
<b>Total</b>	<b>124</b>	<b>153</b>

Manual accruals and GRNs 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
<b>Total</b>	<b>375</b>	<b>528</b>

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:

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



## 15.4 Payables: amounts due after one year

<b>Payables due after one year</b>	29 September 2013	31 March 2013
Amounts due under finance leases	4	4
Bank of Ireland deferred income (Gamma)	24	24
<b>Total</b>	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.

**16. Provisions**

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

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

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

## 6. Interim Report review and Ernst &amp; Young Half Year Review findings

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.



**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
<b>Income tax credit reported in the condensed consolidated income statement</b>	<b>2</b>	<b>18</b>

**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.

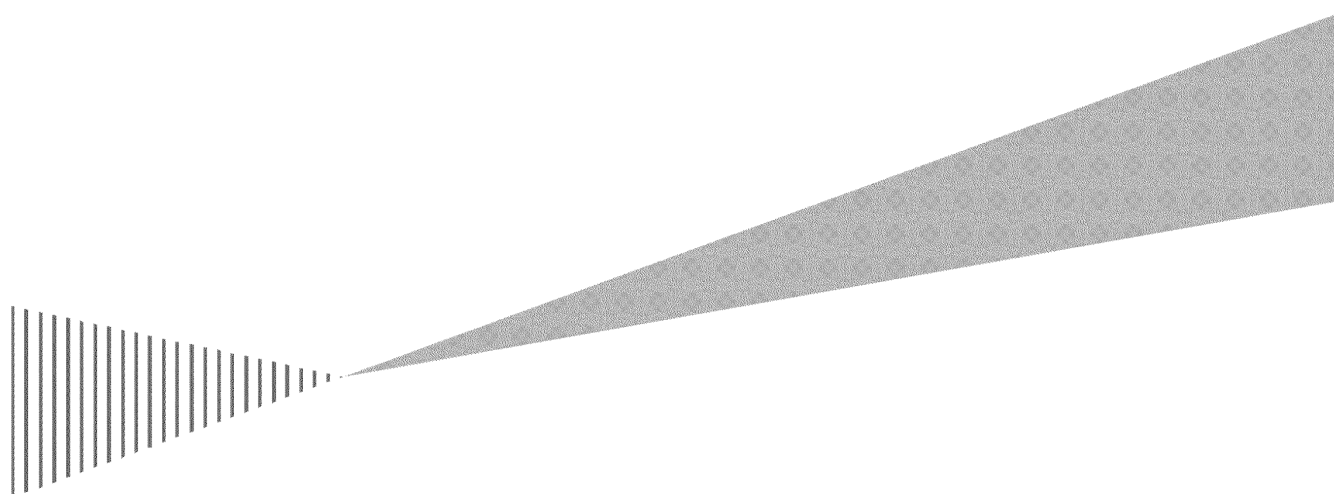
The Group (POL and subsidiaries) has significant tax losses that are available for offset against future taxable profits. It also has unrecognised deferred tax assets relating to fixed asset timing differences. These tax losses/deferred tax assets could be recognised in the future should suitable taxable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

# Post Office Limited

## 2013/14 Half year results report

For the period ended 29 September 2013

13 November 2013



6. Interim Report review and Ernst & Young Half Year Review findings



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GRO



**Private and confidential**

13 November 2013

Audit and Risk Committee  
Post Office Limited  
148 Old Street  
London  
EC1V 9HQ

Dear Members of the Audit and Risk Committee

**Half year results report – FY2013/14**

We are pleased to attach our half year results report for the forthcoming meeting of the Audit and Risk Committee. This report summarises our review findings and conclusion in relation to Post Office Limited's financial position and results of operations for the period ended 29 September 2013. Our review is designed to express a review conclusion on the interim financial information as presented for the period ended 29 September 2013.

This report is intended solely for the information and use of the Audit and Risk Committee, Board of Directors and management, and is not intended to be and should not be used by anyone other than these specified parties.

We welcome the opportunity to discuss this report with you on 19 November 2013, as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

**Angus Grant**  
Engagement Partner  
For and on behalf of Ernst & Young LLP

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6. Interim Report review and Ernst & Young Half Year Review findings

The contents of this report are subject to the terms and conditions of our appointment as set out in our engagement letter.

This report is made solely to the Audit Committee, Board of Directors and management of Post Office Limited in accordance with our engagement letter. Our work has been undertaken so that we might state to the Audit Committee, Board of Directors and management of Post Office Limited those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Audit Committee, Board of Directors and management of Post Office Limited for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.



# Contents

	Page
IAS34 half year review procedures	4
Management representation letter for half year review	9





# IAS 34 Half year review

## Introduction

During the current year, for the first time in its history, Post Office Limited ('POL') intends to issue interim consolidated financial statements for the period ended 29 September 2013, in compliance with IAS 34 *Interim Financial Reporting*. In last year's interim, Post Office issued a trading statement which was not in accordance with IAS 34, with selected disclosure information.

As a result, at the request of management, we have also been engaged to perform a review under ISRE 2410, the standard that covers interim reporting procedures.

## Objective of our review

The objective of our review is to express a conclusion whether, on the basis of the procedures performed, anything has come to our attention that causes us to believe that the interim consolidated financial statements have not been prepared in all material respects in accordance with IAS 34 *Interim Financial Reporting*, as adopted by the European Union.

## Review process

Our review of the Group's financial information for the 6 months ended 29 September 2013 was performed in accordance with ISRE 2410 (UK and Ireland) *Review of Interim Information performed by the Independent Auditor of the Entity*, as adopted by the Auditing Practices Board (APB) in the United Kingdom.

A review is substantially less in scope than an audit, because it does not include:

- ▶ Tests of accounting records by inspection, observation, or confirmation
- ▶ Obtaining corroborative evidence in response to enquiries
- ▶ Application of certain other procedures normally performed during an audit, such as tests of controls and verification of assets and liabilities.
- ▶ Our work therefore consisted primarily of making enquiries of POL's accounting and finance staff, executive management and applying analytical review and other review procedures.

Management anticipates that the half year results will be announced in the month of December 2013. Our review will express a conclusion whether, on the basis of the procedures performed, anything has come to our attention that causes us to believe that the interim financial statements are not prepared in all material respects in accordance with IAS 34, as adopted by the European Union, for the 6 months ended 29 September 2013. We anticipate issuing an unqualified review conclusion.

## Status of review

At the time of issuing this report, our review of the Interim Results is ongoing with the following items outstanding:

- ▶ Review of final interim report including front end.
- ▶ Receipt of the Letter of Representation from the Directors.
- ▶ Subsequent event procedures to be completed through the date of our review conclusion (matter to be updated include: management enquiries, review of latest management accounts, and board minute review to date of signing).

We continue to work with management in order to complete these procedures and will provide a verbal update at the Audit & Risk Committee meeting.

In the following pages, we set out a summary of the Half Year procedures performed and the results of our review.

# IAS 34 Half year review (cont' d)

## Half year review results

Procedure	Findings
Scoping, review differences & anticipated conclusion	
Interim materiality and evaluation of misstatements	<p>We calculated an interim materiality in order to:</p> <ul style="list-style-type: none"> <li>▶ Determine the extent of analytical and other review procedures to perform and evaluate the results.</li> <li>▶ Evaluate errors of misstatement or judgmental differences.</li> <li>▶ Come to a conclusion that the interim financial information is prepared, in all material respects in accordance with IAS 34 'Interim Financial Reporting'.</li> <li>▶ Determine what matters of governance interest should be brought to your attention.</li> <li>▶ Our determination of interim materiality requires professional judgement and takes into account qualitative as well as quantitative considerations implicit in the definition.</li> </ul>
Review of primary statements numbers and support	<ul style="list-style-type: none"> <li>▶ We performed an overall analytical review on both the Balance Sheet and Profit &amp; Loss account (on profit before interest, tax and exceptional items).</li> <li>▶ We noted that operating profit before exceptionals was £53.0m, down by 13% or £8.0m on the same time last year. Operating profit for the period was £185.0m, which included the gain of £102.0m arising on the change to the terms of the Royal Mail Pension Plan, which was reported under exceptional items.</li> <li>▶ Based on our discussions with management, including the financial controller, the fluctuations and variances experienced during the period are consistent with our understanding of the entity and of its financial position as of 29 September 2013. As a result of our procedures, we have not identified any previously unidentified risks of material misstatement due to fraud.</li> </ul>
Summary of review adjustments	<ul style="list-style-type: none"> <li>▶ We report one unadjusted reclassification difference for £6.1m in relation to business transformation payments, which was also reported at year-end. <ul style="list-style-type: none"> <li>▶ This error is a reclassification review difference totalling £6.1m (2012/13: £6.7m) which we believe should be reclassified from accruals to provisions. These relate to a commitment to Crown branch staff for business transformation payments. As noted in our prior year audit results report, POL has recorded this business transformation payment as an accrual rather than a provision. From our review, we believe that these payments are by nature a provision and not an accrual in accordance with IAS 37, due to the element of uncertainty of whether the Communication Workers Union will accept or reject POL's offer. There is no impact of this unadjusted review difference to the income statement.</li> <li>▶ As we did at the prior year end, owing to the quantum and materiality of the unrecorded difference, we had to internally consult on the unadjusted reclassification difference. This consultation has been concluded.</li> <li>▶ There were no other unadjusted review differences.</li> </ul> </li> </ul>
Conclusion	<ul style="list-style-type: none"> <li>▶ Based on work carried out to date, aside from the above unadjusted reclassification difference, there were no amounts that we identified that are individually or in aggregate material to the presentation or disclosures of the interim consolidated financial statements for the period ended 29 September 2013.</li> </ul>



## IAS 34 Half year review (cont' d)

### Half year review results (cont' d)

Procedure	Findings																				
Areas of audit emphasis																					
Revenue recognition	<p>In the period ended 29 September 2013, POL generated revenues of £583m (including the £100m network subsidy payment received from BIS), which was £21m lower than revenues for the corresponding period in the prior year.</p> <p>During our half year review procedures, we held meetings with management to go over management' s detailed revenue schedule, which splits out the performance for every individual sub-revenue line. We carried out a detailed analytical review on POL' s revenue lines, whilst also completing analytical reviews on POL' s deferred and accrued revenues as disclosed in the Balance Sheet. No issues were noted during the course of our review.</p>																				
Counterparty credit risk	<p>One of the significant risks that we have identified in planned our risk based approach is that there is a perceived heightened risk since the 2008 financial crisis over the credit risk exposure of counterparties, particularly the Bank of Ireland.</p> <table><tr><th>Counterparty</th><th>Exposure at 29/09/13 (£m)</th><th>Exposure at 31/03/13 (£m)</th><th>Nature of business with POL to cause exposure</th></tr><tr><td>Bank of Ireland</td><td>92</td><td>123</td><td>ATM Debtor</td></tr><tr><td>IPSL</td><td>52</td><td>14</td><td>Cheque clearing system</td></tr><tr><td>HSBC</td><td>40</td><td>56</td><td>Card payments in network</td></tr><tr><td>JP Morgan</td><td>30</td><td>76</td><td>Processing benefit settlements</td></tr></table> <p>As part of our half year review procedures, we held meetings with the Head of Corporate Finance, and noted that POL' s method of managing and mitigating counterparty risk is consistent with that at the prior year end. During the half-year, total client debtors (which are the main source of credit risk) decreased mainly due to the 2012/13 year end falling on the Easter bank holiday weekend - customer ATM cash withdrawals and benefit payments tend to be significantly higher during the holiday season. The year-end balance was also higher since receipts from key client debtors including JP Morgan, Barclays and the Bank of Ireland were delayed, which was responsible for the larger year end client debtors balance.</p> <p>Based on the procedures performed at half year, we conclude that the counterparty credit risk is periodically monitored and managed. We will continue to monitor the counterparty receivables balance at year end.</p>	Counterparty	Exposure at 29/09/13 (£m)	Exposure at 31/03/13 (£m)	Nature of business with POL to cause exposure	Bank of Ireland	92	123	ATM Debtor	IPSL	52	14	Cheque clearing system	HSBC	40	56	Card payments in network	JP Morgan	30	76	Processing benefit settlements
Counterparty	Exposure at 29/09/13 (£m)	Exposure at 31/03/13 (£m)	Nature of business with POL to cause exposure																		
Bank of Ireland	92	123	ATM Debtor																		
IPSL	52	14	Cheque clearing system																		
HSBC	40	56	Card payments in network																		
JP Morgan	30	76	Processing benefit settlements																		

# IAS 34 Half year review (cont' d)

## Half year review results (cont' d)

Procedure	Findings
Areas of audit emphasis (cont' d)	
<b>Pensions</b>	<p>For the purposes of preparing their half year IAS 34 financial statements, management have obtained an IAS 19R valuation of the pension fund surplus for their RMPP scheme, for the period ending 29 September 2013. This valuation indicated a net pension surplus of £143m for the RMPP scheme, which is net of £21m withholding tax of 35% on the element of the surplus which is recoverable through a refund from the plans. POL also recognised a £2m net surplus relating to their RMSEPP at half year end.</p> <p>During the period, there was a consultation exercise with members of the defined benefit RMPP scheme, on proposed changes to the terms of the scheme. The key change was to the definition of pensionable pay, which, broadly speaking, will increase in line with RPI, but will be capped at 5% in the future, regardless of actual pay growth. The impact of these changes has been to increase the defined benefit surplus by £102m. Management treated this as a "settlement" under IAS 19R, which is "a transaction that eliminates all further legal or constructive obligations for part or all of the benefits provided under a defined benefit plan", and accordingly recognised this in the income statement as an exceptional gain. The exceptional gain is supported by calculation by Towers Watson, who included this in their actuarial valuation report at half year-end. We concur with management's approach to account for the gain.</p> <p>Our review during half-year has included us involving our own actuarial specialists, who have been established members of our audit team since last year's audit. As part of our review, we also held a meeting with the Company's actuaries. We reviewed the key assumptions that underpin the value of the pension obligation at 29 September 2013, and note that the discount rate 4.6% (4.8% in March 2013), RPI 3.3% (3.3% in March 2013), CPI 2.3% (2.3% in March 2013) and the expected rate of non-promotional salary increases 3.3% (4.3% in March 2013) are within the range of assumptions that we would deem reasonable based on our analysis.</p> <p>Management also noted that the transition to IAS 19R and the difference in accounting for interest on plan assets and unvested past service costs did not have a material impact on the net defined benefit plan surplus (less than £1m).</p>
<b>Classification of exceptional costs</b>	<p>Continuing the trend from the previous year, POL continues to have significant exceptional items relating to network transformation &amp; restructuring (£64m in the current year to date), impairments (£35m in the year to date). These were offset by the government grant of £129m, and the Royal Mail Pension Plan amendment gain for £102m, which management has treated as offsetting exceptional gains. This results in a net credit in exceptional items of £132m (2012: £10m net costs). We concur with the accounting treatment and note this is in line with IFRS.</p> <p>The items included within network transformation costs and restructuring costs are consistent with those reported as exceptional in prior years and continue to meet the Group's definition of exceptional costs and guidance from the accounting standards. The only new type of addition to exceptional costs during the year to date was relating to separation costs (£2m), relating to the separation between RMG and POL, which, owing to the one-off nature of the events giving rise to them, were deemed appropriate by management to include as an exceptional item.</p> <p>POL also has a number of exposures that are reflected in the financial statements at each year end. Total provisions have increased from £26m to £30m in the half year ended. We reviewed the breakdown of provisions as at the current half year end, including movements since the prior year. From our meetings with management, we noted that the assumptions used remained appropriate for the half year accounts, noting no issues.</p>



# IAS 34 Half year review (cont' d)

## Half year review results (cont' d)

Procedure	Findings
<b>Areas of audit emphasis (cont' d)</b>	
<b>Corporation Tax</b>	<p>In the half year to 29 September 2013, POL recorded a deferred tax credit of £2m in the income statement and a deferred tax charge of £2m in OCI, both relating to movements on the element of the RMPP pension surplus expected to be recovered through a reduction in future contributions.</p> <p>POL does not expect to be in a tax paying position for the full year. Consistent with the position at 31 March 2013, POL has only recognised deferred tax assets up to the value of the deferred tax liability in respect of pensions, leaving a net deferred tax balance of nil. The remaining potential deferred tax asset balances are not recognised due to uncertainty around the availability of future taxable profits.</p> <p>We have reviewed the full year forecast tax calculations and the allocation of the deferred tax figures in respect of pensions, and made enquiries of management and Wilkins Kennedy, who assisted the POL finance team in the preparation of the figures.</p>
<b>General review procedures</b>	
<b>Review all board meeting minutes in the half-year</b>	<ul style="list-style-type: none"> <li>▶ We have reviewed all the meeting minutes for all board meetings up to the latest date at time of issuance of this Report, being the Pensions Sub-committee on 7<sup>th</sup> October 2013. No further issues to note. We will obtain meeting minutes for all board meetings up to date of releasing our review opinion for the half year financial statements.</li> </ul>
<b>Review of current material litigation &amp; regulatory fines, compensation and accruals.</b>	<ul style="list-style-type: none"> <li>▶ The POL finance team provided us an update on all material provisions and exceptional costs in the business incurred during the half-year. We noted that no material provisions or exceptional costs were incurred or booked in relation to litigation and regulatory fines.</li> <li>▶ We made enquiries of POL's legal counsel to gain an update of POL's litigation and compliance with laws and regulations since year-end, with no issues noted.</li> <li>▶ We discussed the Horizon subpostmaster claim with POL's legal counsel and financial controller. It was noted that management had not made any reserve related to the Horizon subpostmaster claim to date and have assessed they did not require to make one. Based on our discussion with management, we agree that their view appears to be reasonable. We also discussed the progress on the legal situation concerning POL potentially having to pay a separate business tariff on its ATMs in retail premises. A provision had been made in the March 2013 financial statements for £1.7m. Management and legal counsel continue to believe the likelihood of paying these backdated business tariffs is highly probable, and have increased the half year end provision to £2.0m. Based on discussion with management, we agree that their view appears to be reasonable.</li> <li>▶ We will continue to revisit and gain updates from management on the situation through the audit.</li> <li>▶ We also reviewed the minutes of all board meetings and sub-committees and noted there were no other material litigation claims or regulatory claims that management should consider providing for.</li> </ul>

# Management representation letter for half year review

Angus Grant  
Ernst & Young LLP  
1 More London Place  
London  
SE1 2AF

xx December 2013

Dear Sirs

## Post Office Limited

This representation letter is provided in connection with your review of the condensed consolidated balance sheet of Post Office Limited as of 29 September 2013 and the related condensed consolidated statements of income, changes in equity and cash flows for the six-month period then ended for the purposes of expressing a conclusion whether anything has come to your attention that causes you to believe that the interim financial information is not prepared, in all material respects, in accordance with International Financial Reporting Standards as adopted by the EU.

We acknowledge our responsibility for the preparation and presentation of the interim financial information in accordance with International Financial Reporting Standards as adopted by the EU.

We confirm, to the best of our knowledge and belief, the following representations:

- a) The interim financial information referred to above has been prepared and presented in accordance with International Financial Reporting Standards as adopted by the EU.
- b) We have made available to you all books of account and supporting documentation, and all minutes of meetings of shareholders and the board of directors.
- c) There are no material transactions that have not been properly recorded in the accounting records underlying the interim financial information.
- d) There has been no known actual or possible noncompliance with laws and regulations that could have a material effect on the interim financial information in the event of noncompliance.
- e) We acknowledge responsibility for the design and implementation of internal control to prevent and detect fraud and error.
- f) We have disclosed to you all significant facts relating to any known frauds or suspected frauds that may have affected the entity.
- g) We have disclosed to you the results of our assessment of the risk that the interim financial information may be materially misstated as the result of fraud.
- h) We believe that the effects of any unadjusted review differences, summarised in the accompanying schedule, accumulated by you during the current audit and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.
- i) We confirm the completeness of the information provided to you regarding the identification of related parties.

## Management representation letter for half year review (cont' d)

- j) The following have been properly recorded and, when appropriate, adequately disclosed in the interim financial information:
- Related party transactions, including sales, purchases, loans, transfers, leasing arrangements and guarantees, and amounts receivable from or payable to related parties;
  - Guarantees, whether written or oral, under which the entity is contingently liable; and
  - Agreements and options to buy back assets previously sold.
- k) The presentation and disclosure of the fair value measurements of assets and liabilities are in accordance with International Financial Reporting Standards as adopted by the EU. The assumptions used reflect our intent and ability to carry specific courses of action on behalf of the entity, where relevant to the fair value measurements or disclosure.
- l) We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities reflected in the interim financial information.
- m) We have no plans to abandon lines of product or other plans or intentions that will result in any excess or obsolete inventory, and no inventory is stated at an amount in excess of realizable value.
- n) The entity has satisfactory title to all assets and there are no liens or encumbrances on the entity's assets.
- o) We have recorded or disclosed, as appropriate, all liabilities, both actual and contingent.

To the best of our knowledge and belief, no events have occurred subsequent to the balance sheet date and through the date of this letter that may require adjustment to or disclosure in the aforementioned interim financial information.

---

Christopher Day

Chief Financial Officer

## Notes

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.



## 6. Interim Report review and Ernst &amp; Young Half Year Review findings

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**Strictly Confidential****POST OFFICE AUDIT, RISK AND COMPLIANCE COMMITTEE****Update on various Financial Services matters, including Bank of Ireland (UK) plc capital & liquidity****1. Purpose**

1.1 The purpose of this paper is to update the Committee on the:

- Bank of Ireland (UK) plc's ("Bol") capital and liquidity position against its regulatory and Eagle contract requirements;
- Prudential Regulatory Authority's (PRA) stress testing framework for the UK banking system and potential impact on Bol;
- Financial Services sales strategy development;
- Financial Conduct Authority's (FCA) forthcoming review of the Post Office mortgage strategy; and
- Project Polo.

**2. Bank of Ireland (UK) - Capital and Liquidity position**

2.1 Under the Financial Services Joint Venture Agreement ("FSJVA"), Bol must attest that it is meeting the capital and liquidity levels set out in the agreement. This is part of the early warning system that would enable the Post Office to take action within the termination provisions, should this become necessary.

2.2 Bol has confirmed that it continues to meet its obligations during 2013, providing certificates on 27<sup>th</sup> March, 3<sup>rd</sup> June and 23<sup>rd</sup> August that, on each occasion:

- Bol's Core Tier 1 Capital Ratio exceeded the amount required in the FSJVA;
- Bol was holding a surplus over its regulatory liquidity requirements;
- Bol is meeting the Capital Planning Buffer as set by the regulator.

2.3 Post Office is of the view that Bol remains well capitalised with surplus liquidity.

2.4 The public rating agencies' ratings of Bol's parent (BoIG) are stable, but remain a grade below "investment-grade, viz:

- Moody's - Ba1 with negative outlook (April 2013) – this is the same as Bol;
- S&P - BB+ stable outlook (July 2013) - revised up from negative.

2.5 BoIG's financial position continues to improve. Recent announcements include:

- September 2013 – raising €500m of 7 year long term Irish covered bonds/assets covered securities. The offer was significantly over-subscribed, confirming that BoIG has access to the long term capital markets.
- August 2013 - BoIG's net interest margin rose 31 basis points to 165 bps in the six months to June and reached 190bps for the three months to September; this is on track to reach the public target of 200bps. Underlying losses fell to €383m from €933m in the previous year. Excluding provisions of €780m, BoIG made an operating profit of €380m.
- July 2013 – BoIG has had its proposed changes to the EU restructuring plan approved, allowing it to retain the Irish Life business but exit UK commercial and corporate banking and intermediary mortgages in Ireland.

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- October 2013 – BoIG announced agreement with the IBOA<sup>1</sup> to change the Bank's major defined benefit pension scheme. The resolution amends benefits, reducing IAS 19 deficit by approximately €400m.
- As at 30<sup>th</sup> June 2013 BoIG had €72bn of customer deposits of which €26bn were held in the UK, with Post Office customers accounting for 72.7% (€19bn) of the UK balance sheet and 26.4% of the Group's deposits.
- BoIG's residential mortgages (before provisions) were €52.25bn of which €25.14bn were held in the UK.

**3. PRA's stress testing framework for the UK banking system**

- 3.1 In March 2013, the Bank of England Financial Policy Committee recommended that the PRA develop proposals to stress test UK banks. The approach would provide a quantitative, forward-looking assessment of the capital adequacy of the system and of individual institutions.
- 3.2 In October the PRA issued a Discussion Paper setting out the methods and scenarios it would follow.
- 3.3 If the stress-testing changes BoIG's capital and liquidity requirements, BoIG will be required to certify to the Post Office that it is meeting any new standards.

**4. Update on Financial Services sales effectiveness**

- 4.1 The new FS sales and supervisory structure is now operational:
  - There are 274 Financial Specialists (FS) in the network, with 2 FS Regional and 35 FS Area Managers appointed (with 32 accredited and live).
  - 76 offers have been made to Mortgage Specialists (MS); all MSs will complete Mortgage Market Review training to meet the new regulatory requirements from April 2014.
  - We are piloting a limited deployment of FSs in agencies. These FSs are subject to Post Office's new supervisory structure.
  - We have begun the roll out of the new sales process, focusing on understanding customers' needs, supported by a new incentive scheme covering MSs, Financial Services and Crown Regional and Area Managers<sup>2</sup>. The new incentive scheme for FSs is being developed for deployment in January 2014 (deployment has been delayed by a lack of engagement from the CWU)<sup>3</sup>.

**5. FCA's review of the Post Office mortgage strategy**

- 5.1 As part of the FCA's regular oversight of BoIG, it has notified the Bank that it intends to conduct a "deep dive" assessment of the BoIG-Post Office mortgage strategy. This will assess whether BoIG has appropriate governance arrangements in place to ensure sufficient consideration is given to the customer in the formulation and implementation of the branch mortgage strategy.
- 5.2 In making its assessment, the FCA will seek to understand:

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<sup>1</sup> Irish Bank Officials Association.

<sup>2</sup> All these managers fall within CMA linked, or higher, grades.

<sup>3</sup> A briefing paper on the new incentive structure is due to be presented to the Post Office Board in November.

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- Bol and POL's strategy development process, including its consideration of customers' interests against the commercial needs of the business;
  - The effectiveness of the governance arrangements for the implementation and oversight of the strategy;
  - The identification and mitigation of conduct risks which could lead to customer detriment; and
  - The communication of the strategy and conduct standards to front-line staff.
- 5.3 The FCA assessment will comprise:
- an analysis of documentation;
  - interviews with key Bol and Post Office executives; and
  - a visit to a Post Office branch.
- 5.4 Bol is currently collating the necessary information and notifying individuals that they will be interviewed by FCA. All interviewees will be accompanied by a member of the Bank compliance team.

**6. POLO update**

- 6.1 The Proof of Concept trial (launched 13<sup>th</sup> May) has generated 1,623 applications and 818 sales, with a further 80 in the account opening referral process.
- 6.2 An extensive risk governance structure is in place for product sales, including post-sale customer care calls, mystery shopping and regular engagement with the FCA/PRA (including an FCA branch visit).
- 6.3 The FCA focus continues to be on Packaged Accounts. Following a branch visit it advised that Health Declaration questions for travel insurance should be delivered orally by branch staff – this has been adopted. More recently the FCA has challenged banks to advise customers when they have dual insurance with the same provider – Post Office is working with Bol to develop a solution that meets the FCA's requirements.

**7. Recommendations**

- 7.1 The Committee is asked to note the update.

**Nicholas Kennett**  
**Director, Financial Services**  
**November 2013**



**STRICTLY CONFIDENTIAL****POST OFFICE AUDIT, RISK AND COMPLIANCE COMMITTEE****Information Security and Assurance Group  
Brands Database Update****1. Purpose**

- 1.1 The purpose of this paper is to provide the Committee with an update on the current state of the controls framework and future plans for the Brands<sup>1</sup> Database and subcontractor.
- 1.2 Brands is managed by Marketing who liaise and assign work with the prime supplier of these services - RAPP<sup>2</sup>, and engage with specialist marketing analytical suppliers under RAPP's direction. Marketing are supported by the Information Security and Assurance Group who undertake some due diligence exercises in these activities.

**2. Background**

- 2.1 ARC have specific concerns around the Brands Database as it is the Post Office's largest database of personal information; which includes approximately 30 million records. Furthermore, ARC acknowledges that there is a heightened level of risk due to the sensitivity of information held, the number of records, and potentially the suppliers of marketing services.
- 2.2 Due to the nature of the Brands Database, a Control Framework is maintained by Marketing which has recently been reviewed by Information Security and Assurance.
- 2.3 The records for the Brands Database are generated from a number of services provided by our suppliers, these include:
- Bank of Ireland and their product suppliers;
    - (i) Family
    - (ii) Junction
    - (iii) NIIB
    - (iv) Aviva
    - (v) Aegis
  - Aon;
  - FRES;
  - Cap Gemini;
  - HP; and
  - Fujitsu Homephone and Broadband.

**3. Current State of Brands, RAPP and Draft FCB**

- 3.1 RAPP maintains the records from the Brands Database; there are also a number of specialist service providers in the RAPP supply chain. These are listed within the Brands Control Framework. Information Security and Assurance have recently reviewed the Control Framework and have noted some gaps which unless resolved increase the risk of data loss.

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<sup>1</sup> Brands is the Post Office Marketing Database containing all customer (personal data) and product records.

<sup>2</sup> RAPP is the prime supplier of Post Office Marketing Services and holds the complete Marketing Database

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- 3.2 RAPP is ISO27001<sup>3</sup> certified, and subject to Post Office Information Security Standard due diligence, which includes a regular Information Security Management Forum (ISMF) between Post Office and RAPP representatives. The purpose of the ISMF is to discuss risks, issues, incidents and on-site reviews. Despite these assurance activities there have been some Data Protection incidents over the last 6 months, which have been investigated by Post Office Information Security and Privacy and Data Protection and have been found to be as a result of RAPP employee error. Marketing have therefore concluded that they may have to exit their contract with RAPP, refer to Appendix B for Exit Report.
- 3.3 Further to this, Information Security were requested to undertake a review of DraftFCB<sup>4</sup>, a recent addition to the RAPP supply chain and a specialist supplier of marketing analysis and services. DraftFCB lists Post Office as one of its many high profile clients on its website; it is owned by Interpublic Group (IPG)<sup>5</sup> and is globally compliant to Sarbanes Oxley (SOX).
- 3.4 An on-site review of DraftFCB was conducted by Information Security and Assurance in October where their designated global CISO was in attendance. It was found that DraftFCB already have access to some aspects of the Brands Database, via RAPP. It is currently understood that this data is anonymised, although some DraftFCB staff have intimated that there is indeed sensitive Post Office Data included that has not been anonymised.
- 3.5 Although the report is in Draft status an interim view has been provided to Nick Fox – Senior Manager, Customer Management. It is recommended that there should be no further sharing of Post Office information until they are fully compliant to Post Office information Security Standards (including Privacy and Data Protection requirements).

**4. Future Plans**

- 4.1 Marketing are currently producing an exit plan from the RAPP contract which looks to exit by December 2014. See Appendix A.
- 4.2 Marketing is considering next steps for their relationship with DraftFCB, however, this will have to be dealt with cautiously, particularly, if it is found that they do have access to Post Office sensitive data. Recent meetings with Nick Fox have resulted in him meeting DraftFCB; armed with Information Security and Assurance advice to not share any further information with DraftFCB until they have resolved the issues that were found and to ensure any data they currently have is secured.
- 4.3 The Head of Information Security and Assurance has engaged with Martin George the new Head of Commercial, who is fully supportive and understands the need to utilise the specialist skills within Information Security and Assurance. Martin George has directed his team to engage with Information Security and Assurance to ensure that appropriate risk assessment and mitigation is implemented, and that the Brands Control Framework is fit-for-purpose. This activity will assist in raising confidence in the Control Framework and provide an audit trail of steps taken to protect Post Office Customer Personal Data.

<sup>3</sup> ISO27001: An International Standard covering the specification and management of an organisation's Information Security Management System. The guidelines and general principles for initiating, implementing, maintaining and improving information security management within an organisation.

<sup>4</sup> DraftFCB - <http://www.draftfcb.co.uk/> is providing specialist marketing services to Post Office Marketing

<sup>5</sup> Interpublic Group (IPG) <http://www.interpublic.com/> Parent company of Draft FCB

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**4.4 Actions underway:**

- Assign an Information Security and Assurance consultant as a 'point of contact' for Marketing.
- Provide Marketing with a complete review and update of the Brands Control Framework - end November 2013
- Marketing to set up a 'Show and Tell' about their activity to ensure that other projects are addressed.
- Interaction with Company Secretariat to ensure that new and renewed contracts have input from Information Security and Assurance before signature. This is currently underway and was part of the Company Secretariats intention to review their processes. An update is planned for 13<sup>th</sup> November 2013.

**5. Request**

**5.1 ARC is asked to note the content of this paper:**

**Julie George**  
**Head of Information Security and Assurance**  
**November 2013**

**STRICTLY CONFIDENTIAL****Appendix A - RAPP Exit Report (Written and instigated by Marketing)****Background**

Rapp is an external supplier used by POL to manage the Brands Database which hold all the POL customer data and is used for direct marketing and Call Centre background information.

Rapp also runs the direct marketing campaigns for POL

**Incident Summary**

During the period April 2013 to July 2013 there have been 3 incidents caused by human error by Rapp staff:

1. An unencrypted email attachment containing personal client details of 2,322 individuals, was sent 10/04/13 from Rapp to HiFX, (supply/management of International Payments), copying in Firstrate (FRES) and POL.
2. An erroneous Travel Money e-mail sent 31/05/13 by Rapp to 559,900 POL customers, advising that travel money is ready for collection at the POL branch. These customers had not reserved travel money. If the error had not been identified by POL the e-mail would have gone to 3.3m POL customers.
3. Erroneous Travel Insurance and Travel Money e-mails sent between 24/07/13 and 04/08/13 by Rapp to 2,707 Travel Money POL customers and 1,150 Travel Insurance POL customers, advising that the wrong product has been purchased and try to cross-sell the product they have already purchased.

**Contractual Position**

Rapp is a Data Processor for POL, and they have signed the new contract with Information Security and DP House Position Clauses. There is therefore no ambiguity regarding the DP relationship.

The contract was renewed in April 2013 and runs to April 2015, but with 6 months break clause from May 2014.

**Risk Assessment**

For each of the incidents it was the POL opinion that the incident would **not** be required to be reported to the ICO, in line with their guidance.

Despite none of these incidents requiring notification to the Information Commissioner, it would look bad for POL if there was to be an incident that comes to the attention of the Information Commissioner. The Information Security Committee has requested that an Exit Report to be presented at the 08/10/13 meeting.

**Risk Mitigation**

Rapp has implemented a new Management control, which is performed prior to any campaigns being broadcast. In addition POL is creating a Brands Controls Framework, which will document control gaps and recommend controls gap remediation.



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## Exit Strategy options

1. Continue with the current Rapp contract – **not recommended**

POL could continue to utilise the Rapp services until the end of the current contract (April 2016).

This is viewed as having too high a risk from an Information Security, Data Protection and Marketing perspective.

2. Utilise the Customer Management Programme as an exit – **recommended**

The Customer Management Plan to further develop POL's Customer Management capabilities was endorsed by the ExCo on 20th August but not yet authorised by the POL Investment Committee (POLIC).

A key element of the Customer Management Plan is the decommissioning of the Brands database once it has been replaced by Single Customer View (SCV) on the Common Digital Platform (CDP).

The CDP will be available for development from February 2014. All the Data Centre (DC) Tower Services will as part of IT&C Transformation be available from June 2014 to September 2014.

It will therefore be possible to implement SCV by October 2014, with a 6-month parallel running with the Brands database.

3. Interim solution prior to Customer Management Programme – **not recommended**

It will not be possible to develop an interim solution significantly faster than the SCV solution, because of the complexity of the customer data needing to be loaded.

4. Terminate the Rapp Contract now – **not recommended**

To terminate the Rapp Contract with immediate effect will cost (Legal to confirm cost – not available as at 12/11/2013) in penalties.

It will also make it impossible for POL to conduct direct marketing and provide the Call Centre background information.

## Next Steps

1. Business and Information Security Committee sign-off for the Exit Plan
2. Completion of the Brands Controls Framework
3. Implementation of SCV.
4. Decommissioning of Brands and the permanent removal of all data.

Ole Christensen 11/09/13

**POST OFFICE LTD AUDIT, RISK AND COMPLIANCE COMMITTEE****Internal Audit – Activity Update****1. Purpose**

The purpose of this paper is to:

- 1.1 Update the Committee on the outcome of the POL IA audit activity since the previous
- 1.2 Outline the planned, requested and proposed audit and advisory work for Q3/Q4
- 1.3 The committee is requested to note and provide directions as necessary.

**2. Outcome of recent audits**

- 2.1 Branch Audit. – Outcomes. Challenges presented in the audit review are input to the wider considerations of future training and branch review arising from the Second Sight work
- 2.2 As reported at the ARC in September, internal audit work on the efficiency and effectiveness of the function itself was completed in August 2013 with a primary recommendation to management that the future direction needed to be confirmed (see appendix 1). This report was followed up with a separate paper prepared for the October Executive Committee so that an agreed position would be reported to the November ARC.
- 2.3 However it proved essential for the business to consider its options in light of the recommendations arising from Second Sight and the options for the currently combined FSA audit./training. The paper on options for branch audit is thus an input to the Executive Committee to consider the implications of these. The reason being that a broader set of issues need to be considered of which the future of branch auditing would be a part.
- 2.4 At the time of writing, POL IA is in discussion with Executive Committee members.
  - A copy of the original audit summary is in the appendix but ARC members are advised that this report was focused purely on the operation of the function.
  - A separate draft paper is under review. Whilst the initial audit report outlined several structural options which are included in the Executive Committee paper, this includes a recommendation for the building and implementation of a higher skilled and broader focused Retail Audit capability. This would require a full capability assessment, transitional costs and training which would probably require a 12-24 month implementation period.

## 2.4 Summary of other recent audit activity and outcomes since last Audit Committee.

Business Area reviewed	Assurance	Outcomes	Key Risks impacted
<p><b>Software Licensing Management</b></p> <p><i>The committee is directed to the Executive Report Summary in the Appendix</i></p> <p>This is a significant risk which management is now engaged on including the issues arising from the privatisation of Royal Mail under which the licences originally operated and were managed.</p> <p>This is part of the Separation programme and needs to reflect the transition of IT services to the System Integrator (ATOS) and Towers model.</p> <p>Overall there were 11 agreed actions of which 7 were rated as red and 4 as amber. The major actions agreed are shown here.</p>	Low	<p>As a result of the audit, the business, under the direction of the CIO will:</p> <ul style="list-style-type: none"> <li>Define its own software licensing policy and include clear roles and responsibilities for POL and the Service Integrator and Service Desk (SSID) - recently awarded to Atos.</li> <li>Assign the ownership and governance of Software licensing immediately to POL's Support and Service function.</li> <li>Ensure that Atos will apply the key operational requirements for managing software licenses once Atos is fully on board.</li> <li>Ensure that POL Procurement will remind the business that <u>all</u> software licences must be procured via the Procurement teams and not directly by the functioning department.</li> <li>Define a governance and management process to gain on-going day to day assurance over software licensing.</li> <li>Deploy that process over the SSID</li> </ul>	<p>Operational, and Regulatory risks.</p> <p>IT &amp; Change Level risks impacted (Based on current risk map – Sept 2013)</p> <p>- Not specifically identified.</p> <p><u>Executive Level Risks impacted:</u> (based on current risk map)</p> <p>Non compliance with regulatory or contractual obligations.</p>

Business Area reviewed	Assurance	Outcomes	Key Risks impacted
<b>Local Area Network – Access and Identity Management</b>  <i>The committee is directed to the Executive Report Summary in the Appendix.</i>  As security on POLSAP and Horizon was heavily examined both internally and externally in 2012/13, the POL IA Audit plan focused on how access to the local area network (laptops, desktops etc.) was managed and controlled.  Overall 21 specific actions were agreed. Of these 13 were rated as red and 9 as amber.	Low to Medium	<ul style="list-style-type: none"> <li>The Information Security Assurance Group will work with HR to better define the access rights based on roles and job needs for access via the LAN</li> <li>A process will be installed to ensure access rights will be reviewed when employees change function/role.</li> <li>A periodical review of users LAN access rights will be put in place.</li> <li>Leavers access will be disabled on a timely basis and a process to confirm recent leavers and check access will be implemented.</li> <li>The governance of the IAM process will be defined as part of the Future Operating model, defining clear roles and responsibilities for POL, SISD and towers (e.g. EUC).</li> </ul>	Information Security Risks (Confidentiality, Integrity, Availability)
<b>Finance Road Map – new system (CFS)</b>  <i>Internal Audit maintains an on-going audit presence in this programme. This includes examination of processes, key documents and controls, programme governance, risk management and attendance at selected key meetings.</i>  As appropriate IA issues a “highlight” report to the		Risk Management Improvements. Under the management of the Programme manager and oversight by the Programme Board, the programme will:  Risk Management: - <ul style="list-style-type: none"> <li>Re-establish the monthly process to update the top level risk map, showing any movements or new risks for the FRP Board to consider.</li> <li>A weekly process will be established to discuss top level and project level risks and the associated risk and action table with the rest of the team. This should incorporate updated risks from Project Server</li> </ul>	An on going Assurance level was not provided in this highlight memo.  The key risks related to:  Programme risks not being effectively communicated and discussed at the FRP Board level leading to false levels of assurance.  Decision making across the programme.



Business Area reviewed	Assurance	Outcomes	Key Risks impacted
<p>Programme Board.</p> <p>The latest was issued in late September 2013 and covered IA work on risk management, Programme governance and Financial elements.</p>		<ul style="list-style-type: none"><li>• A risk and action table should be maintained</li><li>• All risk issues discussed or raised at FRP board meetings will be documented and the risk map and action table updated accordingly. .</li></ul> <p>Governance</p> <ul style="list-style-type: none"><li>• The Design Authority Terms of Reference will be reviewed to reflect any changes in remit and membership. Changes should be approved by the Programme Board.</li><li>• DA meeting efficiency of meetings will be improved including ensuring meeting minutes are complete and accurate.</li><li>• The Programme Board Terms of reference will be reviewed to confirm scope and approval authorities and quorate.</li></ul> <p>Finance</p> <ul style="list-style-type: none"><li>• Programme finances, specifically run/burn rates will be reviewed on a regular basis and reported to the Programme Board.</li><li>• Savings and reallocation of spend will be discussed with POL Finance teams in accordance with POL Finance procedures.</li></ul>	<p>Clarity of financial spend.</p>

### 3. Other Programmes and Project Assurance work

- 3.1 As the resource assigned to include Programme Assurance work as part of their remit has been conducting the Treasury Audit as part of the agreed audit plan, planned preparation for review of another of the transformation board programmes has yet to take place.
- 3.2 As recently communicated separately to the ARC members, the current IT audit plan will be amended to allow the IT audit manager to devote significant audit time in the rest of the 2013/14 programme to providing independent assurance over the transition to the SSID (ATOS). This transfer should be complete according to management plans by April 2014 and is a high risk area. The ARC members have supported this change.
- IT audits in POLSAP and HR SAP security have been dropped from the current year's programme along with the review of Information Security Governance. The proposed review of IT Change Management will be reassessed in January 2014.
- 3.3 Experience since the establishment of POL IA has proven is not resourced to review each programme within the overall Transformation Programme as well as conduct assurance work in other higher risk non – programme/project parts of the business. POLIA has so far (since mid June 2013)
- Reviewed the effectiveness of the SPMO as reported in September as this is an entity level control over the programme of change.
  - Established project assurance over the FRP programme and is reporting on an on going basis as this was the first of the targeted three programmes to review in 2013.
  - Identified the IT transition work as a high risk priority and has commenced planning as highlighted above.
- 3.4 In light of further discussions with the ARC chair in early November 2013 POL IA will
- Consider how some assurance over the CTP and NTP programmes can be obtained. This will require the Audit Manager who focuses on Supply Chain and Network to postpone planned reviews of the business continuity programme and review of the branch profile model (run by the Security department) into next year's plan. This work would be done jointly with the Audit Manager for Programmes and Projects.
  - Given the ARC priorities about risk management across the business A proposed review is an overall assessment of the risk processes and management at Transformation Board/SPMO and within transformation projects. This will enable IA to obtain a view on a specific theme without the need to get closely involved in a fuller programme assurance review.
  - As part of the planning for 2014/15 IA will review and document an overall assurance map of the Transformation Programme for future discussion with the ARC members and management. An assurance map shows where all types of assurance come from of which Internal Audit is one source, albeit the most independent one.

**4. Current Activity and Q4 planning**

4.1 The following audit and advisory work is underway.

Treasury Review

- The governance, risk management, processes and controls employed by the recently established POL treasury function following the separation from Royal Mail. Review of the process, controls, decision making and authorisation for managing the amount of cash to be held in the branch network vs. balances in cash centres or with the Bank of England. (Optimisation of interest earnings vs. sufficient stock in the network risk)

4.2 Swindon Stores -

- Swindon is a core operational site supporting the valued and non valued stock distribution across Post Office. It was last reviewed in 2010. Some parts significantly automated others manual. Key risks include security, financial loss, continuity to branches and general operations.

4.3 Items planned for Q4 per original 2013/14 plan

- Benefits Realisation - A review of the overall approach for transformation, and application of guidance issued to selected individual projects, and the measurement methods being used. The risk is that projects and programmes don't apply sufficient data/metrics before and during the programme to enable the project to be properly assessed during and post implementation"
- Re-Assessment of Programme Assurance coverage.
- Assessment of the 2<sup>nd</sup> line defence function – Supply Chain Compliance team. This team reports to the Supply Chain Director as part of Network and Sales Directorate. It is mainly focused on compliance to ISO standards for external assessment and accreditation.
  - Examination of the depot/cash centre auditing processes. Assessment of scope, coverage and auditing techniques. Assessment of the degree of assurance that the board can obtain from current approaches.

4.4 Items now under review for either consideration in final quarter or postponement to 2014/15 from original plan.

- Business Continuity Readiness Assessment. Assessment of the actual plans in place across key operational and business sites in POL.
  - Whilst a project is underway to establish a full Business Continuity Management, process and policy, documents and plan exist in various locations. The audit will determine the company's

readiness and ability to react quickly after notification of a major incident. Review of current in progress BCM policy and procedures and future plans. Link to management of company reputation. Includes IT Disaster Recovery/Incident management"

- Social Media – management of reputational and security risk. Social media presents opportunity for Post Office. The immediacy of social networks and tools and instant communication increases the risk of reputational damage either maliciously or unintentionally. Review of company policy over usage by communications staff and general staff and its application. - Assessment of the residual risk facing the organisation.
- IT Change Management – as indicated above and the IT Security testing.
- Information Security Governance. (POLIA have on going involvement with the revised team and committees)

## 5. 2014/15 Internal Audit plan

- 5.1 Commencing in November and running through to January, the IA team will be building the 2014/15 internal audit plan for approval at the February 2014 ARC. The plan will follow normal processes and will include use of the emerging risk management framework, current control frameworks allied to it, discussions with senior management, items identified by POL IA itself and items raised by ARC members.

## 6 Summary of above

- Complete Treasury and Swindon audits.
- Commence IT Transition to Atos programme assurance
- Re-assess programme assurance activity for remainder of year
- Commence proposed overall risk assessment review of Transformation programmes
- Commence audits of Benefits Realisation, Supply Chain Compliance team
- Continue with project assurance work on the FRP programme ( now in Build phase).
- Replan remaining items
- Commence and complete the planning for 2014/15 for ARC approval in February 2014.

## 7. Actions

- 7.1 The Committee is requested to:
- Note the outcomes of the recent audits and reviews.
  - Support the revised priority activity for the remainder of the year and direct as necessary

Malcolm Zack  
Head of Internal Audit  
19<sup>th</sup> November 2013



**NETWORK AUDITING-APPROACH, METHODS AND ASSURANCE****Overall Assurance: -  
Low**

Audit Highlights and Opinion	Strengths	Weaknesses
<p>The Audit and Risk Committee (ARC), requested a review of the branch auditing approach within the context of how Post Office is audited overall.</p> <ul style="list-style-type: none"> <li>Crown, retail multiple and agency branches are subject to various types of audit visits conducted by the Network Support team. They conduct audit and training activity at a cost of approximately £6M per year with a team of 220.</li> <li>Audit activity is restricted to the checking of cash and stock and the validation of procedural compliance questions.</li> <li>There is a lack of independent assurance over Branch Operations</li> <li>Results and management information are insufficient to give senior management a view of control</li> <li>Follow up mechanisms that ensure the control environment is maintained / improved do not formally exist.</li> </ul>	<ol style="list-style-type: none"> <li>1) Approximately 30% of the estate is covered each year</li> <li>2) The audit financial audit programme is well established and structured</li> <li>3) Network Auditing provides a development route for experienced counter staff and managers</li> <li>4) Large pool of experienced staff</li> </ol>	<ol style="list-style-type: none"> <li>1) No assurance over Branch Operations, other than cash and certain valued stock</li> <li>2) Poor management information, only statistics of visit numbers get reported</li> <li>3) Resource is utilised for both audit and training.</li> <li>4) Activity is constrained by the 35 hour working week (capacity is reduced because this includes travel time)</li> <li>5) Company are usually owed hours from the hours pool – inefficient use of resources</li> <li>6) Currently not a professional audit service</li> <li>7) Value for money is not achieved through the current activity</li> <li>8) Audit reports are not effectively summarised, to highlight common issues nor share best practice</li> </ol>
<p>Opinion</p> <ul style="list-style-type: none"> <li>Based upon the audit work undertaken a low level of assurance is given over Network Auditing.</li> </ul>	<p><b>Top Priority Agreed Actions</b></p> <ol style="list-style-type: none"> <li>1) To discuss and agree a way forward for network auditing, such that it can provide meaningful assurance to the business and the board.</li> </ol>	
Executive Responsible	Kevin Gilliland	
Distribution (date)	Chris Day, Susan Crichton, Roger Gale, Drew McBride	
Prepared By	Garry Hooton	Reviewed By Malcolm Zack

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## Local Area Network – Identity and Access management

Overall Assurance: - Low



### Audit Highlights and Opinion

- Identity and access management (IAM) is a cross-function process to manage who has access to what information over time. The audit focused on the IAM process on the Local Area Network (LAN) (including access to POL network, SharePoint, File Share). The review was part of the 2013/14 audit plan agreed with the ARC
- SAP and Horizon systems were out of scope.
- POL currently applies the RMG IAM process which for the local area network is managed by CSC.
- The review was focused on the IAM process steps performed by POL and took place between August and September. The purpose of the audit was to identify current process gaps, eventual access risks and mitigation actions to be taken in consideration in the 'to be' IAM process after the separation.
- Limitations: POL IA does not have full audit rights to CSC since formal separation so technical LAN security tests were limited. The review focused on forward looking issues as IT transfers to the SSID and tower model

### Opinion

- Based upon the audit work undertaken a low to medium level of assurance is given over the IAM process for the local area network. This is based on the lack of process definition and end to end overview of process steps within POL. Furthermore the business has no overview of users' access rights to the local area network (shared drives, applications, SharePoint, etc.) and potential segregation of duties conflicts.

### Strengths

- 1) Identity is managed based on unique used IDs.
- 2) LAN accounts are locked (for 30min) after a defined number of unsuccessful logon attempts (e.g. 10).
- 3) An authorisation process is in place for creating new accounts and granting them access rights.
- 4) An IT process governance exercise is on-going (under the IT Transformation umbrella) to identify the 'to be' IT process and IAM ownership, roles and responsibilities are considered to be assigned.

### Weaknesses (Ambers)

- 1) IAM tools, including a provisioning system, which would allow a full overview of all accounts access rights and their management are not in place.
- 2) Unauthorised access attempts to LAN are not reported to POL Information Security team.
- 3) Examples noted of LAN accounts 'passwords being shared which is contrary to company policy

### Top Concerns (Reds)

- 1) There is no overview of all local area network accounts access rights.
- 2) Access rights are granted on a 'mirroring with a similar account role' base instead of a fit for job principle.
- 3) Movers' access rights are not reviewed and updated to remain fit for job.
- 4) Leavers accounts are not systematically disabled in time and there is no control.
- 5) No review of accounts access rights is in place.

### Top Priority Agreed Actions

- 1) Role based access rights (on LAN) will be defined jointly by ISAG and HR.
- 2) Access rights will be reviewed when employees change function/role.
- 3) A periodical review of users LAN access rights will be put in place.
- 4) Leavers access will be disabled on a more timely basis and a process to confirm recent leavers and check access will be implemented.
- 5) The governance of the IAM process will be defined as part of the Future Operating model, defining clear roles and responsibilities for POL, SISD and towers (e.g. EUC).

Executive Responsible	Lesley Sewell
Distribution (October 31 <sup>st</sup> 2013)	Julie George, Dave Hulbert, Fay Healey, Joe Conner, Cfl Chris Day, Paula Vennells
Prepared By:	Elena-Raluca Nistor
Reviewed By :	Malcolm Zack
Status:	Final ver 1.0

Risk and Control Dashboard

As at: 30/09/2013

Overall risk

Risk that the confidentiality, availability and integrity of data and information is compromised.

Process governance

Risk that the IAM process and related policies are not fit for purpose and they do not cover information risks.

**Key Controls**  
IAM policies have been defined, and they contain clear IAM controls which are fit for purpose, ensuring the process goal is achieved.  
  
Policies are reviewed periodically (at least one per year) .  
  
IAM roles and responsibilities to cover the end to end process have been clearly defined and communicated to parts involved in the process.  
  
Process monitoring controls are in place, to ensure process efficiency.  
  
Tools are in place to ensure IAM is managed in an efficient way.

Segregation of duties

Risk of misuse of information and data due to conflicting access rights

**Key Controls**  
Conflicting access rights have been identified and there is a process in place to ensure a user will not be granted conflicting access rights  
Process in place to ensure users are not granted conflicting access rights  
Process in place to search for and remove conflicting access rights

User management

Risk that the business is unable to identify who did what and when with the information accessed.

**Key Controls**  
Unique user IDs are given to all users  
  
All defined accounts are known and stored in a central repository.  
Passwords must be in place (and complexity criteria should be activated).  
  
Passwords or any other authentication credentials must be kept secret (not written down, disclosed or shared

Authorisation management

Risk that systems and data are accessed without appropriate authorization.

**Key Controls**  
Access logs are activated and they are periodically reviewed or alerts are settled in case unauthorized access attempts are done.  
  
Critical activities of privileged account are identified, logged and monitored.  
Accounts are locked after a number of unsuccessful logon attempts.

Access management

Risk that the business is unable to identify and stop unauthorized access attempts.

**Key Controls**  
All requests for new and changes for accounts access rights are approved.  
  
Access rights are granted based on a job need base concept  
Access rights which have not been used for an extensive period of time 60-90days, are reviewed and disabled  
  
Access rights of users moving roles are reviewed and updated to remain fit for job.  
  
Leavers accounts and access rights are disabled and deleted within a defined period of time.  
  
Accounts and their access rights are periodically reviewed by the line manager and/or the system/data owners.

Key

Controls or processes not in place	
Controls or processes not fully in place to address risk	
Controls in place and operating effectively	
Not yet assessed	



## Software Licensing Management

Overall Assurance: LOW

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### Audit Highlights and Opinion

- Software Licensing Management (SLM) is a structured and systematic approach to managing the full lifecycle (from purchase to disposal) of software licences in an on-going, proactive basis.
- As part of RMG, POL has been following a RMG SLM process run by CSC and currently POL is going through a transition phase to separate from RMG.
- The audit purpose was to assess POL's SLM current risks and to identify the actions to be taken to ensure POL will be in the position to manage software licences in an effective way after the separation. The review was agreed with the ARC as part of the 2013/14 internal audit plan. The SLM risk was highlighted by the CIO during the audit annual planning.
- The review, occurred between August and September 2013, and included input from the Separation programme Manager and the Procurement team:
- *Limitations:* The audit focused on forward looking process and governance issues. POL IA does not have audit rights over CSC, therefore it could not independently verify the current completeness and accuracy of the licence estate.

### Opinion

- Based upon the audit work undertaken a low assurance is given over the current software management (SLM) process. This conclusion is mainly based on the lack of overview POL has on the owned and used software licenses and due to the current missing SLM process. Management is aware of the licence issues and risks within the current changing context for IT.

### Strengths

- 1) The Separation programme will provide POL with an overview of all software licences in use and needed.
- 2) Actions are ongoing, within the Separation programme, to identify the right type of licenses required for POL, which gives an opportunity to align license types to business needs.

### Weaknesses (Ambers)

- 1) There is currently no overview of all licences and licence types POL has and uses. POL is currently at a higher level of risk from sanction should an external software audit take place.
- 2) Licences can currently be purchased by different parts of the business. There is currently no overall control by the Procurement team on the software purchase and change process.

### Top Priority Agreed Actions

#### Short term actions

- 1) A software licensing policy will be defined by POL, and will include clear roles and responsibilities for POL and SISD.
- 2) Software licensing governance and assurance ownership is assigned to POL Support and Service
- 3) POL will include the agreed recommendations in the requirements for the SISD SLM process . The SISD will define the SLM process.
- 4) POL Procurement will remind the business that software licences must be procured via the Procurement teams.

#### Medium – Long term actions:

- 1) A software licensing assurance and governance process will be defined by POL.
- 2) POL will deploy the assurance process over the SSID SLM process.

### Top Concerns (Reds)

- 1) The SLM process is not yet defined.
- 2) POL software licensing assurance and governance process is therefore also not yet defined.
- 3) Currently there is insufficient expertise in house to define the best fit for purpose and cost effective licenses holistically for the company needs.

Executive Responsible	Lesley Sewell
Distribution (date)	Dave Hulbert, Brian Deveny cfi: - Chris Day, Paula Vennells , Roger Middleton – Status – FINAL Ver 2.0 CONFIDENTIAL
Prepared By:	Elena-Raluca Nistor Reviewed By Malcolm Zack



As at 25 September 2013

## Risk and Control Dashboard

Risk that software is not appropriately obtained or managed resulting in possible financial or legal sanction

## Key Sub Risks to Manage

Key Controls		Key Controls		Key Controls	
<u>Process governance</u> Risk of inadequate software licensing management and non-compliance with licence agreements.		<u>Process governance - risk management</u> Risk that the business might be disrupted or will have increased penalties' costs due to inadequate licences.		<u>Process design and deployment</u> Risk that the business procures software licences that are not fit for purpose or cost effective.	
Software licensing management (SLM) is identified as corporate process (cross business and IT) and a clear approach to managing software licences is in place (approving, reviewing, monitoring, updating, etc.), ensuring that the process from procurement until monitoring is managed at all levels.		Risk of non compliance with copyright and licences contractual agreements have been identified and they are part of an overall corporate risk register.		An asset register (e.g. systems and applications requiring) is in place, containing an overview of all assets and their licences and it is periodically updated.	
The process is documented and related procedures/guidelines have been defined, approved and they have been communicated to relevant users involved in the process.		Criteria to measure the efficiency of the SLM process have been identified.		A review of all existing licences is periodically performed.	
Other process responsibilities have been identified and assigned: e.g. resources within the organisation to control and monitoring software licences in each directorate or centrally.		Mitigating controls for SLM risks have been identified. Additional monitoring/assurance controls are in place to ensure the mitigating controls are operating effectively.		The procurement of licences is managed with a central oversight to ensure it is cost-effective and fit for purpose.	
Software licensing compliance (with contractual agreements) process has been defined and is performed periodically.		The SLM process is periodically evaluated to ensure it is fit for purpose (covers the identified risks).		A process owner has been identified and his/her roles and activities clearly defined and understood.	

## Key

controls not in place	
Controls not fully covering the risks, improvements required	
Controls in place sufficiently address risk	
Not yet assessed	

**Confidential****POST OFFICE LTD AUDIT, RISK AND COMPLIANCE COMMITTEE****Internal Audit – Status of Agreed Actions****1. Purpose**

The purpose of this paper is to:

- 1.1 Update the committee on the status of agreed actions arising from formal audit and advisory activity
- 1.2 The committee is requested to note and provide directions as necessary.

**2. Changes to process**

- 2.1 As outlined in the September 12<sup>th</sup> ARC papers, the actions arising from IA activity are tracked and reported. The report highlights period movements since the last ARC, analyses overdue and highlights any high risk items for attention.
- 2.2 The original agreed target dates are retained in the log even though it may be agreed to re-set a target date. It is important for the business to remain aware that risks identified from audit work have yet to be addressed if an action date is changed.
- 2.3 As at October 31<sup>st</sup> 2013
  - 32 Actions were brought forward from September 2<sup>nd</sup> 2013, of which at that time 11 were overdue from original target dates. Most of these were reported as longer standing and known information security items which were re-targeted for 31<sup>st</sup> December 2013 and are therefore not yet due.

Through the period September and October 2013:

- 43 actions were added through a mix of audit and advisory work that took place in that period.
- 12 actions were implemented by management. This is the same rate as over the previously reported 2 month period bring the total to 24 since the transition in June 2013.
- Of the 63 items carried forward, 43 are not yet due, a large portion being from the recently completed audits or not due from earlier. 20 are overdue from original target dates but all are in progress. One of these, the review and verification of bonus rules was completed and approved by the Remuneration Committee on November 6<sup>th</sup>. This action will be reflected in the next set of statistics and was rated an amber.
- The 6 items rated as red risks in the overdue section are:
  - Embedding the information security governance into the supplier requirements for the remaining three towers. As contractual negotiations are still ongoing this is expected to run into 2014.

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- Completing the embedding of Information Security requirements into the product and service projects being developed around the business. This is underway and aiming for completion by the end of the year.
  - The single action arising from the review of branch auditing which is on-going and subject to a wider examination in the context of Second Sight and cost challenges by the Executive Committee.
  - Three red rated actions arising around the risk management processes for the Finance Road Map programme which at the time of writing were underway but yet to be fully demonstrated. These have since been partly addressed and will be assessed by Internal Audit at the next FRP Programme Board.
- 2.4 The actions implemented in the period include key actions arising from the recent SPMO audit especially around the risk management processes
- Risk heat map now re-enstated at Transformation Board (and also reporting to the Risk and Compliance Committee).
  - SPMO reiterating the need to bring risk documentation to meetings to ensure risk discussions are focussed and ensuring stronger KPI challenge, review and consistent scoring.
  - Actions raised within the FRP programme in July around engagement of senior finance management, and risk management have been implemented.
- 3 ARC members action**
- The committee is requested to note the status and to provide direction as necessary

**Malcolm Zack**  
**19<sup>th</sup> November 2013**

**Appendix**  
**Table and graphs.**

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## Appendix

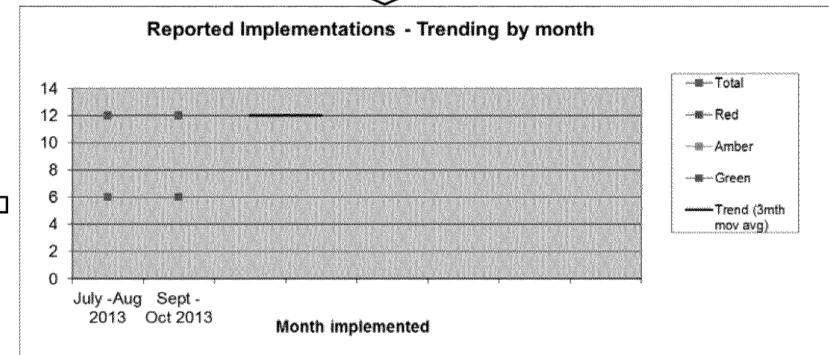
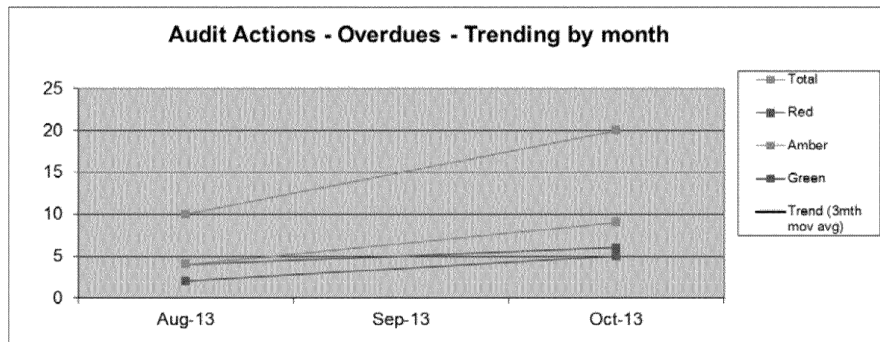
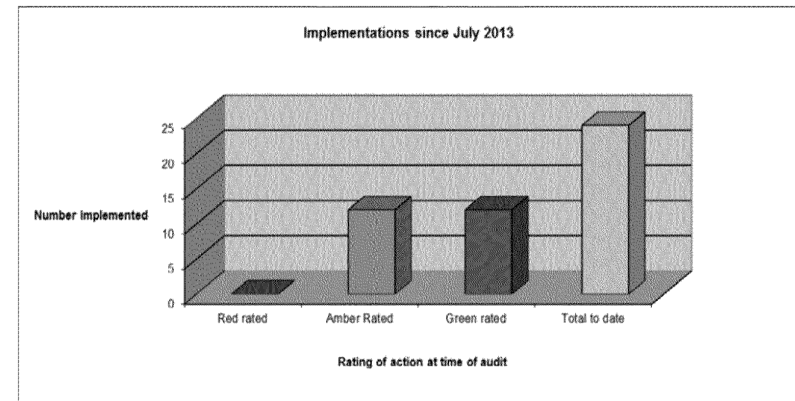
### Overall Summary as at 30th October 2013

	Total	Red	Amber	Green
Total actions bfwd as at 2 September 2013	32	3	19	10
Implemented by Mgt - to 31st Oct	(12)		(6)	(6)
Actions added (audits and advisory)	43	24	16	3

Carried Forward as at November 1st	63	27	29	7
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### Analysis of Carried forward

Overdue - Work in progress	20	6	9	5
Not yet due	43	21	21	1
	63	27	30	6





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**POST OFFICE LTD AUDIT, RISK AND COMPLIANCE COMMITTEE****ARC – Self Assessment****1. Purpose**

The purpose of this paper is to:

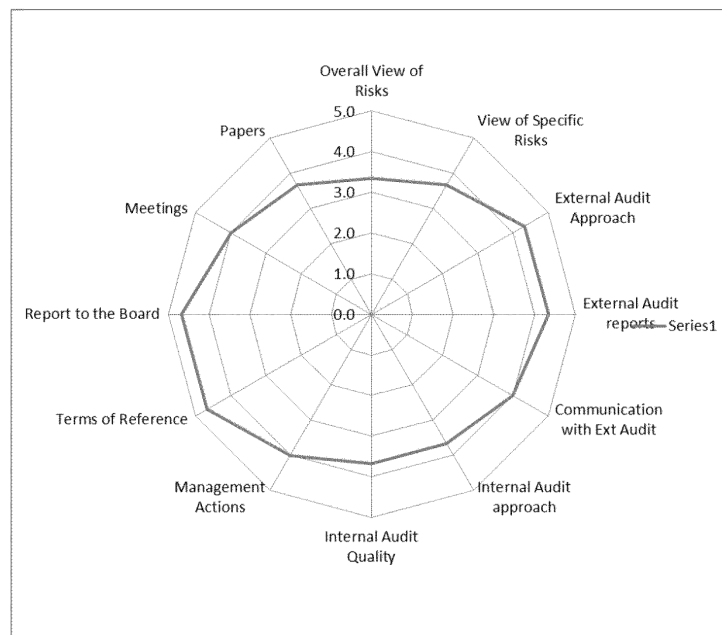
- 1.1 Summarise the results of the committee's first self assessment.
- 1.2 The committee is requested to note and determine the next steps with the Board and Executive committee as appropriate.

**2. Background**

- 2.1 The terms of reference require the audit committee to conduct a self assessment of its activities and performance annually.
- 2.2 There is no prescribed method of achieving this. Most organisations will utilise either an in-house designed questionnaire or use the services of an external independent source such as interviews with an external audit partner.
- 2.3 These options were discussed and it was agreed to use a simple questionnaire approach based on an excel template. Twelve questions were agreed and using a drop down menu members assessed the questions using a score of 1 – 5. Each score had a qualifying comment and a free form box to add any additional views. A copy of the template is in the appendix.

**3. Results**

- 3.1 Table 1 in the appendix summarises the results with comments where these were made. The template assigned green to scores 4 or 5, amber to 3 and red to scores of 1 or 2. The graph below illustrates the overall average for the areas assessed. Table 2 in the appendix details the responses to three further free form questions which were not scored.



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**3.3 Risk Management**

- There is some difference of opinion across the ARC members. Two raised serious challenges to the current view of business risks and there is a desire for more detail in specific business areas especially in Financial Services and IT.
- It is accepted by the comments made that the work is heading in the right direction, but there was consistent message in requiring the owners of the risks to be visible to the committee and to discuss these more directly.

**3.4 Internal Audit**

- Whilst there was agreement on overall approach and processes in place. There was disagreement among the ARC members on the resource levels employed in the corporate team given the risks faced by the business.

**3.5 Meetings and general ARC processes**

- Views differed on the effectiveness and content. Meetings need to move the bar upwards to focusing on the risks and how these are managed rather than reporting on progress and process.

**3.6 External Audit**

- There was generally satisfaction with the external audit approach but some challenge over how the audit committee, internal audit and external audit liaised as a group.

**3.7 Other**

- Other areas were assessed as either good or very good by the ARC members.
  - In addition to the twelve questions, ARC members were asked three free form questions. See appendix for detail but the trend for 2014 is for improved focus on risk and greater visibility of management's assessment and actions.

**4. Conclusions**

- 4.1 The committee appears generally satisfied with overall governance, processes and procedures. As this has been the first year of its existence, effort has understandably focused on the operation of the committee.
- 4.2 The committee requires management to step up the visibility, content and discussion of the risk agenda. This requires the Executive to complete its current assessment with the assistance of the Head of Risk and to commence

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discussing the risks in detail including Directorate presentations at ARCs in 2014.

- 4.3 The committee recognises the challenges facing the small internal audit team in providing independent assurance over the management of key risks in the business. There remains challenge to the business but the committee is not fully united on this.

**5. Actions**

- 5.1 The committee is requested to consider the outcomes of the self assessment and discuss the next steps with the Board and Executive committee as appropriate.
- 5.2 Should the committee decide to invite executive management to present their risk assessments the committee is requested to consider the following running order based on assumed ARC dates.

- February 2014 – Financial Services
- March 2014 – IT
- May 2014 – Network and Supply Chain
- September 2014 – Commercial
- November 2014 – Finance, Legal and HR

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Questions assessed		ARC1	ARC2	ARC3	Comments made by respondents
<b>Risk Management</b>					
1. The Committee has a good overall view of risks in the business, is confident that management is actioning plans and that the framework is balanced, practical and easy to understand.		5	2	3	Risk management process still being refined by the Exec team so WIP but heading in the right direction. Lots of good effort to put process in place which was necessary. Not enough time spent yet agreeing the risks, or how to manage them
2. The committee has a sufficient view of specific risk areas such as Information Technology, Legal, Fraud detection, operational and financial risk. The committee has oversight on management processes and controls to manage these areas		4	3	4	Follows on from number 1. Overall I agree, but I think we need a more granular appreciation of the specific risks we face in IT as we move into the transformation programme. Also need more over sight of matters relating to delivery of the Financial Services Strategy and the risks there, given the importance of this pillar to delivery of the overall plan.
<b>External Audit</b>					
3. The committee has a good understanding of the external audit approach, risk assessment, its scope and audit approach.		4	4	5	
4. The committee is able to understand the financial reports from external audit, comment upon disclosures, accounting policies or adjustments		5	4	5	
5. There is an effective communication and liaison process between the committee, external audit and management		5	3	4	
<b>Internal Audit</b>					
6. The committee has a good understanding of the internal audit scope, approach, its risk based focus and methods		4	3	4	New Head of Audit in place and putting in place good processes/procedures



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Questions assessed		ARC1	ARC2	ARC3	Comments made by respondents
employed by the IA team					
7. The IA team is appropriately resourced, able to respond to requests from the committee and the business and is sufficiently independent and led.		5	2	4	However we will need to continue to review as the PO changes shape including the role of the Field Audit teams. I am still unsure that there is adequate and appropriate resource. Not sure how it could be really if I feel as I do about answer number 1.
<b>Actions by Management</b>					
8. The committee is confident that actions agreed with external and internal auditors are implemented in a timely fashion with regard to risks, costs and benefits.		4	4	4	
<b>Governance</b>					
9. The ARC terms of reference are clear, can be met annually and are properly reviewed with the Board		5	4	5	
10. Reporting to the Board by the Audit Committee is sufficient, highlighting key risks and control issues to provide the Board with the level of assurance required.		5	4	5	
<b>Meetings</b>					
11. Meetings are well structured, allow sufficient time for all items, and reach appropriate conclusions and actions.		5	3	4	Maybe too much emphasis on discussing process, with not enough on risks/actions
12. Papers are available in good time, well presented and clear in their purpose and intent.		4	3	4	

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## Free form questions

**What are the top two items you wish the committee to change or improve in 2014?**

Agree risks between the Board, ExCo and ARC and then start managing them better.

More visibility of risks in IT and Financial Services.

Further development on Risk Management. Further develop the role of the ARC as the PO changes

**What should it stop doing or what should it do more of?**

Less process to be discussed at the ARC. Needs to take less time and spend more on content.

See more of the Executive Members with specific risk accountability to talk about their risks and the mitigating actions. This would create more direct line of sight between the AC and the risk owners and create a greater sense of accountability.

**How does this committee compare with others you have worked on in the past or currently. What are its relative strengths and relative weaknesses.**

This is young and evolving, so not really a valid comparison. The journey we are on is necessary, we probably just need to go a bit faster. That may happen naturally now that we have our first year under our belts.

Stronger than most. Good representation of people with financial background. Only suggestion for improvement is in relation to more interaction between committee and risk owners. I have seen this work very effectively elsewhere.

Strengths - good understanding of the business and strong links with the Exec team and Board. Weaknesses - further work required to tie down Risk Management with the Exec team

## 9. Papers for noting\_

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**NAME**

INSTRUCTIONS: Answer each of the 12 questions using the drop down box  
If possible please add a comment to your score to aid the assessment process using the box to the right of the drop down  
The final 3 questions are general and require freeform answers.  
**Please complete and return to malcolm.zack@postoffice.co.uk by October 25th 2013**

	Level of effectiveness	COMMENT
<b>Risk Management</b>		
The Committee has a good overall view of risks in the business, is confident that management is actioning plans and that the framework is balanced, practical and easy to understand.	3. Agree In place, but needs improvement	3 Risk management process still being refined by the Exec team so WIP but heading in the right direction
The committee has a sufficient view of specific risk areas such as Information Technology, Legal, Fraud detection, operational and financial risk. The committee has oversight on management processes and controls to manage these areas	4. Generally agree. In place and generally effective	4
<b>External Audit</b>		
The committee has a good understanding of the external audit approach, risk assessment, its scope and audit approach.	5. Fully Agree. Good visibility and debate.	5
The committee is able to understand the financial reports from external audit, comment upon disclosures, accounting policies or adjustments	5. Fully Agree. Policies and accounting well explained	5
There is an effective communication and liaison process between the committee, external audit and management	4. Agree. Meets needs.	4
<b>Internal Audit</b>		
The committee has a good understanding of the internal audit scope, approach, its risk based focus and methods employed by the IA team	4. Agree. Items are discussed.	4 New Head of Audit in place and putting in place good processes/procedures
The IA team is appropriately resourced, able to respond to requests from the committee and the business and is sufficiently independent and led.	4. Agree for the most part	4 However we will need to continue to review as the PO changes shape including the role of the Field Audit teams
<b>Actions by Management</b>		
The committee is confident that actions agreed with external and internal auditors are implemented in a timely fashion with regard to risks, costs and benefits.	4. Agree. Management tends to act well.	4
<b>Governance</b>		
The ARC terms of reference are clear, can be met annually and are properly reviewed with the Board	5. Strongly Agree. Scope is appropriate and fit for purpose	5
Reporting to the Board by the Audit Committee is sufficient, highlighting key risks and control issues to provide the Board with the level of assurance required.	5. Fully Agree. Committee report is comprehensive	5
<b>Meetings</b>		
Meetings are well structured, allow sufficient time for all items, and reach appropriate conclusions and actions.	4. Agree	4
Papers are available in good time, well presented and clear in their purpose and intent.	4. Agree. Overall good information.	4



**POST OFFICE LTD AUDIT, RISK AND COMPLIANCE COMMITTEE****Annual Review of Terms of Reference and Internal Audit Charter****1. Purpose**

The purpose of this paper is to:

- 1.1 Review and approve the committee's annual review of its governance documents
- 1.2 Request approval of any changes and highlight these to the Board where necessary

**2. Annual Requirement**

- 2.1 Sections 2.2 and 2.4 of the ARC terms of Reference require the committee to review and re-approve the Internal Audit Charter and its own Terms of Reference annually
- 2.2 The documents were circulated to ARC members and to senior attendees in October 2013 for review and to highlight any amendments.

**3. Results**

- 3.1 All respondees were satisfied with both documents. The only proposed amendment was to the Internal Audit Charter on the role of the IA function which currently states in section 3
  - "The role of Internal Audit is to understand the key risks of the organisation and to examine and evaluate the adequacy and effectiveness of the frameworks of risk management and internal control as operated by the organisation."
- 3.2 The comment was to go beyond understanding of the key risks and verify that the organisation's key risks have been properly identified, and ensure that adequate controls and processes are in place to mitigate the risks
- 3.3 The verification was considered implicit in "examine" and "evaluate" but it is accepted that verification should be added for clarity. The controls may be verified as operating and adequate, but they may not be as efficient or effective as they could be so an evaluation is necessary.

**4. Proposed rewording**

- 4.1 "The role of Internal Audit is to understand the organisations key risks, verify the identification of those risks, examine and evaluate the adequacy, efficiency and effectiveness of the controls, frameworks and processes used to manage risk."



**5. Recommendations**

5.1 The committee is requested to:

Reapprove its Terms of Reference.

Reapprove the Internal Audit Charter with the proposed amendments or as discussed in the meeting.

Malcolm Zack  
Head of Internal Audit  
November 2013

**Post Office Ltd**  
**ARC Meeting**  
**19 November 2013**

**Location:**

By teleconference and Room 501, 148 Old Street, London, England, EC1V 9HQ, United Kingdom

**ATTENDANCE LIST**

ATTENDEES	SIGNATURE
Alasdair, Marnoch	
Neil, McCausland	
Tim, Franklin	

**Also in attendance**

Alwen, Lyons	
Alice, Perkins	
Aujard, Chris	
Chris, Day	
Paula, Vennells	